

A Perspective

SALIENT POINTS

- GDP growth rate estimate for 2010-11 at 8.6% and for FY12 at 8.75-9.25%.
- Gross domestic savings & the rate of gross capital formation increased to 33.7% & 36.5% of GDP, while per capita income rose by 6.1% in FY11.
- Policy retains emphasis on inclusive growth – increased spending on agriculture supply chain, education, infrastructure and rural economy.
- Capital flows/Infrastructure: FII investment limit in corporate bonds related to infrastructure hiked by \$20 bln to \$40 bln; Allowed foreign individual investors to access equity mutual funds directly and setting up of infrastructure debt funds.
- Disinvestment: Defers some of the divestments planned for the current year to next owing to windfall of revenues from tax and non-tax sources; Rs. 40,000 crore disinvestment target for FY12.
- Fiscal deficit for FY11 seen at 5.1% of GDP and target for next year set at 4.6%; to further reduce fiscal deficit to 3.5% by FY14.
- Taxation:
 - Personal tax exemption hiked to Rs.180,000 from Rs. 160,000
 - Qualifying age for senior citizens brought down to 60 from 65
 - Senior citizens aged 80 and above to enjoy income tax exemption up to Rs. 500,000
 - No change in corporate rates and MAT increased to 18.5% of book profits from 18%
 - Surcharge on companies reduced to 5% from 7.5%
 - Service tax retained at 10% and excise duty rate at 10%
 - DTC to come into force in April 2012; Has indicated that preparations for GST rollout are in final stages and the bill will be introduced in the current session

There has been a clear focus on inclusive growth in recent years and the Union Budget has come to be a balancing act between fiscal prudence and spending for inclusive growth. This year's Budget was no different – it was largely a balancing act between political, social & economic factors, with the key positive being the roadmap on fiscal consolidation. The backdrop of the Union Budget for the fiscal year ending March 2012 was challenging, with the economy facing headwinds such as high inflation and twin deficits. While the importance of the Union Budget has diminished over the years as the key policy indicator, it continues to provide an insight into the government's plans.

As part of the efforts to address food inflation, the government has announced a series of measures to bolster agri-infrastructure – some of the major initiatives include infrastructure status to cold storage chains and fertilizer production. While there were several new initiatives announced in the agri sector, there were no significant reforms to encourage private sector investments.

The continued focus on agriculture and rural sectors would diversify the economic drivers for India and help the economy remain resilient in the event of a global slowdown as witnessed in 2008/09. The new initiative of direct transfer of subsidies (cash payments) and the increased focus on tackling corruption/black money are positives. However, there has been no indication with regard to reforms in key areas such as FDI in retail, labour reforms, etc.

The expected introduction of Public Debt Management Agency of India Bill in the next financial year is important as the setting up of an independent debt management office had been put on the back burner for the last few years. This will reduce the conflict of interest for RBI who currently has the responsibility to set short term interest rates as well as sell government bonds.

EQUITY MARKETS

The fiscal deficit projections and largely unchanged tax structure boosted market sentiment, but markets lost ground from intra-day highs. The enhanced exemption limits and increased rural spending along with moves to ensure affordable housing gave a boost to FMCG and real estate sectoral indices. The government's additional equity infusion to PSU banks to ensure that Tier I capital is at 8% boosted some of the PSU stocks. Indications that RBI will announce guidelines for issuing banking licenses to private sector players boosted NBFC stocks.

	Change from Friday's close		Change from Friday's close
BSE Sensex	0.69%	BSE Realty	1.30%
S&P CNX Nifty	0.56%	BSE Power	0.07%
BSE MidCap	0.31%	BSE FMCG	4.47%
BSE SmallCap	0.36%	BSE IT	-0.003%
BSE Bankex	0.07%	BSE Healthcare	-0.04%
BSE Oil & Gas	0.58%	BSE PSU	2.00%
BSE Metals	0.03%	BSE CG	0.60%

The rising input costs due to demand-led pressures and higher global commodity prices pose challenges to Corporate India. In recent months, the trade deficit has moderated due to rising exports, but the current account deficit at close to 3.5% of GDP still remains a concern. The government introduced additional measures to ensure that capital flows remain strong, which include - allowing foreign individual investments in equity mutual funds and the US\$20 bln hike (overall US\$40 bln) in FII investment limits for corporate debt.

We believe the recent corrections in the Indian market due to a fall in global risk appetite and reallocation towards developed markets, does offer attractive long term investment opportunities. As always, the effectiveness of any Budget is in the implementation of policies. To meet the long term growth expectations the government would need to address the infrastructural bottlenecks and expedite key reforms in areas such as tax, labour and education. Over the coming years, ability to manage inflation, pushing through institutional reforms for tackling graft and ensuring affordable housing in urban areas will be critical for sustainable growth.

DEBT MARKETS

Markets benefitted from the announcement of a lower fiscal deficit for the coming years. In FY11 government finances benefitted from one-off items such as 3G spectrum auction, divestment and buoyant tax revenues. The projection of centre's fiscal deficit at 4.6% of GDP for the next fiscal year is clearly a positive given the absence of one-off items. The market borrowings estimate for the next year has come in lower than market expectations, despite the hike in social spending. However, progress on this front will need to be

tracked closely as fuel subsidy burden could witness an upside in the current oil price environment and achievement of the divestment target will depend a lot on market sentiment. Another uncertainty is the introduction of the food security bill and NREGA wages being linked to inflation.

	25/2/2011	28/2/2011
1-yr gilt yield (%)	7.48	7.50
5-yr gilt yield (%)	8.05	8.00
10-yr gilt yield (%)	8.13	8.08
5-yr AAA corporate bond yield (%)	9.28	9.30

The Indian rupee had been under pressure due to FII outflows amidst ongoing increase in risk aversion owing to geopolitical tensions in the MENA region. The increased FII investment limits in the corporate bond segment (5-year paper related to infrastructure) augur well for both infrastructure financing as well as capital flows.

The economy continues to face headwinds in terms of inflation and rising global commodity prices. Continued rise in fuel prices will put upward pressure on inflation and credit off-take seems to be picking up. While the fiscal consolidation plans are commendable, we need to see if the assumption on revenues and expenditure would be in line with estimates. Until inflation tapers off meaningfully, RBI will continue to pursue monetary tightening. We expect debt markets to remain under pressure until then due to the various uncertainties.



Franklin Templeton Investment Management Limited
 Office No. 505, Building No. 3
 Dubai International Financial Centre
 P.O.Box 506613
 Dubai, U.A.E.
www.franklintempletongem.com

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