



Budget 2010-11 and market outlook

February 2010

Union Budget: Macro economic backdrop

Key strengths:

- **Economy showed huge resilience during the global downturn due to structural factors and policy stimulus. In a demand constrained world, India is placed well with growth engines of domestic consumption and infrastructure build up**
- **Signs of increasing momentum in industrial growth and services**
- **High savings rate, strong financial sector, Household gearing too low**
- **Corporate sector: manageable gearing, On track for robust earnings growth**
- **Huge Demographic dividend to boost consumption and savings**
- **Healthy external sector with comfortable Forex reserves, strong FDI and portfolio flows**
- **Buoyancy in capital markets, Favorable monetary conditions**
- **Stable pro-growth government at centre, increased focus on reforms**
- **Policy moves showing result in revival of rural economy**

Indian Economy: Where we are

Challenges

- **Fragile global recovery with large excess capacities, high unemployment, weak credit conditions. Though India largely a domestic driven economy but capital market linkages with rest of world are strong, impact real economy as well.**
- **Globally, withdrawal of policy stimulus and sovereign balance sheet issues could increase risk averseness and volatility in economic variables as well as asset values**
- **Policy stimulus cushioned the impact of global and cyclical downturn, private consumption and investment need to pick up as stimulus is withdrawn**
- **Supply side constrains: acute shortage of infrastructure, inflationary pressures due to supply constraints, increasing complexity for monetary policy management**
- **Poor Monsoon impacted agricultural growth and put upward pressure on inflation, global commodity prices also on rise**
- **High levels of public debt and consolidated fiscal deficit**
- **Pace of reforms and execution has been slow**

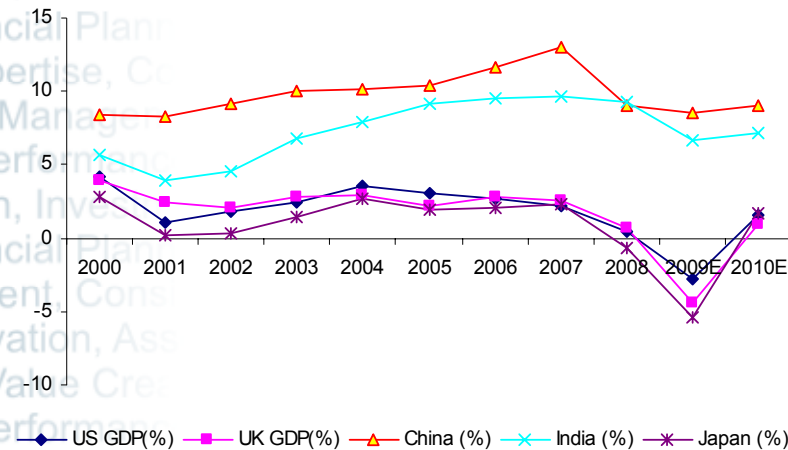
7-8% growth is given, what for achieving 10% in medium term ?

- Fiscal consolidation: Expenditure management, tax reforms, privatization
- Financial sector and capital market reforms
- Massive Investment in physical infrastructure
- Removing structural rigidities
- Further opening up of external sector, capital and technology import in critical sectors
- Focus on employment creation and investment in social infrastructure (education, healthcare) to capitalize on demographic dividend
- Labor market and land reforms
- Governance: Government's focus needs to move from outlay to outcome, Judicial and administrative reforms are critical for efficient delivery
- Urbanization to move excess labor from agriculture
- Substantial improvement in agriculture productivity,
- Sustainable development, energy and water management

Fiscal deficit: Relatively India on improved trajectory

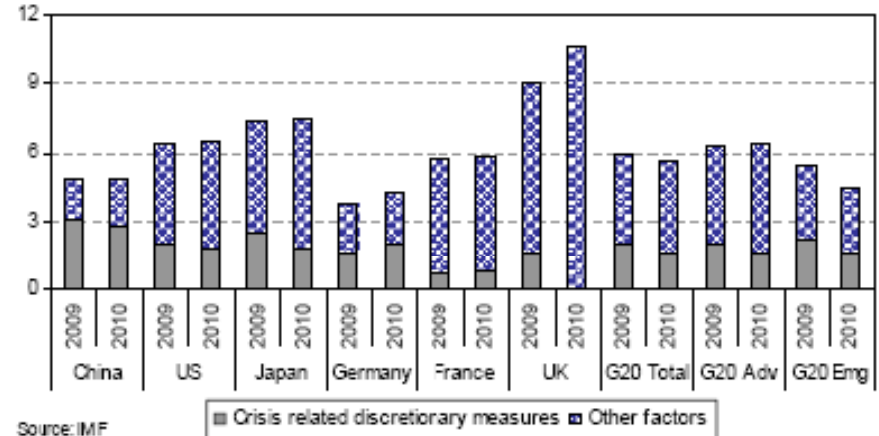
Shift in the global growth engines

World Real GDP YoY, by region



- India and China led the recovery in global growth with sustained growth momentum even during the crisis period last year
- With strong domestic drivers of growth that of consumption & infrastructure, India to be one of the new growth engines in the post crisis world

Massive fiscal stimulus by every government



Source: IMF

- India's stimulus measures that resulted in 6.7% of fiscal deficit in 2009-10 not out of sync when compared globally
- With clear roadmap on fiscal consolidation & 5.5% fiscal deficit in FY11 and strong growth momentum, India to face lesser fiscal constraints among various economies across the globe

Union Budget: A fine balancing act while laying long term roadmap

- **Focus on Fiscal Consolidation, improved transparency with consolidating off-balance sheet items in fiscal deficit**
- **Careful withdrawal of stimulus to ensure growth momentum is maintained**
- **Continued focus on inclusive growth**
- **Long term reforms like GST, Direct Tax code, committee on revamp of Financial sector legislations, moves towards better subsidy management , disinvestment etc**
- **Focus on boosting consumption and infrastructure development through taxation measures and higher outlays**
- **Moves towards improving delivery mechanism**

Budget by numbers

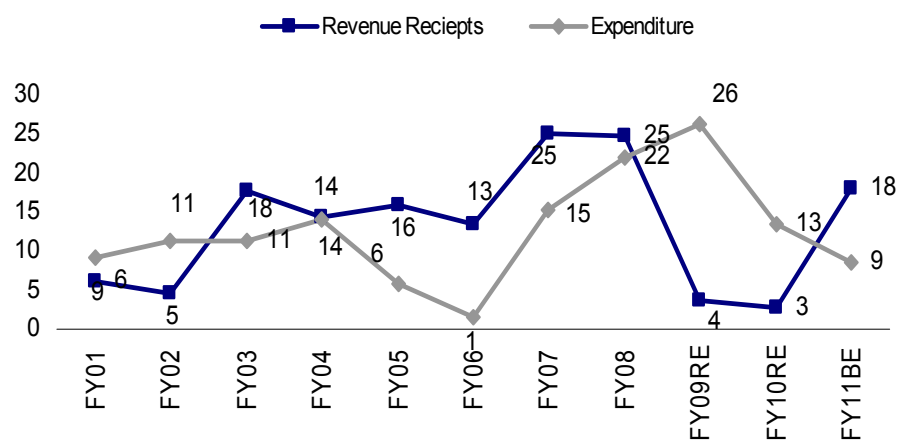
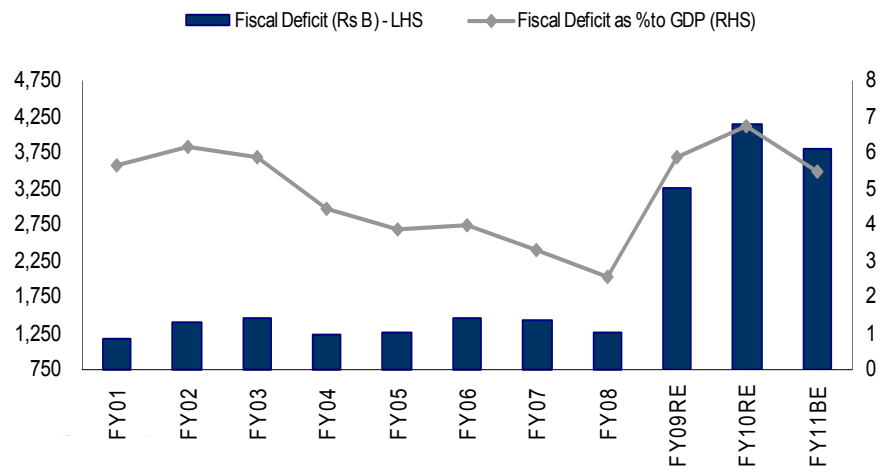
	2008-09RE	2009-10 BE	2009-10RE	2010-11E
Net Tax Revenues	4,660	4,742	4,651	5,341
Non-tax Revenues	962	1,403	1,122	1,481
Net Revenue Receipts	5,622	6,145	5,773	6,823
Non-debt Capital Receipts	123	53	302	451
Total Revenues	5,744	6,198	6,075	7,274
Revenue Expenditure	8,034	8,972	9,064	9,587
Non-plan Expenditure	5,617	6,188	6,419	6,436
Plan Expenditure	2,417	2,784	2,644	3,151
Capital Expenditure	975	1,236	1,152	1,500
Plan Expenditure	413	468	508	580
Non-plan Expenditure	562	769	644	921
Total Expenditure	9,009	10,208	10,215	11,087
Fiscal Deficit	3265	4010	4140	3814
% to GDP	6%	6.54%	6.72%	5.50%
Revenue Deficit	2,413	2,827	3,291	2,765
% to GDP	4.40%	4.61%	5.34%	3.99%
Primary Deficit	1,338	1,755	1,945	1,327
% to GDP	2.50%	2.86%	3.16%	1.91%

Roadmap for Fiscal Consolidation

Fiscal consolidation path for centre & states (% to GDP) (As recommended by thirteenth finance commission)						
	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Revenue Deficit-Centre	4.8	3.2	2.3	1.2	0	-0.5
Fiscal Deficit-States	2.8	2.6	2.5	2.5	2.4	2.4
Fiscal Deficit-Centre	6.8	5.7	4.8	4.2	3	3
Fiscal Deficit-Consolidated	9.5	8.3	7.3	6.7	5.4	5.4
Consolidated Debt as a % of GDP	78.8	78.3	76.6	74.3	70.8	67.8

A calibrated exit strategy from the expansionary fiscal stance of 2008-09 & 2009-10 reducing the fiscal deficit to 5.5% in 2010-11

Revenue growth expected at 18%, expenditure growth projected at 8%, both bit optimistic



Budget 2010-11: Key measures

- **Increase in personal tax slabs that would result in higher disposable income in the hands of the common man. For a person having taxable income in excess of Rs. 800000: tax savings would be Rs. 51000.**
- **Partial hike of 2% in excise duty increasing it to 10% was better than market expectations**
- **Service tax maintained at 10% while its scope has been widened which would negatively impact some of the sectors (aviation/ airport services, real estate etc)**
- **Effective tax rates for corporates reduced due to reduction in surcharge**
- **MAT increased from 15% to 18% which could impact several corporates in sectors like IT & Infrastructure.**
- **Continued support to exports with extension of interest subvention of 2% for one more year for exports covering handicrafts, handlooms, and small & medium enterprises**
- **Continued thrust on agriculture growth. Credit support provided to farmers by extending the repayment of the loans under the debt waiver scheme to June 30, 2010 from earlier deadline of Dec 31, 2009. Exemptions on custom duty and excise in selective agriculture investments. Allocation towards improving agriculture production provided.**
- **Focus on Inclusive development with increased spending on social sector which is 37% of the total plan outlay for 2010-11 including investment in rural development schemes like NREGS, Bharat Nirman etc. Urban development & housing, education, health and Micro, Small & Medium Enterprises**

Budget announcement's sectoral impact

NO MAJOR BUDGET ANNOUNCEMENT THAT HAS A LONG TERM STRUCTURAL IMPACT ON THESE SECTORS

Sector	Impact
Metals	Excise duty hike for all manufacturing companies by 2% from 8% to 10% is negative as this ultimately reduces net realisation on their products
	Increase in MAT from 15% to 18% to negatively impact the sector
	Incidence of coal cess of Rs 50 is negative, as cost of captive thermal power would go up, aluminum producers and companies with power subsidiaries would be more impacted
	Competitive bidding for coal blocks would be positive as it would ensure availability of coal in future although at higher cost
Construction	Extension of tax benefit under section 80C for Infrastructure Bond investments up to Rs 20,000 positive for all construction companies
	MAT rate increased from 15% to 18% is negative for all infra developers as BOT projects pay tax on MAT for 10 years
Fertilizers	Announcement of intention to pay entire subsidy in cash is positive for all companies in terms of working capital management
Cement	Excise duty hike from 8% to 10% is neutral, companies would be able to pass on this ~Rs 5/bag hike to consumers since demand is buoyant
Cons Staples	Increase in excise duty on cigarettes by 17% is negative, as price increases would likely impact volumes
	Reduction in personal income tax rates could boost demand
	Increase in MAT & excise duty to have a marginal negative impact on the sector
Aviation	Domestic and international aviation has been brought under service tax net (10%), is negative for the sector
Hotels	Investment linked deduction to new hotels of 2-star category and above is positive

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Sector	Impact
IT	Clarification on retrospective application of SEZ tax benefit is positive
	MAT rate increased from 15% to 18% which will impact cash flow marginally
Pharma	200% weighted deduction of tax for in house research and development activities is positive for the sector
Financials	RBI considering additional banking licenses to private sector players & NBFCs, likely to be positive for some large NBFCs
	Rs 16,500 crore capital provided to PSU banks, positive for PSU banks with low CAR and GOI holding near 51%
	Deduction of an additional amount of Rs 20,000 allowed for investment in long-term infrastructure bonds is positive for issuing institutions (yet to be notified)
	Period for repayment of loan amount by farmers extended by six months is a mild positive for banks in terms of delaying NPL recognition & provisioning requirement
Auto	Excise duty hiked by 2% across all segments is negative, but expect companies to pass this on to consumers
	Reduction in personal income tax rates could boost demand
Power Utilities	Incidence of coal cess of Rs 50 is negative for power plants based on Case I/Case II tariffs as the increased cost would have to be absorbed by the developer, no impact in case of regulated return based power plants

Budget announcement's sectoral impact

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Sector	Impact
Oil & Gas	Restoration of customs duty of 5% crude oil, increase in customs duty on petrol/diesel from 2.5% to 7.5% and other products from 5% to 10% to benefit upstream companies (higher duty protection) but hit oil mktg cos (under-recovery for the sector increases)
	Announcement of intention to pay entire subsidy in cash is positive for all companies in terms of working capital management, however currently there is no provision for subsidy support in FY11
	MAT rate increased from 15% to 18% to impact some companies
Telecom	MAT rate increased from 15% to 18% which will impact cash flow marginally
Real Estate	Extension of interest subvention scheme on low cost housing up to March 31, 2011 to benefit affordable housing segment
	Focus on slum rehabilitation through allocation of Rs. 12.7 bn in Rajiv Awas Yojna to have long term positive impact on slum rehabilitation development projects which is largely in Mumbai currently
	Increase in personal tax slabs would result in higher disposable income that will positively impact the overall housing affordability and demand
	The extension of service tax on the construction of complex service may result in increase in residential prices, that will negatively impact the housing demand
	The extension of service tax on the additional services like preferred location, external & internal development charges provided by a builder to the buyers to have a marginal negative impact
	Service tax on renting of immovable property (commercial office) & vacant land to have marginal negative impact on the rental cost for the tenants

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Equity Market outlook

- **Budget 2010-11 presented in the backdrop of improving growth prospects, broadly in line with market expectations with no major surprises**
- **The fiscal deficit at 5.5% of GDP and market borrowing for the next year are in line with expectations which will sooth fears of crowding out and sharp spike in interest rates, the Budget aimed at strengthening the pillars of India growth story: Consumption & Infrastructure build up**
- **Measures on the personal taxation & increased spending on Govt. programmes to keep the consumption story intact.**
- **Measures like deduction for investment in long term infrastructure bonds and increased allocation towards infrastructure development that accounts for over 46% of the total plan allocation would fasten the pace of infrastructure build up, Continued support to Agriculture, Education, Rural development and social sector augurs well for economy.**
- **Roadmap on fiscal consolidation provided with fiscal deficit projected to come in lower at 4.8% in FY12 and 4.2% in FY13.**
- **The long ranging reforms like roll out of GST, Direct tax code, further opening of banking sector, reforms on the subsidy front will assist in removing the structural rigidities & increase the growth potential of the Indian Economy**
- **Though no major surprise, budget is positive for the equity market. As the event is behind us, the market would now focus on cues from global markets, incremental economic data and corporate earnings.**

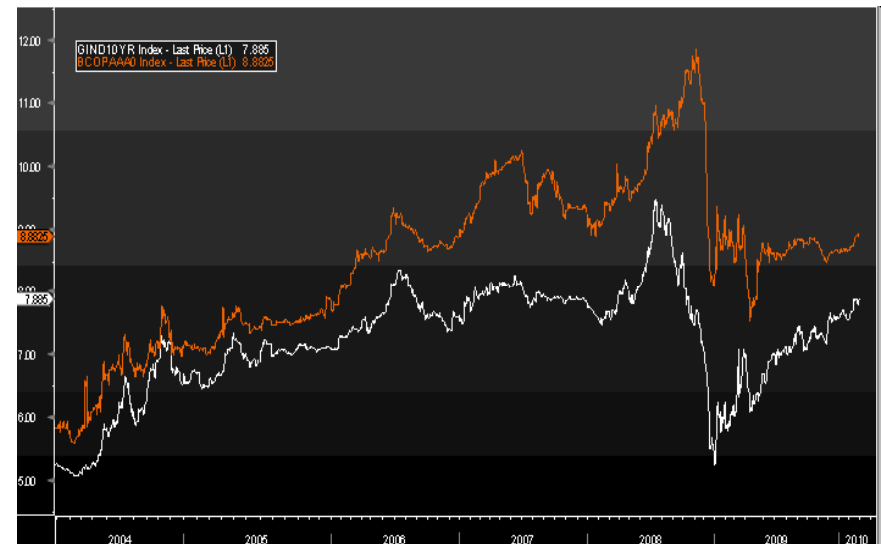
Gsec Market Outlook

- **Net central government borrowing of Rs. 3.45 lakh crore announced in today's budget while a fiscal deficit of 5.5% is projected for FY11**
- **Considering issuances by states too, it appears that the market will find it tough to absorb this supply especially in the wake of RBI's exit moves from an accommodative monetary stance**
- **It appears that yields will spike up at some point during Q1 / Q2 of FY 11 in response to the supply and RBI action pressures / reduced appetite from Banks once credit picks up. However, this does not seem an immediate scenario and may take some time to materialize**
- **While shorter term rates are already under pressure, maturity details and scheduling of Government borrowing and RBI's management of borrowing programme would determine the impact on the medium and longer end of yield curve**
- **Over all, while market may provide trading opportunities in the first half, sustained gains in bonds seem possible only after market has absorbed a sizeable portion of borrowing and RBI slows down on its tightening moves**
- **10-year G-sec yield may stay in the 7.5-8.5% band for a major portion of the first half of the next fiscal**

Credit markets

- Short term rates have already moved up owing to expectation of RBI action, issuance pressure from Banks and impending change in Mutual Fund valuation guidelines
- The same has put pressure in the 2-5 year segment of the curve too
- While AAA spreads have widened by about 20-25 bps recently, corporate bond spreads are not expected to compress in an environment where Government borrowing is heavy and corporate look to raise money.. Also, the impact of RBI's proposed base rate implementation for Banks on corporates borrowing behavior needs to be assessed.
- With the sharp up move in short term rates, it appears that yield curve may provide better trading opportunities at the shorter end.

GOI Yield and AAA yields (%)



Source: Bloomberg, RBI

Thank You

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