India - Pre Budget

Vasudeo Joshi – *Head, Institutional Equity Research, Strategy/Economics*
(vasudeo.joshi@manfinancial.in) +91 22 6667 9754
Anjali Verma – *Economist*, **Equity Research Team**

Man Financial

Crystal gazing - Budget FY2008

Pro-growth, pro-employment budget with thrust on fiscal consolidation (along with removal of open ended exemptions), agriculture, infrastructure, health, education and employment guarantee programs. Push to creation of Indian Depository Receipts market likely.

Stocks

Positive Impact: Siemens, Punj Lloyd, Thermax, Patel Engineering, HCL Infosystems, HLL, Asian Paints, ONGC, IOC, HPCL, BPCL, Kirloskar Brothers Ltd, Crompton Greaves, Jain Irrigation, Mahindra and Mahindra, Indian hotel

Negative Impact: ITC

February 2, 2007

Disclaimer & disclosures
This report must be read with the disclaimer and disclosures on the last page that form part of it

CONTENTS

Highlights 3

Budget FY08 – The crystal ball 4

Anatomy of pre and post (1-month) budget BSE-30 market returns 8

Fiscal consolidation at Centre and State level – On course 11
- Central government 12
- State Government 16
- Combined Fiscal Deficit 19

Exemptions cost Rs1587bn in FY05 20

Sectoral Impact – The Crystal Ball

Automobiles 32
Banking 33
Capital Goods and Infrastructure 34
Cement 35
Cigarettes 36
FMCG 38
Information Technology 40
Media 41
Metals 42
Oil & Gas 44
Paints 46
Petrochemicals 47
Telecom 48

HIGHLIGHTS

- FY08 budget to **continue the countercyclical fiscal consolidation** while the economy is growing above the trend with output gap. Strong buoyancy on direct taxes front driven by FY07E real GDP growth at @ 8.6% and more than mandated fiscal improvement have been the hallmark of the last fiscal (FY07). Alternatively, the extent of fiscal correction required in FY08E would be lower leaving more resources to fund flagship programs needed for inclusive growth with equity.
- With FY08 budget likely to project **nominal GDP growth of 13.2% for FY2008**, a combination of close to 8% real GDP growth and @ 5% to 5.5% of inflation, India will emerge as USD 1 trillion economy in FY08. **FY07RE fiscal deficit at 3.6% (on the back of higher revenue collection and revised nominal GDP figures released by CSO) is likely to be lower than budgeted 3.8% and will stay on course for 3.3% fiscal deficit in FY08BE**. The consolidated fiscal deficit of the centre and states is likely to decline to 6.5% in FY07BE from the highs of 9.9% in FY02. (With oil bonds and Food Corporation of India bonds, the fiscal deficit will be higher by 70bps). **Improving fiscal health would be a confidence booster for foreign investors.**
- Total plan expenditure (Gross budgetary support to the central plan and grants to states and UTs) is estimated to increase by 21.6%, from Rs1727bn in FY07BE to Rs2100bn in FY08E, leading to plan expenditure rising to 4.6% of GDP in FY08E from 4.4% in FY07BE. Expect impetus to infrastructure, education, health, employment guarantee and agricultural programs.
- **Peak customs duty** is likely to be reduced to 10% from 12.5% while the **service tax** is likely to increase to 14% with around 40 new services to come under tax net. **Central sales tax** could be reduced to 2% from 4%.
- Government may eliminate 10% surcharge on **corporate tax and personal income tax** above Rs10lakh income. However, a 2% **health cess and an increase in the education cess** from 2% to 4% is a likelihood. **Thus, peak corporate tax rate can decline from 33.66% at present to 31.824%, a reduction of 1.836%.** However, FY07 budget documents highlight that in FY05, tax exemptions cost Rs1587bn to exchequer in FY05. **Thus, expect removal of certain exemptions, which could effectively increase tax burden of the corporates.** Corporate Dividend distribution tax (DDT) may be cut to 10% from current 14%.
- Oil and gas pipe lines business, LNG terminals to be covered under section 80-IA with exemptions for infrastructure projects.
- **Dividend distribution tax on debt mutual funds** is likely to be withdrawn. Debt mutual funds that attract a dividend distribution tax (DDT) of 14% for retail investors and 23% for corporates as against tax exemption for investment in equity schemes would be given exemption from DDT.
- ***Push to Financial sector reforms*** *– Creation of Indian Depository Receipts (IDR) market where domestic companies can raise money and foreign investors can invest without having to go through normal registration process.*
- **Removal of exemptions** FY07 will be the penultimate budget of the UPA government in power before it goes to General Parliamentary Elections in CY09. Therefore, one can expect the government to take some tough decisions like the removal of open-ended exemptions in some cases, especially in a year when revenue buoyancy is there. Therefore, in this budget, the "fine print" will become even more important. **The budget may increase effective tax burden on corporates.**

Sectors

Positive: Construction, Engineering, Power, Capital Goods, FMCG stocks with strong rural linkage, Oil and Gas, IT Hardware, Agriculture related equipment manufacturers like pumps, tractors, Hotels
Neutral: Automobile, Banking, Cement, Media, Metals, Petrochemicals, Telecom, IT Services
Negative: Cigarettes, Real estate

Stocks

Positive Impact: Siemens, Punj Lloyd, Thermax, Patel Engineering, HCL Infosystems, HLL, Asian Paints, ONGC, IOC, HPCL, BPCL, Kirloskar Brothers Ltd, Crompton Greaves, Jain Irrigation, Mahindra and Mahindra, Indian hotel
Negative Impact: ITC

*FY07BE – Estimates given in budget document, FY07E – Man Financial Estimates, FY08E – Man Financial Estimates

BUDGET FY08 – THE CRYSTAL BALL

- **Customs duties:** Reduction in peak customs duty to 10% from 12.5%
- **Excise duty** to remain at 16%
- **Service tax** is likely to increase to 14% with around 40 new services to come under tax net
- **Central sales tax** could be reduced to 2% from 4%
- **Surcharge on Corporate and personal income tax, Cess and Corporate Dividend distribution tax:** Government may eliminate 10% surcharge on corporate tax and personal income tax above Rs10lakh income. However, a 2% health cess and an increase in the education cess from 2% to 4% is a likelihood. Corporate Dividend distribution tax (DDT) may be cut to 10% from current 14%
- **Infrastructure status to additional businesses:** Oil and gas pipe lines business, LNG terminals are likely to be covered under section 80-IA that gives exemptions for infrastructure projects
- **Dividend distribution tax on debt mutual funds** is likely to be withdrawn. Debt mutual funds that attract a dividend distribution tax (DDT) of 14% for retail investors and 23% for corporates as against tax exemption for investment in equity schemes would be given exemption from DDT
- To give incentives to foreign companies in India which do not pay dividend by lowering their tax liability. The tax rate on such companies is at 41.82% compared with 33.66% (excluding dividend distribution tax) for the domestic companies and foreign companies that pay dividend
- **Stamp duty waiver** in certain states for the sugar, food processing and leather tanning industries for 7-10 years
- **Resurgent India Bond (RIB):** Reintroduce RIBs to attract NRI's to invest in India on a long-term basis in order to finance the infrastructural sector developments
- **Metro cess:** States are planning to impose metro cess at Rs 200-300 per sq ft else decided by the individual states on the city dwellers and housing properties which should in turn speed up the metro projects in important cities.
- **Inverted duty structure** is where inputs are charged higher than the finished products. The commerce ministry has demanded that customs duty on inputs be brought in line with the finished products in the case of Free Trade Agreements (FTA's) except for a few sensitive items like palm oil. For example, customs duty were steeply reduced for electric fans under the India-Thai FTA but that of its inputs remains the same which impacted the manufacturers in India who bought inputs at higher cost while the Thai fans became cheaper

The budget may not extend IT sops for EOUs beyond FY09

Income-tax holiday for export-oriented units (EoUs), set to expire in 2009, are unlikely to be extended in Budget 2007. There have been reports that the PM's economic advisory council had recommended the deduction under Section 10B should not be extended beyond assessment year 2009-10. The finance ministry argued that since the tax benefit under Section 10A was similar to Section 10B, the recommendation also applies in case of Section 10A.

Since STPIs and EoUs have been given tax benefits under the same chapter of the foreign trade policy, an extension in sops for the latter is also likely to apply to the former. While the government has not decided to extend tax sops to STPIs yet, it is under serious consideration.

Tourism industry may get 10-year tax holiday

A conditional 10-year tax holiday for all tourism projects in the country may be declared in the budget. While companies would enjoy full tax exemption up to 50% of the profit, for enjoying tax benefits for balance amount they would be required to re-invest that part of the profit in tourism projects.

It is proposed that this no-tax regime should operate for at least 10 years beginning from April 1, 2007. The tax concession period will; however, be computed from the date of commencement of commercial operations. The proposed move is aimed at encouraging existing tourism industry to re-invest in the sector that has significant employment potential. An additional incentive package may be unveiled to encourage investments in tourism projects in hilly areas, rural areas and pilgrim centers.

In order to attract foreign tourists, it may be proposed that tax exemptions should be allowed to tourism establishments for their expenditure on overseas promotional and publicity activities. Exemptions are also sought for the money spent on training hospitality and tourism staff in the recognized institutes.

In order to encourage tour operators, it is proposed to rationalise depreciation rates on vehicles. While determining the rate of depreciation, factors like mileage covered by a vehicle and year of manufacturing should be considered instead of the month of purchase, as is the existing norm, the ministry said.

Rationalising of service tax is possible. Service tax has to be on the service charge for the services rendered by operators of tourism industry and not on the total cost which includes components like hotel charges, transport charges, guide fee and meals.

M&A related tax benefits may be extended to airlines, telecom, healthcare and finance

The forthcoming budget is likely to amend the tax law to make mergers and acquisitions (M&As) easier. The existing tax benefit for M&A is likely to be extended to sectors like airlines, telecom, healthcare and finance.

Further, the mandatory period for continuing with the same line of business post-merger could be brought down. The tax benefit is in the form of a set-off of the carry-forward losses and depreciation of the amalgamating company with the profits of the amalgamated entity.

The benefit is available under Section 72 A of the Income Tax Act. The scope of the section may be widened further. Under this provision, if company A takes over company B, then company A can claim credit for carry-forward losses and unabsorbed depreciation allowance of company B against its own profits. Also, the stipulation of continuing the same business of the amalgamating company in order to get the benefits of accumulated depreciation or set-off or carry-forward of its losses, may be pruned from five years to three years. The tax benefit is currently available to various industrial undertakings, ships and banks. Airlines would qualify for the benefit, considering that many of them are now moving out of the red and could be moving into a phase of consolidation. Also, the impending merger of the two state-owned carriers is a consideration, sources said

In the case of telecom, certain activities like cellular service are listed, but the sector per se is not specifically mentioned under the Act. With the communication technology world over changing each day, the industry demands of a specific mention may be addressed. The provision may also be extended to cover some other service sectors like healthcare and financial sector. In the financial sector, while a bank taking over another bank can avail of the benefit, the provision does not apply if bank takes over a financial institution.

Infrastructure financing through securitisation to be facilitated further

Budget ’07 may provide a leg up to infrastructure financing by securitisation, where future cash receivables are converted into tradable debt instruments. The government may consider easing guidelines for securitisation to enhance liquidity for the sector.

For infrastructure projects to be financed through securitisation, changes will have to be made according to the way future flows are recognized under RBI guidelines. Current norms cannot be applied to infrastructure because banks find lending to long-term projects illiquid. As per current norms, only existing streams of cash flows can be securitized, which arise from a “true sale” or when receivables are assigned.

Bankers feel there is also a disincentive to securitizing assets since the originator has to amortize the gains from the sale over the asset maturity but book all expenses in relation to the asset sale upfront.
It is difficult to finance large projects through securitisation because the financial transactions are long-term. Mutual funds, typically, would not have the appetite for long tenor assets going up to 15 years. Besides, capital provisioning norms for credit enhancement are the other challenges faced by originator banks. Securitized instruments need to be rated under current

guidelines and considering that most projects in India will be at the lower end of investment grade, the appetite for securitized project finance instruments is low. Since these instruments are usually not rated, investors do not want to buy them. The government hopes to table the Bill amending the Securities Contract Regulation Act in the Budget session. The Bill will give greater clarity to asset-backed securities (ABS).

Tax exemptions removal may hit corporates

The government is likely to target open-ended tax exemptions by stipulating a time period for their conclusion in the forthcoming Budget. The government is obliged to keep many time-bound exemptions for a period. But there are many open-ended exemptions too.

Mr. Chidambaram admitted that the SEZ policy was one big exemption. "But we had argued against the tax exemptions in SEZs and lost the battle." 80 HHC, which gave an income tax break on export profits, is now back through SEZs. This exemption had been phased out.

Corporates, for instance, enjoy two kinds of open-ended exemptions. One, where the exemption is perennial. Two, where the exemption is for a finite period but companies are free to claim it at any point of time. The tax deduction available to companies under a section in the Income Tax Act known as 80 G falls in the first category.

Companies can claim a tax deduction on donations to charitable trusts and institutions under this section. Similar tax breaks are given for donations to political parties under Section 80 GGB. The second category of open-ended exemptions include tax holiday available to infrastructure service providers under Section 80 IA of the Income Tax Act.

Companies that develop, operate and maintain infrastructure facilities can claim full deduction on the profits for the first ten years. Roads, water supply, port, airport, inland waterway, water treatment, irrigation, sanitation and sewerage and solid waste management feature in the list of beneficiary infrastructure facilities. The exemption has no termination date set for it, unlike in the case of investment in the power sector, where a developer cannot commence claiming the 80IA benefit after March 31, 2010.

Similarly, a deadline has been fixed for industrial parks as well. Tax breaks are also given under a Section known as 80 IB of the IT Act to companies engaged in the commercial production or refining of mineral oil anywhere in India. A full tax holiday is available for seven years, whenever it is commissioned.

Excise duty rationalisation

The excise duty regime could be sharply tightened by cleaning up the exemptions slate in the Budget 2007, but there is unlikely to be any change in the median rate of 16%. The excise duty has recorded the lowest growth in collections among the five major taxes.

The plethora of exemptions on excise front has complicated the structure with multiplicity of rates while acting as a drag on the revenue collections. These exemptions have been prone to rampant misuse.

The area-based exemptions have drawn protests from states, which do not have those benefits. The government has also found that these exemptions, instead of serving the objective of industrial development in the given states, were becoming vehicles of rampant misuse. In the backdrop of all these factors, these concessions may be reviewed. Though concessions to Uttaranchal and Himachal Pradesh have been extended till 2007-08 this year, the government may put some curbs. The same may be done for North-East zone and Jammu & Kashmir. The government had withdrawn a host of excise and customs exemptions in the last Budget and this exercise is expected to continue.

Also, as a policy, the government may be willing to do away with end use-based exemptions, as they are prone to misuse. Also, there are a couple of exemptions, which have outlived their utility or need certification or give rise to disputes. These also may be phased out.

Other initiatives

- Education expenditure to be increased to 6% of GDP
- Import duty on edible oil to be hiked to help farmers
- Planning commission has advised to revamp the Centrally Sponsored Scheme (CSS) by scrapping 120 of them; 52 schemes with outlay of Rs3bn each to be retained and 25 schemes with an outlay of 1-3bn to be transferred to states
- Tax holiday for the entertainment industry - expected industry size of Rs800 bn by 2010
- The tax ceiling for self employed such as architects, engineers accountants etc. may be raised from the current limit of Rs20, 000 considering the growth seen in the size of their projects
- Weather index based insurance schemes for the farmers

Bills to be introduced in the budget session

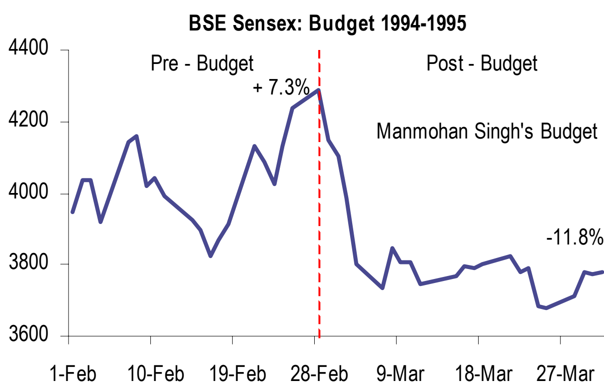
- Pension Fund Regulatory Development Authority (PFRDA) bill
- Airport Economic Regulatory Authority bill
- Broadcast Services Regulation bill
- Warehousing Development and Regulation Bill
- Limited Liability Partnership bill
- Securities Contracts Regulation amendment bill
- Competition amendment bill
- Factories amendment bill
- Information Technology amendment bill
- Merchant Shipping amendment bill
- Foreign Trade Development and Regulation amendment bill
- Electricity amendment bill
- Special Economic Zone (SEZ) Act amendment bill
- Banking Regulation amendment bill
- Labor Laws Exemption bill
- Drugs Control Repeal bill
- Unorganized Sector Worker's bill – an expenditure of Rs250bn in 5-years for health and life insurance cover, sickness allowance, maternity benefits and pension to all the workers in the unorganized sector with monthly salary of Rs6500 – providing social security in the unorganized sector
- To initiate marginal divestment process in the public sector companies and banks
- To enhance the foreign investment cap by removing the restrictions on foreign investments

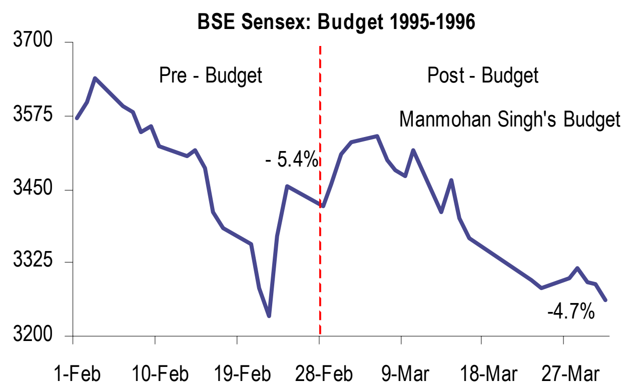
Anatomy of pre and post (1-month) budget BSE-30 market returns

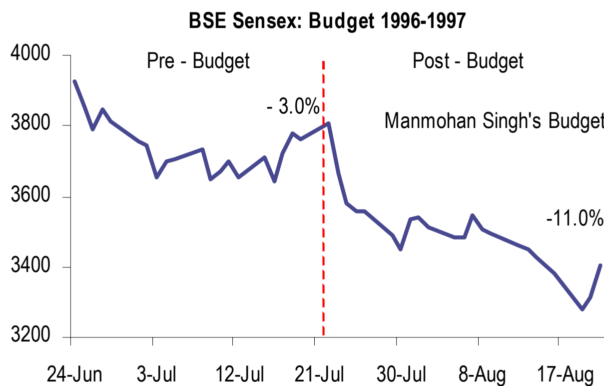
Not worth punting on the budget

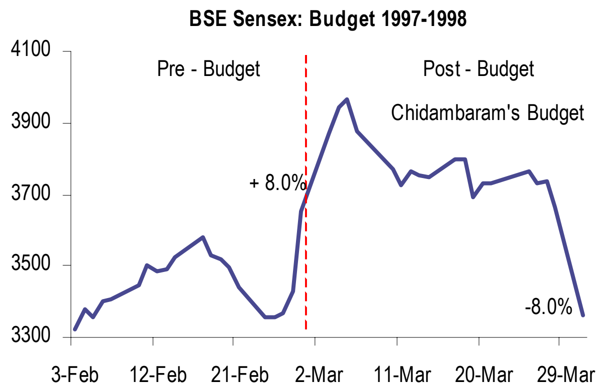
As can be seen for the charts and tables below, out of the last 17 budgets since 1991-1992, on 10 occasions, the market has fallen after the budget in the ensuing 1-month period. Only 5 times market has given positive returns in 1-month period before and after the budget. While on other 4 occasions, there had been a directional change from +ve returns in the pre-budget period to –ve in the post budget period. As can be seen from Table 3, post-budget –ve median returns of the market are higher than pre budget +ve median returns. Also, volatility adjusted mean returns (Coefficient of variation) is higher for the post budget 1 month period.

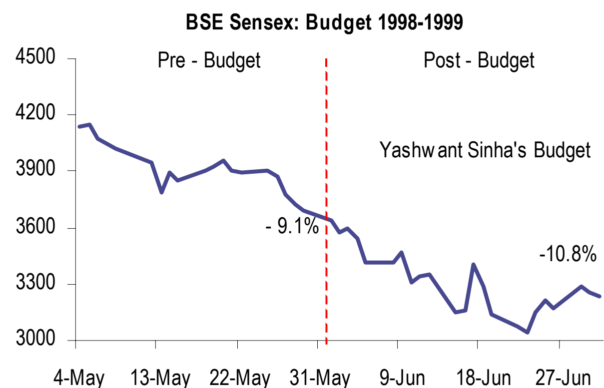
Thus, it does not make sense to punt on the budget in the short term. What is important is to take note of long-term directional statement that the budget is making and then act on it.

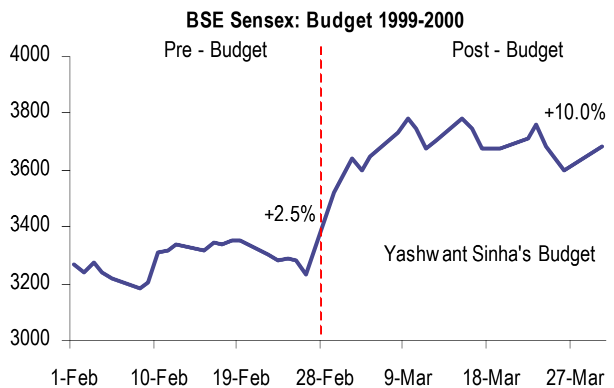




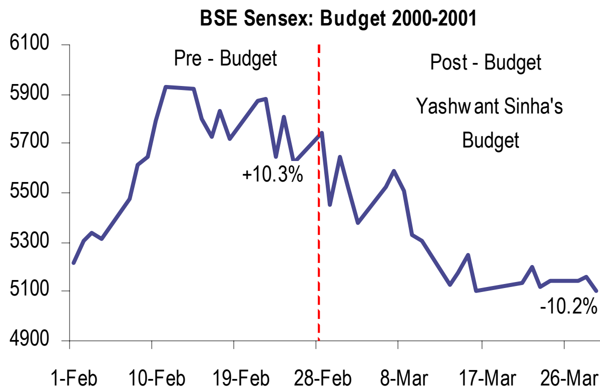


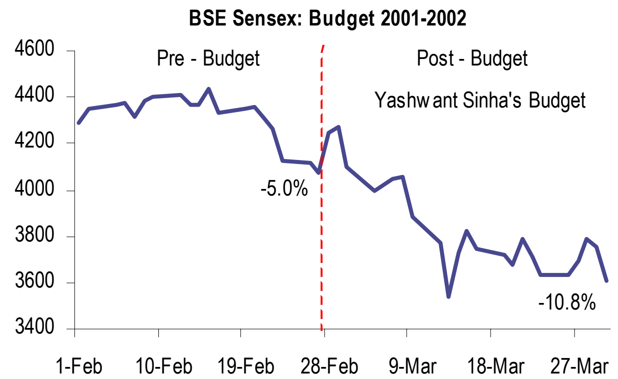


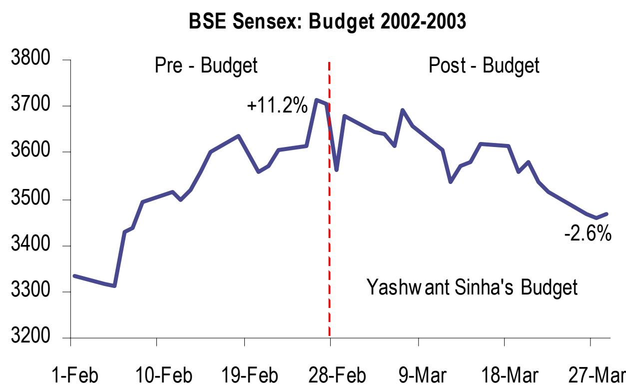


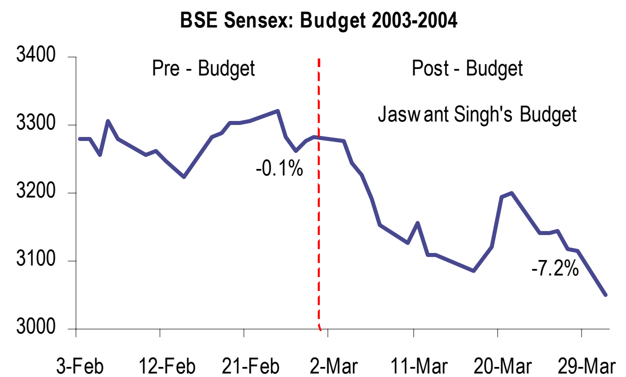


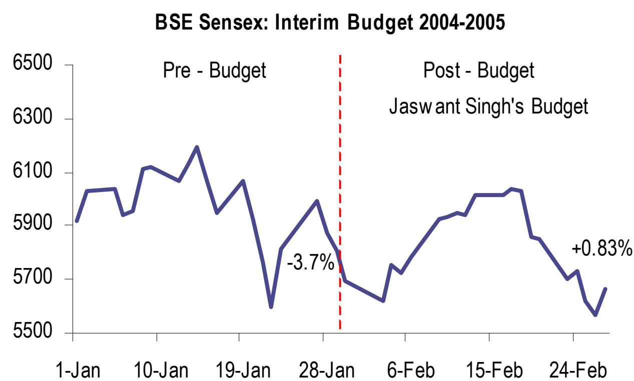
Source: Bloomberg, Man Financial Research

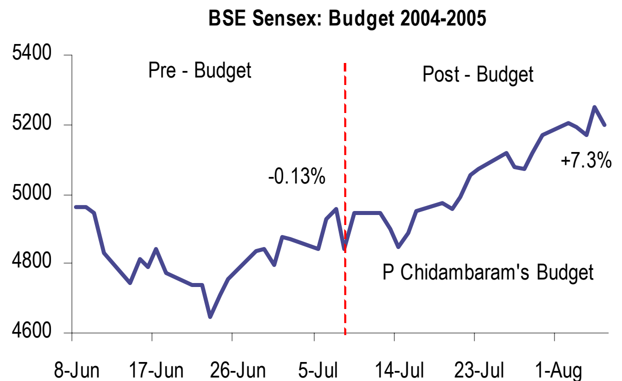


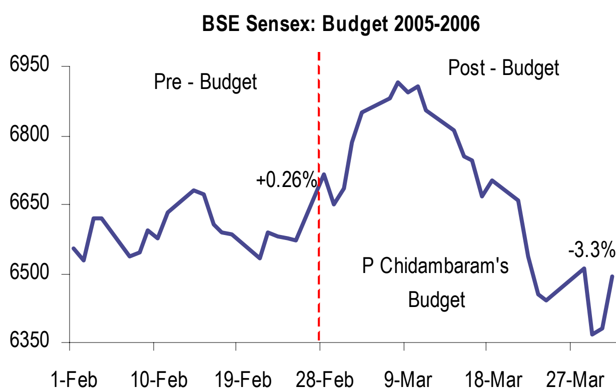


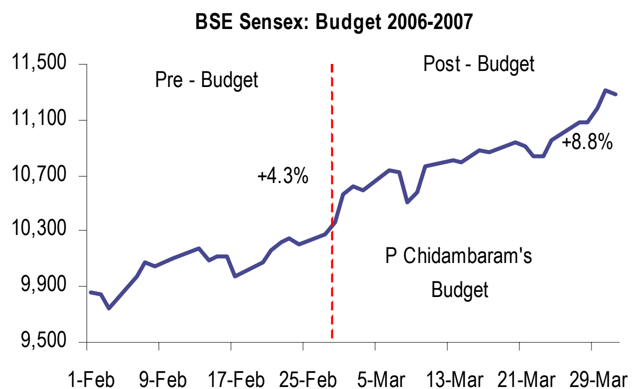












Source: Bloomberg, Man Financial Research

Pre and post (1 month) budget BSE-30 market returns

	Pre-Budget	Post-Budget	Budget Presented By
1991-92	11.70%	6.80%	Manmohan Singh
1992-93	22.90%	5.14%	Manmohan Singh
1993-94	-1.10%	-14.00%	Manmohan Singh
1994-95	7.30%	11.80%	Manmohan Singh
1995-96	-5.40%	-4.70%	Manmohan Singh
1996-97	-3.00%	-11.00%	Manmohan Singh
1997-98	8.00%	-8.00%	P. Chidambaram
1998-99	-9.10%	-10.80%	Yashwant Sinha
1999-00	2.50%	10.00%	Yashwant Sinha
2000-01	10.30%	-10.20%	Yashwant Sinha
2001-02	-5.00%	-10.80%	Yashwant Sinha
2002-03	11.20%	-2.60%	Yashwant Sinha
2003-04	-0.10%	-7.20%	Jaswant Singh
2004-05	-3.70%	0.83%	Jaswant Singh
2004-05	-0.13%	7.30%	P. Chidambaram
2005-06	0.26%	-3.30%	P. Chidambaram
2006-07	4.3%	8.8%	P. Chidambaram

Source: Bloomberg, Man Financial Research

The count of positive and negative returns

(%)	Pre Budget	Post Budget
Positive returns	9	7
Negative returns	8	10
Total	**17**	**17**

Source: Man Financial Research

Change of direction from pre-budget to post-budget

Both +ve	Both - ve	Positive to -ve	Negative to +ve
5	6	4	2

Source: Man Financial Research

Volatility of budget related market returns

	Pre Budget	Post Budget
Median	0.26%	-3.30%
Average	3.00%	-1.88%
SD	0.08	0.09
Coefficient of variation	2.70	-4.60

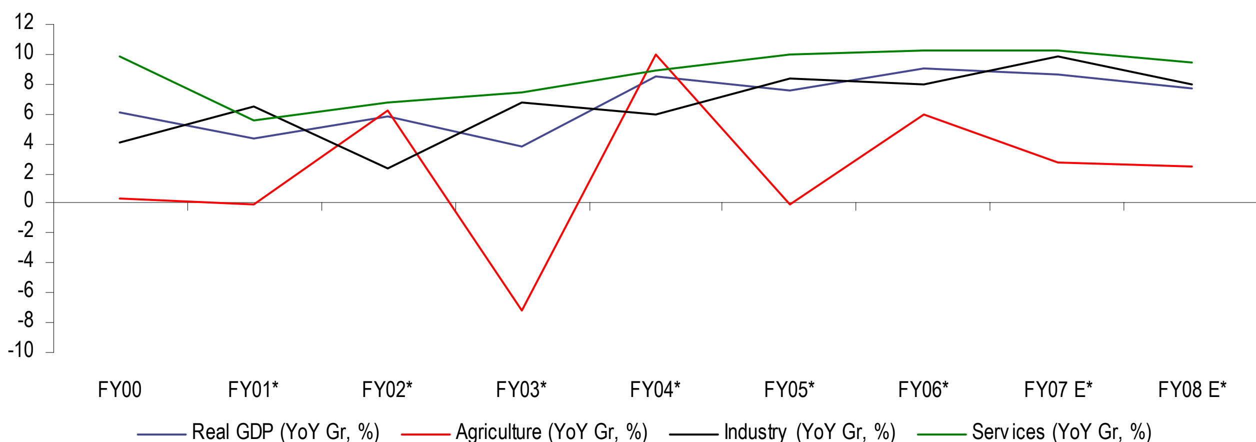
Source: Man Financial Research

FISCAL CONSOLIDATION AT CENTRE AND STATE LEVEL – ON COURSE

Pro-growth, pro-employment FY08 budget to maintain thrust on fiscal consolidation, but the infrastructure bottleneck (physical and reforms) may put a cap on the growth

The FY08 budget is likely to project nominal GDP growth of 13.2% for FY08E, a combination of close to 8% real GDP growth and 5.2% of inflation. This will be on the back of @ 14% nominal growth expected in FY07E. However, considering the fact that agriculture is likely to grow at 2.5% in FY08E, the burden of growth will have to be shared by manufacturing and services. We expect services to grow at 9.4% and manufacturing at 8.5% in FY08E.

The burden of growth to be shared by services and manufacturing



* Base 1999-2000. Source: RBI, Man Financial Research

Higher plan outlay to support growth

The budgetary support to centre, states and union territories for plan expenditure in FY08E is expected to increase to Rs 2100bn, a yoy increase of 21.6% as compared to 20% growth last year. The higher allocation is expected to fund the government's flagship programs in the areas of employment guarantee, health, education, agriculture and infrastructure. It also includes a reward of Rs100bn for the ministries and states for the timely implementation of these programs. The budgetary allocation to the centre and state is expected to rise by 20.3% and 25.6% respectively. Given below is the trend in the central plan outlay that includes Gross Budgetary Support (GBS) and Internal and Extra Budgetary Resources (IEBR) over the last 2 years and, as can be seen, almost 72% of the resources find allocation to energy, social services like health and education and transport that includes railways.

Central Plan Outlay (GBS + IEBR) Rs bn	FY06 RE	% of total	FY07 BE	% of total
Energy	537	26.2%	696	27.4%
Social Services	537	26.2%	659	26.0%
Transport	404	19.7%	486	19.1%
Communications	175	8.5%	199	7.8%
Rural Development	142	6.9%	156	6.2%
Industry and Minerals	101	4.9%	145	5.7%
Science Technology & Environment	60	2.9%	81	3.2%
Agriculture and Allied Activities	59	2.9%	74	2.9%
General Economic Services	28	1.4%	32	1.2%
General Services	5	0.2%	6	0.2%
Irrigation and Flood Control	4	0.2%	6	0.2%
Grand total	**2,053**	**100.0%**	**2540**	**100.0%**

Source: Budget documents

CENTRAL GOVERNMENT

Contours of fiscal improvement

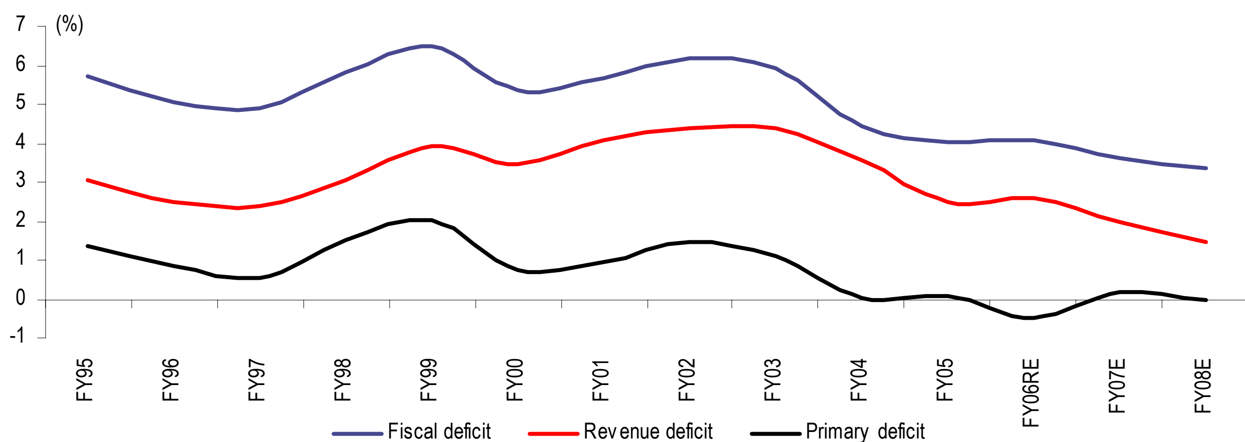
Fiscal prudence targets to be met in FY07 and FY08, with a positive surprise in FY07E

The move towards fiscal prudence under Fiscal Responsibility and Budget Management (FRBM) Act is likely to continue in FY08 by the centre as well as the state government, even amidst a scenario of expected slower GDP growth and higher infrastructural and social spending. The planning commission is asking for the extension of FRBM targets by 2 years, by front-loading the expenditure, in order to move to a higher growth path of 9% during the 11th five year plan (FY08 to FY12). In FY07, the finance minister would be able to achieve the fiscal deficit target of 3.8% and may even surprise us by a lower number like 3.6% as happened the last year, considering the higher revenue collections, revised nominal GDP growth for the last few years by CSO and the ongoing buoyant economic growth. Revenue deficit target of 2.1% should also be achieved.

FRBM Act was enacted on August 26, 2003 by NDA government while its rules were notified by the United Progressive Alliance (UPA) government on July 5, 2004. FRBM Act recommends that fiscal deficit should decline by 30bps as a percentage of GDP and revenue deficit by 50bps annually; according to which within 5 years (i.e. by FY2009) the fiscal deficit should fall to 3% and revenue deficit to 0%. Each state also had to enact fiscal responsibility legislation to this effect.

Central government finances – On course of improvement

Deficits in line with FRBM



Source: RBI, Budget documents, Man Financial Research

Revenue deficit in line on account of revenue buoyancy

Revenue deficit indicates the usage of taxes to finance the non-developmental expenditure, is also on a consolidation trend from the peak of 4.4% in FY02 to 2.1% in FY07BE. Its consolidation is not only warranted but it is imminent so that resources can be utilized efficiently by offering maximum productivity. Robust revenue collection, which may surpass the budgeted estimates by Rs120-300bn, may result in lower revenue deficit (than budgeted) provided the revenue expenditure remains in line with the budgeted estimates.

Receipts exhibit strong revenue buoyancy in FY07BE/ YTD

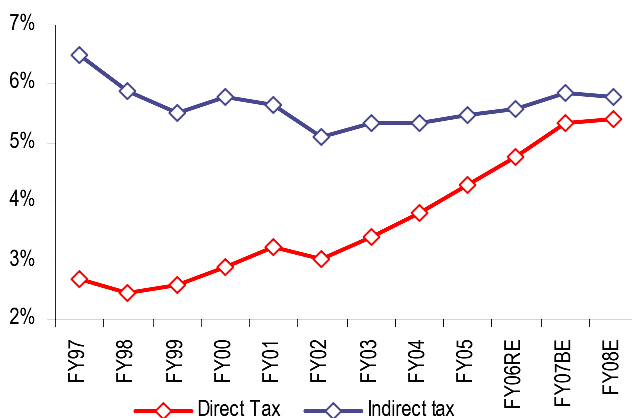
For FY07BE, the government is budgeted to garner revenue collection of Rs4035bn; however considering the expected 8.6% real GDP growth in FY07 and strong corporate earnings, it is likely that government will surpass this target by Rs 120-300bn. In FY07E, we expect an excess of Rs 130bn in the tax revenue over and above the budgeted estimate; bringing the revenue receipts to Rs 4163bn (a yoy increase of 19.5% Vs budgeted 15.8%) For the period of April-November 2006, tax revenue registered a yoy growth of 36% Vs 22% last year and 19.4% budgeted for the full year. It amounted to Rs1770bn (54% of the BE) for 8MFY07.

Direct taxes contribution to total tax revenue rises significantly due to buoyancy and improved compliance

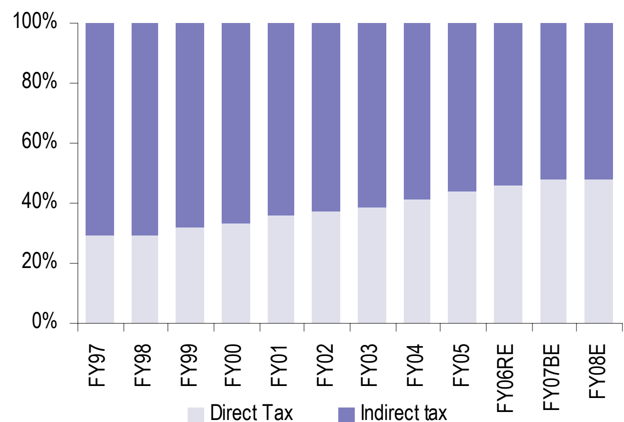
The over-dependence on indirect taxes (excise, custom, service tax) as a source of revenue has reduced significantly due to buoyancy in direct taxes (income and corporate tax) driven by deployment of technology in the tax administration and buoyancy due to higher growth in the economy. Direct taxes have tripled while indirect taxes have doubled during the last 5 years of FY02-FY07BE. The direct taxes' contribution to tax revenue has gone up from 37% in FY02 to 48% in FY07BE and that of indirect tax has fallen from 62% in FY02 to 52% in FY07BE. As on FY07BE, direct tax form 5.3% of the GDP and indirect tax forms 5.8% of GDP.

Direct taxes set to converge with indirect taxes – A positive trend

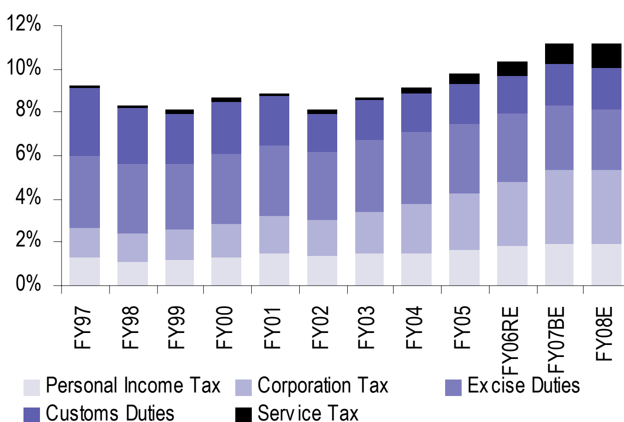
Direct and indirect tax as a % of GDP



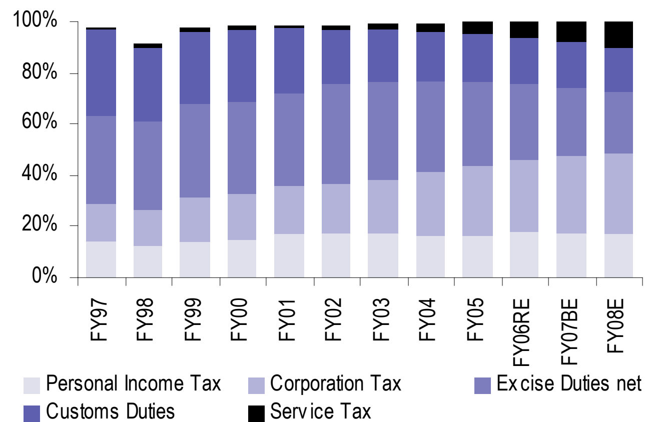
Direct and indirect tax as a % of total tax collection



Tax components as a % of GDP



Tax components as a % of gross tax revenue



Source: Budget documents, Man Financial Research

As on FY07BE, corporate tax as a % of GDP forms 3.4%, excise duty 3%, personal income tax 2%, customs duties 1.9% and service tax at 0.9% as compared to corporate tax of 1.6%, excise duty 3.2%, personal income tax 1.4%, customs duties 1.8% and service tax of 0.1% of GDP in FY02. The income tax, corporate tax and service tax has seen a noticeable increase and is expected to remain so due to robust economic growth, tax base expansion, higher corporate earnings and more services expected to come under tax net.

Revenue collection to remain stable in FY08

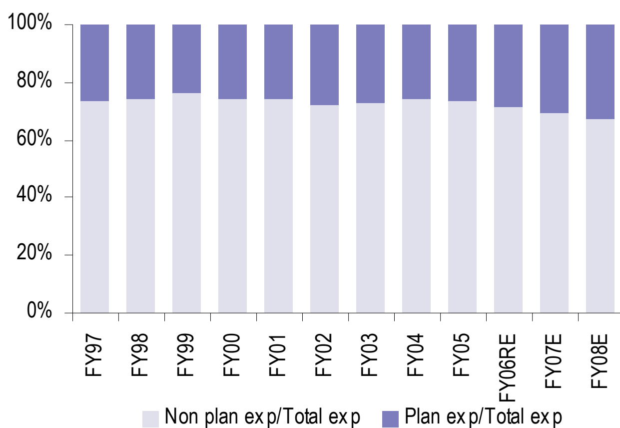
In FY08 (On the base of FY07E) we expect both revenue and capital receipts to grow by 14.8% and 10.3% respectively due to ongoing economic growth and expected reforms. Total receipts (Revenue + Capital) are expected to rise to Rs 6493bn Vs Rs 5715bn in FY07E (a yoy growth of 13.6%; 14.1% of the GDP, assuming nominal GDP to grow at 13.2%). The revenue collection as a proportion of GDP is expected to remain stable and in line with FY07.

Expenditure rebalancing on course

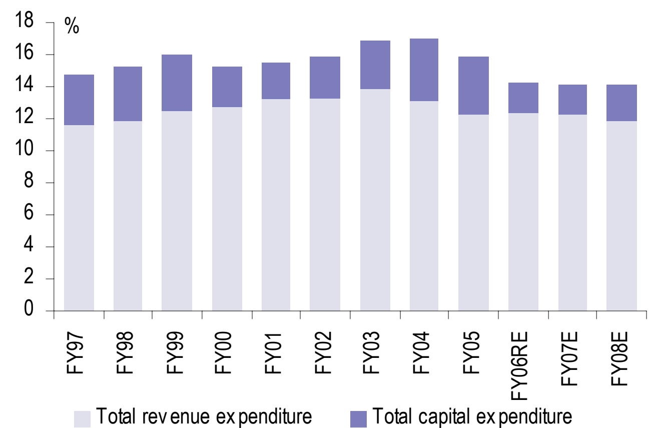
Along with the boosting revenues, government also needs to continue to focus on curtailing expenditure specially the non-plan expenditure and allocate more to the plan expenditure. For FY07BE, plan and non-plan expenditure are estimated at Rs 1727bn (4.3% of GDP) and Rs 3988bn respectively (9.8% of the GDP). While non-plan expenditure is on a declining trend – from 12.6% of GDP in FY04 to 10.2% of GDP in FY06; the plan expenditure has remained stable at 4.3% similar to FY04 levels after falling in FY05 and FY06. Approximately, 33% of the total expenditure in FY07BE is estimated to be spent on interest payments (24.5%) and subsidies (8.1%). Some of the major items that are subsidized by the government include food, fertilizers, and petrol on the commodity front along with interest and other form of subsidy. For FY07BE, food accounts for half of the subsidy followed by 22.5% to indigenous fertilizer, 12.4% to sale of decontrolled fertilizer to the farmers and 6.7% forms the petrol subsidy. Although subsidies as a % of GDP has fallen to 1.1% from the highs of 1.8% in FY03; it needs to be further streamlined by ensuring that it is rightly targeted so that it does not lead to a hole in governments' finances.

Subsidies have fallen from 1.8% of GDP in FY03 to 1.1% in FY07E

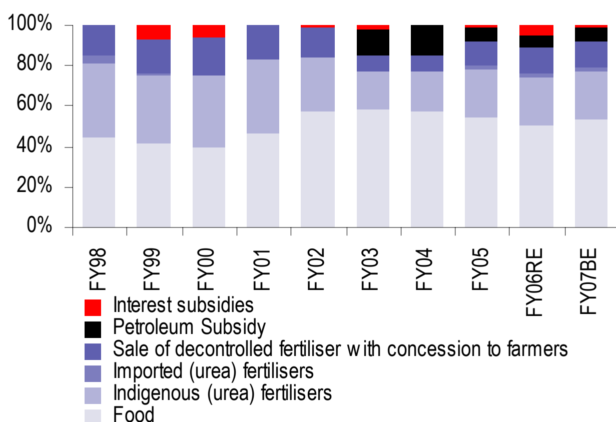
Proportion of non-plan and plan expenditure



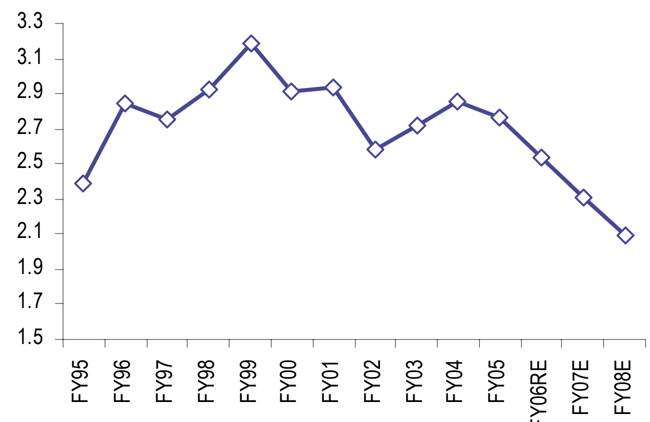
Revenue and capital expenditure as a % of GDP



Break up of subsidies



Non-plan to plan expenditure ratio (%)



Source: Budget documents, Man Financial Research

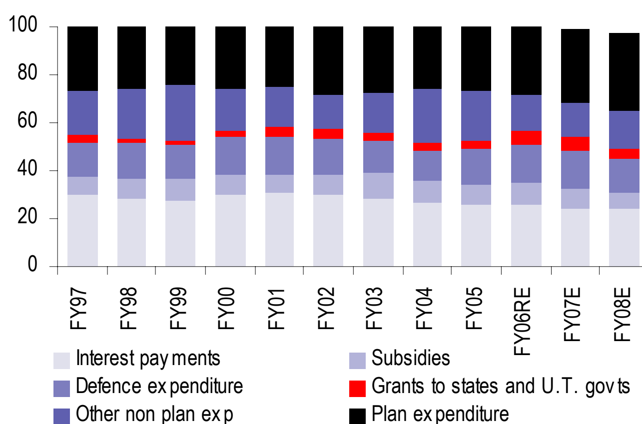
Falling trend in expenditure

Looking at the trends in revenue and capital expenditure, revenue expenditure is budgeted to fall to 12.2% of GDP in FY07E from the highs of 13.8% in FY03 while capital expenditure is also seeing a falling trend from 4% in FY04 to 1.9% in FY07E. Total expenditure for FY07E is estimated to fall to 14.1% of the GDP as compared to 17% in FY04. Falling expenditure is the key to fiscal prudence however the cut should primarily be in the revenue expenditure whereas capital and social expenditure should be further enhanced. Currently the revenue expenditure is seven times higher than the capital expenditure.

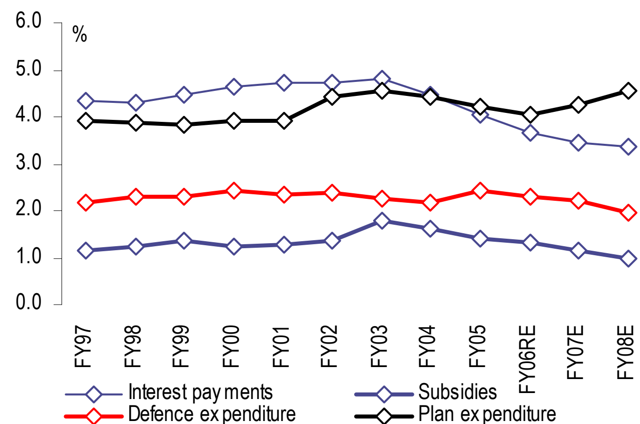
For the period of April-November 2006, total expenditure was 15% (10.9% growth estimated for the full year) higher than last year at Rs3365bn (60% of the BE). Non-plan expenditure stood at Rs2454bn (63% of the BE), registering a growth of 16.5% and plan expenditure at Rs911bn (53% of the BE) growing at a rate of 10.6%. For the full year FY07E, we expect a similar trend of expenditure to culminate as budgeted by the finance minister.

Centre's non-plan expenditure declines from 76% in FY99 to 70% in FY07 driven by fall in interest payment

Break up of expenditure as a % of total expenditure (%)



Break up of expenditure as a % of GDP



Source: Budget documents, Man Financial Research

For FY08, we expect total expenditure at 14.1% of GDP similar to FY07E. Non-plan expenditure is expected to fall to 9.6% of the GDP Vs 9.8% in FY07E and plan expenditure to rise to 4.6% Vs 4.3% in FY07E. We expect the finance minister to concentrate more on the large size schemes and wound up the schemes having smaller outlays due to administrative bottlenecks. Although expenditure levels are expected to remain more or less stable, this does not incorporate the liabilities like oil bonds, dues to Food Corporation of India etc. hence, it can be argued that actual fiscal deficit is higher.

Pattern of deficit financing shifts to market borrowing

A shift has been seen in the pattern of fiscal deficit financing of the central fiscal deficit from small savings, state provident funds, special deposits, reserve funds, T-Bills etc. to market borrowings. Currently the market borrowings are estimated to finance 76.5% of the fiscal deficit for the central government at Rs1138bn. Internal financing continues to dominate over external financing at 94.4%. The debt position of the central government as a % of GDP at current market prices has declined to 40.4% in FY07BE from 43.3% in FY02; further pruning is required.

STATE GOVERNMENT

Finances on improving trend

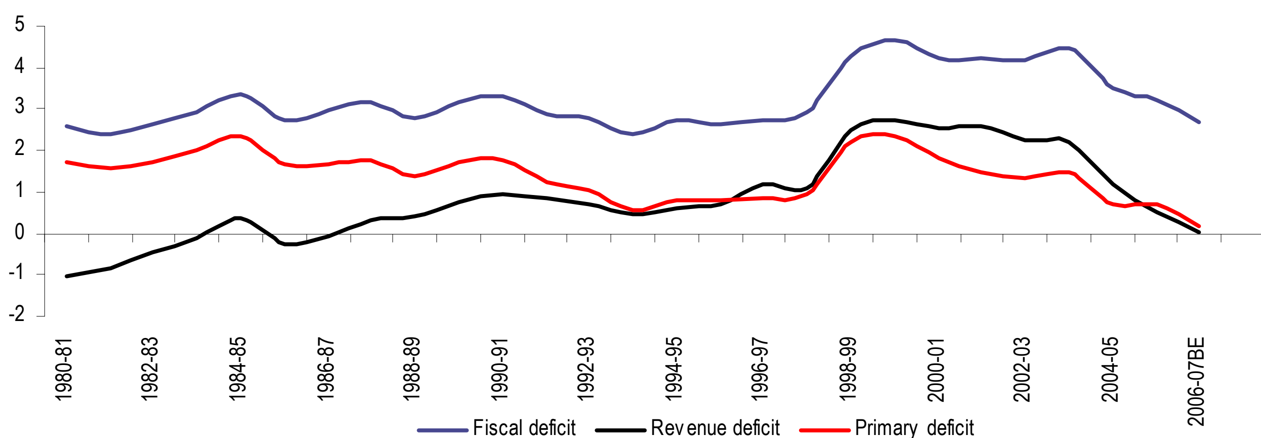
Fiscal deficit at the state level has also seen substantial correction from the peaks of 4.7% of GDP in FY00 (due to repercussions of fifth pay commission), to 3.2% in FY06 and 2.7% in FY07BE. This has happened primarily through revenue enhancement by select states, slower expenditure growth, debt swap scheme, and general reduction in cost of borrowing with states depending more market borrowings. The weak states are yet to catch up with the process of fiscal consolidation. As of May 19, 2006, 22 states have enacted the FRBM act as planning commission has incentivized states by making it (FRBM enactment) an eligibility criterion for debt relief and debt write-off for the states.

The financial health of the states has improved and expected to remain so on the back of incentives measure that have been introduced. Higher cash balances with the states, currently invested in 14-day treasury bills at Rs416bn (weekly average) during April-December 2006 as compared to Rs328bn in the corresponding period of the previous year, have mainly come from the large capital inflows of the small savings, larger central tax devolution and finance commission grants. The surplus cash and the revenues are expected to be allocated for the social and capital expenditure to make the economic growth more inclusive.

Financing pattern of state fiscal deficit has changed with states relying more on market borrowings

The financing pattern of the state fiscal deficit is now inclined to market borrowings and loans from NSSF at 21% and 53.5% of the total fiscal deficit. The dependence on the loans from the centre has substantially reduced from 53% in FY91 to only 4.8% now in FY07 leaving funds with the centre to fulfill their own goal of fiscal alignment.

State deficits (as a % of GDP) fall due to debt swap, higher revenue growth and more incentives from the 12th Finance commission

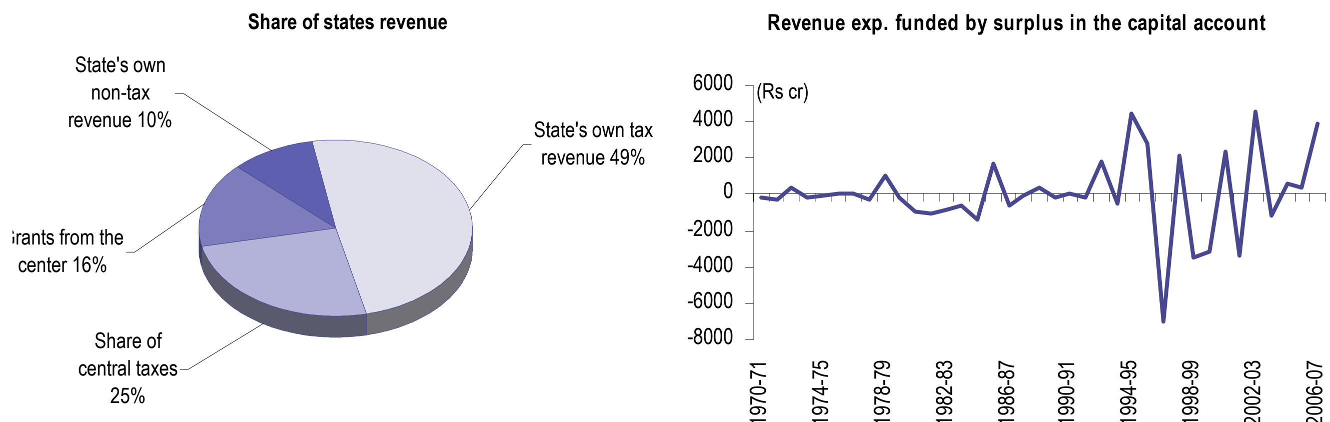


Source: RBI, Budget documents, Man Financial Research

Revenue growth has picked up with direct taxes showing higher growth

The sources of receipts of a state government can be broadly divided into central transfers (shareable taxes and grants), own revenue receipts (tax and non-tax receipts) and capital receipts (loans from the centre and other sources). In FY07BE, revenue receipts are budgeted to grow at 14.5% on top of 22.1% growth last year. The budgeted increase in revenue receipts during FY07 over that of FY06 would be contributed by own tax revenue (49.1%), share in central taxes (25.3%), grants from the Centre (15.5%) and States' own non-tax (10.1%). In FY07, five of the remaining states implemented VAT, taking the total number of states under VAT to 27. Direct tax to indirect tax ratio stands at 12:88 in FY07BE, however the average growth rate of direct taxes is higher than the indirect taxes at 16% Vs 14% for the period of FY91-FY07.

Revenue expenditure by states is funded by capital account surplus



Source: RBI, Budget documents, Man Financial Research

While expenditure growth slowed down, share of non-development expenditure has moved up. Revenue expenditure (both plan and non-plan is funded by capital account surplus)

On the expenditure front, the total expenditure is budgeted to fall from 17.2% of GDP in FY06 to 16.9% in FY07BE. Revenue expenditure is going to remain stable at 13.3% of GDP while the capital expenditure is expected to fall to 3.6% in FY07BE from 3.9% last year (which is not a good sign). On year-on-year growth basis, revenue expenditure is expected to decelerate to 11.3 % in 2006-07 from 15.4 % growth in the previous year. The budgeted rise in revenue expenditure during 2006-07 would be primarily contributed by non-interest revenue expenditure (80.4%). Within revenue expenditure, developmental expenditure (economic and social services) would decelerate to 9.1% (from 21.4% in the previous year) while non-developmental expenditure would accelerate to 13.2% (from 7.9 % in the previous year) primarily due to higher provisions in respect of interest payments, administrative services and pensions. The non-developmental expenditure to developmental expenditure has been rising and currently stands at 59.4% from 27% in FY81. Currently, the surplus funds of the capital account which gets funded by market borrowings, are being used to finance the revenue expenditure to the extent of Rs39bn

12th Finance commission incentives to states and debt swap scheme linked to fiscal consolidation

In order to address the rising debt burden of states, a general scheme was introduced. As per the general scheme of debt relief and a loan write-off scheme, all loans from the centre (excluding the high cost loans under National Small Savings Fund) were to be consolidated and a uniform interest rate of 7.5% charged on them. Under the loan write-off scheme, repayments on loans from the centre between FY06 to FY10 were to be written-off, with the quantum of write-off linked to the absolute amount of reduction of revenue deficit of the state in each successive year as well as the containment of the fiscal deficit at the level of FY05. The benefits of these schemes were to be made available to only those states that had passed fiscal responsibility legislations.

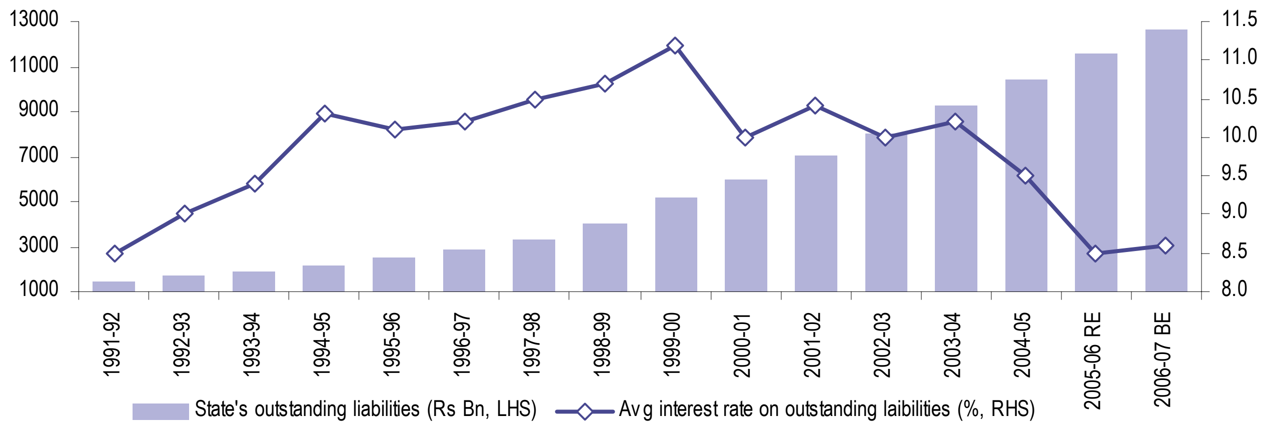
The 12th Finance Commission (TFC) has recommended -

- 30.8% as debt to GDP ratio of states to be achieved by 2010 as compared to 31.8% currently to ensure debt sustainability in the medium-term
- An overall cap to borrowings at 3% of Gross State Domestic product by 2010
- The ratio of interest payments to revenue receipts at 15% by 2010 as compared to 19.1% currently (FY07)

States' interest payments and wages and salaries as % of revenue expenditure decline

The ratio of interest payments to revenue receipts of the state governments was as high as 25.8% in FY04 but declined thereafter mainly due to debt swap scheme introduced in FY03; it is expected to be 19.1% in FY07. This has brought down the cost/interest on the outstanding liabilities of the state governments to 8.6% from a high of 11.2% in FY00. Interest payments as a % of revenue expenditure has fallen from 21.6% in FY04 to 19.3% in FY07. Wages and salaries as a % of revenue expenditure has also fallen from 38% in FY00 to 30.3% in FY07 and expenditure on operations and maintenance has stabilized at 9.7% although higher than the trend in the past 6 years.

Improving debt cost of states



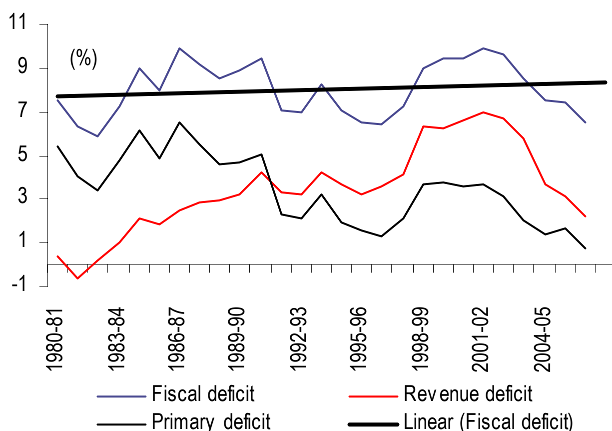
Source: RBI, Budget documents, Man Financial Research

Combined Fiscal Deficit

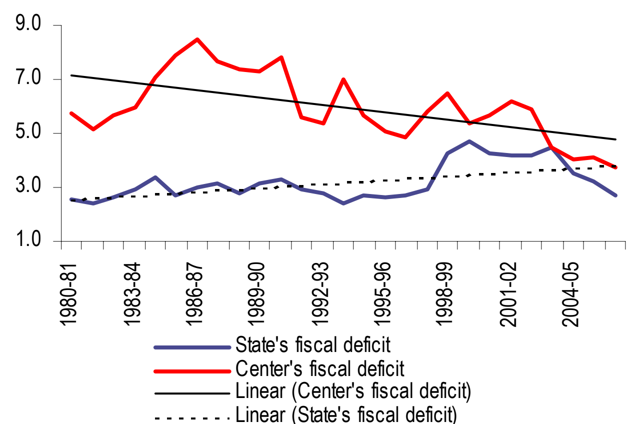
The consolidation in the finances of the centre and state government has brought the combined fiscal deficit to 6.5% of GDP in FY07BE from the highs of 9.9% in FY02. However the debt position of the government of India remains a bottleneck, which has risen from 49% of GDP in FY97 to 62.5% in FY07BE, although on a declining trend in the past 4 years. Sound debt position is an important indicator of a country's credibility, which continues to remain below investment grade in the case of India (only recently upgraded to investment grade). Also, the non-developmental expenditure continues to be high and on a rising trend, brakes on which are very important as it reflects the non-productive utilization of the revenues. The non-developmental to developmental expenditure of the centre has risen from 74% in FY81 to 142% in FY01 to 120% currently; for the states it has risen from 27% in FY81 to 66.5% in FY03 to 59% currently.

Combined fiscal deficit of centre and states shows sustained decline

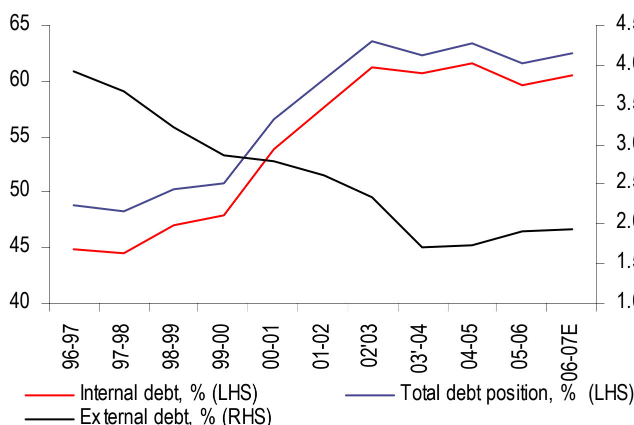
Combined deficit as a % of GDP



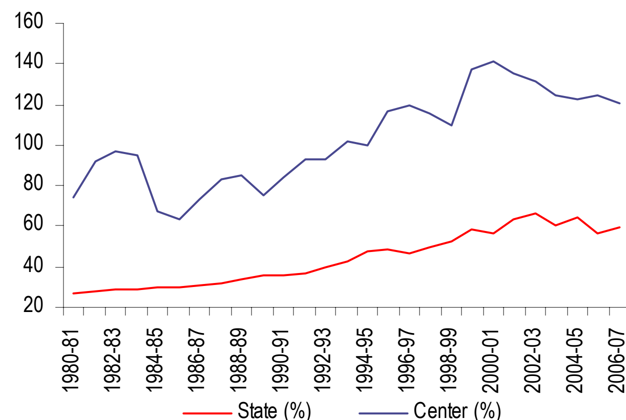
Trends in centre and state fiscal deficit as a % of GDP



Debt position of the GOI as a % of GDP



Non-developmental to developmental expenditure



Source: RBI, Budget documents, Man Financial research

Continuation of the ongoing fiscal consolidation is crucial for India's growth prospects. During FY09, fiscal pressures will increase due to the expected interim award of the sixth pay commission (SPC) and parliamentary elections. Thus, forthcoming FY08 budget is expected to aggressively focus on removing some of the tax exemptions to the corporate sector while lowering headline tax rates so that the overall budget will be revenue accretive at a macro level and more resources are made available for surpassing 8% growth target in FY08.

EXEMPTIONS COST RS1587BN IN FY05

(Note – This section is reproduced in parts from FY07 budget documents)

Based on the calculations done in the receipts budget document of FY07, the total revenue foregone on various heads due to exemption in FY05 was estimated at Rs 1587bn.

Total Revenue Foregone

(Financial Year 2004-05)	Rs bn	% of total	As a % of GDP
Corporate income tax	579	36.5	1.9
Personal income tax	117	7.4	0.4
Co-operative sector related	15	1.0	0.0
Excise duty (i) Exemptions (other than through notifications)	180	11.4	0.6
(ii) Exemption notifications	124	7.8	0.4
Customs duty	926	58.3	3.0
Total	1,941	122.3	6.2
Less: Export credit related	354	22.3	1.1
Total Exemptions	**1,587**	**100.0**	**5.1**

Corporate Income tax

The sample 1689 companies reported Rs 1023bn as profits before taxes (excluding losses reported by companies) but declared a total income (hereafter referred to as "taxable income") of Rs507bn only. These companies paid Rs198bn as corporate tax during the financial year 2003-04. Therefore, the sample companies account for 30.14% of voluntary tax payment of Rs657bn (i.e., aggregate of tax deduction at source and advance tax) during the year. Companies with profits above Rs5bn accounted for 73.5% of the total profits of the sample companies but their share in the total taxes was only 60.70% at an effective tax rate of 15.99%. This was substantially lower than the effective tax rate of 19.37% for the sample companies and the statutory tax rate of 35.87%.

Major tax expenditure on corporate tax-payers during financial year 2004-05

S. No.	Nature of Incentive/deduction	Revenue forgone (Rs bn)	As a % of total)
1.	Export profits of software producing units located in Software Technology Parks (section 10A)	71	12.2
2.	Export profits of units located in Special Economic Zones, including Export Processing Zones and Free Trade Zones (section 10A)	13	2.3
3.	Export profits of units located in Export Oriented Units (section 10B)	23	4.0
4.	Profits derived from development of infrastructure facilities, SEZs and Industrial Parks, generation of power, providing telecommunication services (section 80-IA)	58	10.1
5.	Profits derived from housing projects, production of mineral oil, development of scientific research, integrated business of handling, storage and transportation of food grains, industries set up in backward areas (section 80-IB)	115	19.9
6.	Profits derived by units set up in Special category States like North-Eastern States, Uttaranchal, Himachal Pradesh and Jammu and Kashmir (section 80-IC)	4	0.6
7.	Accelerated depreciation (section 32)	271	46.8
8.	Weighted deduction for scientific research and development [section 35(2AB)]	23	4.0
	TOTAL	**579**	**100.0**
	As a % of nominal GDP	**1.9**	

Non-corporate tax-payers during the financial year 2004-05

The task force on direct taxes set up by the Government on 6th September, 2002, had constructed a typical tax payer profile for different income groups based on income-tax return data of 9.25 lakh individual tax payers from the city of Mumbai, which accounts for 35% of the country's direct tax collections. The data related to four assessment years: 1998-99, 1999-2000, 2000-01 and 2001-02. The sample data for the four years was segregated into two categories, i.e. salaried and non-salaried taxpayers. For every income group and category, a typical taxpayer profile for each of the four assessment years was separately obtained. Thereafter, the four-year average of such profiles for each income group was determined to obtain a typical

taxpayer profile for all income groups for the purposes of revenue estimation. The typical tax-payer profile developed by the task force on direct taxes has been adjusted to reflect subsequent changes in the tax legislation. The tax expenditure on the individual taxpayers during the financial year 2004-05 has been estimated on the basis of the adjusted profile during the relevant year. Table below lists the major tax expenditure (in terms of revenue loss) on the non-corporate tax-payers during the financial year 2004-05.

Non-corporate tax incentive/deduction

S.No.	Nature of Incentive/deduction	Revenue forgone (Rs bn)	% of total
1.	Tax rebate for investment in specified savings instruments.	66	56
2.	Tax rebate for senior citizens.	14	12
3.	Tax rebate for women.	21	18
4.	Interest income on securities, deposits with banks, etc.	16	13
	TOTAL	**117**	**100**
	As a % of nominal GDP	**0.37**	

Estimate of revenue loss from excise duty exemptions

The data generated by the excise department are captured by SERMON, a system that compiles returns received from the Commissionerates. In 2004-05, SERMON data captured gross revenue of Rs950bn representing 93% of the actual gross revenue collection of Rs1044bn. This has been blown up to 100% by assuming that the same pattern of coverage also applies to the remaining 7%. The duty-foregone statement, therefore, has been inflated proportionately to estimate the total revenue foregone. Subject to the limitations discussed above, excise duty foregone during 2004-05 on account of exemption notifications is estimated at Rs124bn. Obviously, the revenue foregone is understated for the reasons mentioned above. From other sources, information has been collected to estimate the revenue foregone in respect of certain major exemptions (Table below).

Excise duty exemptions

S.No.	Details of Exemption	Estimated revenue forgone (Rs bn)	% of total
1.	Small Scale Industries Exemption1	113	62.8
2.	Fertilizers 2	40	22.2
3.	Area based exemptions applicable in North Eastern States, J&K, Uttaranchal, Himachal Pradesh and Kutch District of Gujarat. 3	15	8.3
4.	50% exemption from all duties of excise for North East Oil refineries.	12	6.7
	TOTAL	**180**	**100.0**
	As a % of nominal GDP	**0.58**	

Estimate of revenue loss from customs duty exemptions

The estimate of the revenue foregone for 2004-05 on account of issue of various exemption notifications is based on the data generated from bills of entry filed in the Indian Customs Electronic Data Interchange System (ICES) at 20 Electronic Data Interchange (EDI) locations. The EDI data, however, are not complete, as certain ports fall outside EDI. Besides, the EDI data did not capture bills of entry in respect of imports by EOUs, warehouse bills of entry, and where manual bills of entry are filed in EDI locations. The revenue foregone takes into account exemptions from basic customs duty, CV duty and also exemption notifications issued under the Central Excise Tariff Act, 1985, which are relevant for levy of CV duty. Though, generally, the tariff rates should be taken into account for working out the revenue foregone, some exceptions have been made because of the software used by the ICES.

The above figures of revenue foregone do not exclude all export-related input taxes. This information was calculated separately on the basis of returns received from the Commissionerates. The figures are as under and are included in the overall figure of Rs926bn. Most items in Table below may not, therefore, be termed incentive schemes, since they largely represent input tax credit that has to be allowed in order to offer a level playing field to our exporters in international markets. In this sense, the revenue foregone from customs duties - Rs926bn - should be scaled down somewhat.

Export-linked Drawbacks

S.No.	Scheme	Revenue foregone (Rs bn)	% of total
1	Duty Entitlement Pass Book (DEPB)	97	27.3
2	Quantity Based Advance License (QBAL)	89	25.0
3	100 % Export Oriented Units (EOUs)	68	19.3
4	Export Promotion Capital Goods Scheme (EPCG)	47	13.3
5	Special Economic Zone (SEZs)	13	3.7
6	Value Based Advance License (VBAL)	13	3.6
7	Special Imprest Licence (SIL)	12	3.3
8	Software Technology Parks (STPs)	9	2.4
9	Duty Free Replenishment Certificate (DFRC)	8	2.2
10	PASS BOOK	0	0.0
	TOTAL	**354**	**100.0**
	As a % of nominal GDP	**1.13**	

The above does not include revenue foregone on account of exemption notifications issued under Section 25(2) of the Customs Act, 1962.

Major tax exemptions under the customs duty

List of Commodities	Revenue foregone (Rs cr)	% of total exemption	Cumulative % of total exemption
Precious stones, jewellery	15024	16.2%	
Mineral fuels and mineral oils	13725	14.8%	31.1%
Electrical machinery	12385	13.4%	44.4%
Machinery	8660	9.4%	53.8%
Animal or vegetable fats	7545	8.2%	61.9%
Iron and steel	6866	7.4%	69.4%
Organic chemicals	3238	3.5%	72.9%
Man made filaments	3023	3.3%	76.1%
Optical/photographic instruments	2435	2.6%	78.8%
Plastics	1194	1.3%	80.0%
Cotton	1193	1.3%	81.3%
Motor vehicles	1183	1.3%	82.6%
Sugar	1096	1.2%	83.8%
Edible fruit and nuts	1021	1.1%	84.9%
Articles of iron and steel	901	1.0%	85.9%
Inorganic chemicals	814	0.9%	86.8%
Miscellaneous chemical products	712	0.8%	87.5%
Paper	673	0.7%	88.3%
Fertilizers	627	0.7%	88.9%
Edible vegetables, certain roots and	625	0.7%	89.6%
Special woven fabrics	577	0.6%	90.2%
Man made staple fibres	554	0.6%	90.8%
Pharmaceutical products	505	0.5%	91.4%
Rubber	458	0.5%	91.9%
Ships, boats and floating structures	452	0.5%	92.4%
Aluminum and articles thereof	409	0.4%	92.8%
Printed books, newspapers	393	0.4%	93.2%
Coated textile fabrics	370	0.4%	93.6%
Tanning and dyeing extracts, pigments	345	0.4%	94.0%
Silk	341	0.4%	94.4%
Project imports, baggage	317	0.3%	94.7%
Hide and skins and leather	277	0.3%	95.0%
Copper and articles thereof	276	0.3%	95.3%
Wool	262	0.3%	95.6%
Wood Pulp	229	0.2%	95.8%
Aircrafts	219	0.2%	96.1%
Coffee, tea, mate and spices	208	0.2%	96.3%
Tools and implements	201	0.2%	96.5%
Zinc and articles thereof	179	0.2%	96.7%
Arms and ammunitions	178	0.2%	96.9%
Salt, sulphur earths and stone	167	0.2%	97.1%
Photography goods	167	0.2%	97.3%
Miscellaneous manufactured articles	164	0.2%	97.4%
Glass and glass ware	154	0.2%	97.6%
Nickel and articles thereof	150	0.2%	97.8%
Railways/tramways locomotives, rolling stocks etc.	145	0.2%	97.9%
Knitted fabrics	139	0.2%	98.1%
Ceramic products	128	0.1%	98.2%
Made ups	119	0.1%	98.3%

Source: Budget Document

List of Commodities	Revenue foregone (Rs cr)	% of total exemption	Cumulative % of total exemption
Residues and waste from food industry	105	0.1%	98.5%
Ores	102	0.1%	98.6%
Essential oils	96	0.1%	98.8%
Lead and articles thereof	83	0.1%	98.9%
Miscellaneous articles of base metals	78	0.1%	98.9%
Furniture etc	76	0.1%	99.0%
Other base metals	75	0.1%	99.1%
Soap and washing preparations	73	0.1%	99.2%
Wadding and non woven	64	0.1%	99.3%
Other Vegetable fibres	63	0.1%	99.3%
Toys and games	63	0.1%	99.4%
Beverages and spirits	54	0.1%	99.5%
Articles of stone, plaster	53	0.1%	99.5%
Oilseeds, grains, seeds, fruits	52	0.1%	99.6%
Misc edible preparations	49	0.1%	99.6%
Albuminoidal substances	38	0.0%	99.7%
Footwear	38	0.0%	99.7%
Lac, gums and resins	35	0.0%	99.7%
Preparations of cereals	33	0.0%	99.8%
Clocks and watches	26	0.0%	99.8%
Woven garments	25	0.0%	99.8%
Tin and articles thereof	25	0.0%	99.9%
Carpets	18	0.0%	99.9%
Dairy Products	16	0.0%	99.9%
Articles of leather	12	0.0%	99.9%
Knitted ready made garments	10	0.0%	99.9%
Other products of animal origin	9	0.0%	99.9%
Fish and crustaceans, other aquatic	8	0.0%	99.9%
Cocoa	8	0.0%	99.9%
Preparations of vegetables	8	0.0%	100.0%
Umbrellas	8	0.0%	100.0%
Explosives, matches	6	0.0%	100.0%
Products of the milling industry	5	0.0%	100.0%
Live animals	3	0.0%	100.0%
Tobacco	3	0.0%	100.0%
Fur skins	3	0.0%	100.0%
Musical instruments	3	0.0%	100.0%
Live trees and other plants	2	0.0%	100.0%
Cereals	1	0.0%	100.0%
Vegetable plaiting materials	1	0.0%	100.0%
Head gear	1	0.0%	100.0%
Feathers/artificial flowers	1	0.0%	100.0%
Meat and edible meat offal	0	0.0%	100.0%
Preparations of meat or fish	0	0.0%	100.0%
Cork	0	0.0%	100.0%
Manufactures of straw	0	0.0%	100.0%
Works or art, antiques	0	0.0%	100.0%
TOTAL	**92,561**	**100.0%**	**200.0%**

Budget statistics

(Rs bn)	FY00	FY01	FY02	FY03	FY04	FY05	FY06RE	FY07BE	FY07E	FY08E
Nominal GDP	**19,520**	**21,024**	**22,811**	**24,581**	**27,655**	**31,266**	**35,672**	**39,552**	**40,594**	**45,953**
Revenue receipts	1,815	1,926	2,014	2,317	2,639	3,060	3,484	4,035	4,163	4,781
Tax (net)	1,283	1,369	1,337	1,594	1,870	2,248	2,741	3,272	3,400	3,956
Non - tax	532	557	678	723	769	812	743	763	763	825
Capital receipts	**1,166**	**1,330**	**1,610**	**1,824**	**2,075**	**1,916**	**1,602**	**1,605**	**1,552**	**1,712**
Recovery of loans	101	120	164	342	673	620	117	80	80	118
Other receipts (mainly PSU disinvestment)	17	21	36	32	170	44	24	38	0	55
Borrowings and other liabilities	1,047	1,188	1,410	1,451	1,233	1,252	1,462	1,487	1,472	1,539
Total receipts*	**2,981**	**3,256**	**3,625**	**4,142**	**4,714**	**4,976**	**5,086**	**5,640**	**5,715**	**6,493**
Non-plan expenditure**	**2,219**	**2,429**	**2,613**	**3,027**	**3,491**	**3,654**	**3,649**	**3,913**	**3,988**	**4,393**
Revenue A/c	2,023	2,268	2,400	2,681	2,835	2,969	3,261	3,444	3,520	3,938
Capital A/c**	196	162	213	346	656	685	388	468	468	455
Interest payments	902	993	1,075	1,178	1,241	1,269	1,300	1,398	1,398	1,547
Subsidies	245	268	312	435	443	437	469	462	462	450
Defence	471	496	543	557	601	759	817	890	890	900
Plan expenditure	**762**	**827**	**1,012**	**1,115**	**1,223**	**1,323**	**1,438**	**1,727**	**1,727**	**2,100**
Revenue A/c	468	511	617	716	786	875	1,142	1,438	1,438	1,510
Capital A/c	294	316	395	399	436	448	296	290	290	590
Total revenue expenditure	**2,491**	**2,779**	**3,016**	**3,396**	**3,621**	**3,844**	**4,403**	**4,882**	**4,958**	**5,448**
Total capital expenditure**	**490**	**478**	**608**	**745**	**1,092**	**1,133**	**684**	**758**	**758**	**1,045**
Total expenditure**	**2,981**	**3,256**	**3,625**	**4,142**	**4,714**	**4,977**	**5,087**	**5,640**	**5,715**	**6,493**
Fiscal deficit**	**1,047**	**1,188**	**1,410**	**1,451**	**1,233**	**1,253**	**1,462**	**1,487**	**1,472**	**1,539**
Revenue deficit	**676**	**852**	**1,002**	**1,079**	**983**	**784**	**919**	**847**	**795**	**667**
Primary deficit	**145**	**195**	**335**	**273**	**-8**	**-17**	**162**	**89**	**74**	**-8**
Fiscal deficit (including unaccounted oil bonds+FCI)							**1,577**	**1,487**	**1,742**	**1,637**

Source: Budget Document, Man Financial Research. * Does not include Borrowings **Small savings excluded from non plan capital expenditure from FY00

Fiscal parameters as % of GDP

% of GDP	FY00	FY01	FY02	FY03	FY04	FY05	FY06RE	FY07BE	FY07E	FY08E
Revenue receipts	**9.3**	**9.2**	**8.8**	**9.4**	**9.5**	**9.8**	**9.8**	**10.2**	**10.3**	**10.4**
Tax (net)	6.6	6.5	5.9	6.5	6.8	7.2	7.7	8.3	8.4	8.6
Non - tax	2.7	2.6	3.0	2.9	2.8	2.6	2.1	1.9	1.9	1.8
Capital receipts	**6.0**	**6.3**	**7.1**	**7.4**	**7.5**	**6.1**	**4.5**	**4.1**	**3.8**	**3.7**
Recovery of loans	0.5	0.6	0.7	1.4	2.4	2.0	0.3	0.2	0.2	0.3
Other receipts (mainly PSU disinvestment)	0.1	0.1	0.2	0.1	0.6	0.1	0.1	0.1	0.0	0.1
Borrowings and other liabilities	5.4	5.7	6.2	5.9	4.5	4.0	4.1	3.8	3.6	3.3
Total receipts*	**15.3**	**15.5**	**15.9**	**16.8**	**17.0**	**15.9**	**14.3**	**14.3**	**14.1**	**14.1**
Non-plan expenditure**	**11.4**	**11.6**	**11.5**	**12.3**	**12.6**	**11.7**	**10.2**	**9.9**	**9.8**	**9.6**
Revenue A/c	10.4	10.8	10.5	10.9	10.3	9.5	9.1	8.7	8.7	8.6
Capital A/c**	1.0	0.8	0.9	1.4	2.4	2.2	1.1	1.2	1.2	1.0
Interest payments	4.6	4.7	4.7	4.8	4.5	4.1	3.6	3.5	3.4	3.4
Subsidies	1.3	1.3	1.4	1.8	1.6	1.4	1.3	1.2	1.1	1.0
Defence expenditure	2.4	2.4	2.4	2.3	2.2	2.4	2.3	2.3	2.2	2.0
Plan expenditure	**3.9**	**3.9**	**4.4**	**4.5**	**4.4**	**4.2**	**4.0**	**4.4**	**4.3**	**4.6**
Revenue A/c	2.4	2.4	2.7	2.9	2.8	2.8	3.2	3.6	3.5	3.3
Capital A/c	1.5	1.5	1.7	1.6	1.6	1.4	0.8	0.7	0.7	1.3
Total revenue expenditure	**12.8**	**13.2**	**13.2**	**13.8**	**13.1**	**12.3**	**12.3**	**12.3**	**12.2**	**11.9**
Total capital expenditure	**2.5**	**2.3**	**2.7**	**3.0**	**3.9**	**3.6**	**1.9**	**1.9**	**1.9**	**2.3**
Total expenditure	**15.3**	**15.5**	**15.9**	**16.8**	**17.0**	**15.9**	**14.3**	**14.3**	**14.1**	**14.1**
Fiscal deficit	**-5.4**	**-5.7**	**-6.2**	**-5.9**	**-4.5**	**-4.0**	**-4.1**	**-3.8**	**-3.6**	**-3.3**
Revenue deficit	**-3.5**	**-4.1**	**-4.4**	**-4.4**	**-3.6**	**-2.5**	**-2.6**	**-2.1**	**-2.0**	**-1.5**
Primary deficit	**-0.7**	**-0.9**	**-1.5**	**-1.1**	**0.0**	**-0.1**	**0.5**	**-0.2**	**-0.2**	**0.0**
Fiscal deficit (including oil + FCI bonds)							**-4.4**	**-3.8**	**-4.3**	**-3.6**

Source: Budget Document, Man Financial Research. * Does not include Borrowings **Small savings excluded from non plan capital expenditure from FY00

Annual growth in fiscal parameters

YoY Growth, %	FY00	FY01	FY02	FY03	FY04	FY05	FY06RE	FY07BE	FY07E	FY08E
Nominal GDP	**12.1**	**7.7**	**8.5**	**7.8**	**12.5**	**13.1**	**14.1**	**10.9**	**13.8**	**13.2**
Revenue receipts	**21.4**	**6.1**	**4.6**	**15.0**	**13.9**	**16.0**	**13.9**	**15.8**	**19.5**	**14.8**
Tax (net)	22.6	6.7	-2.4	19.3	17.3	20.2	21.9	19.4	24.0	16.4
Non - tax	18.7	4.6	21.7	6.7	6.3	5.6	-8.5	2.6	2.7	8.1
Capital receipts	**-10.2**	**14.1**	**21.1**	**13.3**	**13.7**	**-7.6**	**-16.4**	**0.2**	**-3.1**	**10.3**
Recovery of loans	-4.7	18.9	36.2	108.4	96.7	-7.8	-81.1	-31.6	-31.6	47.5
Other receipts (mainly PSU disinvestment)	-70.7	23.3	71.6	-13.6	438.0	-73.9	-46.7	63.0	-100.0	47.0
Borrowings and other liabilities	-7.6	13.5	18.6	2.9	-15.0	1.6	16.8	1.7	0.7	4.5
Total receipts*	**6.7**	**9.2**	**11.3**	**14.3**	**13.8**	**5.6**	**2.2**	**10.9**	**12.4**	**13.6**
Non-plan expenditure**	**4.4**	**9.5**	**7.5**	**15.9**	**15.3**	**4.7**	**-0.1**	**7.2**	**9.3**	**10.2**
Revenue A/c	14.4	12.1	5.8	11.7	5.8	4.7	9.9	5.6	7.9	11.9
Capital A/c**	-45.0	-17.5	31.8	62.6	89.4	4.5	-43.4	20.8	20.7	-2.8
Interest payments	15.9	10.0	8.2	9.6	5.3	2.3	2.4	7.5	7.5	10.6
Subsidies	3.8	9.6	16.3	39.5	1.8	-1.5	7.4	-1.4	-1.4	-2.6
Defence expenditure	18.0	5.4	9.4	2.6	7.9	26.3	7.7	8.9	8.9	1.1
Plan expenditure	14.0	8.5	22.4	10.1	9.7	8.2	8.7	20.1	20.1	21.6
Revenue A/c	15.5	9.1	20.7	16.1	9.9	11.3	30.5	25.9	25.9	5.0
Capital A/c	11.7	7.5	25.1	0.9	9.4	2.7	-33.8	-2.3	-2.3	103.7
Total revenue expenditure	**14.6**	**11.5**	**8.5**	**12.6**	**6.6**	**6.1**	**14.6**	**10.9**	**12.6**	**9.9**
Total capital expenditure**	**-20.9**	**-2.5**	**27.4**	**22.5**	**46.5**	**3.8**	**-39.6**	**10.8**	**10.8**	**37.9**
Total expenditure**	**6.7**	**9.2**	**11.3**	**14.3**	**13.8**	**5.6**	**2.2**	**10.9**	**12.3**	**13.6**

Source: Budget Document, Man Financial Research. * Does not include Borrowings **Small savings excluded from non plan capital expenditure from FY00

Revenue Heads in absolute, % growth, % of GDP and % of gross tax revenue

(Rs bn)	FY00	FY01	FY02	FY03	FY04	FY05 RE	FY06RE	FY07BE	FY08E
Gross Tax Revenue	1,718	1,886	1,871	2,163	2,543	3,060	3,701	4,422	5,138
% growth	19.4	9.8	-0.8	15.6	17.6	20.3	21.0	19.5	16.2
% of GDP	8.8	9.0	8.2	8.8	9.2	9.8	10.4	11.2	11.2
In bn									
Direct Tax	563	675	686	830	1,049	1,339	1,698	2,104	2,479
Personal Income Tax	257	318	320	369	414	509	662	774	882
Corporation Tax	307	357	366	462	636	830	1,036	1,330	1,596
Indirect tax	1,125	1,187	1,161	1,313	1,473	1,711	1,992	2,306	2,660
Excise Duties net	619	685	726	823	908	1,007	1,120	1,190	1,250
Customs Duties	484	475	403	449	486	563	642	771	886
Service Tax	21	26	33	41	79	142	230	345	524
% Growth									
Direct Tax	25.9	19.7	1.7	21.0	26.4	27.6	26.8	23.9	17.8
Personal Income Tax	26.7	23.8	0.8	15.2	12.2	23.1	30.1	16.9	14.0
Corporation Tax	25.1	16.3	2.6	26.1	37.7	30.6	24.8	28.4	20.0
Indirect tax	17.3	5.5	-2.2	13.1	12.2	16.2	16.4	15.7	15.4
Excise Duties	16.3	10.7	5.9	13.4	10.3	11.0	11.2	6.3	5.0
Customs Duties	19.1	-1.8	-15.3	11.4	8.4	15.7	14.2	20.0	15.0
Service Tax	8.7	22.8	26.4	24.8	91.4	79.3	62.5	50.0	52.0
% of GDP									
Direct Tax	2.9	3.2	3.0	3.4	3.8	4.3	4.8	5.3	5.4
Personal Income Tax	1.3	1.5	1.4	1.5	1.5	1.6	1.9	2.0	1.9
Corporation Tax	1.6	1.7	1.6	1.9	2.3	2.7	2.9	3.4	3.5
Indirect tax	5.8	5.6	5.1	5.3	5.3	5.5	5.6	5.8	5.8
Excise Duties	3.2	3.3	3.2	3.3	3.3	3.2	3.1	3.0	2.7
Customs Duties	2.5	2.3	1.8	1.8	1.8	1.8	1.8	1.9	1.9
Service Tax	0.1	0.1	0.1	0.2	0.3	0.5	0.6	0.9	1.1
% of Gross Tax Revenue									
Direct Tax	32.8	35.8	36.7	38.4	41.3	43.8	45.9	47.6	48.2
Personal Income Tax	14.9	16.8	17.1	17.0	16.3	16.6	17.9	17.5	17.2
Corporation Tax	17.9	18.9	19.6	21.3	25.0	27.1	28.0	30.1	31.1
Indirect tax	65.5	62.9	62.1	60.7	57.9	55.9	53.8	52.1	51.8
Excise Duties net	36.0	36.3	38.8	38.1	35.7	32.9	30.3	26.9	24.3
Customs Duties	28.2	25.2	21.5	20.7	19.1	18.4	17.3	17.4	17.2
Service Tax	1.2	1.4	1.8	1.9	3.1	4.6	6.2	7.8	10.2

Direct Taxes do not include wealth tax, gift tax, estate duty and taxes pertaining to expenditure and interest

Source: Budget documents, Eleventh plan document, Man Financial research

Plan outlay as per Head of Development (Rs bn)

(Rs bn)	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07BE	FY08E
A. Expenditure on Central Plan by Head of Development	**417.0**	**475.0**	**601.1**	**671.3**	**724.7**	**801.2**	**1,072.5**	**1,312.9**	**1,579.4**
1. Economic Services	246.4	288.3	385.6	433.8	461.4	453.4	603.4	724.7	
1.01 Agriculture and Allied Activities	28.8	29.1	30.1	31.5	38.1	46.4	58.4	72.7	
1.02 Rural Development	51.8	44.4	62.3	119.4	122.1	83.4	142.4	156.4	
1.03 Irrigation & Flood Control	4.5	2.1	4.2	1.9	2.0	3.5	4.2	5.9	
1.04 Energy	44.8	37.3	48.7	42.8	48.9	42.7	46.3	80.1	
1.05 Industry & Minerals	19.2	29.3	44.3	28.8	29.5	33.7	44.9	53.8	
1.06 Transport	64.0	100.6	143.7	148.8	162.2	165.2	214.0	237.6	
1.07 Communication	8.0	16.8	13.2	16.1	6.3	2.7	4.8	5.9	
1.08 Science, Technology & Environment	18.7	21.0	30.2	32.6	38.4	51.4	60.3	80.6	
1.09 General Economic Services	6.7	7.7	8.8	12.0	13.9	24.4	28.1	31.7	
2. Social Services	164.5	178.7	207.9	227.0	251.3	343.7	464.5	581.8	
2.01 Education Art & Culture	46.9	51.8	59.7	68.7	78.5	98.1	144.7	198.2	
2.02 Health & Family Welfare	41.1	43.2	50.7	54.1	59.0	67.4	88.0	116.5	
2.03 Water Supply, Sanitation, Housing and Urban Development	42.0	46.5	56.8	64.7	75.8	77.0	94.3	99.7	
2.04 Information & Broadcasting	1.8	2.5	2.5	3.2	2.2	1.9	4.0	4.4	
2.05 Welfare of SC/ST and other backward classes	9.4	9.6	10.8	11.4	11.2	12.1	14.6	17.4	
2.06 Labour & Labour Welfare	0.8	1.0	1.1	1.2	1.2	1.5	1.9	3.0	
2.07 Social Welfare & Nutritution	22.5	24.1	26.2	23.7	23.4	23.5	38.0	46.7	
2.08 North Eastern Areas	...	...	...	...	...	61.9	78.8	95.7	
2.09 Other Social Services	...	...	...	...	...	0.2	0.2	0.3	
3. General Services	6.1	8.0	7.6	10.4	12.0	4.1	4.6	6.3	
Central Plan on Revenue account	302.6	345.8	421.9	493.7	525.0	580.3	828.4	1,074.7	
Central Plan on Capital account	120.5	129.2	179.2	177.6	199.6	220.9	244.2	238.2	
B. Central Assistance for State Plans	**333.6**	**338.7**	**398.1**	**428.4**	**485.0**	**507.6**	**350.8**	**389.6**	
C. Central Assistance to UT Plans	**11.2**	**13.0**	**12.7**	**15.0**	**13.2**	**13.9**	**14.6**	**24.8**	
Total-Central Assistance to States and UT Plans	**344.8**	**351.7**	**410.9**	**443.4**	**498.1**	**521.6**	**365.4**	**414.4**	**520.6**
On Revenue account	167.6	164.9	194.7	222.0	261.4	294.6	313.2	362.9	
On Capital account	177.3	186.7	216.2	221.4	236.8	227.0	52.2	51.5	
Grand total	**761.8**	**826.7**	**1,011.9**	**1,114.7**	**1,222.8**	**1,322.8**	**1,437.9**	**1,727.3**	**2,102.0**
On Revenue account	468.0	510.8	616.6	715.7	786.4	875.0	1,141.5	1,437.6	
On Capital account	293.8	315.9	395.4	399.0	436.4	447.8	296.4	289.7	

Source: Budget documents, Eleventh plan document, RBI, Man Financial research

Plan outlay as per Head of Development (as a % of GDP)

As a % of GDP	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07BE	FY08E
A. Expenditure on Central Plan by Head of Development	2.1	2.3	2.6	2.7	2.6	2.6	3.0	3.3	3.4
1. Economic Services	1.3	1.4	1.7	1.8	1.7	1.5	1.7	1.8	
1.01 Agriculture and Allied Activities	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	
1.02 Rural Development	0.3	0.2	0.3	0.5	0.4	0.3	0.4	0.4	
1.03 Irrigation & Flood Control	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
1.04 Energy	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2	
1.05 Industry & Minerals	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	
1.06 Transport	0.3	0.5	0.6	0.6	0.6	0.5	0.6	0.6	
1.07 Communication	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	
1.08 Science, Technology & Environment	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	
1.09 General Economic Services	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	
2. Social Services	**0.8**	**0.8**	**0.9**	**0.9**	**0.9**	**1.1**	**1.3**	**1.5**	
2.01 Education Art & Culture	0.2	0.2	0.3	0.3	0.3	0.3	0.4	0.5	
2.02 Health & Family Welfare	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	
2.03 Water Supply, Sanitation, Housing and Urban Development	0.2	0.2	0.2	0.3	0.3	0.2	0.3	0.3	
2.04 Information & Broadcasting	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
2.05 Welfare of SC/ST and other backward classes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
2.06 Labour & Labour Welfare	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
2.07 Social Welfare & Nutritution	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	
2.08 North Eastern Areas	...	...	...	...	...	0.2	0.2	0.2	
2.09 Other Social Services	...	...	...	...	...	0.0	0.0	0.0	
3. General Services	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	
Central Plan on Revenue account	1.6	1.6	1.8	2.0	1.9	1.9	2.3	2.7	
Central Plan on Capital account	0.6	0.6	0.8	0.7	0.7	0.7	0.7	0.6	
B. Central Assistance for State Plans	**1.7**	**1.6**	**1.7**	**1.7**	**1.8**	**1.6**	**1.0**	**1.0**	
C. Central Assistance to UT Plans	**0.1**	**0.1**	**0.1**	**0.1**	**0.0**	**0.0**	**0.0**	**0.1**	
Total-Central Assistance to States and UT Plans	**1.8**	**1.7**	**1.8**	**1.8**	**1.8**	**1.7**	**1.0**	**1.0**	**1.1**
On Revenue account	0.9	0.8	0.9	0.9	0.9	0.9	0.9	0.9	
On Capital account	0.9	0.9	0.9	0.9	0.9	0.7	0.1	0.1	
Grand total	**3.9**	**3.9**	**4.4**	**4.5**	**4.4**	**4.2**	**4.0**	**4.4**	**4.6**
On Revenue account	2.4	2.4	2.7	2.9	2.8	2.8	3.2	3.6	
On Capital account	1.5	1.5	1.7	1.6	1.6	1.4	0.8	0.7	

Source: Budget documents, Eleventh plan document, RBI, Man Financial research

Plan outlay as per Head of Development (YoY growth)

YoY growth (%)	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07BE	FY08E
A. Expenditure on Central Plan by Head of Development	**11.7**	**13.9**	**26.5**	**11.7**	**8.0**	**10.6**	**33.9**	**22.4**	**20.3**
1. Economic Services	9.8	17.0	33.7	12.5	6.3	-1.7	33.1	20.1	
1.01 Agriculture and Allied Activities	8.8	1.1	3.4	4.6	20.9	21.7	26.0	24.5	
1.02 Rural Development	-11.5	-14.2	40.4	91.5	2.2	-31.7	70.8	9.9	
1.03 Irrigation & Flood Control	231.9	-52.9	100.0	-56.2	8.6	76.1	18.1	40.4	
1.04 Energy	13.4	-16.8	30.7	-12.3	14.4	-12.6	8.2	73.2	
1.05 Industry & Minerals	-32.9	53.1	51.1	-34.9	2.2	14.3	33.0	19.8	
1.06 Transport	59.1	57.2	42.8	3.5	9.0	1.8	29.5	11.0	
1.07 Communication	32.0	109.9	-21.4	22.0	-61.0	-57.4	80.6	22.5	
1.08 Science, Technology & Environment	14.7	12.4	43.9	7.8	18.0	33.7	17.4	33.6	
1.09 General Economic Services	-10.4	14.0	15.0	36.4	15.6	75.5	15.4	12.7	
2. Social Services	14.4	8.6	16.3	9.2	10.7	36.8	35.1	25.3	
2.01 Education Art & Culture	9.9	10.3	15.3	15.1	14.3	25.0	47.5	37.0	
2.02 Health & Family Welfare	27.8	5.3	17.3	6.7	9.1	14.2	30.5	32.4	
2.03 Water Supply, Sanitation, Housing and Urban Development	9.9	10.9	22.1	13.9	17.1	1.6	22.4	5.7	
2.04 Information & Broadcasting	116.7	37.9	0.8	26.9	-31.5	-13.2	108.9	9.3	
2.05 Welfare of SC/ST and other backward classes	3.9	1.9	12.9	5.3	-2.1	8.8	20.6	19.1	
2.06 Labour & Labour Welfare	22.4	15.9	15.8	6.4	6.0	22.6	24.3	59.8	
2.07 Social Welfare & Nutritution	11.4	7.0	8.8	-9.5	-1.2	0.4	61.5	23.0	
2.08 North Eastern Areas	...	...	...	...	...	...	27.3	21.4	
2.09 Other Social Services	...	...	...	...	...	...	21.1	21.7	
3. General Services	19.0	32.5	-5.6	37.5	14.6	-65.8	12.2	37.3	
Central Plan on Revenue account	14.7	14.3	22.0	17.0	6.4	10.5	42.7	29.7	
Central Plan on Capital account	10.0	7.3	38.7	-0.9	12.4	10.6	10.6	-2.5	
B. Central Assistance for State Plans	**17.0**	**1.5**	**17.6**	**7.6**	**13.2**	**4.7**	**-30.9**	**11.1**	
C. Central Assistance to UT Plans	**15.3**	**15.8**	**-2.1**	**17.9**	**-12.1**	**5.5**	**5.1**	**69.7**	
Total-Central Assistance to States and UT Plans	**16.9**	**2.0**	**16.8**	**7.9**	**12.3**	**4.7**	**-29.9**	**13.4**	**25.6**
On Revenue account	18.5	-1.6	18.0	14.1	17.7	12.7	6.3	15.9	
On Capital account	15.5	5.3	15.8	2.4	6.9	-4.2	-77.0	-1.4	
Grand total	**14.0**	**8.5**	**22.4**	**10.2**	**9.7**	**8.2**	**8.7**	**20.1**	**21.7**
On Revenue account	15.5	9.1	20.7	16.1	9.9	11.3	30.5	25.9	
On Capital account	11.7	7.5	25.1	0.9	9.4	2.6	-33.8	-2.3	

Source: Budget documents, Eleventh plan document, RBI, Man Financial research

Financing of the fiscal deficit of the central government

	Internal finance					
(Rs crore)	Market borrowings	Other borrowings	Draw down of cash balances	Total	External finance	Total finance/Gross Fiscal deficit
1990-91	8,001	22,103	11,347	41,451	3,181	44,632
	(18)	(50)	(25)	(93)	(7)	(100)
1995-96	34,001	16,117	9,807	59,925	318	60,243
	(56)	(27)	(16)	(100)	(1)	(100)
2001-02	90,812	46,038	-1,496	1,35,354	5,601	1,40,955
	(64)	(33)	(-1.1)	(96)	(4)	(100)
2002-03	1,04,126	50,997	1,883	1,57,006	-11,934	1,45,072
	(72)	(35)	(1)	(108)	(-8.2)	(100)
2003-04	88,870	51,833	-3,942	1,36,761	-13,488	1,23,273
	(72)	(42)	(-3.2)	(111)	(-10.9)	(100)
2004-05	50,939	67,640	-8,130	1,10,449	14,753	1,25,202
	(41)	(54)	(-6.5)	(88)	(12)	(100)
2005-06 BE	1,03,791	34,557	3,140	1,41,488	9,656	1,51,144
	(69)	(23)	(2)	(94)	(6)	(100)
2005-06 RE	1,01,082	22,541	15,037	1,38,660	7,515	1,46,175
	(69)	(15)	(10)	(95)	(5)	(100)
2006-07 BE	1,13,778	26,584	0	1,40,362	8,324	1,48,686
	(77)	(18)	0	(94)	(6)	(100)

Source: Budget documents, RBI, Man Financial research

Financing of the fiscal deficit of the state government

	Market borrowings	Loans from centre	Loans against securities issued to NSSF	Loans from LIC, NABARD, NCDC etc	State Provident funds	Reserve funds	Deposits & Advances	Suspense & Miscellaneous	Remittances	Overall surplus (+)/ Deficit (-)	Others	Gross fiscal deficit
1990-91	2,556	9,978	-	241	2,488	1,120	1,670	376	-154	74	438	18,787
	(13.6)	*(53.1)*	-	*(1.3)*	*(13.2)*	*(6.0)*	*(8.9)*	*(2.0)*	*(-0.8)*	*(0.4)*	*(2.3)*	*(100.0)*
1995-96	5,888	14,801	-	635	4,201	2,101	2,947	3,096	-338	2,850	-4,754	31,426
	(18.7)	*(47.1)*	-	*(2.0)*	*(13.4)*	*(6.7)*	*(9.4)*	*(9.9)*	*(-1.1)*	*(9.1)*	*(-15.1)*	*(100.0)*
2000-01	12,519	8,396	32,606	4,550	10,846	3,099	7,136	2,355	1,032	2,346	4,647	89,532
	(14.0)	*(9.4)*	*(36.4)*	*(5.1)*	*(12.1)*	*(3.5)*	*(8.0)*	*(2.6)*	*(1.2)*	*(2.6)*	*(5.2)*	*(100.0)*
2001-02	17,249	10,974	35,648	6,285	7,977	4,521	4,996	-2,452	-427	-3,426	14,649	95,994
	(18.0)	*(11.4)*	*(37.1)*	*(6.5)*	*(8.3)*	*(4.7)*	*(5.2)*	*(-2.6)*	*(-0.4)*	*(-3.6)*	*(15.3)*	*(100.0)*
2002-03	28,484	-932	52,243	4,858	7,195	4,799	711	1,212	93	4,611	-1,151	1,02,123
	(27.9)	*(-0.9)*	*(51.2)*	*(4.8)*	*(7.0)*	*(4.7)*	*(0.7)*	*(1.2)*	*(0.1)*	*(4.5)*	*(-1.1)*	*(100.0)*
2003-04	47,286	14,117	20,813	4,132	7,122	6,377	-374	-5,429	1,850	-1,164	28,340	1,23,070
	(38.4)	*(11.5)*	*(16.9)*	*(3.4)*	*(5.8)*	*(5.2)*	*(-0.3)*	*(-4.4)*	*(1.5)*	*(-0.9)*	*(23.0)*	*(100.0)*
2004-05 P	32,910	-16,529	72,649	60	8,034	7,127	8,074	-10,649	1,240	651	5,689	1,09,256
	(30.1)	*(-15.1)*	*(66.5)*	*(0.1)*	*(7.4)*	*(6.5)*	*(7.4)*	*(-9.7)*	*(1.1)*	*(0.6)*	*(5.2)*	*(100.0)*
2005-06 RE	17,911	2,668	74,035	5,490	9,045	3,343	-558	-918	957	331	1,672	1,13,978
	(15.7)	*(2.3)*	*(65.0)*	*(4.8)*	*(7.9)*	*(2.9)*	*(-0.5)*	*(-0.8)*	*(0.8)*	*(0.3)*	*(1.5)*	*(100.0)*
2006-07 BE	22,235	5,135	56,623	7,133	8,233	4,365	-728	1,777	1,975	3,891	-4,745	1,05,895
	(21.0)	*(4.8)*	*(53.5)*	*(6.7)*	*(7.8)*	*(4.1)*	*(-0.7)*	*(1.7)*	*(1.9)*	*(3.7)*	*(-4.5)*	*(100.0)*

Source: Budget documents, RBI, Man Financial research

SECTORAL IMPACT

THE CRYSTAL BALL

POSITIVE

CAPITAL GOODS AND INFRASTRUCTURE

FMCG

OIL & GAS – POSITIVE FOR MARKETING AND UPSTREAM COMPANIES

PAINTS

NEUTRAL

AUTOMOBILES

BANKING

CEMENT

INFORMATION TECHNOLOGY

MEDIA

METALS

PETROCHEMICALS

TELECOM

NEGATIVE

CIGARETTES

AUTOMOBILES

Neutral

Stocks with positive budget impact – Nil

Likely Positive: Uniform excise duty of 16% on all passenger vehicles

Key proposals by SIAM in its Pre Budget Memorandum to Ministry of Finance

- Excise duty on all passenger vehicles including MUVs should be 16%. Small cars should be defined only on the basis of length. Fuel and engine capacity should not be included in definition. This is to remove the anomaly of higher excise duty on utility vehicles and cars, which are not defined as small cars.
- **Two and Three Wheelers:** Excise duty on two & three wheelers should be reduced to 8%
- **Utility Vehicles:** Rate of excise duty for motor vehicles having seating capacity up to 13 persons including driver when registered as maxi-cab (taxi) should be 16%.
- **Goods carriers:** Rate of excise duty for Motor vehicles for transport of goods fitted with petrol engine should be 16%.
- **Deduction under Income Tax on car loans:** A deduction similar to Housing loan should be granted for the car loans as this will lead to a growth in the passenger car segment.
- **Depreciation Rate** on Plant & Machinery to be increased from 15% to 25%.
- Motor Vehicle Depreciation to be raised from 15% to 25%.

Proposed Excise Duty Structure Excise duty %

Proposed Excise Duty Structure	Excise duty %	
	Current	Proposed
Passenger Vehicles		
Small Cars	16.3	16.3
Other Passenger Vehicles	24.5	16.3
UVS		
6-12 seater	24.5	16.3
>12 seater	16.3	16.3
Two/three wheelers	16.3	8.0
Commercial Vehicles		
Goods Carriers fitted with petrol engine	24.5	16.3

Source: Budget Documents

Customs duty

- The Government has already announced a cut in import duties on primary and Semi-finished metals from 7.5% to 5%.
- As OEMs are sourcing most of their components domestically, we believe that the duty cut would not have any significant impact on Auto Companies profitability.
- Auto component companies might have the respite for a short period as they could keep the benefit to themselves. In a longer run, OEMs will have better bargaining power with the component companies.
- Customs duty cut of mere 2.5% will not have any significant impact on the profitability but will make the sourcing of the components more competitive.

Research Associate
Prachi Kulkarni

BANKING

Neutral

Stocks with positive budget impact – ICICI Bank

Banking sector reforms are likely to surprise positively with the likely amendments in the Banking Regulation Act, 1949 allowing banks to raise capital by issue of preference shares and allowing foreign banks to acquire undercapitalized private sector banks, paving the way for the much-needed consolidation in the banking sector. However, we do not expect any major changes in the legal reforms in terms of relaxation of voting rights (cap @ 10%) in private banks or hiking the FII/FDI limit in the public sector banks. On the insurance sector front, we expect the FDI to be hiked to 49% from the existing 26%.

Tax sops to bank deposits – increasing the relative attractiveness as an investment vehicle

Credit growth (30.6%) in the economy continues to outpace deposit growth (23.1%). However, incremental deposit mobilization (in absolute terms) has exceeded the incremental credit disbursements in FY07E so far. Notwithstanding the higher interest rates (1-yr SBI deposit rate up by 200 bps in 2006), the higher deposit growth this fiscal may be partially attributed to the tax break awarded to the long term fixed deposits (in the corpus that forms the Rs 1,00,000 limit under Section 80C of the Income tax Act) in the last budget. However, we believe that the government might adopt either one or combination of the following alternatives for increasing the relative attractiveness of deposits further:

- Restoration of tax exemption on interest income up to Rs 15,000 under Section 80L
- Increase in ceiling for TDS on fixed deposits from Rs 5,000 to Rs 10,000
- Relaxation in the lock in period for savings under Section 80C from the current stipulated 5 yrs
- Exemption of interest income from savings bank deposits (might be of great help in garnering low-cost deposits)

Tax sops for trusts set up by ARCs - leading to faster recovery of NPAs

- Tax incentive for trusts set up by ARCs [exemption of entire income of trusts set up by ARCs) under Section 10(23) D]
- Tax incentive for banks contributing initial capital for setting up ARCs

Deduction for repayment of principal amount of housing loans – status quo to be maintained

The deduction for repayment of principal amount of housing loans up to Rs 100,000 under section 80C of the Income-Tax Act (amended in FY 2005-06) will be maintained

Legal reforms – Do not expect fireworks

There may be amendments to the Banking Regulation Act to include permission for banks to issue perpetual non-cumulative preference shares eligible for inclusion in Tier I capital and redeemable cumulative preference shares eligible for inclusion in Tier II capital. This will give banks an additional source to augment their capital base ahead of implementation of Basel II in March'08.

Consolidation is inevitable, but may face hiccups. We do not expect the proportionate voting rights to come through in case of the private sector banks. But, the government has indicated of allowing the foreign banks to take over undercapitalized private sector banks (ahead of RBI's proposed roadmap for opening up of the banking sector to foreign banks post FY09).

We do not expect the government to change its stance on maintaining a minimum 51% stake in Public Sector Banks. FDI / FII limit in Public Sector Banks is unlikely to be hiked from the current cap of 20%. Further, in case of SBI, the FDI / FII limit is unlikely to be hiked from the current cap of 20%

Analyst
Parthapratim Gupta

Capital Goods and Infrastructure

Positive

Stocks with positive budget impact – Siemens, Punj Lloyd, Patel Engineering, Thermax

Budget expectations

- Favorable budget is expected for infrastructure sector and related capital goods companies. Last budget has extended benefits to segments like Road, Power etc along with capital goods companies servicing power sector.
- Infrastructure investments of $350bn are envisaged over next five years. For this to succeed a lot is needed on the debt market reform side. We expect this budget to initiate reforms on this front.

Macro aspects

Excise duty

- We expect excise duty on raw materials and machinery to remain unchanged at 16%.

Customs duty

- During January'07 government reduced customs duty to 7.5% from 12.5%. On aluminum, copper, zinc and steel alloys has been further reduced to 5% from 7.5%. This we expect will benefit many companies importing raw materials. The duty on tubes, pipes and fittings of copper, aluminum or zinc to 7.5 % from 12.5 %. The duty on halogens, sulphur, carbon and hydrogen etc. are down to 5 % from 10 %, while Portland cement is completely exempt from duty. We don't expect any further change here.
- Latest duty cuts on capital goods are quite significant with many entries in Chapters 84, 85 and 90 of the Customs tariff will now attract 7.5 % duty instead of the present 12.5 %. During last budget the peak duty for many capital goods has been brought down to 10% from 12.5%.
- The duty rate under Project Imports under the Customs Tariff (98.01) has been brought down to 7.5 % from 10 % in the January move.
- Cement customs duty has been reduced to nil from 12.5% to contain the cement prices through imports. But the financial viability of this option is still not known.
- The positive move has already been made ahead of the budget so no great change is expected in budget.

Corporate tax

- Any cut in the tax rate will benefit capital goods companies as most of them are paying full corporate tax.
- Tax sops under section 80 IA are most likely to be extended till 2012.
- The 80IA benefit could be extended to project other than UMPP based on capacity in wind, Bio-mass and Hydro Space.

Micro aspects

Power sector

- The 80IA benefits given to the ultra mega power projects could be extended to the other segments like hydro benefiting the growth of the sector and the power equipment suppliers. This could benefit companies like BHEL, Siemens, Alstom and the civil construction companies.
- Allocation of coal blocks to power producers has been initiated during the last budget to mitigate the coal shortage for power generation. Further initiatives on the same can be expected during the budget.

Road sector

- Last budget allocation for NHDP has been increased from Rs 93.2bn in FY05-06 to FY06-07 99.5bn. We expect it to increase further.
- During last budget the restructuring of NHAI has been proposed. This has been done during the year. We could see some more initiatives on this front.
- Urban infrastructure, Ports and water and irrigation segments of infrastructure are expected to see further boost during the budget.

Analyst
Abhijeet Dakshikar

CEMENT

Neutral

Stocks with positive budget impact - Nil

Budget expectations

The import duty on cement has been brought down from 12.5% to NIL. While we do not expect a major threat to cement prices from the duty cut, we believe that more negative news for cement manufacturers is unlikely in the forthcoming budget. CMA has made a strong case for the Government continuing with the specific rate of excise duty on cement as against an imposition of Ad-valorem system. We believe that imposition of Ad-valorem system is unlikely as this could result in further cascading effect on cement price inflation.

Likely Positive: Duty cut in pet-coke prices.
Likely Negative: Increase in excise duty or imposition of Ad-valorem system vs. specific rate currently.

Key proposals from Industry Associations:

Excise

- **Reduction of excise duty on cement:** Cement Manufacturers' Association (CMA) has demanded for a reduction in excise duty (currently at Rs408/tonne). We believe that such a move is unlikely given the current high margins enjoyed by cement companies.

Customs duty

- **Abolishment of Import Duty on Pet Coke:** CMA has demanded for a reduction in import duty on pet coke. Customs duty on pet coke was reduced from 20% to 10% in the previous budget.

Analyst
Shobhit Khare

CIGARETTES

Negative

Stocks with negative budget impact - ITC

Budget expectations

- The specific excise duty structure to be maintained
- Additional excise might be replaced/reduced if VAT is implemented
- Upto 5% increase in excise duty

Excise duty

Raw materials

- Excise duty on cigarette is the key, raw materials are insignificant from this angle Gross margins in cigarette are very high and hence any change in excise duty on the raw materials are unlikely to make any impact on the profitability.

Finished goods

- The specific excise duty structure to be maintained: We believe that this arrangement works the best, as has been upheld by many Finance Commissions as well in the past. We do not see any change to it. However, there could be some confusion if VAT is implemented. VAT, by its very definition, levies taxes on value addition. We believe that even VAT rates would be based on cigarette lengths, with an implicit correlation with MRP.
- Additional excise might be replaced/reduced if VAT is implemented: We believe that it would be illogical to retain AED along with VAT. Even if the government wants additional revenue, having two separate tax heads would not serve any better than having just one with higher rates. Also, beyond a certain point, there is an adverse impact on total tax collected. Also, the logic behind bringing in AED was to collect tax on behalf of the States. Since states would anyway collect VAT directly, there would be no reason why the Centre should also continue with AED.
- Upto 5% increase in excise duty, excise duty on filter premium cigarettes might increase at higher rate: Barring FY04 and FY05, excise duties have been raised every year. However, if VAT were to be implemented with rates that impact more than5% of MRP, we might not see any excise hike this year.

Customs duty

Raw materials

- Not significant

Finished goods

- Custom duty at 30.6% likely to be maintained. Despite the industry clamouring to reduce duty free import for personal consumption (within limits) and take measures to reduce the gray market of imported cigarettes, there is unlikely to be any change.

Freight

- Goods are generally transported by road, freight rates are 2-2.5% of net sales, No significant impact

Power and fuel

- Not significant, as manufacturing costs are low.

Corporate tax

The sector pays taxes at the marginal tax rate, no change likely in tax rates, reduction in surcharge if happens, will benefit the industry

Duty structure

Excise per 1000 sticks	Excise duty		Customs duty	
%	05-06	06-07	05-06	06-07
> 85 mm	2,000	1,645	30.6	30.0
75-85 mm	1,627	1,340	30.6	30.0
70-75mm	1,224	1,005	30.6	30.0
< 70 mm	754	620	30.6	30.0
60-70 mm	505	415	30.6	30.0
< 60 mm	153	125	30.6	30.0

Source: Budget Documents

Analyst
Shishir Manuj

FMCG

Positive

Stocks with positive budget impact – HLL

We expect Agri-processing industry to get infrastructure status in the budget. Sops inherent in IT section 10(23)A may be given. This will boost sentiment for FMCG stocks specifically for stocks like ITC, HLL, Nestle, and wine industry players like Champagne Indage. Rice processors, Solvent extractors, Jain irrigation, Finolex pipes, Kirloskar pumps and Godrej Industries may also benefit.

Budget expectations

- Increase in abatement rate of excise on shampoos, Toothpaste, Soaps and Detergents.
- Increase in infrastructure spending and employment generation measures in rural India, which would increase affordability and boost demand
- Tax breaks and incentives for setting up of Agro and food processing industries

Excise duty

Raw materials

- No major changes likely. Some Food products which were not included in the lower excise duty structure last year, might get some break

Finished goods

- Abatement rate on a few home and personal care products might be increased: The industry expects this to help reduce the cost to the consumer helping increase the penetration and per capita consumption of these consumer goods. However, we believe that likelihood of these being met has declined in the recent past with crude oil led inflation lowering. The argument that the abatement does not reflect the cost of production has been weakened by the recent decline in crude oil price.

Customs duty

Raw materials

- No changes likely this year

Finished goods

- No changes likely

Freight

- Likely decline in diesel prices offsets higher cost of transportation for the companies who set up units in backward areas for tax benefits, as the freight rates there are high

Power and fuel

- No significant impact

Corporate tax

- Reduction in tax surcharge will be beneficial for the sector as the companies have been paying highest rate of taxation, but for units in backward areas

Duty structure

	Excise duty		Customs duty		Abatement rate	
%	05-06	06-07	05-06	06-07	05-06	06-07
Hair oils	16.3	16.3	20.4	15.3	40.0	40.0
Skin care	16.3	16.3	15.3	13.6	40.0	40.0
Deo's and anti -perspirants	16.3	16.3	15.3	13.6	40.0	40.0
Shaving products	16.3	16.3	15.3	13.6	40.0	40.0
Shampoos	16.3	16.3	20.4	15.3	40.0	40.0
Toothpastes	16.3	16.3	20.4	15.3	35.0	35.0
Toilet Soaps	16.3	16.3	20.4	15.3	35.0	35.0
Detergents	16.3	16.3	20.4	15.3	35.0	35.0
Laundry Soaps	16.3	16.3	20.4	15.3	35.0	35.0
Caustic Soda	16.3	16.3	15.3	10.2		
Linear Alkyl Benzene	16.3	16.3	15.3	12.8		
Tea (CTC)	0.0	0.0	102.0	102.0		
Instant Tea	16.3	16.3	30.6	30.6		
Coffee (Arabica Cherry)	0.0	0.0	102.0	102.0		
Coffee (Robusta Parchment)	0.0	0.0	102.0	102.0		
Instant Coffee	16.3	16.3	30.6	30.6		

Source: Budget Documents

Analyst
Shishir Manuj

INFORMATION TECHNOLOGY

Neutral

Stocks with positive budget impact – HCL Infosystems

Budget expectation

- **Concessions to SEZs to be extended to STPs:** The concessions given to software exports from special economic zones (SEZs) should be extended to software technology parks (STPs). This will play an important role in the future planning of software companies especially small and medium size, since the STP scheme is coming to a close in 2009.
- **Clarity in the definition of export turnover:** Export turnover to include the earlier exclusions of freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses.
- **Service Tax on maintenance of software:** The withdrawal of the service tax on the maintenance or repair of software would positively impact net margins and reduce procedural issues.

Custom duty

Customs duty on ITA items 1 and 2 has been reduced to 0% and a countervailing duty of 4% was imposed in the previous budget. The duty has been reduced inline with the Information Technology Agreement and further change in the custom duty is unlikely.

Corporate tax

Continuation of tax benefits under Section 10A / 10B until 2009

Duty structure

	Customs		Excise	
(%)	2005-06	2006-07	2005-06	2006-07
Application and system software	0.0	0.0	0.0	8.2
Computers accessories (excluding PPCBs)	0.0	0.0	16.3	16.3
Computers and peripherals	0.0	0.0	0.0	12.2
Monitor, keyboard, mouse, printer	0.0	0.0	16.3	0.0
FDD, HDD, CD-ROM drive and other storage drives	0.0	0.0	0.0	0.0
Ink cartridges with print head assembly	0.0	0.0	16.3	16.3
Integrated circuits and micro assemblies	0.0	0.0	16.3	16.3
Microprocessors	0.0	0.0	0.0	0.0
Routers and other networking equipment	0.0	0.0	16.3	16.3
Other units of automatic data processing machines	0.0	0.0	8.2	8.2
Storage devices	0.0	0.0	16.3	16.3
Computer parts other than ink cartridges, PPCBs, motherboards	0.0	0.0	16.3	16.3
Digital video disc drive CDs & CD writers	0.0	0.0	16.3	16.3
Speakers	15.3	15.3	16.3	16.3
Printed circuits (PPCBs)	0.0	0.0	16.3	16.3
Key switches for key boards	0.0	0.0	16.3	16.3
Others, including modems, routers, ISDN terminals, etc	0.0	0.0	16.3	16.3

Source: Budget Documents

Analyst
Nimesh Mistry

MEDIA
Neutral

Budget expectations
- There is scope to bring-in parity between service tax rates levied on advertisement for the broadcasting media and the print media. Broadcasting media attracts a service tax of 12.24% while it is nil for the print media.
- No change expected in excise duties and customs duty in Set Top and other broadcasting equipments.

Service Tax
- Broadcasting media pays a service tax of 12.24% while it is nil for print media. Given the Govt.'s thrust to increase the number of services under the service tax bracket we do not expect any reduction in rates for the broadcasting industry.

Excise duty
Set Top Box
- FY07 budget levied an excise duty of 16% in Set Top Boxes, which increased the prices marginally. No change expected.

Broadcasting Equipment
- 16% excise duty has been levied which is not expected to change.

Customs duty
Set Top Box
- FY07 budget reduced customs duty on Set Top Box to Nil and expected to be maintained.

Broadcasting Equipments
- Broadcasting equipment governs a customs duty of 12.5%, which is not expected to change.

Fringe Benefit Tax
- Valued at 5% of the expenditure and not expected to change.

Entertainment Tax
- It is a State level affair and not covered in the budget.

Duty structure

	Excise duty		Customs duty	
%	05-06	06-07	05-06	06-07
Set Top Box	16	16	0	0
Broadcasting Equipments	16	16	12.5	12.5

Source: CBEC

Analyst
Vinod Nair

METALS

Neutral

Budget expectations

- Duties on a whole host of items were reduced on January 23, 2007, therefore, going forward we expect no further reduction in duties. The list of items where duties were reduced are as follows:
  - Ferroalloys stainless steel and other alloy steel to 5 % from 7.5 %
  - Calcined alumina to 5 % from 7.5 %
  - Pipes of aluminum, copper and zinc to 7.5 % from 12.5 %
  - Refractories to 5 % from 7.5 %
  - Specified raw materials of refractories to 5 % from 10.75 %
  - Primary and semi-finished forms of copper, aluminum, zinc, tins other base metals were reduced to 5 % from 7.5 %.
- Duties on steel currently stand at 5%, we expect no change in the present duty structures
- No changes in excise duties are expected for aluminium, copper and steel.

Excise duty

Raw materials

- The raw materials for copper is the concentrate which does not carry any excise, similarly for aluminium it is bauxite and for steel it is iron ore both of which do not have any excise duties.

Finished goods

- Copper and aluminium excise duties are presently at 16% for which we expect should be maintained.
- Steel excise duties are presently at 16%, which we expect to remain unchanged.

Customs duty

Raw materials

- Copper concentrates which are major import item for the copper smelting industry presently carry an import duty of 5%, which we expect to be maintained in order to keep the duty differential intact at 5%.
- Excise duty on coking coal with ash content below 12% and non-coking coal and met coke is already at 5% and for refractories is at 10% for which expect no change in the forthcoming budget.

Finished goods

- Steel duties are already at extremely low levels of 5% leaving very little scope for further reduction.

Power and fuel

- Aluminium producers have power plants situated at pitheads and procure limited amount of coal from open markets for which duties are already at low levels from which we do not expect any further reduction.

Corporate tax

- Most companies are paying full corporate tax rate hence any reduction would be earnings accretive.

Duty structure

	Excise duty		Customs duty	
%	06-07	07-08	06-07	07-08
Copper concentrate	NA	NA	5	5
Copper	16	16	7.5	5
Aluminium	16	16	7.5	5
Steel	16	16	5	5

Source: Budget Documents

Duty structure

	Excise Duty 06-07	Custom Duty 06-07
Lime Stone	NA	5.00
Lime Stone (Silica <0.6)	NA	5.0
Pellet	16.0	2.0
Coking Coal (Ash < 12%)	NA	NA
Coking Coal (Ash > 12%)	NA	5.0
Met Coke*	NA	5.0
Non Coking Coal	NA	12.5
Rolling Oil	16.0	12.5
Refractories	16.0	7.5
Melting Scrap	16.0	5.0
S. S. Scrap	16.0	5.0
M. S. Slab	16.0	5.0
H. R. Coil (Prime)	16.0	5.0
H. R. Coil (Second & Defective)	16.0	20.0
C. R. Coil	16.0	5.0
C. R. sheet	16.0	5.0

Source: Budget Documents

Analyst
Rahul Jain

OIL & GAS

Positive for marketing and upstream companies

Top Picks: ONGC, HPCL, BPCL, IOC

Budget expectations

- Rationalization of excise duty structure is likely to be the focal point for the sector in the forthcoming budget. Finance Minister may bring in some of the recommendations made by Rangarajan committee on petroleum product pricing last year.
- Government is likely to continue with the policy of providing subsidy on domestic LPG and PDS kerosene.
- Steps towards dual pricing policy for LPG and kerosene may be announced, which will reduce the subsidy burden on oil marketing companies.
- Infrastructure status likely to be granted to exploration & production and pipeline projects

Excise duty

Raw materials

- Crude oil and natural gas are key raw materials, on which no excise duty is applicable.

Finished goods

- Significant changes in additional excise duty structure for MS and HSD can be expected.
- There could be cut in excise duty on naphtha and fuel oil from the current level of 16%
- Zero excise duty on LPG and SKO are likely to continue.

Customs duty

Raw materials

- Custom duty on crude oil is unlikely to be cut from the current level of 5%.

Finished goods

- Customs duty on MS and HSD attract rate of 7.5%, which would be cut in future to remove the duty differential against crude oil. However, we may not see it happening this year and could be delayed
- There could be reduction in duty on other petroleum products which currently attract rate of 10%, such as ATF, LDO, FO, etc

Cess

- Cess on petrol, diesel and crude oil production is likely to remain unchanged.

Corporate tax

- The sector pays taxes at the marginal tax rate, no change likely in tax rates, reduction in surcharge if happens, will benefit the industry
- Income tax benefit under S. 10 (23G) and S 80 IA could be granted to the exploration & production and gas pipeline projects as a part of the infrastructure status.

Duty structure

%	Excise duty		Customs duty	
	05-06'	06-07'	05-06'	06-07'
Motor Spirit*	8.2	8.2	10.2	7.7
High Speed Diesel**	8.2	8.2	10.2	7.7
SKO (Domestic Use)	0.0	0.0	0.0	0.0
SKO (Industrial Use)	0.0	0.0	10.2	10.2
LPG (Domestic Use)	0.0	0.0	0.0	0.0
LPG (Industrial Use)	0.0	0.0	5.1	5.1
ATF	8.2	8.2	10.2	10.2
Furnace Oil	16.3	16.3	10.2	10.2
Naphtha – fertilizers	0.0	0.0	0.0	0.0
Naphtha – petrochemicals	16.3	16.3	5.1	0.0
Naphtha – others	16.3	16.3	5.1	5.1
Crude Oil	0.0	0.0	5.1	5.1
Natural Gas	0.0	0.0	10.2	5.1
LNG	0.0	0.0	5.1	5.1
CNG	16.3	16.3	0.0	0.0

Source: Budget Documents
* Custom duty revised w.e.f. 14.06.06. Attracts additional excise duty of Rs 11/ltr plus road cess of Rs 2/ltr
** Custom duty revised w.e.f. 14.06.06. Attracts additional excise duty of Rs 1.25/ltr plus road cess of Rs 2/ltr

Analyst
Mandar Pawar

PAINTS

Positive

Stocks with positive budget impact - Asian Paints

Budget expectations

- No change expected in excise
- Customs duty on raw materials might be brought down
- Removal of principal payment on housing loans from section 88 of income tax act, individuals might get additional Rs. 100000 rebate
- Additional thrust on infrastructure development

Excise duty

Raw materials

- No change expected in excise duty on raw materials

Finished goods

- No change likely in excise duty

Customs duty

Raw materials

- Customs duty on some raw material could be cut marginally. There has been some disconnect of late between the import price and the domestic prices. Such reduction in import duty will help maintain parity.

Finished goods

- No significant change expected

Freight

- Freight sensitive, increase in diesel prices to increase the transportation costs

Power and fuel

- No significant change likely

Corporate tax

- All major companies are paying taxes at the nominal rate, any reduction there could boost profits

Duty structure

	Excise duty		Customs duty	
%	05-06	06-07	05-06	06-07
Paints	16.3	16.3	15.3	12.8
Dyes	16.3	16.3	15.3	12.8
Varnishes	16.3	16.3	15.3	12.8
Inks	16.3	16.3	15.3	12.8
Orthoxylene	16.3	16.3	15.3	12.8
Phthalic Anhydride	16.3	16.3	15.3	12.8
Titanium Dioxide	16.3	16.3	15.3	12.8

Source: Budget Documents

Analyst
Shishir Manuj

PETROCHEMICALS

Neutral

Budget expectations

- Indian petrochemicals industry is facing stiff competition from Middle East, which is expected to increase further. Customs duty protection for major petrochemical products is most likely to continue.

Excise duty

Raw materials

- Scope for cut in excise duty on naphtha.
- Other key raw material i.e. natural gas carries no excise duty.

Finished goods

- Excise duty on MEG could be further cut to 8% from 12% at present

Customs duty

Raw materials

- Naphtha for petrochemical production carry zero customs duty and is likely to be maintained

Finished goods

- No cut from current duty rate is expected for the major products.

Corporate tax

- The sector pays taxes at the marginal tax rate, no change likely in tax rates, reduction in surcharge if happens, will benefit the industry

Duty structure

	Excise duty		Customs duty	
%	05-06'	06-07'	05-06'	06-07'
hdPE, ldPE, lldPE	16.3	16.3	10.2	5.1
Polypropylene	16.3	16.3	10.2	5.1
PVC	16.3	16.3	10.2	5.1
PS	16.3	16.3	10.2	5.1
ABS	16.3	16.3	10.2	5.1
Ethylene	16.3	16.3	5.1	5.1
Propylene	16.3	16.3	5.1	5.1
Styrene	16.3	16.3	5.1	2.0
POY	16.3	8.2	15.3	10.2
PSF	16.3	8.2	15.3	10.2
PX	16.3	16.3	5.1	2.0
PTA	16.3	8.2	15.3	10.2
DMT	16.3	8.2	15.3	10.2
MEG	16.3	12.2	15.3	10.2

Analyst
Mandar Pawar

TELECOM

Neutral

Likely Positive

- Lowering of revenue sharing license fee from 6-10% circle wise to a uniform 6% across the country. To result in ~2-3% cost savings for operators, but likely to be passed on.

Likely Negative

- Increase in Service tax: slightly negative, No direct impact on revenues

Key proposals from Industry associations

- **Reduction in revenue license fee for wireless operators from 6-10% of AGR to 6%:** License fee currently stands at 10% of Adjusted Gross Revenues for Metros and A circles, 8% for B circles and 6% for C Circles. Industry associations have been demanding for a uniform 6% licence fee in line with that levied on NLD and ILD services

- **Removal of additional duty of 4% on handsets**: To bring down further the handset prices. Positive for market growth.

- **Full 10 year tax exemption under 80IA vs. 5 year currently:** Long drawn demand from telecom operators; unlikely to fructify.

Service tax

- Likely to increase, negative for telecom operators

Customs duty

- Removal of additional duty of 4% on handsets

Corporate tax

- Demand for full 10-year tax exemption under 80IA vs. 5-year currently. Unlikely in the fact of Government's intent of reducing tax exemptions.

Analyst
Shobhit Khare

Gangadhara Kini	**Head – Institutional Equities**	**91-22-6667 9752**	**gangadhara.kini@manfinancial.in**
Vasudeo Joshi	**Head – Institutional Equity Research**	**91-22-6667 9754**	**vasudeo.joshi@manfinancial.in**
Jignesh Shah	**Head – Equity Derivatives**	**91-22-6667 9735**	**jignesh.shah@manfinancial.in**

Equity Research

Abhijeet Dakshikar	Engineering, Construction & Power	91-22-6667 9963	abhijeet.dakshikar@manfinancial.in
Anjali Verma	Economist	91-22-6667 9969	anjali.verma@manfinancial.in
Mandar Pawar	Oil & Gas	91-22-6667 9987	mandar.pawar@manfinancial.in
Nimesh Mistry	IT Services	91-22-6667 9768	nimesh.mistry@manfinancial.in
Parthapratim Gupta	Financial Services	91-22-6667 9962	parthapratim.gupta@manfinancial.in
Rahul Jain	Metals	91-22-6667 9758	rahul.jain@manfinancial.in
Shishir Manuj	FMCG & Retail	91-22-6667 9759	shishir.manuj@manfinancial.in
Shobhit Khare	Telecom & Cement	91-22-6667 9974	shobhit.khare@manfinancial.in
Vinod Nair	Media	91-22-6667 9766	vinod.nair@manfinancial.in
Aravind Manickam	Research Associate	91-22-6667 9992	aravind.manickam@manfinancial.in
Chaturya Tipnis	Research Associate	91-22-6667 9764	chaturya.tipnis@manfinancial.in
Manik Taneja	Research Associate	91-22-6667 9986	manik.taneja@manfinancial.in
Prachi Kulkarni	Research Associate	91-22-6667 9966	prachi.kulkarni@manfinancial.in
Rupesh Sonawale	Research Associate	91-22-6667 9769	rupesh.sonawale@manfinancial.in
Shridatta Bhandwaldar	Research Associate	91-22-6667 9965	shridatta.bhandwaldar@manfinancial.in
Vaibhav Agarwal	Research Associate	91-22-6667 9967	vaibhav.agarwal@manfinancial.in
Pankaj Kadu	Database Analyst	91-22-6667 9972	pankaj.kadu@manfinancial.in
Ganesh Deorukhkar	Production	91-22-6667 9756	ganesh.deorukhkar@manfinancial.in

Institutional Cash Equity Sales

Vijay Baoney	Senior Vice President	91-22-6667 9753	vijay.baoney@manfinancial.in
Sweta Ganguly	Asst. Vice President	91-22-6667 9973	sweta.ganguly@manfinancial.in
Smitesh Sheth	Asst. Vice President	91-22-6667 9991	smitesh.sheth@manfinancial.in
Roshan Sony	Asst. Vice President	91-22-6667 9964	roshan.sony@manfinancial.in
Sajid Khalid (UK)	Equity Sales	44-20-7144 5246	skhalid@mansecurities.com

Institutional Cash Equity Sales Trading

Suketu Parekh	Sales Trader	91-22-6667 9746	suketu.parekh@manfinancial.in
Chetan Savla	Sales Trader	91-22-6667 9749	chetan.savla@manfinancial.in

Institutional Cash Equity Dealing

Chetan Babaria	Dealer	91-22-6667 9749	chetan.babaria@manfinancial.in
Rajesh Ashar	Dealer	91-22-6667 9748	rajesh.ashar@manfinancial.in
Bhavin Shah	Dealer	91-22-6667 9749	bhavin.shah@manfinancial.in

Man Financial Sify Securities India Pvt Ltd

This report is issued by Man Financial Sify Securities India Pvt Limited, is authorised and regulated by SEBI. Man Financial Sify Securities India Pvt Ltd is a member of the Man Group. References to "MFSSIPL" in this report shall mean Man Financial Sify Securities India Pvt Limited unless otherwise stated. The report was prepared and distributed by MFSSIPL for information purposes only. The report should not be construed as solicitation nor as offering advice for the purposes of the purchase or sale of any security, investment or derivative. The information and opinions contained in the Report were considered by MFSSIPL to be valid when published. The report also contains information provided to MFSSIPL by third parties. The source of such information will usually be disclosed in the report. Whilst MFSSIPL has taken all reasonable steps to ensure this information is correct, MFSSIPL does not offer any warranty as to the accuracy or completeness of such information. Any person placing reliance on the report to undertake trading does so entirely at his or her own risk and MFSSIPL does not accept any liability as a result. Securities and Derivatives markets may be subject to rapid and unexpected price movements and past performance is not necessarily a guide to future performance. Man Financial Sify Securities India Pvt Limited. 2nd Floor, C-Block, Modern Centre, Mahalaxmi, Mumbai-400 011. To be removed from future MFSSI e-mail updates, including rate offers, simply reply to this e-mail and enter, "REMOVE FROM E-MAIL LIST" on the subject line. CUSTOMERS PLEASE NOTE: When unsubscribing, unless you specifically request not to, you will CONTINUE to receive your statements electronically if you already do so.

MFSSIPL Disclaimer

This Document is for private circulation and for information purposes only. It does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may receive this report. Investors should seek financial advice regarding the appropriateness of investing in any securities or investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. In no circumstances it be used or considered as an offer to sell or a solicitation of any offer to buy or sell the Securities mentioned in it. We and our affiliates, officers, directors, and employees world wide, including persons involved in the preparation or issuance of this material may; (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company (ies) discussed herein or act as advisor or lender / borrower to such company(ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. The same persons may have acted upon the information contained here. The information contained in the research reports may have been taken from trade and statistical services and other sources, which we believe are reliable. Man Financial -Sify or any of its group companies do not guarantee that such information is accurate or complete and it should not be relied upon as such. Any opinions expressed reflect judgments at this date and are subject to change without notice.
Caution: Risk of loss in trading in can be substantial. You should carefully consider whether trading is appropriate for you in light of your experience, objectives, financial resources and other relevant circumstances.