# Union Budget 2012-13 – A Perspective

March 2012

## Budget Impact on Equity Markets

- Higher excise and service tax – Negative for earnings across the board
- Inclusion of a new tax scheme to benefit small investors in direct equity
- Reduction in STT tax rate – a marginal positive
- Hopes of fiscal consolidation
  - Institutional investors could have cheered solid steps to reduce fiscal deficit
  - India's long standing concerns on the level of subsidies not addressed
  - India's investment climate remains unchanged
- Interest rates unlikely to come down in the near future – equity markets perform well in a falling interest rate scenario

## Sectoral Impact

| Sector | Measure | Impact |
|---|---|---|
| Metals / Mining | Customs duty hiked 5% to 7.5% on flat steel products | **Positive** for domestic steel producers |
| | Customs duty on imported coal for power removed | **Positive** for coal importers (though clarity is awaited whether benefit is only for Independent Power Producers) |
| | Customs duty on import of iron ore pelletisation & beneficiation equipment reduced to 2.5% from 7.5% | **Positive** for steel makers and merchant miners |
| | Customs duty on machinery and instruments for surveying and prospecting reduced from 10%/7.5% to 2.5% | **Positive** for steel makers and merchant miners |
| Oil and Gas | Cess increased from INR 2500/tonne to INR 4500/tonne | **Negative** for upstream players |
| | Oil & Gas/LNG storage facilities as well as Oil & Gas pipelines will be eligible for viability gap funding | **Positive** for LNG re-gasifiers and gas transmission utilities |
| Cement | Excise of 12% on MRP after 30% abatement + Rs 120 per tonne | **Neutral** |
| Telecom | Budgeted receipts of INR 40,000 crs from spectrum auctions & INR 18,200 crs from annual License Fee (LF) & Spectrum Usage Fee (SUF) | **Negative** for the sector as spectrum receipts target seem aggressive, given the streched balance sheets of the telecom companies.<br>The LF & SUF receipts assumes ~10% sector revenue growth, which is a realistic figure. |
| FMCG | Ad valorem duty of 10% imposed on 50% of MRP on cigarettes | **Positive** for cigarette manufacturers, as excise increase is lower than market expectations |
| | Excise increased from 10% to 12% | **Marginal Negative** as companies could pass on the impact through price increases that could impact demand |
| | Import duty increased from 2% to 4% on imported gold | **Marginal Negative** as this would lead to higher gold jewellery prices and could impact demand |
| Media & Entertainment | Film industry : Exemption from service tax net on copyrights relating to recording of cinematographic films | **Positive** for movie production & distribution firms |
| Banks | Re-capitalisation fund of INR 160 bn for PSU, Regional Rural Banks, NABARD and other financial institutions | **Marginal Positive** for capital starved PSU banks |
| | Higher net market borrowing of INR 4.8 tn vs. INR 4.3 tn last year | **Negative** as pressure on bond yields will impact bank's treasury profits and possibly lead to MTM losses on the "Available for Sale" part of the Bank's investment book |
| | Tax exemption for savings deposits up to INR 10,000/yr | **Marginal Positive** for savings deposit growth |

HSBC Mutual Fund

| Sector | Measure | Impact |
|---|---|---|
| **Pharmaceuticals** | All persons, other than companies, claiming profit linked deductions to be included under MAT | **Negative** for companies which had set up their manufacturing units using the partnership structure to avoid taxes |
| **Industrials** | Exemption of existing 5% import duty on coal | **Positive** for companies that are major importers of coal among private power generation companies and have a fixed price Power Purchase Agreement(PPA) and/or merchant sale |
| | Allowance of ECBs to partly refinance rupee debt and deduction of withholding tax from 20% to 5% | **Neutral** for Independent Power Producers(IPP) with cost plus PPA. Positive for IPPs with fixed price contracts/merchant sale. |
| | Section 80 IA benefits (10 year tax concession) for power companies extended by one more year | **Positive** but was on expected lines |
| | Multi – tier cascading effect of Dividend Distribution Tax has been removed | **Positive** for Asset Developers who have multi-tier SPV structures |
| | Increased Budgetary expenditure | **Neutral** as increase in budgetary expenditure is largely on expected lines. Higher emphasis has been given for Roads. |
| | Irrigation, dams and canals have been made eligible for VGF (Viability Gap Funding) | **Positive** for companies which have reasonable presence in water / irrigation projects |
| | Investment linked deduction under section 35AD has been extended to Inland Container Depot / Container Freight Stations | **Positive** for Logistics companies |
| **Auto** | Upper limit of 20% personal income tax slab moved from INR 8 lakhs to INR 10 lakhs | **Positive** as tax savings of INR 22,000 for income of INR 10 lakhs creates higher disposable income |
| | Excise duty increased to 12% from 10% for small cars and 2 wheelers | **Negative** as cost to increase by INR 4,500 - 9,500 for compact cars; increase of INR 600 - 1,100 likely for 2 wheelers |
| | Excise duty increased to 24% from 22% for large cars | **Negative** as cost will increase by INR 14,000 and should be passed on to consumer, impacting demand |
| | Excise duty increased to 27% from 22% plus INR 15,000 for UV | **Negative** as cost will increase by INR 10,000-38,000 and should be passed on to consumer, impacting demand |
| | No tax on diesel vehicles | **Positive** as no additional cost burden for diesel vehicles |
| | R&D deduction of 150% on in-house R&D, has been retained for next 5 years | **Positive** for all auto companies |

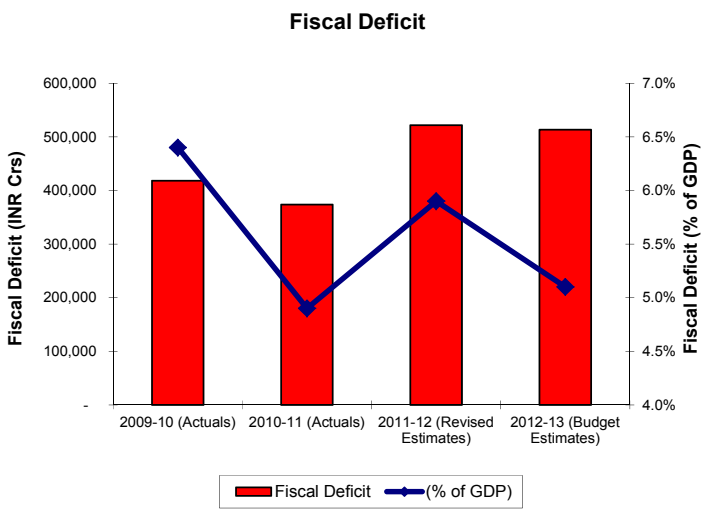
## Key Highlights for the Debt Market

- Tax revenue projected 20% higher than 2011–12 (RE) on the back of anticipated buoyancy due to stronger GDP growth at a nominal rate of 14% and increase in Indirect Tax rates
- Disinvestment target of INR 30,000 Crores has been budgeted
- Unlike last year, expenditure is budgeted to increase: Non-plan expenditure up 8.7%, plan expenditure up 22%
- Overall, fiscal deficit projected at INR 513,591 Crores (5.1% of GDP) versus a revised figure of INR 521,981 Crores (5.9% of GDP) for 2011-12
- Net market borrowing projected at INR 4,79,000 Crores for FY 2012-13 versus INR 4,36,414 Crores for FY 2011-12

## De-constructing the Blueprint

- Market borrowing forms 93% of total budgeted fiscal deficit, signifying pressure on yields going forward
- Key points that need to be considered are:
  - Projected tax revenue growth is higher by 20% owing to increase in Indirect Tax rates back at the pre-crisis (2008) levels and optimistic estimate of the non-plan expenditure may need aggressive management on part of the government
  - Expenditure is expected to be lowered through a reduced subsidy estimate, which remains dependent on the fertilizer subsidy and international crude oil prices for fuel
  - Target for dis-investment at INR 30,000 Crores and from the auction of spectrum at INR 40,000 Crores
  - Government re-focusing on charting out a new roadmap for fiscal consolidation

- Absolute numbers of fiscal deficit remain elevated
- Fiscal deficit as a percentage of GDP is improving, on the back of higher nominal GDP growth
- Net supply to the market may be significantly higher if Open Market Operations (OMOs) are absent




| INR Crs | FY 2010-11 | FY 2011-12 | FY 2012-13 |
|---|---|---|---|
| Net Borrowing | 335,414 | 436,414 | 479,000 |
| OMO | 67,040 | 124,700 | |
| Net Supply | 268,374 | 311,714 | 479,000 |

## Effects on the Debt Market

**We remain positive on duration funds and endeavor to build duration selectively owing to the following reasons**

- Expectation of rate cuts on the back of benign GDP numbers and moderating Inflation
- But, volatility will remain because of higher supply and tight liquidity
- Lower credit growth augurs positively for demand of government bonds
- OMO's are likely to bail out higher gross borrowing requirement and tight liquidity conditions again in 2012-13

**Expect some upward bias to bond yields as the market gears up to absorb the fresh auction calendar in April 2012**

**Short end rates may ease as the liquidity returns in the first quarter of next financial year, leading to bullish steepening of the bond curve**