

Budget 2011-12

Fiscal deficit - Optically good, but the devil is in the detail.....

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Impact on equities and sectors

The Union Budget 2011-12 is marked by a strong emphasis on agricultural productivity, distribution and warehousing, as an effort to curb inflation by supply-side management. The Finance Minister did not announce any major change in standard Excise duty, Service tax and Direct taxes; albeit putting a few more products and services under the tax net.

Focus on Consumption and Investment

- **Focus on Rural Growth:** Farm Credit raised to 4.75tn INR from 3.75tn INR - interest subsidy of 3% to Farmers in FY 2012. NREGA wages have been indexed to inflation (CPI) in order to sustain rural consumption. The government has also allocated 580 Bn INR to social schemes.
- **Direct tax for Individuals:** Exemption limits for general citizens increased from Rs 160,000 to Rs 180,000, for senior citizens (age limit reduced from 65 years to 60 years) from Rs 240,000 to Rs 250,000, while a new category of very old citizens (80 years and above) introduced with tax exemption limit of Rs 500,000.
- FY12 Divestment Target of INR 400bn (out of the FY11 Divestment Target of 400bn, 220 bn has been achieved as some divestment have got rescheduled keeping in mind the higher than expected Tax Revenue mop-up).
- FIs allowed additional \$20bn investment in Infra Bonds - Limit raised from \$5bn to \$25bn.

Fiscal health

- Fiscal Deficit for FY12 has been budgeted at 4.6%, which was lower than consensus expectation of 4.8%.
- Announced net borrowing is INR 3.43 tn for FY12 as against expectation of around INR 3.8 tn.
- However, these numbers assume a fall in fuel subsidy from INR 383.86 bn for FY11, to INR 236.40 bn for FY12 and a fall in fertilizer subsidy from INR 549.97 bn for FY11, to INR 499.98 bn for FY12, both of which could prove to be challenging.
- This could also mean that the government is very soon looking to deregulate diesel and fertilizer and possibly increase prices of kerosene and LPG, which at this juncture looks difficult.
- In the absence of deregulation, fuel and fertilizer subsidy and fiscal deficit numbers could be revised upwards significantly.

Other taxes

- Excise duty and Service tax retained at 10%, with increase in the tax net. There was no increase in excise on automobiles as against an expectation of a 2% increase.
- Direct Tax for Corporate: MAT increased from 18% to 18.5%, while surcharge reduced from 7.5% to 5.0%.

Sector	Salient Features	Budget Impact
Banking	<ul style="list-style-type: none"> ➤ The budget proposes to provide Rs. 6000 crores in FY12 towards recapitalization of public sector banks (PSBs). ➤ Also, Government is targeting capital infusion of Rs. 20157 crores in FY11-12 in public sector banks to help the banks maintain Tier I Capital Adequacy Ratio (CAR) at 8% and increase government equity in some PSBs to 58%. ➤ RBI will come out with draft guidelines for banking licenses by the end of this financial year. 	Positive
Real Estate	<ul style="list-style-type: none"> ➤ Limits for housing loan qualifying for priority sector lending was increased from Rs. 2 mn to Rs. 2.5 mn. ➤ Existing scheme of interest subvention of 1% on housing loans extended to housing loan upto Rs. 1.5 mn where the cost of the house does not exceed 2.5 from the present limit of 1 mn and 2 mn respectively. ➤ Minimum Alternate Tax (MAT) imposed on developers of Special Economic Zones (SEZ). 	Neutral
Cement	<ul style="list-style-type: none"> ➤ Excise duty has been changed from 10% on retail price to 10% ad valorem + Rs 160 per tonne for retail price exceeding Rs 190 per 50kg bag. ➤ For retail price not exceeding Rs 190 per bag duty is changed from Rs 290 per tonne to 10% ad valorem + Rs 80 per tonne. ➤ Based on the current average cement price of Rs 260 per bag in the country, excise duty as per the old rate is Rs 520 per tonne. Under the new structure excise duty works to approximately Rs 550 per tonne which is marginally higher. 	Negative
Industrials	<ul style="list-style-type: none"> ➤ Excise Duty exemption for domestic suppliers producing capital goods needed for expansion of existing mega or ultra mega power projects. ➤ Budgeted capital expenditure outlay for defence services increased by ~15% to ~Rs 692bn. ➤ Base rate of excise duty maintained at 10%. ➤ FII investment limit in infrastructure corporate bonds raised to USD\$25 billion from USD\$5 billion, FII investment allowed at SPV level with minimum residual tenure of 5 years. ➤ Rs 21.4 tn planned to be spent on infrastructure sector in FY12, implying a growth of 23.3% yoy. 	Neutral
Information Technology	<ul style="list-style-type: none"> ➤ Lower rate of 15 per cent tax on dividends received by an Indian company from its foreign subsidiary benefits IT companies with foreign subsidiaries. 	Positive

Sector	Salient Features	Budget Impact
Pharmaceuticals	<ul style="list-style-type: none"> ➤ Planned allocation increased to Rs 26,760 crore from Rs 22,300 crore; up by 20%. ➤ Excise duty on medical equipments and formulation drugs increased to 5% from 4%. ➤ Weighted deduction for scientific outsourced work in R&D extended to 200% from 175% (only to national level labs and universities). ➤ Hospitals with 25 or more beds with facility of central air conditioning and health check up services under the ambit of service tax. 	Neutral
Consumer Staples	<ul style="list-style-type: none"> ➤ No increase in excise duty for all companies, including tobacco companies. ➤ Excise duty for Sanitary Napkins and Diapers has been reduced from 10% to 1%. Interestingly, these categories were brought into Excise net only last year. 	Neutral
Utilities	<ul style="list-style-type: none"> ➤ No excise on Power plant equipment for existing mega and Ultra Mega Power Project. No major impact on UMPP costing, as all existing projects are in contract with foreign entities. 	Neutral
Metals	<ul style="list-style-type: none"> ➤ Increase in export duty on iron ore fines to 20% from current 5% levels in order to conserve natural resources. ➤ Aligning export taxes on all grades of iron ore to 20%. ➤ No export tax on iron ore pellets. 	Negative
Auto	<ul style="list-style-type: none"> ➤ No increase in excise duty across the sector, including diesel vehicles as against an expectation of an increase in excise duties to 2007 levels. 	Neutral
Oil and Gas	<ul style="list-style-type: none"> ➤ 7-year tax holiday on crude production withdrawn for blocks licensed after 31-Mar-2011 under New Exploration Licencing Policy (NELP). ➤ The expected cut in excise/import duty to lower the impact of high oil price on under-recoveries of the oil marketing companies (OMCs) did not materialise. ➤ Subsidy provisioning of Rs 20,000 crores for under recoveries against a provision of Rs 35,000 crores in FY11. ➤ Subsidy provision for under recoveries is much lower than expected given current crude prices at \$113 bbl. This suggests that the government may de-regulate diesel prices in the future and increase Kerosene and LPG prices. In the absence of de-regulation further subsidies would need to be provided. 	Negative
Agriculture Products, Fertilizer and Chemicals	<ul style="list-style-type: none"> ➤ Nutrient-based subsidy for Urea under consideration. ➤ Direct subsidy to farmers, interim report of the task report is expected by June 2011 and systems will be in place by March 2012. ➤ Increased allocation on rural credit and lower rate of interest on farm loan. ➤ Provision for Fertilizer Subsidy for 2011-12 at Rs 49,998 cr (v/s Rs 54,976 cr) for 2010-11. 	Positive

Impact on Fixed Income Market

Fiscal Deficit for FY12 has been budgeted at 4.6%, which was lower than consensus expectation of 4.8% and announced net borrowing is INR 3.43 tn for FY12 as against expectation of around Rs. 3.8 tn. However, these numbers assume a fall in fuel subsidy from INR 383.86 bn for FY11, to INR 236.40 bn for FY12 and a fall in fertilizer subsidy from INR 549.97 bn for FY11 to INR 499.98 bn for FY12, both of which could prove to be challenging. There is risk of the subsidy numbers being increased as we move into the next year.

While the fiscal deficit as well as net market borrowing for FY12 is lower than market expectation, the borrowing calendar is expected to be front loaded with around 60-65% of the borrowing being scheduled for first half of FY12. This along with expectation of continuing tight monetary policy stance of RBI due to sticky nature of food inflation and volatile crude oil price, could cause the yields to rise once the borrowing program starts in April. Yields in the very short term (in March) could, however, remain supported at lower levels due to lack of borrowing program and due to year end issues.



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