HSBC Global Research

Multi asset class
India

India Budget

Spend It!

- **FY2010/11 budget unlikely to unfold any major stock catalysts other than higher spending plans in key areas**
- **Sectors likely to benefit: Infrastructure, Construction & Engineering, Banks on higher spend**
- **Stocks impact: Positive – L&T, BHEL, IRB, Voltas, Banks, HCL Tech; Negative – BPCL, HPCL, ACC**

Muted expectations

We expect that the budget for the fiscal year ending March 2011 is unlikely to represent a major shift in government policy. A gradual winding down of fiscal stimulus, a 15-20% rise in government expenditure, and building in robust economic growth of 8.5-9% is likely to lead the government to project a lower deficit (of 5.5%). However, given that most of the lower deficit number is on account of cyclical rather than structural factors, our economist, Robert Prior-Wandesforde, believes the RBI may raise rates at or shortly before the next policy on 20 April 2010, given the combination of this modest budget disappointment and more inflation upside surprises. Risk of this may blunt any budget related enthusiasm for stocks.

Notwithstanding our expectation of a muted market impact, there may be select sectors that could benefit from higher spending (construction & engineering, infrastructure) and higher growth + rates (banks), but oil marketing and cement companies (in the South) run the risk of a negative market reaction given the sharing of subsidy burden and lack of pricing power.

Key downside risks are 1) likely optimistic revenue projections in case economic growth fails to pick up, and 2) large borrowing by the government to fund the deficit potentially crowding out private borrowers.

Please refer our summary of macro and sector related impacts of the budget inside.

For a more details on the India Budget 2010 expectations, please also refer to *2010/11 budget preview: Time to stop the stimulus?*, published today by our economist, Robert Prior-Wandesforde.

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Macro view

Summary of budget expectations – overall market view

Key theme	Measure	Our view	Market/ Sector impact
Fiscal deficit	Headline deficit projected in budget	Our economics team expects the fiscal deficit to be 5.8% next fiscal year, the government is likely to project 5.5%. Lower projected deficit is likely to be based on higher revenue projections, we expect government expenditure to grow at 15-20%	Market reaction will hinge on the credibility of the plan to reduce the deficit. Since the key will be higher revenues on the back of robust economic growth, market will focus on risks to growth projections. We expect GDP growth of 8.5% next fiscal year higher then consensus of c8%
		Auction of 3 G spectrum unlikely to contribute significantly to plugging of fiscal deficit	Close to 0.5% of GDP
Unwinding of fiscal stimulus	Service tax Excise duties	Service tax cut of 2% may be reversed Some rollback of excise rate reduction on auto and cement Some industries may be removed from the list of 2% interest rate subvention scheme for exporters	We expect that this will be largely be a market neutral event as policy makers have already indicated that since the economy is picking up, the government will gradually exit the stimulus.
Divestment	Government likely to indicate amount of resources it will raise via divestment of stakes	Government likely to pursue a piecemeal divestment program i.e. selling small stakes of 5%-10% with the stated target of INR600bn over 2-3 years likely to be achieved.	A marginal positive for markets, as this will help government raise resources of around 0.25-0.5% of GDP, helping in plugging the deficit; Small stake sale of 5-10% in firms unlikely to be viewed as serious reforms High amount of equity issuance can be a dampener for valuation levels
Government focus areas	We expect that the thrust areas of expenditure will be power, agriculture, water resources, roads & other infrastructure projects and social sector schemes	We expect a major increase in infrastructure, especially in roads, execution will be key	This will be a marginal positive for markets, and markets will focus on progress on execution given previous experience
Indirect taxes	GST	GST implementation in FY11 difficult as agreement between centre and states still pending, and requires a constitutional amendment, finance minister may announce a new roadmap	Neutral for markets
Subsidies	Food subsidies and Kirit Parikh report on pricing of retail fuel	We do not expect the government to cut subsidies or to raise prices on account of inflationary concerns	Negative for oil & gas marketing companies
Direct taxes	Direct tax code	Still in consultation stage, finance minister may lay a roadmap for implementation, key measure of the new code that markets will focus on are: Lowering of corporate tax rate, the aim being to lower rates but remove exemptions Removal of distinction between long and short term capital gains tax and lowering of personal income tax rates	Neutral

Source: HSBC

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Sector view table

2010 Budget expectations by sector

Sector	Measures	Stock impacts	Remarks
Automobile	Neutral to Negative if excise duty is rolled back; Positive, if the excise duty rates are kept unchanged	Hero Honda - Positive, Ashok Leyland - Negative	Neutral for 2 wheelers and car makers, Negative for truck makers if rollback happens, else positive for entire sector
Financials	Positive if market believes lower deficit; Positive as interest rates likely to rise; Positive if higher tax rates are applied on dividend distribution at mutual funds; Negative for insurers on removal of tax exemptions for life insurance products, but low probability	Basket of bank stocks with a bias towards PSU banks. Positive for Union Bank, HDFC Bank	PSU bank stocks could outperform if deficit surprises positively; However, if it is a negative surprise, then earlier-than-anticipated RBI action could lead to a correction across the sector in the near term, but positive over the next 12 months as growth & margins expand
Power	Positive: Increased allocation to APDRP/RGGVY; Negative - Increase in excise duty for power equipment for non mega power projects	BHEL, ABB, Crompton (the latter unrated) - Positive; All developers - marginally Negative	
Oil & Gas	Negative - Govt may share subsidy burden with OMCs; Positive - tax holiday on city gas distribution; Positive - extension of tax holiday on new refineries	BPCL, HPCL, IOCL (the latter unrated) - Negative; GAIL - Positive, Essar Oil, IOCL (both unrated) - Positive	Overall budget impact is expected to be Neutral
Construction & Engineering	Positive - Increased allocation to the road development sector; Positive- Clarity on take out financing; Positive- Higher expenditure budgets for infrastructure development schemes	Major beneficiary- IRB. Other beneficiaries - L&T, Reliance Infra, IVRCL, NCC and HCC; Punj Lloyd & Simplex; Voltas - Positive	Overall budget impact is expected to be Positive
Real Estate	Positive- Re-introduction of tax holiday for housing projects under Sec 80 IB (10); Positive- Increase in income tax deduction under Sec 80 C on home loan principal re-payment from INR0.1m to INR0.2-0.3m	DLF, Unitech, HDIL, IBREL,	Overall budget impact is expected to be Neutral to Positive
Cement	Positive - providing abatement on excise duty to industry, however seems unlikely given possible revenue loss to government Negative - Raising excise duties back to 12%.	Negative for south based companies given their limited ability to raise prices namely ACC, India Cements and Madras Cements	
IT Services	Positive - STPI tax exemption beyond FY12 (31st March 2011)	All IT stocks	If extended: Material earnings revision for smaller companies in FY12 (10-12% EPS accretion for HCL, MphasiS and MindTree); For top 3, modest EPS accretion. If not extended, no impact on earnings, but Negative in terms of sentiment for the sector
FMCG	Increase in excise duty - Neutral / marginally Negative. Companies will be able to pass on increase to consumers. There may be a short lag before the pass through is effected	Across the sector	
Tobacco	Increase in excise duty - 0% Positive, 5% Neutral, 10% Negative	ITC	
Transmission lines	Positive - Fund allocation for APDRP and RGGVY and Transmission and distribution fund	Jyoti Structures, Kalpataru Power and KEC Int'l- Positive	
Pipes	Positive - Infrastructure status to the sector will lead to tax benefits under 80 IA Negative - Removal of DEPB (Duty entitlement pass book) scheme benefit on seamless pipes exports which is currently 6%.	Jindal SAW, Welspun Gujarat and PSL Ltd - Positive	
Sugar	Negative - Increase in MAT	Bajaj Hindusthan and Balrampur Chini - Negative	
Electrical equipment	Positive - Policies which will lift consumption and real estate demand Negative - Increase in excise duty and MAT	Havells India and Finolex Cables - Positive	

Source: HSBC

Stocks mentioned in this note

Ticker	Company	Rating	Target price (INR)	Current price (INR)	*Analyst, HSBC Securities and Capital Markets (India) Private Limited; **Analyst, HSBC Bank plc
ASOK.BO	Ashok Leyland	Underweight (V)	41	50.65	Sachin Gupta*
HROH.BO	Hero Honda	Overweight (V)	1,980.00	1,618.30	Sachin Gupta*
UNBK.BO	Union Bank Of India	Overweight (V)	335	251.7	Sachin Sheth*
HDBK.BO	HDFC Bank	Overweight (V)	2,068.00	1,571.65	Sachin Sheth*
BHEL.BO	BHEL	Overweight (V)	2,850.00	2,332.15	Sumeet Agrawal*
ABB.BO	ABB India	Underweight (V)	712	784.60	Sumeet Agrawal*
BPCL.BO	Bharat Petroleum	Underweight (V)	552	560.55	Kumar Manish*
HPCL.BO	Hindustan Petroleum	Underweight (V)	280	343.30	Kumar Manish*
GAIL.BO	GAIL	Neutral (V)	369	408.70	Kirtan Mehta**
IRBI.BO	IRB Infrastructure Ltd	Overweight (V)	297	243.75	Ashutosh Narkar*
LART.BO	Larsen & Toubro	Neutral (V)	1,768.00	1,461.85	Sumeet Agrawal*
RLIN.BO	Reliance Infrastructure	Neutral (V)	1,203.00	1,058.90	Sumeet Agrawal*
IVRC.BO	IVRCL Infrastructure	Neutral (V)	375	311.95	Ashutosh Narkar*
NGCN.BO	Nagarjuna Construction	Overweight (V)	186	155.85	Ashutosh Narkar*
HCNS.BO	Hindustan Construction	Neutral (V)	133	132.25	Ashutosh Narkar*
PUJL.BO	Punj Lloyd Limited	Underweight (V)	180	175.15	Sumeet Agrawal*
SINF.BO	Simplex Infrastructure	Overweight (V)	571	415.10	Ashutosh Narkar*
DLF.NS	DLF Ltd	Overweight (V)	386	305.95	Ashutosh Narkar*
UNTE.BO	Unitech Ltd	Neutral (V)	83	71.05	Ashutosh Narkar*
HDIL.BO	Housing Development & Inf	Overweight (V)	419	304.10	Ashutosh Narkar*
INRL.BO	Indiabulls Real Estate	Overweight (V)	252	167.35	Ashutosh Narkar*
VOLT.BO	Voltas Ltd	Neutral (V)	170	156.55	Sandeep Somani*
ACC.BO	ACC	Underweight (V)	775	867.75	Jatin Kotian*
ICMN.BO	India Cements	Neutral (V)	116	116.75	Jatin Kotian*
MSCM.BO	Madras Cements	Underweight (V)	97	110.40	Jatin Kotian*
HCLT.BO	HCL Technologies	Overweight (V)	455	346.75	Yogesh Aggarwal*
MBFL.BO	MphasiS	Overweight (V)	770	722.85	Yogesh Aggarwal*
MINT.BO	MindTree Ltd	Overweight (V)	750	572.60	Yogesh Aggarwal*
ITC.BO	ITC	Overweight	295	243.90	Percy Panthaki*
JYTS.BO	Jyoti Structures Ltd	Overweight (V)	170	167.05	Sandeep Somani*
KAPT.BO	Kalpataru Power Transmiss	Overweight (V)	1,300.00	1,061.50	Sandeep Somani*
KECL.BO	KEC International	Neutral (V)	595	577.50	Sandeep Somani*
JIND.BO	Jindal Saw Ltd	Overweight (V)	260	193.95	Sandeep Somani*
WGSR.BO	Welspun Gujarat Stahl Roh	Overweight (V)	335	244.70	Sandeep Somani*
PSLH.BO	PSL Ltd	Neutral (V)	180	149.20	Sandeep Somani*
BJHN.BO	Bajaj Hindusthan	Overweight (V)	310	174.95	Sandeep Somani*
BACH.BO	Balrampur Chini Mills Ltd	Overweight (V)	185	117.80	Sandeep Somani*
HVEL.BO	Havells India Ltd	Neutral (V)	575	548.40	Sandeep Somani*
FNXC.BO	Finolex Cables Ltd	Underweight (V)	47	50.65	Sandeep Somani*

Source: HSBC; Prices as at close of 9 Feb 2010. * / ** Employed by a non-US affiliate of HSBC Securities (USA) Inc, and is not registered/qualified pursuant to NYSE and/or NASD regulations.

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