RBI Monetary Measures & Fiscal Stimulus package update - II

In less than a month since the UPA Government announced its first fiscal stimulus package in December 08, the government again announced its second fiscal stimulus package dose which was combined with significant monetary measures from the RBI announcing further cuts in key benchmark interest rates, both being aimed at kick starting investments and stimulating demand in the economy which has seen a significant slowdown in demand arising out of recessionary conditions in several global markets.

The second stimulus package has five elements this time which include a strong focus on interest rate reduction, additional liquidity enhancement to productive sectors, export sector being offered financial aid, a boost being given to the Infrastructure Sector and finally easier access to ECB's and FIIs.

The stimulus package announced has an additional plan expenditure of Rs. 20,000 crs during current year, mainly for critical Rural, Infrastructure and Social Security sectors, and measures to support Exports, Housing, Micro, Small & Medium Enterprises (MSME) and Textile sectors.(Estimated benefits to Exports and Textiles. (Estimated benefits to the tune of Rs 6800 crs).

In this package, government has focused on the Infrastructure needs wherein the India Infrastructure Finance Company Limited (IIFCL) would be raising Rs. 10,000 crs to refinance infrastructure projects worth Rs 25000 crs. It has also envisaged funding of additional projects worth Rs 75000 crs at competitive rates over the next 18 months. Funding for these projects to IIFCL would be enabled in tranches of additional Rs 30000 crs by way of tax free bonds, once funds raised during current year are effectively utilized. (Estimated benefits to the tune of Rs 40000 crs)

Highlights of the Monetary Measures announced by RBI:

The RBI has reduced the Repo and the Reverse Repo by 100 bps to 5.5% (from 6.5%) and 4% (from 5%) and in addition to it, the cash reserve ratio, will be cut by 50 bps to 5% (from 5.5%) starting from January 17 which will inject additional liquidity of Rs.20000 crs into the system.

The reduction in the policy interest rates and the CRR will further encourage banks to lower interest rates and hence provide additional credit infusing more liquidity in the market. We expect both deposit and lending rates of banks to come down consequent to this RBI measure but the key issue remain on quick implementation in terms of actual disbursal of funds to corporates.

HIGHLIGHTS OF THE GOVERNMENT'S SECOND STIMULUS PACKAGE:

Liberalizing the ECB policy:

- The 'all-in-cost' ceilings on such borrowing would be removed, under the approval route of RBI.
- 'Development of integrated townships' would be permitted as an eligible end-use of the ECB, under the approval route of the RBI.
- NBFCs, dealing exclusively with infrastructure financing, would be permitted to access ECB from multilateral or bilateral financial institutions, under the approval route of RBI.

Measures to ease credit flows:

- FII investment limit in rupee denominated corporate bonds in India has been increased from US$6bn to US$15bn.
- A Special Purpose Vehicle (SPV) would be created to provide about Rs.25000cr support against investment-grade paper to NBFCs on fulfilling certain conditions.
- Credit targets of Public Sector Banks are to be raised i.e. an increase in the provision of sectorial credits which the Government will closely monitor, these on a fortnightly basis,

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- Guarantee cover by Credit Guarantee Fund Trust will be increased to 85% for credit facility up to Rs.5 lakh for micro and small enterprises

- Government also plans for another Rs.20000crore re-capitalization for banks over the next two years. This will ensure that banks are not short of funds and would ensure that there is a sustained flow of credit to industry.

Infrastructure gets a significant boost

- States will be allowed to raise in the current financial year additional market borrowings of 0.5% of Gross State Domestic Product (GSDP), amounting to about Rs.30000cr, for capital expenditure.

- India Infrastructure Finance Company (IIFCL) has been enabled to access the market for raising in tranches an additional Rs.30000 cr (from earlier authorized amount to raise of Rs.10000 cr) through tax-free bonds to fund additional projects of about Rs.75000cr at competitive rates over the next 18 months.

- The Government also work with State Govts. to encourage them to release land for low income and middle income housing schemes.

More thrust on Exports

- DEPB rates are to be restored to those prevailing prior to November 2008. The DEPB Scheme would be extended till 31.12.2009 which will provide predictability and stability of regime in the short term for future contracts.

- Duty drawback benefits on certain items including knitted fabrics, bicycles, agricultural hand tools and specified categories of yarn are being enhanced. These changes will take effect retrospectively from September 1, 2008.

- A committee chaired by finance secretary including secretaries of the departments of revenue and commerce will examine and resolve any export related procedural issues on a fast-track basis.

- EXIM Bank will provide pre-shipment and post-shipment credit, in rupees or dollars, to Indian exporters at competitive rates from the line of credit of Rs.5000 crore obtained from RBI.

Incentives for the Commercial Vehicle Segment

- States,as a one time measure up to June 2009, will be provided assistance under the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) for the purchase of buses for their urban transport systems.

- Accelerated depreciation of 50% will be provided for commercial vehicles to be purchased on or after 1.1.2009 up to 31.03.09.

- An arrangement to be worked out with leading government-owned banks to provide credit to NBFCs specifically to buy commercial vehicles

OTHER SPECIFIC SECTOR RELATED MEASURES:

- Exemptions from counter-vailing duties (CVD) on TMT bars and structurals, and CVD and Special CVD on cement, which were given to contain inflation, are being withdrawn

- Full exemption from basic customs duty on zinc and ferro alloys, which was also provided to contain inflation, is being similarly withdrawn.

With both the fiscal stimulus packages announced by the government and the rate cuts announced by the RBI since the last two months, it is clear that increased money flows are being made available to India Inc through a variety of channels. The RBI has pumped in an additional Rs 3 lac crs in the financial system through various measures since October 08 onwards and more specifically the government announced stimulus package ensures stronger credit flows to infrastructure wherein capital requirements had dried up consequent to a fall in equity funding and private equity funding sources and hence these measures are definitely positive.

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However going ahead as mentioned earlier in our fiscal stimulus package report (Dated 8th December 2008) we understand that the Indian economy will continue to need a sustained stimulus in FY2010 also and this can be achieved by substantial increase in budget spending for next year. The government has already indicated that it expects next fiscal (FY10) to be a tough year ahead considering the recessionary conditions being witnessed in large global economies.

Meanwhile on the domestic macro front, warning signs have already started getting reflected with the latest official revenue data suggesting that the government's books could have a bigger deficit hole as policy makers grapple with options to maintain growth amidst the global crisis. Advance tax collections from India Inc, have declined by over 22% to Rs 42,600 crore in the third quarter of this fiscal from Rs 54,900 crore in the same period last year. Also with fresh measures taken by the government to boost the economic growth, the fiscal deficit may exceed 5% of the GDP for FY09 as against the original target of 3%.

Net net we believe the governments second stimulus package is a positive development and would stimulate demand and infuse fresh liquidity to corporates which would undoubtedly help the Indian economy grow at a steady 6-6.5% growth pace, due to strong domestic demand despite severe recessionary market conditions observed globally. However it is unlikely that in the short term we could see any dramatic improvements in corporate performances or in demand flows and the cumulative impact of all these fiscal initiatives would actually start getting reflected only over the next 2-3 quarters ahead.

More specifically measures announced for Exports in this second fiscal package look inadequate as the core issue here is of real demand from end customers which is yet weak and will take more time to rebound. As far as infrastructure, the requirements are enormous and against this mammoth requirement, the amount provided is not much but nevertheless it is a welcome move and a good initiative from the government.

But we do believe that RBI's aggressive stance of cutting the Repo rates and CRR rates in the last two months would act as a strong demand stimulator for corporates provided banks disburse funds on a timely basis. Some of the key sectors which are benefited partially from these measures include Auto's, Real Estate, Construction and Metals. Some sectors which we feel were left out and did not get any direct fiscal benefits and were hopeful to get some respite include Hotels, Hospitality, Leather and Diamond units. We give a first cut view on the broad impact on sectors which have got benefits from the second stimulus package.

- Reliance Money Research Team

Fiscal Package Impact - II

Automobile Sector

Further rate cuts to boost demand in the long term

Further rate cut to soften interest rates

RBI as a part of the monetary policy has cut rates by 50bps for the CRR and Repo and Reverse Repo by 100bps each. We believe the cut in CRR and Repo and Reverse Repo would induce financial institutions to reduce the interest rates further. This is likely to benefit loans offered to auto consumers like two wheeler, cars, trucks etc. But we believe the process of reduction in interest rates on auto loans to be slow and the concern of stringent financing norms would remain.

Accelerated depreciation rate for commercial vehicles

Accelerated depreciation rate for CVs to help manufacturers to clear inventory to a small extent, but is unlikely to trigger volume growth

The government has announced that commercial vehicles purchased on or after 1st January 2009 to 31st March 2009 would get accelerated depreciation benefit of 50%. The normal rate of depreciation on commercial vehicles (used in the business of running hire) is 30%. We believe this move to accelerate demand from truck fleet operators who have been deferring their decision to purchase new commercial vehicle. We believe this benefit will not boost the demand enormously as other concerns like slowdown in the overall economy, decline in industrial production and softening of freight rates are likely to depress the trigger factor. This is likely to help commercial vehicle manufacturers to clear a small part of the inventory.

Product	Depreciation rate (if purchased before 30th September)	Depreciation rate (if purchased after 30th September)	Depreciation rate (if purchased on or after 1st Jan 09 to 31st March 09)
Commercial Vehicle	30%	50% of 30%	50%

Source: Reliance Money Research,

Support to NBFCs

Support to NBFCs through a SPV to indirectly help automobile sector

The government has proposed to form a Special Purpose Vehicle (SPV) to provide liquidity support against investment grade paper to NBFCs. The scale of liquidity potentially available through this window would be Rs.250bn. We believe the liquidity support offered to NBFCs which provide loans to automobiles would indirectly help the industry to some extent. The additional liquidity offered to NBFCs would work as an incentive to auto loan consumers. But the timeline about the liquidity support has not yet announced by the government, so the impact of this announcement is likely to come only after finalizing the details.

Additional Capital Expenditure by States

The government has allowed the States to raise additional market borrowing of 0.5% of their Gross State Domestic Product (GSDP) amounting to about Rs.300bn for capital expenditures. Incremental capital expenditure by the States is likely to indirectly benefit auto demand to a small extent.

We believe measures announced are unlikely to trigger demand and concerns on the sector remain. We remain negative on the sector

We believe accelerated depreciation on commercial vehicles would trigger demand to a small extent, but will not be able to revive the industry out of the slowdown. The positive impact because of this initiative is likely to be minimal in near future. Other measures like cut in interest rates, support to NBFCs would indirectly help the auto industry to a small extent in near future. Slowing economic activity, declining freight rates, stringent financing policies, rising delinquencies and high interest rates still remain concerns for the sector. We continue to remain negative on the sector.

Fiscal Package Impact - II

Real Estate - No major announcements….

Monetary Measures Announced

- Reverse Repo Rate cut by 100 bps to 4% from 5%.
- Repo Rate Cut by 100 bps to 5.5% from 6.5%
- Cash Reserve Ratio (CRR) Cut by 50 bps to 5% from 6%

Fiscal Measures Announced

'Development of integrated townships' would be permitted as an eligible end-use of the ECB, under the approval route of RBI.

- To facilitate access to funds for the housing sector, the 'development of integrated townships' would be permitted as an eligible end-use of the ECB, under the approval route of RBI.

- Government of India (GOI) will work with State Governments to encourage them to release land for low income and middle income housing schemes.

- Exemptions from CVD on TMT bars & structurals and from CVD and Special CVD on cement, which were given to contain inflation, are being withdrawn.

Our view / Impact on the Real Estate Sector

Reduction in rates has eased liquidity in the system but this move has failed to address the issue of credit flow to the developers.

The cut in CRR, Repo Rate and Reverse Repo Rate is likely to bring down home loan rates. The reduction in rates has eased liquidity in the system but this move has failed to address the issue of credit flow to the developers. However, key issues like industry status to real estate, increases in income tax rebate on home loans, and increase in exemption limit for rental income in the housing sector were not addressed in the fiscal stimulus package. Exemptions from CVD and Special CVD on cement will have neutral impact on the sector. Measures to facilitate access to funds through ECB (integrated townships) for the housing sector is welcome move but raising ECB from international markets in the current situation would be hard. In another move wherein Government of India (GOI) will work with state governments to encourage them to release land for low income and middle income housing scheme requires further clarification, but this measure is unlikely to bring immediate respite to the sector. With measures announced (Fiscal and Monetary) demand for real estate is not expected to get boast immediately until the key issue of credit flow to the sector is not addressed. DLF is likely to be one of the key beneficiary as the company is developing a integrated township.

Fiscal Stimulus Package Expectations

Expectations	Announcements
Industry status to real estate sector and infrastructure status to housing sector	Not Addressed
Income Tax rebate on home loans should be doubled to Rs. 3 lakh	Not Addressed
Rise in limit on home loans classified as priority sector lending from banks to Rs. 30 lakh from Rs. 20 lakh now.	Not Addressed
Increase in exemption limit for rental income	Not Addressed

Source: Media reports and Reliance Money Research

Fiscal Package Impact - II

Infrastructure

Fiscal Measures Announced

IIFCL to raise further Rs. 30,000 crs (in addition to Rs. 10000) through tax free bonds over 18 months.

- IIFCL to raise further Rs. 30,000 crs (in addition to Rs. 10000) through tax free bonds over 18 months to refinance bank lending of longer maturity eligible infrastructure projects.

- NBFCs, dealing exclusively with infrastructure financing, would be permitted to access ECB from multilateral or bilateral financial institutions, under the approval route of RBI. (This decision would be reviewed after June 30, 2009.)

- States will be allowed to raise in the current financial year additional market borrowing of 0.5% of Gross State Domestic Product (GSDP) amounting to about Rs. 30,000 crs for capital expenditure.

- Exemptions from CVD and Special CVD on cement, which were given to contain inflation, are being withdrawn.

Impact of Fiscal Stimulus Package on Infrastructure Sector

States allowed to raise 0.5% of Gross State Domestic Product (GSDP) amounting to about RS. 30000 crs for capital expenditure this will provide further boast to infrastructure projects.

The funds raised by IIFCL will be used by it to refinance bank lending of longer maturity to eligible infrastructure projects. In this way it is expected that IIFCL resources used for refinance can leverage bank financing of double the amount. In particular, these initiatives will support a PPP programme of Rs.75000 crore (earlier Rs. 25000). With states allowed to raise 0.5% of Gross State Domestic Product (GSDP) amounting to about RS. 30000 crs for capital expenditure this will provide further boast to infrastructure projects. . Exemptions from CVD and Special CVD on cement will have neutral impact on the sector.

Fiscal Stimulus Package Expectations

Expectation	Announced	Effect
Increase refinace facility to Infrastructure Investment Finance Corporation Ltd (IIFCL)	IIFCL borrowing limit raised by 30,000 crs to 40,000 crs from 10,000 crs	Positive: To fund additional projects of about Rs.75,000 crore at competitive rates over the next 18 months

Source: Media reports and Reliance Money Research

Fiscal Package Impact - II

Metals Sector

Withdrawal of Exemption of CVD on TMT bars:

The CVD on TMT bars and other structurals has been restored to 10%

The CVD on TMT bars and other structurals has been restored to 10% thus reducing the price difference between the domestically produced and imported TMT bars and structurals. These items were earlier exempted from CVD so as to increase the supply from abroad. This measure virtually makes no difference as the TMT bars account for roughly 3% of the total industry capacity and being a long product it is seldom imported.

Import duty on Zinc and Ferro-alloys are re-instated to 5%:

A positive move for Zinc producing industry particularly Hindustan Zinc and Binani Zinc. This reduces the price differential between imported and domestically produced Zinc and Ferro-alloys, whereby protecting the interests of domestic players.

As a whole, the exercise has yielded very little to the Steel Sector and there will be marginal benefits, if any to JSW Steel, SAIL and Tata Steel

As a whole, the exercise has yielded very little to the Steel Sector and there will be marginal benefits, if any to JSW Steel, SAIL and Tata Steel. We remain neutral on the sector.

Reliance Money Stock Rating

Rating	Stock Performance
BUY	Appreciate more than 15% in next 12 months
HOLD	Appreciate upto 15% in next 12 months
REDUCE	Depreciate upto 10% in next 12 months
SELL	Depreciate More than 10% in next 12 months

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