Union Budget 2010-11

FEBRUARY 26, 2010

A Perspective

Salient Points

- GDP growth rate estimate for 2009-10 at 7.2%. Aim to bolster it to 9-10% over the medium term.
- Gross domestic savings & the rate of gross capital formation decreased to 32.5% & 34.9% of GDP, while per capita income rose by 5.3%.
- Continued emphasis on bolstering infrastructure, rural economy, agriculture and relief to exporters.
- Continued focus on rural, social and infrastructure development.
- Fiscal Consolidation : Fiscal deficit for FY 11 targeted at 5.5% and is expected to be reduced to 4.1% by FY 13. This year's fiscal deficit inclusive of oil/fertilizer subsidies is estimated to be 6.9%.
- Disinvestment proceeds of Rs.40,000 crs in FY11 estimated.
- Taxation :
  - No change in corporate rates and Minimum Alternate Tax increased to 18% of book profits from 15%. Surcharge reduced to 7.5% from 10%.
  - Personal income tax slabs limits revamped.
  - Services Tax retained at 10%.
- Goods & Services Tax (GST) and Direct Tax Code (DTC) to be implemented by April 2011.

The Union Budget was largely positive and a balancing act between political, social & economic factors. It has to be viewed in the context that in recent years most policy announcements have been made outside of the budget and that it is being increasingly used to announce revenue raising/tax measures. As expected, the economic statements on GDP growth, deficits & tax measures were positive and reflect the ongoing economic recovery. The roadmap for fiscal consolidation, direct tax measures and lower-than-expected borrowings were other key positives.

However, there have been no indications with regard to reforms in key areas such as liberalization, labour reforms, etc. The timelines for introducing DTC seem to have been firmed up, but GST introduction continues to be plagued by lack of consensus amongst centre/states. The various studies commissioned by the Thirteenth Finance Commission (TFC) had indicated that GST can boost GDP by 0.9-1.7% and recommended an Rs.50,000 crore grant to the states to break the current impasse.

As seen in the recent years, increased focus on agriculture and rural sector would help a wider section of India's population to benefit from the economic growth. The strength in the rural economy helped India during the recent slowdown due to the global crisis. The increase in tax exemptions will boost disposable incomes. The setting up of commissions to study financial sector reform and effective tax administration are steps in the right direction

The government continues to focus on various social sector & infrastructure development programmes, which is a positive for the economy as a whole, as it would help benefits of economic growth to percolate to all segments of the society. This in turn could help in bridging the socio-economic divide and boost economic activity across the country. As always, implementation of policies and the various infrastructure projects will remain key to the eventual economic progress

Equity markets

Markets reacted positively to the announcements in the Union Budget, fiscal consolidation roadmap and the continuation of fiscal stimulus measures. The latter helped stocks in sectors such as real estate and auto. Banking stocks also got a boost – the government is providing a grant to PSU banks to ensure that Tier I capital is at 8%. Sectors such as infrastructure development could be impacted by the MAT increase and excise duty hikes would affect cigarettes and cement.

Change from yesterday's close		Change from yesterday's close	
BSE Sensex	1.08%	BSE Realty	1.26%
S&P CNX Nifty	1.29%	BSE Power	0.26%
BSE MidCap	1.47%	BSE FMCG	-2.25%
BSE SmallCap	1.08%	BSE IT	-0.29%
BSE Bankex	2.26%	BSE Healthcare	1.55%
BSE Oil & Gas	1.08%	BSE PSU	1.05%
BSE Metals	2.58%	BSE CG	1.06%

We remain positive about the medium to long term direction of the markets, as India's growth momentum increases and companies benefit from the higher demand for goods/services. However, short term direction depends on global liquidity situation and risk appetite given the recent developments on the sovereign front. Earnings growth has been positive and while valuations are closer to long term averages, we believe that India's growth potential warrants a valuation premium. Our interactions with long term global investors clearly indicates a growing appetite for India and this along with a large savings pool could provide liquidity support to the market.

Debt Markets

The clear roadmap for fiscal consolidation helped debt markets rally and this along with better-than-expected fiscal deficit projections and efforts to cap the subsidy bill boosted sentiment. The gross market borrowings for FY 11 are estimated to be Rs.457,000 crs (net Rs.345,000 crs). Compared to recent years, the gross borrowings are on the higher side and a lot depends on revenue collections, divestment, successful 3G auction – could be a possible over run. These concerns seem to have weighed on the market and bond prices have fallen from day's highs.

	25.02.2010	26.02.2010
1-yr gilt yield (%)	5.00	5.01
5-yr gilt yield (%)	7.51	7.59
10-yr gilt yield (%)	7.80	7.87
5-yr AAA Corporate Bonds	8.60	8.66

The US dollar has been benefiting from the ongoing increase in risk aversion due to sovereign debt worries in Europe and other parts of the world. However the rupee could benefit from continued strength in capital flows.

The economy is yet to experience the complete pass-through effect of the international crude oil prices and the possibility of demand-pull inflation given the indications of pickup in aggregate demand. On the other hand, credit offtake is expected to sustain a high growth rate. Markets are expected to be range bound going ahead and domestic rate movements would be dependent on fundamentals such as inflation and liquidity along with factors such as oil & commodity prices and rupee appreciation. Yields at the long end of the curve are likely to remain under pressure, while easy liquidity should help the short end of the curve. All eyes will be now on RBI, given that fiscal stimulus measures are largely unchanged.

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For any queries, our investor line is available to assist you at 1-800-425-4255 or 60004255 (if calling from a mobile phone, please prefix the city STD code; local call rates apply for both numbers) from 8 a.m to 9 p.m, Monday to Saturday. Alternatively, you can also e-mail us at service@templeton.com.