



Budget FY12 was presented in the context of significant domestic and global economic challenges as well as domestic political and governance challenges. Let us enumerate the same in a table:

**Table I: Domestic and Global challenges for the Budget**

	<b>Economic</b>	<b>Political</b>	<b>Governance</b>	<b>Financial</b>
<b>Domestic</b>	Inflation Monetary tightening  Interest rates Capex cycle  Credit growth Oil price impact Current Account Deficit (CAD) Spiraling subsidies	Policy paralysis Upcoming state elections  Coalition compulsions Cabinet reshuffle	Corruption Delay/hurdles in approvals	Earnings growth slowdown Margin pressures  Relative valuation to EM Financing gap due to CAD, Fiscal Deficit
<b>Global</b>	Commodity prices Developed Market rebound  BRIC inflation challenge	Middle East turmoil		FII flows Asset class performance disparity

Our H'ble Finance Minister rose to the challenges. Apart from the conventional budget parameters, H'ble Finance Minister has addressed the most crucial parameter of domestic financing. He has done so by relieving the pressure on the financing of Current Account Deficit (CAD) and the pre-emption of household savings by Government borrowings. He has dealt with the CAD by opening up \$20bn of incremental Corporate Debt limit for bonds with residual maturity of more than 5 years, Notified Infrastructure Debt funds with favourable withholding tax, and letting foreigners invest directly into Indian SEBI registered Mutual Funds subject to KYC norms. He has dealt with the Government borrowings pre-empting household savings by reducing the Fiscal Deficit, narrowing the Fiscal Deficit as % of GDP. This should alleviate the liquidity pressure by making the borrowing calendar less onerous on the domestic debt market. This should reflect on the benchmark 10 year GSec after the short-end tightness of Mar 2011 is behind us.

He has also persisted on the growth path by boosting rural incomes and rural spends through continued emphasis on NREGA, farm produce prices, and loan access for farmers. He is also fostering consumption by reducing tax incidence for taxpayers by relaxing exemption limits. Most importantly, all this has been achieved without burdening the corporate sector with additional taxes and retaining the stimulus of 2% excise, 2% service taxes.

It is a marked departure from standard government practices, he is encouraging Infrastructure spends, by improving access to infrastructure financing (Incremental Corporate debt limit of \$20bn, Notified Infrastructure Debt funds for Foreign investors, Tax free bonds for domestic investors, Take-out financing by



IIFCL) and thereby reducing the dependence on Government spends on infrastructure financing for Private sector and PPP initiatives.

Under the expenditure method of computing GDP,

$$\text{GDP} = \text{C} + \text{I} + \text{G} + (\text{X}-\text{M})$$

**C = Consumption, I = Investment, G = Government expenditure, X = Exports, M = Imports**

Hence, H'ble Finance Minister is wisely adding to the growth thrust by **pushing Consumption and Investments rather than Government expenditure.**

Also, Strategic shifts and policy initiatives like GST, DTC, UID roll-out, Direct transfer of cash subsidy for Kerosene, LPG and Fertilisers (Urea), steps towards a more liberal Capital account (increased Corporate debt limit for foreign investors - \$20bn, allowing foreign investors to access Indian SEBI registered MFs, lower taxation for dividends received from foreign companies) go a long way towards demonstrating that the reform process is on, with appropriate attention to detail. He has resisted the pressure to go overboard on the expenditure side, and has demonstrated fiscal discipline in this matter too.

A 4.6% Fiscal Deficit and a borrowing target of Rs.3.43 lac crores are impressive numbers in the backdrop of the challenges faced by the Indian economy as well as the Developed Market fiscal conditions. It demonstrates a will to pursue fiscal consolidation, which also leads to dilution of fiscal stimulus. A lot of skepticism has been focused on the feasibility of the budget numbers, especially the subsidies (mainly fuel subsidy). We would like to step back and take a wider perspective.

1. Pranabda has a hard-earned reputation for being reliable in a tough situation, as well as for his ability to deliver. We do not think he is about to endanger the same.
2. Relentless focus on Fiscal discipline (centre and state), progressive policy (GST, DTC), attention to detail (UID, GST network), striking a fine balance (fiscal deficit, economic growth) have been the hallmarks of Pranabda's budgets, especially in this innings.
3. FY11 Revised Estimates (RE) of Receipts include about Rs.1 lac crore of 3G licence windfall, but FY11 RE of Expenditure also include ~Rs.60,000 crore of additional grants/expenses. It is unfair to criticize the FY12 Budget Estimates (BE) without adjusting non-recurring items on both the receipts as well as expenditure side when comparing it to FY11 RE.
4. Even if one were to grant that there could be additional fuel subsidy burden of about \$15bn (assuming a delta of \$15/barrel over the budget assumption), there would also be a revenue impact of 25-30% of the same on account of Customs and other taxes. Hence, the net impact would be about \$10-11bn. It may also be that Pranabda has kept the fuel price hikes and diesel price deregulation up his sleeve for the near future, immediately on some relief on the inflation front.
5. One may or may not give him the benefit of doubt on the roll-out of UID cards, but one cannot fail to appreciate the fact that India will be in a position to roll-out 1mn UID cards a day by end of September 2011.



6. On the subsidy side, H'ble Finance Minister may not be way off the mark in the context of the historical subsidy numbers (refer Table II below). We appreciate the fact that now our budget statement is WYSIWIG (What you see is What you get), i.e. all subsidies are paid in cash rather than using bonds as an off-balance sheet funding mechanism which would hit future budgets.

**Table II: Trend for provision of subsidy in Budget**

								Rs. Crs
Subsidy	2008 A	2009 A	2010 A	2011 E	MEAN	MEDIAN	2012 B	% chg YoY
Food	31,328	43,751	58,443	60,600	48,531	51,097	69,573	19.0%
Fertilizer	32,490	76,603	61,264	54,976	56,333	58,120	49,998	-18.4%
Petroleum	2,820	2,852	14,951	38,386	14,752	8,902	23,640	58.1%
Grants	860	375	850	250	584	613	200	-76.5%
Other Subsidies	3,428	6,127	5,843	9,941	6,335	5,985	9,159	56.8%
Total Subsidies	70,926	129,708	141,351	164,153	126,535	135,530	152,570	7.9%
Nominal GDP	4,947,857	5,574,448	6,231,172	7,877,947	6,157,856	5,902,810	8,980,860	44.1%
<b>Subsidies % of GDP</b>	<b>1.4%</b>	<b>2.3%</b>	<b>2.3%</b>	<b>2.1%</b>	<b>2.0%</b>	<b>2.2%</b>	<b>1.7%</b>	<b>-25.1%</b>
<i>Food</i>	<i>0.6%</i>	<i>0.8%</i>	<i>0.9%</i>	<i>0.8%</i>	<i>0.8%</i>	<i>0.8%</i>	<i>0.8%</i>	
<i>Fertilizer</i>	<i>0.7%</i>	<i>1.4%</i>	<i>1.0%</i>	<i>0.7%</i>	<i>0.9%</i>	<i>0.8%</i>	<i>0.6%</i>	
<i>Petroleum</i>	<i>0.1%</i>	<i>0.1%</i>	<i>0.2%</i>	<i>0.5%</i>	<i>0.2%</i>	<i>0.1%</i>	<i>0.3%</i>	

\*Source:- Budget 2011

**Thematic inferences for investors from the Budget FY12 are:**

1. **Agriculture** – fastest Agricultural GDP growth in recent times, higher credit by Banks to farmers, higher prices for produce (Beneficiaries - Agrochem and Fertiliser companies)
2. **Housing** – recognizing need to enhance low income group housing increased limits by Rs. 5 lakhs in loan amount and value of property for interest subvention of 1% on housing loans. (Beneficiaries - Housing Finance companies)
3. **Consumption** – NREGA, higher tax threshold, no stimulus withdrawal (Beneficiaries - FMCG, Durables and Auto companies)
4. **Interest rate sensitives** – Auto (no excise hike, lower interest rates anticipated), Banking (lower Fiscal deficit, lesser monetary tightening, easier Current Account Deficit financing, Direct Cash transfer for subsidies)
5. **Infrastructure** – Tax free bonds, Notified Infrastructure Fund for foreigners with favorable withholding tax, take-out financing access, structural shift from Government spend based infrastructure to Government acting as a facilitator for Private and PPP initiatives to be able to access funds



Table III: Sectoral Impact analysis

Sector	Key announcement	Impact
<b>Airlines</b>	Service tax increased on domestic travel by Rs.50 to Rs.150 and on international by Rs.250 to Rs.750. Whereas, travel by other than Economic class on domestic routes to be taxed at 10% standard rate.	<b>Negative</b>
<b>Autos</b>	Excise rate unchanged at 10%	<b>Positive</b>
<b>Banking</b>	Allocation of Rs.60,000 crores for PSU banks' recapitalization. No change in market borrowing of Rs.3.43 crores for next year to ease pressure of yields and will ease liquidity crunch.	<b>Positive</b>
<b>Branded Apparels and Jewellery</b>	Excise duty of 1% imposed on branded jewellery and branded articles of precious metals. Excise duty of 10% imposed on branded readymade garments and textile made ups.	<b>Negative</b>
<b>Cement</b>	Existing excise duty structure will be replaced by ad valorem rates which will increase total excise burden on the sector. Import duty on pet coke and gypsum reduced from 5% to 2.5%.	<b>Negative</b>
<b>Cigarettes</b>	No changes in excise duty rates.	<b>Positive</b>
<b>Education</b>	Allocation to the sector increased by 24% to Rs.52,057 Crores.	<b>Positive</b>
<b>Fertilizers</b>	Proposal for direct transfer system of cash subsidy to farmers and Nutrient based subsidy. Capital investment in fertilizer production to be included under infrastructure sub-sector.	<b>Positive</b>
<b>FMCG</b>	Higher allocation to schemes such as NREGA and Rashtriya Krishi Vikas Yojana, and higher personal income tax slabs to increase consumption. 1% increase in Excise duty to 5% on prepared foodstuff.	<b>Positive</b>
<b>Hospitals</b>	All services provided at air-conditioned clinical establishments having more than 25 beds will be subject to service tax.	<b>Negative</b>
<b>Hotels</b>	Hotel accommodation charges in excess of Rs.1000 per day will be subject to service tax of 5%.	<b>Negative</b>



	Air-conditioned restaurants having liquor license will also be subject to service tax of 3% of the bill	
<b>Housing / Housing finance</b>	Extension of 1% interest rate subvention on home loans upto Rs 15 lacs for houses costing upto Rs.25 lacs.  Home loans upto Rs.25 lacs will qualify as priority sector lending.	<b>Positive</b>
<b>Iron ore exports</b>	Increase in export duties on Iron ore from 20% to 30%, while unifying the effective rate of export duty on fines and lumps at 20%.	<b>Negative</b>
<b>Oil &amp; Gas</b>	No change in excise and import duties on crude. Government to directly provide cash subsidies to BPL families on Kerosene and LPG.  Tax benefits from NELP blocks no longer available for blocks awarded after 31 <sup>st</sup> March 2011	<b>Positive</b>
<b>Power Equipment</b>	Equipment manufacturers supplying to UMPP will be charged excise duty of 2.5% from current 10% in line with concessional basic customs duty of 2.5% on imported equipments.	<b>Positive</b>
<b>SEZ</b>	MAT rate of 18.5% to be applicable to developers of SEZ and units operating in them.	<b>Negative</b>
<b>Software</b>	No extension of STPI benefits. SEZ establishments to attract MAT rate of 18.5%.	<b>Negative</b>

**Significant Statements or Assumptions made by the FM in Budget for FY12 are:**

1. 9% GDP growth,
2. 5% inflation
3. Higher Savings
4. Better tax compliance
5. "Manufacturing sector to contribute 25% of GDP, as compared to 16% now"
6. "Discussions underway to further liberalise the FDI policy" - Could this be a precursor to FDI for Retail and Insurance?
7. Financial sector legislations – Insurance Laws amendment, Life Insurance Corporation amendment, revised PFRDA, Banking Laws amendment, Bill on Factoring and Assignment of Receivables, State Bank of India (Subsidiary Banks Laws) amendment, amendment to RDBFI Act and SARFAESI act



8. Adherence to FRBM targets not just by the Centre, but also by the States

**Risks / Concerns:**

1. Monsoons
2. Oil price
3. Divestment target of Rs.40,000 crores which was not achieved even in FY11 (Rs.22,000 crores)

**Conclusion:**

The budget is about intent and this has to be followed by execution. The intent through the various announcements highlights the continuing shift of the government from doer to facilitator; lower but more focused government spending is combined with an attempt to create a conducive environment for companies to directly tap domestic and international savings (through tax free bonds and more liberal rules for foreign capital). All the major reforms (GST, DTC, UID, etc) have a common underlying theme – simplify procedures, plug leakages, and lower government involvement. We remain optimistic that the government will make good the promise on these reforms, each of which can be a game changer. To conclude we want to leave you with one thought – we are growing at close to 9% without implementing these reforms – what happens when we implement them?

---



## DISCLAIMER:

**We are committed to providing completely independent and transparent recommendations to help our clients reach a better decision.** This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Nothing in this document should be construed as investment or financial advice, and nothing in this document should be construed as an advice to buy or sell or solicitation to buy or sell the securities of companies referred to in this document. The intent of this document is not in recommendary nature. The recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. Trust Financial Consultancy Services Pvt. Ltd. has not independently verified all the information given in this document. Accordingly, no representation or warranty, express or implied, is made as to the accuracy, completeness or fairness of the information and opinions contained in this document. The Company reserves the right to make modifications and alternations to this statement as may be required from time to time without any prior approval. Trust Financial Consultancy Services Pvt. Ltd., its affiliates, their directors and the employees may from time to time, effect or have effected an own account transaction in, or deal as principal or agent in or for the securities mentioned in this document. They may perform or seek to perform investment banking or other services for, or solicit investment banking or other business from, any company referred to in this report. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting the document. This report has been prepared on the basis of information, which is already available in publicly accessible media or developed through analysis of Trust Financial Consultancy Services Pvt. Ltd. The views expressed are those of analyst and the Company may or may not subscribe to all the views expressed therein. Neither the Firm, not its directors, employees, agents or representatives shall be liable for any damages whether direct or indirect, incidental, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. This document is being supplied to you solely for your information and may not be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, copied, in whole or in part, for any purpose.

**Copyright in this document vests exclusively with Trust Financial Consultancy Services Pvt. Ltd.**

**Trust Financial Consultancy Services Pvt. Ltd.**

109/110, 1st Floor, Balarama, Bandra Kurla Complex, Bandra (E), Mumbai -400 051, Maharashtra.

Ph: +91 22 4084 5000 • Fax: +91 22 4084 5052 • [www.trustgroup.co.in](http://www.trustgroup.co.in)