

Budget 2010-11: Curtain Raiser

India's Finance Minister Pranab Mukherjee will present the Union Budget for 2010-11 in the Parliament on February 26. While the Budget in any year is the most important policy document that a government uses to articulate its economic agenda for the coming year, the forthcoming Budget takes a lot more importance from the ongoing debate on the timing of exit from the fiscal stimulus. The acumen of the finance ministry will also be on a test on bringing down the fiscal deficit which is set to touch a 16-year record high of 6.8% of the gross domestic product (GDP) in current fiscal.

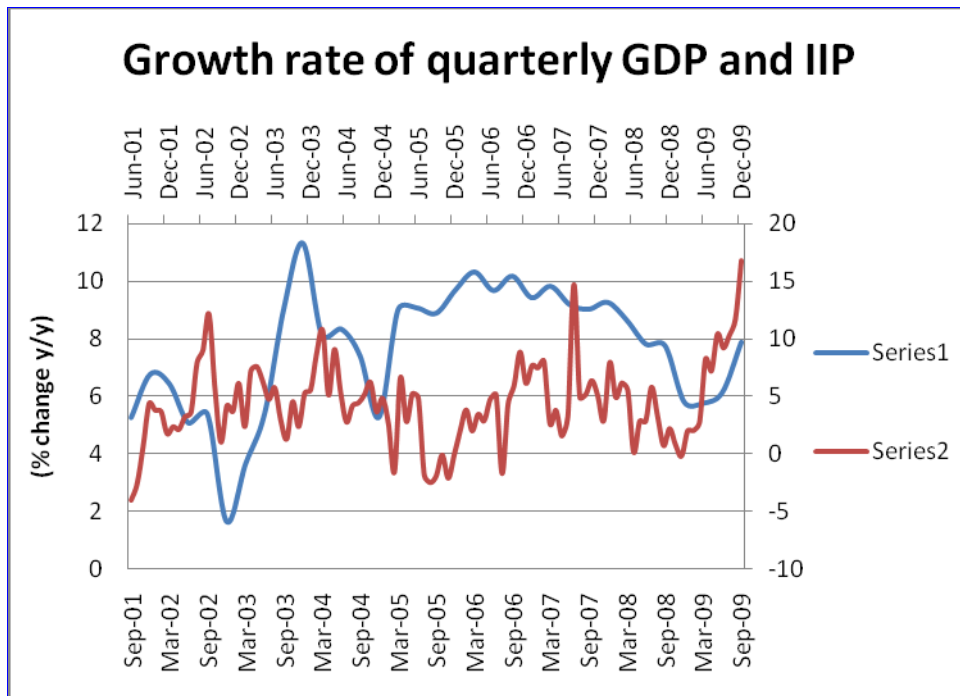
Further, there are issues like the goods and services tax (GST) and the direct tax code regarding which the forthcoming Budget will provide important details. The government will also try to reaffirm its reformist credentials in the Budget as doubts have been raised on slow pace of reforms despite the UPA government coming back into power sans the support of the left parties last year.

Overall, the Budget-2010 will witness a tight-rope walk by the finance ministry which on the one hand will try to bring down the fiscal deficit while on the other hand try to ensure that the nascent recovery of Indian economy remains intact, while at the same time will also look to push key reforms including those in the taxation and financial sectors.

Key Themes of Budget-2010-11

Stimulus Exit

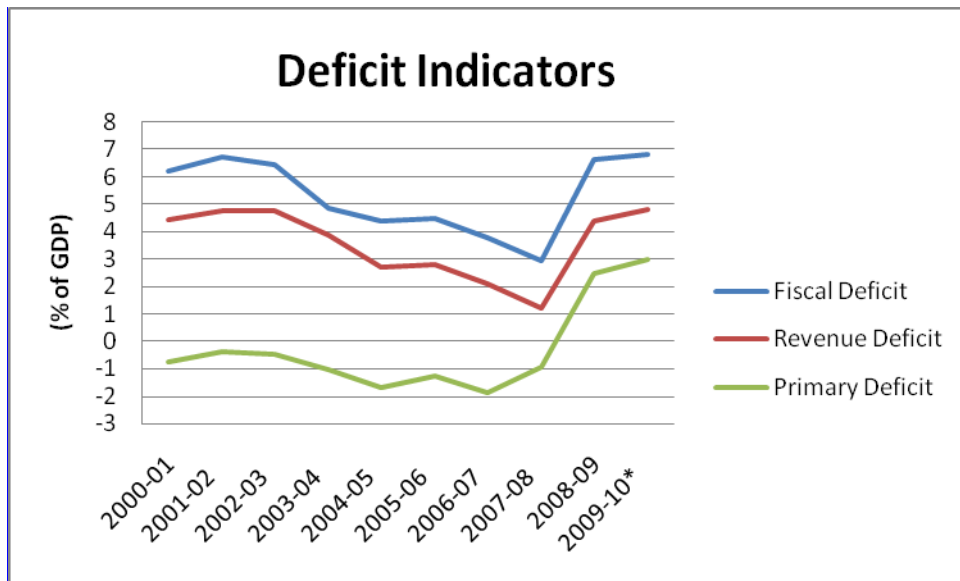
India's growth story witnessed a strong external shock following the aftermaths of September 11 events. However, riding on the fiscal stimulus launched by the government coupled with the easy money policies followed by the Reserve Bank of India (RBI), growth in the Indian economy surged to 7.9% in September quarter from 5.8% in last quarter of 2009. Further, the negative impact of the poor monsoon last year is also likely to be significantly lower than what was being anticipated a quarter ago. As a result, the overall growth scenario over last one quarter has seen considerable upside with most research houses raising their growth projection for FY10 by 50-100 basis points. An idea can be obtained from the fact that the median of RBI's survey of professional growth forecasts improved in the latest quarter to 6.9% from 6% three months ago, while the Central Bank raised its own forecast by a whopping 150 basis points from 6% with upside bias to 7.5%.



Clearly the economy is witnessing strong growth momentum. Any doubts that remained have been shattered by huge industrial expansion number of 16.7% for the month of December. With industrial growth surging, services sector posting strong recovery, the finance ministry is likely to tilt a bit more towards the exit process. Nonetheless, we do not expect a complete withdrawal of stimulus. Most likely, the excise duty will be across the board raised by 2% while for a handful of sectors like auto the increase may be 4%, the amount by which it was cut following the events of September 2011.

Fiscal Consolidation

Fiscal deficit of the government has reached 16-year high level of 6.5% of the estimated GDP for FY10. Further, this only reflects the union deficit and after adding the 4% deficit of state level government and nearly 1% off-budget items, overall deficit in current fiscal will little over 11% of GDP. Such a high deficit is obviously unsustainable in the long run and has to be brought down. The finance ministry had said in the medium term fiscal outlook report presented along with the Budget last year that the deficit will be brought down to 5.5% in current fiscal and further to 4% in FY12.



Various quarters including the Reserve Bank of India (RBI) have also urged the government to bring the fiscal deficit down as it hinders the conduct of monetary policy and hampers the efficacy of monetary instruments. The finance ministry in this wake is expected to accept the key recommendations of the 13th Finance Commission (TFC) including the TFC's roadmap for fiscal consolidation. The TFC has recommended a new expenditure management strategy which involved ensuring commercial viability of most of the projects being undertaken by the government and mapping all new expenditures to new sources of revenue.

Even though the finance ministry is expected to start curtailing the deficit, absolute amount of market borrowings are unlikely to come down from last year's record level of Rs 4.51 lakh crore. With the bond yields already hardening, the borrowing figure will be a key figure to be watched. We expect absolute level of borrowings to be around the last year's level itself.

Reforms

Although the issue of fiscal consolidation has taken most of the attention of policy makers and fiscal reforms have been dominating the run up to Budget, the government is still likely to take forward its reform agenda in other areas as well in the Budget. Overall tone of the Budget is expected to be more reformist. Given the kind of disappointment that welcomed the last Budget on the lack of any reform announcements, Finance Minister Pranab Mukherjee may be more cautious this time around to ensure that the document reinforces the reformist face of the UPA government.

Most crucial in this space will be how the government approaches the mega taxation reforms, namely the goods and services tax and the direct tax code. With the GST set to miss the deadline of April 1, 2010, the finance ministry is likely to reassure that the same will be implemented within next one year. There are also some expectations that finance ministry may chip in with some selective provisions of the direct tax code too, which otherwise is to be implemented earliest by FY12. However, the stress being on fiscal consolidation, finance ministry is unlikely to experiment on anything that can hit its revenues and hence we do not expect any substantial manoeuvring in the direct tax space. A reasonable hike in the

exemption limit however may be in the offing given the high food-inflation regime the country has been going through.

India Inc has also been asking the government to use the faster than expected recovery in Indian economy and its new found space as an emerging economic superpower as an opportunity to make the country most favourable foreign investment destination. Sectors which are in focus include banking and insurance where major announcements might find their way into the Budget. There are also expectations that at least a small amount of foreign investment in print media will be allowed. Education is another sector which is expecting a clear and long term FDI policy that shall enable Indian students to avail the international education at affordable costs in the country itself.

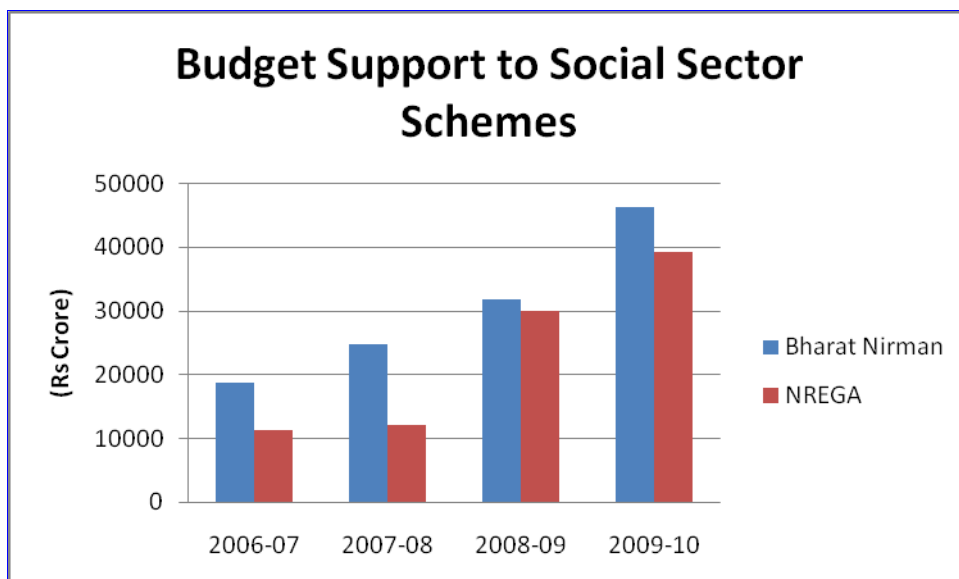
Infrastructure Development

The Union Budget for FY10 is committed to improve the infrastructure investment to 9% of the GDP from currently around the 5% level. India faces substantial gap to the tune of \$1 trillion in the infrastructure funding over next five years or so and the government therefore is likely to give more stress to the public- private partnership schemes in infra domain in the Budget.

We expect the infrastructure sector will continue to remain a key theme of government policy and some policy announcements on ports and power sector are likely. In particular, the issue of tax holidays to the power sector is likely to be cleared in the Budget.

Social Sector Schemes

The government is likely to carry forward its agenda of inclusive growth in the forthcoming Budget. Its focus in this regard will be on flagship schemes like national rural employment guarantee act (NREGA) and Bharat Nirman.



In fact NREGA has been dubbed as one of the biggest factor that helped the UPA government come back into power in the 2009 general elections and we expect substantial increase in allocation to all flagship schemes, in particular the NREGA and Bharat Nirman.

Inflation

Soaring inflation has probably been the single biggest spoilsport of the government's performance so far in the present term, which otherwise has received ample appreciation for countering the impact of global economic downturn in a very effective manner. In this wake, we expect the government to announce some steps aimed at bringing down prices. These may include measures to improve the supply side of food-commodities and is likely to result in enhanced budgetary support for development of irrigation facilities. Some reforms to bring more Greenfield investment in the fertilisers sector are also expected that would help boost agri production going forward.

Sector Watch

Expected Measures	Likely Impact
Banks	
Recapitalisation plan for PSU banks	Will improve their financial health and help achieve CAR of over 12% to targeted banks
Tax sops for term deposits of 3+ years	Improve the deposit mobilisation for banking industry
Auto	
Excise duty on all the segments likely to be hiked by 2-4%	Higher duty will be passed on to customers, sale growth may moderate
Cement	
Excise duty hike 2-4%	Prices will increase, margins will come under pressure
Focus on infra to increase	Demand will increase from rapid infrastructure development
Petroleum	
Roadmap to partial deregulation of fuel prices	Will provide private oil marketers compete with state-owned OMCs on equal footing
Steel & Iron	
Hike in export duty on iron ore lumps from 10%	Will reduce raw material cost for steel producers, but lower margins of miners
Import duty on steel to be maintained	Flat products will continue to see high import
Increase in excise duty on steel	Prices will increase, but demand unlikely to be impacted
Textile	
Import duty on manmade fibres to be scrapped	Will reduce cost of raw material for garment makers
Export sops likely to be extended	Will help boost exports

Hotel Industry	
Infrastructure status may be granted to hotel Industry	Will help bring down cost of financing
FMCG	
Excise likely to be increased by 2%	Will increase prices, pressure margins
Telecom	
MAT rate may be further increased from current 16.5%	Margins will come under further pressure
Real Estate	
More sops for affordable housing	Will boost demand in this segment
Edible Oils	
Import duty structure to be maintain at status quo	Imports will continue to rise
Farm sector	
Increase in allocation irrigation and agri infrastructure	More business to companies engaged in irrigation,