Union Budget 2010-11

February 2009

Equities

The second Budget from the current UPA administration continues to underpin on its key focus areas of infrastructure and social sector spending. Infrastructure accounts for 46% of plan spending while the latter constitutes around 37%. This is in line with the focus areas of the government.

Key highlights are as under

- Growth impetus to continue with FY2009-10 GDP growth targeted at 7.2% with a target to raise growth to 9% in future. Aim to rein in fiscal deficit to 4.1% of GDP by FY2012-13.
- Strong stress on divestment (INR 25,000 crores for FY2009-10) with an aim to raise this amount to INR 40,000 crores in FY2010-11. Government is therefore likely to remain capital market friendly.
- Direct tax changes (reduction in personal taxes by way of raising income tax slabs) and NREGA to continue effort to boost consumption
- Increase in MAT (from 15% to 18%) to be partly offset by cut in corporate surcharge from 10% to 7.5%
- CENVAT raised by 2% from 8 to 10%. This could be mildly inflationary in the short term
- New direct tax code / GST to be implemented as per plan from 1 April 2011

At a sectoral level, we see the impact based on excise/customs duty changes, which are summarized as under:

Information Technology

- Hike in MAT from 15% to 18% will have a small (<5%) impact on earnings in the near term
  Impact : Marginal Negative
- No extension of Sec 10A/B
  Impact : Neutral

Media

- No significant announcement
  Impact : Neutral

Cement

- Increase in infrastructure / low cost housing
- Competitive bidding for domestic coal
- Increase in excise duty
- Increase in duties on coal, a key cost
- Increase in freight costs given higher fuel prices
  Impact : Negative

HSBC Mutual Fund

Oil & Gas

- Hike in crude import duty from 0% to 5%
- Hike in petrol, diesel customs duty from 2.5% to 7.5%
- Excise duty by specific rate of INR 1/lit on petrol and diesel
- MAT rates increased

  Impact : Neutral

Telecom

- MAT rates increased

  Impact : Neutral

Infrastructure

- Increase in infrastructure spend through various new projects as well higher allocations
- MAT rates increased

  Impact : Neutral

Financials

- Government borrowing plan mostly inline with expectation
- Additional banking licenses to be issued to private players including NBFCs
- INR 165bn to be provided to PSU banks for re-capitalization
- Extension for farm loan re-payment by six months

  Impact : Positive

Real Estate

- Construction of a new property intended for sale and the service of renting of immovable property to attract service tax to the extent of 10.3%
- Service tax on pre-sale of immovable property

  Impact : Negative

Consumer Staples

- Roll back of excise duty from 8% - 10% - marginal negative
- Substantial increase in excise duties on cigarettes
- MAT rate increased to hurt few companies marginally

  Impact : Negative

Pharmaceuticals

- Increase in tax rebate on R&D spends

  Impact : Positive

Retail

- Service tax on rental income could increase cost

  Impact : Negative

Automobiles

- Increase in excise duty to 10% (earlier 8%) for small cars, 2 wheelers and commercial vehicles and 22%+Rs15,000 (earlier 20%+Rs15,000)
- Increase in weighted deduction for R&D to 200% from earlier 150%

  Impact : Neutral

Fixed Income

The Union Budget FY2010-11 strives for a balance between exercising an extent of gradualism while withdrawing fiscal stimulus on the one hand, and the need to head towards fiscal consolidation on the other. The key highlights are as follows:

- Tax revenue projected up 15% from FY2009-10 (RE) on the back of anticipated buoyancy on stronger GDP growth and a 2% hike in excise duty
- 3G auction proceeds of INR 35,000 crores and disinvestment target of INR 40,000 crores budgeted
- Visible effort towards controlling expenditure: Non-plan expenditure up only 4%, plan expenditure up 18%
- Overall fiscal deficit projected at INR 3,81,408 crores (5.5% of GDP) versus a revised figure of INR 4,14,041 crores (6.7% of GDP) for FY2009-10
- Net market borrowing of INR 3,45,010 crores versus INR 3,98,411 crores (including de-sequestering) for FY2009-10

Including maturities for the year, the gross market borrowing for FY2010-11 is pegged at 4,57,000 crores versus 4,51,000 crores in FY2009-10. This is very much in line with market expectation and to that extent does not constitute a negative surprise. However, we remain bearish on rates over the medium term due to the following reasons:

- Inflation has already breached RBI's revised expectation and we expect it to head towards double digits before easing later in the calendar year 2010. The budget's measures to hike excise duties is expected to put further upward pressure on prices in products where demand strength may enable the producer to pass on the rise.
- Demand for government bonds is expected to be weaker in the year ahead, given rising inflation, lower liquidity, expectations of policy rate rise and relatively better credit growth. Additionally, RBI bought INR 57,487 crores of government securities under open market operations (OMO) over FY2009-10. Given a hawkish monetary policy stance, this is unlikely to happen in the year ahead. Additionally, INR 28,000 crores of market stabilization bonds were de-sequestered and added to accounts of the government during FY2009-10, a space that is not available in FY2010-11.

Overall, we expect a gradual upward bias to bond yields as the market gears up to absorb the fresh auction calendar in April 2010. The shorter end of the corporate bond curve may be more susceptible in the near term on liquidity withdrawal, reducing demand and rate hike fears. We reiterate our view of a bearish flattening of the corporate bond curve.