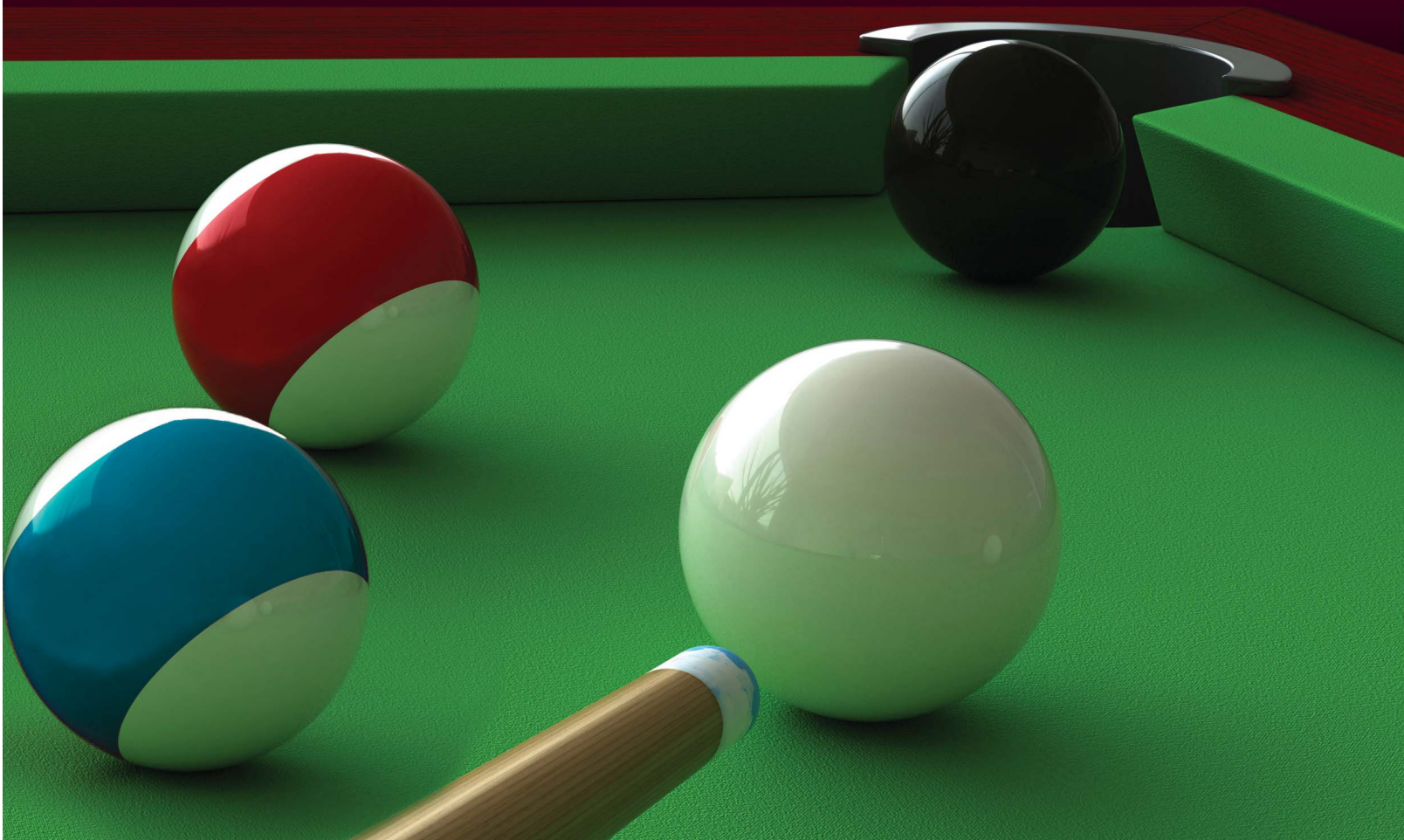


# Union Budget - 2011 -12

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**Analysis & Outlook**





# Economy

## Economy analysis

### Positive, but thinly spread

The three key macroeconomic concerns before the Union Budget 2011-12 were high inflation, high current account deficit (CAD), and fiscal consolidation. Additionally, there was an expectation that the government would restart the reform process. The Budget has made an attempt to address all these issues, albeit through small steps. Despite the strong performance of the economy in 2010-11, the outlook for 2011-12 is clouded by stubborn and persistently high inflation, and rising external risks. While the Budget sets a lower nominal gross domestic product (GDP) growth target of 14 per cent, we believe that the real GDP growth target of 9 per cent factored in the Budget is on the optimistic side. CRISIL expects GDP growth to moderate to 8.3 per cent in 2011-12.

By lowering the fiscal deficit target to 4.6 per cent in 2011-12 from 5.1 per cent achieved in 2010-11, the Budget reiterates its commitment towards medium-term fiscal consolidation. The absence of rollback of stimulus (excise) was a bit of a disappointment, though, given that economic growth has recovered. As the Budget sets a lower deficit and net borrowing target, it is not expansionary, and does not conflict with the Reserve Bank of India's measures to tame inflation, at least in intent. The issue is how realistic the target is. We believe that the fiscal deficit will settle around 5 per cent of GDP in 2011-12 – a slippage of 40 basis points – as we expect lower growth, lower tax buoyancy, and absence of one-off gains. There are further risks of slippages on subsidy expenditure – on oil and fertilisers, the Budget estimates are conservative. Some bold steps towards expenditure reforms were missing, and will have to be initiated through the year to keep a lid on the subsidy bill and maintain the fiscal space for increased spending on physical and social infrastructure.

On the infrastructure front, like in the previous Budget, physical infrastructure has been accorded prime importance. An allocation of Rs 2,140 billion has been provided for infrastructural development in 2011-12, which is 23.3 per cent higher than in 2010-11 and amounts to 48.5 per cent of the gross budgetary support to Plan expenditure.

To remove the funding constraints for the infrastructure sector, the disbursement target of the government-established India Infrastructure Finance Company Limited (IIFCL) will be raised by Rs 50 billion to Rs 250 billion by March 31, 2012, along with issuance of tax free bonds worth Rs 300 billion by various government undertakings. In addition, the FII limit for investment in corporate bonds with residual maturity of over five years issued by infrastructure companies has been raised by an additional US\$20 billion, taking the limit to US\$25 billion. In order to facilitate the funding of rural infrastructure, the corpus of the Rural Infrastructure Fund (RIDF) was raised by Rs 20 billion to Rs 180 billion for 2011-12.

Social sector spending too remains one of the top priorities of the government. However, refraining from announcing new schemes, the Budget has laid stress on providing reasonable allocation to the existing schemes, in order to curb fiscal deficit and provide room for the committed Right to Food Act. An allocation of Rs 1,914 billion has been provided to social services and rural development in Budget 2011-12. However, y-o-y growth of total budget support, together with internal and extra budgetary resources (IEBR), stands at 7.8 per cent in 2011-12 as compared to 27.4 per cent in 2010-11.



## Economy analysis

On the inclusiveness front, this year's Budget allocation of Rs 741 billion to the Department of Rural Development is nearly 3 per cent lower than the revised estimate for 2010-11. The allocation to the government's flagship rural social safety net programme MGNREGA is Rs 400 billion, Rs 1 billion lower than the previous year's allocation in spite of indexing wages under the scheme to inflation. The Pradhan Mantri Gram Sadak Yojana, a programme that aims to connect every village with a motorable road, has seen a 20 per cent decline in allocation in this Budget compared with 2010-11. While resource allocation to rural development has not been increased this year, the implementation record of various schemes can be improved significantly, thereby raising the effectiveness of the rural development programmes towards creation of productive assets.

Dharmakirti Joshi

**Chief Economist, CRISIL**

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Industry

## Overall sectoral impact

Industry	Effect
<p><b>Airport infrastructure</b></p> <p><b>Neutral impact on airport infrastructure</b></p> <p>The Union Budget 2011-12 proposal to attract more foreign funds to the infrastructure sector will not result in any significantly increase in funds for airport infrastructure companies.</p>	<p><b>Neutral</b></p>
<p><b>Auto components &amp; Tyres</b></p> <p><b>Budget to have neutral impact</b></p> <p>The Union Budget 2011-12 is not likely to have any significant impact on the Indian auto components and tyres industry. The exemption on customs duty on spare batteries for electric vehicles (cars and two-wheelers) and concessional excise duty of 4 per cent on these batteries will reduce the maintenance cost of these vehicles. However, this is not expected to have any significant impact on demand for auto components, given the low population of electric vehicles in India. Natural rubber (NR) will attract customs duty of 20 per cent or Rs 20 per kg (whichever is lower), with effect from April 2011. This will not have any significant impact on the landed cost of NR at current price levels.</p>	<p><b>Neutral</b></p>
<p><b>Automobiles</b></p> <p><b>Budget to have no significant impact on automobile industry</b></p> <p>The Union Budget 2011-12 is not likely to have any significant impact on the Indian automobile industry. The extension and enhancement of interest subvention on crop loans from 2 to 3 per cent, revision of wage rates under the NREGA scheme and continued focus on rural development will have a marginally positive impact on rural two-wheeler and tractor sales. The extension of tax slabs for individual tax payers from Rs 1.6 lakh to Rs 1.8 lakh will aid two-wheeler sales. The overall impact on passenger cars and commercial vehicles segment will be largely neutral. The launch of a 'National Mission for Hybrid and Electric Vehicles' and various excise and customs duty benefits proposed for hybrid, electric, fuel cell and hydrogen cell technology-based vehicles or their parts is unlikely to have any immediate impact, though it will aid alternate fuel vehicle sales over the longer term.</p>	<p><b>Neutral</b></p>
<p><b>Banking and Finance</b></p> <p><b>Rise in priority sector home loan limit to benefit banks</b></p> <p>As per the Union Budget 2011-12, housing loan limit under priority sector would be enhanced from Rs 2.0 million to Rs 2.5 million. Also, the limit for interest rate subvention of 1 per cent on home loans would be increased from Rs 1.0 million to Rs 1.5 million, for houses priced below Rs 2.5 million. These measures are expected to assist banks in accomplishing their priority sector lending targets and lower lending rates for borrowers.</p> <p>The hike in interest rate subvention for agriculture loans from 2 per cent to 3 per cent and increased target for credit flow to farmers would facilitate availability of funds at cheaper rates.</p> <p>Public sector banks will be provided Rs 60 billion in 2011-12 (in addition to the Rs 232 billion provided in the last 3 years) to maintain a minimum tier-I capital adequacy ratio of 8 per cent, thus improving their ability to pursue loan growth more aggressively.</p>	<p><b>Positive</b></p>

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## Overall sectoral impact

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Industry	Effect
<p><b>Cement</b></p> <p><b>Increase in excise duty negative</b></p> <p>The Union Budget 2011-12 has proposed the replacement of existing excise duty rates with a 10 per cent ad valorem rate and an additional Rs 160 per tonne of cement. This results in an effective 2-4 per cent increase in the excise duty for the cement industry. In the current operating environment, cement players will not be able to pass on the increase in duty to customers. Further, the Union Budget has proposed a reduction in custom duties for gypsum and pet coke from 5.0 per cent to 2.5 per cent. Gypsum accounts for a mere 2-3 per cent of the total cost of sales for cement players. Moreover, pet coke is used as raw material by a select few companies only. Hence, the reduction in custom duties is insignificant for the cement industry.</p>	<p><b>Negative</b></p>
<p><b>Construction</b></p> <p><b>FII limit on corporate infrastructure bonds raised; tax-free bonds permitted</b></p> <p>An increase in the foreign institutional investment (FII) limit by \$20 billion for investment in corporate infrastructure bonds will help mop up bond issues. Further, select government undertakings like Indian Railway Finance Corporation have been allowed to issue tax-free bonds totalling Rs 300 billion. Also, the allocation for Bharat Nirman has been increased by 20 per cent in 2011-12. IIFCL's loan disbursement target has been set higher as well at Rs 250 billion for 2011-12 from an estimated Rs 200 billion in 2010-11. The additional tax exemption of Rs 20,000, provided in 2010-11, on investment in long-term infrastructure bonds has been extended to 2011-12. These proposals are expected to address the funding needs of the infrastructure segment, and could lead to a faster take-off of infrastructure projects. However, these may not push up the bottomlines of construction companies. Hence, CRISIL Research believes that the impact of the budget on the construction sector is neutral.</p>	<p><b>Neutral</b></p>
<p><b>Fertilisers</b></p> <p><b>Urea to be included in NBS gradually</b></p> <p>Budgetary allocations towards the agricultural sector — in the form of higher agricultural credit, subvention of interest on timely repayment of farm loans and a continued emphasis on expansion of the Green Revolution in eastern states — are expected to increase fertiliser demand. The government plans to gradually include urea under the nutrient-based subsidy policy and is developing a model for the same. With a view to encourage capacity expansions, government has provided tax benefits similar to infrastructure sub-sectors to fertilisers. Companies will also enjoy investment-linked deductions on their tax liabilities. The government has also said that it intends to directly transfer the cash subsidy to farmers living below the poverty line. A task force has been constituted to work out the modalities for the same and the system is expected to be in place by March 2012. When this happens, players will benefit in terms of lower working capital requirement.</p>	<p><b>Marginally positive</b></p>

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## Overall sectoral impact

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Industry	Effect
<b>Hotels</b>	<b>Negative</b>
<b>Service tax on rooms and restaurants to impact the hotels industry negatively</b>	
The levy of a 5 per cent service tax on room accommodation and 3 per cent service tax on restaurants will negatively impact players in the industry. Competition is intense in the current operating environment; hence, the ability of hotel players to pass on levy of service tax by way of higher charges is limited.	
<b>Household Appliances</b>	<b>Marginally Positive</b>
<b>Increase in disposable income to boost demand for household appliances</b>	
An increase in the income tax exemption limit from Rs 160,000 to Rs 180,000 for general category taxpayers will reduce the annual tax liability by Rs 2,000 and result in higher disposable income in the hands of the salaried class. This is expected to have a marginally positive impact on the household appliances industry.	
<b>Housing</b>	<b>Positive</b>
<b>Increased focus on affordable housing</b>	
The interest rate subvention of 1 per cent has been extended for housing loans up to Rs 1.5 million (for houses costing less than Rs 2.5 million) from Rs 1.0 million earlier (for houses costing less than Rs 2 million). Further, priority sector lending limit for housing loans provided by banks has been enhanced from Rs 2.0 million to Rs 2.5 million. The rural housing fund has been enhanced to Rs 30 billion from Rs 20 billion while HUDCO has been allowed the issue of tax free bonds up to Rs 50 billion. These measures will provide a boost to affordable housing. The budget has also proposed investment linked tax deduction for affordable housing projects. This will lead to higher investments in affordable housing projects.	
Note: The proposal to levy 18.5 per cent minimum alternate tax on developers of special economic zone will have a negative impact on real estate companies with a SEZ focus. This could negate the positive impact of the residential segment thus, making the impact neutral for the overall real estate segment.	
<b>Information Technology</b>	<b>Negative</b>
<b>MAT levy on SEZ and non-extension of STPI benefits to impact player profitability</b>	
The proposal to bring SEZ units under the purview of the Minimum Alternative Tax (MAT) and the non-extension of tax benefits for STPI units is expected to adversely impact the profitability of IT players. Mid-sized players would be more affected as a larger proportion of their revenues accrue from STPI units vis-à-vis tier-I players. MAT has been raised from 18 per cent to 18.5 per cent, whereas surcharge has been reduced from 7.5 per cent to 5 per cent, keeping the effective MAT rate at the same level.	
Domestic IT services, which constitute about 20 per cent of the IT services revenues, are expected to get a shot in the arm from the planned government expenditures aimed at improving IT infrastructure and delivery mechanisms.	

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## Overall sectoral impact

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Industry	Effect
<p><b>Media and Entertainment</b></p> <p><b>Overall impact on the Media &amp; Entertainment sector is neutral</b></p> <p>The impact of the Union Budget 2011-12 on the Media &amp; Entertainment sector is neutral. Colour, unexposed jumbo rolls of 400 and 1,000 feet are fully exempt from excise duty. Mailroom equipment would also benefit from the concessional basic customs duty of 5 per cent and countervailing duty (CVD) of 5 per cent, available to for high speed newspaper printing presses. A concessional import duty structure of 5 per cent CVD and nil special addition duty (SAD) has been prescribed on parts for manufacture of DVD writers, combo drives and CD drives, subject to actual user condition. The mentioned proposals are not likely to have any significant impact on the overall sector.</p>	<p><b>Neutral</b></p>
<p><b>Non-ferrous Metals</b></p> <p><b>Neutral impact on non-ferrous metals industry</b></p> <p>The reduction in basic customs duty on calcined petroleum coke (raw material used in manufacturing aluminium) to 2.5 per cent from 5.0 per cent will have a negligible effect on the aluminium industry. Consequently, the impact of the budget on the non-ferrous metals industry is neutral.</p>	<p><b>Neutral</b></p>
<p><b>Oil and Gas</b></p> <p><b>No major impact on oil &amp; gas sector</b></p> <p>The Union Budget (2011-12) will have no major impact on the oil &amp; gas sector. However, the government has indicated that it would gradually move towards direct transfer of cash subsidies on LPG and kerosene to people living below the poverty line. This will reduce under-recoveries for oil marketing companies in the future. The government has provided for Rs 237 billion as its share in under-recoveries for 2011-12. This is significantly lower than the revised estimates of Rs 386 billion for 2010-11. However, we believe that if under-recoveries increase significantly, the government will increase its contribution towards the same.</p>	<p><b>Neutral</b></p>
<p><b>Paper</b></p> <p><b>Positive impact of changes in customs and excise duty</b></p> <p>The impact of Union Budget 2011-12 on the domestic paper industry is positive. The increase in basic excise duty on W&amp;P paper and industrial paper to 5 per cent from 4 per cent is expected to be passed on given healthy operating rates in the industry. Reduction in customs duty on wastepaper to 2.5 per cent from 5.0 per cent is likely to lower raw material costs and offset the introduction of 1 per cent excise duty on wood pulp. Introduction of 1 per cent excise duty on W&amp;P paper, used specifically for educational purposes, and on certain types of specialty paper is expected to be passed on. Enhanced allocation for education is expected to benefit W&amp;P players.</p>	<p><b>Positive</b></p>

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## Overall sectoral impact

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Industry	Effect
<p><b>Petrochemicals</b></p> <p><b>No significant impact on petrochemicals industry</b></p> <p>The overall impact of Union Budget 2011-12 on the domestic petrochemicals industry is neutral with no changes announced in excise and customs duties. The customs duty on carbon black feedstock (CBFS) has been reduced from 5 per cent to 2.5 per cent. As CBFS is the largest component of input costs for carbon black manufacturers, a reduction in its customs duty will lower the raw material costs.</p>	<b>Neutral</b>
<p><b>Pharmaceuticals</b></p> <p><b>Neutral impact of the budget on the Pharmaceutical sector</b></p> <p>The impact of the Union Budget 2011-12 on the Pharmaceuticals industry is neutral. The increase in excise duty on formulations from 4 per cent to 5 per cent will have negligible impact on the industry.</p>	<b>Neutral</b>
<p><b>Ports infrastructure</b></p> <p><b>Funds availability for port projects to improve</b></p> <p>Increase in allocation of funds for infrastructure and enhanced limit up to Rs 50 billion, of tax free bonds for the ports sector, will facilitate improved fund availability for the development of port projects. The proposal to create special purpose vehicles in the form of notified infrastructure debt funds and tax exemption on their income will attract more foreign funds to the ports sector.</p>	<b>Neutral</b>
<p><b>Power</b></p> <p><b>Limited impact of budget on power sector</b></p> <p>There were no major announcements addressing the power sector in the Union Budget 2011-12. Sunset date for tax holiday under section 80IA for the sector has been extended by another year to March 31, 2012, which will encourage investments. The enhanced limit of USD 40 billion for Foreign Institution Investors (FIIs) investing in corporate bonds issued by infrastructure companies and the creation of infrastructure debt funds with tax benefits will improve availability of funds to the sector.</p> <p>Domestic equipment manufacturers for Mega Power Projects (MPPs) and Ultra Mega Power Projects (UMPPs) have been exempted from central excise duty to bring them on an even platform with foreign suppliers who have a cost advantage and also enjoy a concessional custom duty. However, this will have a marginally positive impact on domestic equipment manufacturers.</p>	<b>Neutral</b>

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## Overall sectoral impact

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Industry	Effect
<b>Roads &amp; highways</b>	<b>Positive</b>
<b>Measures aimed at improving fund availability</b>	
<p>There have been a slew of measures announced in the Union Budget aimed at improving fund availability for the infrastructure sector. A large portion of these funds is expected to flow into the roads sector. The National Highway Authority of India has been allowed to issue tax-free bonds totalling Rs 100 billion as against the earlier Section 54EC capital gain bonds. Also, the foreign institutional investment limit for investment in corporate infrastructure bonds has been raised by \$20 billion, which is expected to lead to a better mopping up of bond issues. Further, IIFCL's loan disbursement target has been set at Rs 250 billion for 2011-12 from an estimated Rs 200 billion in 2010-11. Also, the additional tax exemption of Rs 20,000, provided in 2010-11, on investment in long-term infrastructure bonds has been extended to 2011-12.</p> <p>The additional fund availability will result in more projects being awarded, and quicker financial closure. Meanwhile, an increase in the Minimum Alternate Tax is expected to be offset by a reduction in surcharge. Hence, the overall impact on the roads sector is positive.</p>	
<b>Steel</b>	<b>Neutral</b>
<b>Iron ore export duty hike a step towards conservation</b>	
<p>Overall, the Union Budget will have a neutral impact on the steel industry. The export duty on iron ore fines and lumps has been hiked to 20 per cent each from 5 per cent and 15 per cent, respectively. This will benefit the steel industry in the long term as the increased thrust on conservation will help India to continue to be self-reliant in terms of iron ore requirements.</p>	
<b>Sugar</b>	<b>Neutral</b>
<b>No impact on the industry</b>	
<p>Impact of Union Budget 2011-12 on the sugar sector is neutral. The basic customs duty for sugarcane harvesters, which was reduced from 7.5 per cent to 5.0 per cent in the previous budget, has been reduced further to 2.5 per cent. This is expected to result in moderate cost savings for farmers.</p>	

## Overall sectoral impact

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Industry	Effect
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<b>Telecom</b>	<b>Neutral</b>
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### Neutral impact on telecom services sector

The government has marginally increased the Minimum Alternate Tax (MAT) from 18 per cent to 18.5 per cent. At the same time, it has reduced the surcharge levied from 7.5 per cent to 5 per cent. The cut in the surcharge rate neutralises the impact of the increase in MAT by keeping the effective rate of MAT unchanged.

The exemption from basic, countervailing duty (CVD) and special additional duty (SAD) on components and accessories of mobile handsets has been extended for the next financial year and a few more items have now been included in its ambit. The extension of duty exemptions would help in sustaining the current low prices of mobile handsets.

<b>Textiles</b>	<b>Negative</b>
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### Mandatory excise on branded garments negative for textiles

The impact of the Union Budget 2011-12 is negative for the textiles sector. A mandatory excise duty of 10 per cent is being imposed on branded readymade garments (RMG) and textile made-ups. Since it is under Cenvat Credit, yarn and fabric manufacturers may have to pay an increased excise duty at 5 per cent vis-à-vis an optional and concessional 4 per cent duty paid earlier. This will exert further pressure on the margins of RMG and made-ups manufacturers who are already struggling with an unprecedented rise in input costs. However, the reduction in customs duty on Acrylonitrile and rayon grade wood pulp, from 5 per cent to 2.5 per cent each, will benefit acrylic and viscose fibre manufacturers respectively by reducing their raw material costs. As a result, the cost competitiveness of viscose and acrylic will improve vis-à-vis cotton and polyester. Higher budgetary allocation under Technology Upgradation Fund Scheme (TUFS) to Rs 29.8 billion from Rs 22.7 billion is a positive for the sector.



# Capital markets

## Equity market

### Comsi Comsa (so, so)

Although Budget 2011-12 has not rolled back the stimulus for the markets, it is low on significant policy actions. Hence, CRISIL Equities believes it is essentially neutral for the domestic equity markets. The markets are expected to cheer the lower-than-expected fiscal deficit target of 4.6% and an effective revenue deficit of 1.8% for FY12. However, CRISIL expects 4.6% to be challenging – based on CRISIL’s GDP growth estimate of 8.3% for 2011-12 – which is less than the government’s target of 8.75-9.25% growth.

Increased capital outlay and other policy measures for infrastructure, education and realty sectors are expected to boost sentiments and support players’ growth, but the overall impact on profitability may not be significant. The allocation to infrastructure has been raised by 23.3% to Rs 2.14 lakh crore. The FII limit for investment in corporate bonds (with maturity over five years) issued in the infrastructure sector has been raised by US\$20 bn. Further, the additional deduction of Rs 20,000 for investment in long-term infrastructure bonds would be extended in FY12. While these measures will facilitate financing of infrastructure projects, we believe execution delays rather than financing pose a bigger challenge for infra companies. The budget allocation for education too has been increased by 24%, which includes Rs 21,000 crore under Sarva Shiksha Abhiyan. The liberalisation of interest subvention of 1% on housing loans and enhancement of housing loan limit to Rs 25 lakh for units under priority sector lending would be positive for players in affordable and low income housing.

On the taxation front, increase in exemption limits - resulting in uniform tax relief of Rs 2,000 - would be positive for consumer discretionary items. On the one hand, reduction in surcharge from 7.5% to 5% is positive for corporates; on the other, increase in MAT rate from 18% to 18.5% is negative. Further, the Direct Taxes Code (DTC) is expected to be rolled out as scheduled and the Goods and Services Tax (GST) Amendment Bill will be introduced in this parliament session.

Continuing with its divestment agenda, the government has set a target of raising Rs 40,000 crore through divestment of its stake in central public sector undertakings. However, volatile market conditions could put a spoke in the government’s divestment wheel.

We believe that allowing foreign investors to invest in the domestic market through the mutual fund route is a key positive, and will increase funds flow from foreign investors. It would prove to be a shot in the arm for the domestic mutual fund industry in the long run.

CRISIL Equities expects FY12 to be a tale of two halves for the Indian market. In the first half, we expect the market to remain subdued due to concerns over high commodity prices, inflation and earnings downgrade, whereas in the second half we expect a potential absence or a bare minimum impact of most of these factors to provide buoyancy to the markets. Expectation of strong GDP growth coupled with attractive valuation would support the market in the second half. In the light of global concerns and earnings downgrade, we have tempered our expectations of returns. We expect the Nifty to trade at 6200-6400 (Sensex 20700-21200) by the year-end (December 31). We expect banking, IT and pharmaceuticals to deliver strong returns but we remain neutral on telecom and infrastructure, and negative on real estate.