

Equity Market Impact

Overall Budget Tone

The overall tone of the budget was positive with a continued commitment to reforms, focus on growth and a welcome move to fiscal consolidation.

Fiscal consolidation was one of the biggest positive outcomes from the budget. The government has targeted a fiscal deficit of 5.5% in FY11 (from 6.7% in FY10) and has done this by controlling expenditure and increasing tax (+14%) and non-tax revenues (32%). Within that, the nature of spending has improved (+8%) with more being spent on plan (+14%) versus non-plan items (+4%). The overall net borrowing program has been curtailed (down 13%) and thus does not crowd out private sector borrowing. Over the medium term, the fiscal deficit target of 4.1% (by FY13) was welcome and highlights the government's commitment to fiscal responsibility. The expected divestment proceeds of Rs 40,000cr (vs. Rs 25,000cr in FY10) and those from 3G (Rs 36,000cr) would help ease the financial burden.

On the reform front, the government reiterated its commitment to tax reforms – implementation of GST and Direct Tax Code by April-11, which will help reduce inefficiencies and leakages within the system. However, lack of a clear roadmap on oil sector reforms was a negative surprise.

On the growth front, the government reiterated its commitment towards inclusive growth by increasing spending on various agricultural and social sectors programs. More specifically, they increased spending on Bharat Nirman and NREGA. Furthermore, by increasing the income tax exemption limits, the government has put more money in the hand of consumers, which would in turn spur both savings and consumption. At the same time, it has also increased expenditure in various areas such as in road and power.

Specific Proposals

Direct Taxes

- Increase in MAT rate from 15% to 18% would negatively impact select companies. This to some extent would be mitigated by a reduction in the income tax surcharge to 7.5% from 10%.
- Increase in income tax exemption limits – will boost the tax base and increase consumption and savings.

Indirect Taxes

- Increase in excise rate by 2% from 8% to 10%. This was in line with expectations as the government begins to roll back the stimulus measures introduced last year.
- Service tax net to be widened further which is a continuation of an earlier trend. Items that have been added include airline tickets and commercial real estate.

Sector wise impact

Sector	Impact (+ive/-ive)	Specifics
FMCG	Neutral (overall) - ive (for Tobacco)	Tobacco – sharp increase in excise (weighted average increase of 17% for ITC). However, new slab (<60mm) introduced at lower excise rate, which will help spur conversion. Change in direct tax brackets should spur consumption. Increase in excise rate from 8% to 10% was along expected lines.
Sector	Impact (+ive/-ive)	Specifics
Banking	+ ive	<ol style="list-style-type: none"> 1. Extension of interest subvention of 1% by 1 year to 31st Mar'11 for home loans upto Rs. 10 lakh and cost of home of less than Rs. 20 lakhs - Positive for housing finance companies and real estate. 2. Extension of 6 months for the repayment of amounts under Agri-debt relief scheme. 3. Increase in allocated amount for capital infusion in PSBs to maintain Tier I capital of at least 8%. 4. Issue of new branch license to private players and NBFCs - License to be issued post fulfillment of conditions laid down by RBI. Positive for NBFCs. 5. Net market borrowing to be lower at Rs3450bn as against ~Rs3970 bn in FY10 - lowers the concerns for crowding of private investment
Pharma	+ ive	Weighted R&D deduction for in house R&D increased from 150% to 200%. Positive for R&D focused companies.
IT	Neutral	No mention of Section 10A/B, will be allowed to expire. Full SEZ tax benefit extended for profits from FY06 by amendment of Sec 10 AA.
Telecom	Neutral	No major proposals. Increase in MAT a -ive for telcos.
Oil & Gas	Neutral	On deregulation, the Kirit Parikh report is under

		<p>discussion and we will have to await the outcome of these deliberations.</p> <p>Reintroduction of custom duty (5%) on crude oil positive for exploration companies.</p> <p>Additional excise (of Re 1) on petrol and customs duties negative for oil marketers.</p> <p>The decision to pay oil subsidies in cash was the silver lining.</p>
Metals and Mining	Neutral	<p>Formation of coal regulatory Authority: This is to provide a level playing field for coal resource allocation.</p> <p>Cess on domestic coal of Rs50/t:</p>
Infrastructure	Positive	<p>Increased spending on road projects by 14%.</p> <p>Increased spending on power projects by 34%.</p> <p>Increase in MAT, and non-extension of 80IA benefits and cess on coal are some negatives.</p>
Auto	Neutral	<p>2% excise roll back across the board - largely expected and better than a feared 4% roll back</p> <p>Increase in excise duty to 22% + Rs 15,000 from earlier 20% + Rs 15,000 (on >4m cars)</p> <p>Thrust of infra should benefit commercial vehicle manufacturers</p> <p>Realignment of direct tax slabs will help spur demand.</p>

The key takeaway from the budget was a commitment to fiscal discipline both from a short term and medium term perspective. The government's decision to increase income tax exemption came as a positive surprise and will help mitigate the impact of the rollback in excise rates. The overall commitment to reforms and inclusive growth is a continuing theme and is certainly welcome. However, there are concerns that some of the measures, such as the increase in excise and duty rates, will stoke inflationary pressures. At the same time, while revenue expectations seem reasonable (with tax to GDP at 10.8% remaining stable), certain expectations of subsidies / expenditures may be optimistic.

Debt Market Impact

The government intends to cut fiscal deficit from 6.7% of GDP in FY 2010 to 5.5% of GDP in FY2011. The reduction in deficit has been possible through increase in revenues (higher excise duties, disinvestments, and 3G auction) and containment of non-plan expenditure. For the first time the government is targeting to bring down its public debt to GDP ratio, which if achieved, would free up resources for the credit needs of private sector.

The heavy supply of Government securities in the first half of FY11, could result in yields moving higher. However, RBI may have the option of intervening in the form of OMO (buyback of Govt securities) to smoothen the volatility.

The attempt by the government to reduce the debt to GDP ratio is very positive for fixed income markets over the medium term.

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