RBI Monetary Measures & Fiscal Stimulus package update

After the RBI's move to effect changes in the Repo rates on the weekend, the government followed this up with a Rs 30,700-crore fiscal stimulus package mainly comprising additional spending and excise duty cuts aimed at boosting consumption, and steering the economy away from a painful slowdown. The government's fiscal package, announced a day after the central bank cut the Repo and Reverse Repo rates, has Rs 20,000 crore as additional expenditure, an across-the-board 4% excise duty cut amounting to Rs 8,700 crore and benefits worth Rs 2,000 crore for exporters.

Highlights of the Monetary Measures announced by RBI –

Reverse Repo and Repo rates, both have been cut by 100 bps each from 6% to 5% and from 7.5% to 6.5% respectively which essentially means lower return for Banks parking there money with RBI instead of lending to corporates.

SIDBI and NHB are also being given liquidity support to the extent of Rs.7000 crores and Rs.4000 crores to provide liquidity support both SME segment as well as Housing Finance companies. SIDBI would also help apart from SMEs, NBFCs and State Financial Corporates in terms of meeting their liquidity requirements.

FCCBs are now being allowed to be bought back by Indian Corporates, out of their own dollar resources raised through ECB or FCCB. It has now decided to permit premature buyback of FCCBs from their customers. For buyback of FCCBs out of rupee resources there is a minimum discount of 25% on the book value. The amount of the buyback is limited to US $50 mn of the redemption value per company wherein this window will be kept open till March 09.

This in essence should bring back the confidence among global investors partially, thus bringing down the substantial discount to the maturity value. This discount was in excess of the merit of these issuers during the last two months due to credit aversion in the global market.

Loans granted to HFCs to fund less than Rs.20 lacs of housing dwelling units, would be classified under the priority sector lending.

RBI has announced, as a one time measure, that the second restructuring by banks of exposures (other than exposures to commercial real estate, capital market exposures and personal/ consumer loans) up to June 30, 2009, will also be eligible for exceptional regulatory treatment.

The interest rate on Post-shipment Rupee Export Credit up to 180 days will not exceed BPLR minus 2.5 percentage points. This interest rate will also be applicable for overdue bills. In respect of overdue bills up to 180 days from the date of advance.

Highlights of the Governments Stimulus Package –

Ad Valorem Cenvat Rate Cuts

The Ad valorem Cenvat Rate Cut of 4% will be across-the-board which will be in effect till 31st March 2009 on all products other than petroleum and those other products where the current rate is less than 4%.

The revised Cenvat slabs will be 4 per cent, 8per cent and 10 percent for most manufactured products. Cenvat on big cars is being cut to 20 percent on value from 24 percent earlier. Cenvat on cement has been cut by 2 percentage points to 10 percent or 280 rupees per 1,000 kilogram, which ever is higher. Cenvat on cotton textiles cut to nil from 4 percent earlier

Export oriented measures

- An interest subvention of 2% subject to minimum rate of interest of 7% per annum will be provided for Pre and post-shipment export credit for labor intensive exports, such as for textiles (including handlooms, carpets and handicrafts), leather, gems & jewellery, marine products and SME sector
- Additional funds of Rs.1100crore will be provided to ensure full refund of Terminal Excise duty/CST.
- An additional allocation for export incentive schemes of Rs.350cr will be made
- Government back-up guarantee will be made available to ECGC to the extent of Rs.350cr
- Exporters will be allowed refund of service tax on foreign agent commissions of up to 10% of FOB value of exports

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Sector Specific measures

Metal Industry

Ad-valorem export duty on iron ore - Export duty on iron ore fines will be eliminated from earlier 8% and on lumps will be reduced by 10% to 5%.

Power Industry

Import duty on Naphta - Import Duty on Naphtha for use in the power generation will be eliminated from earlier 5%.

Infrastructure Industry

Infrastructure Financing - Government has authorized the IIFCL to raise Rs.10000 crore through tax-free bonds by 31st March 2009 which will be used to refinance bank lending of longer maturity to projects particularly in highways and port sectors.

Housing Industry

RBI will be putting in place a refinance facility of Rs.4000cr for the National Housing Bank. Incentives for loans on housing for up to Rs.500000, and up to Rs.2 million will be provided

Textiles Industry

An additional allocation of Rs.1400cr will be made to clear the entire backlog in TUF Scheme. All items of handicrafts will be included under 'Vishesh Krishi & Gram Udyog Yojana'.

Medium, small and micro enterprises (MSMEs) Sector

RBI has announced a refinance facility of Rs.7000cr for SIDBI which will be available to support incremental lending, either directly to MSMEs or indirectly via banks, NBFCs and SFCs -

Current guarantee cover under Credit Guarantee Scheme for Micro and Small enterprises on loans will be extended from Rs.50lakhs to Rs.1cr with guarantee cover of 50%.

The lock in period for loans covered under the existing credit guarantee scheme will be reduced from 24 to 18 months

Government will issue an advisory to Central Public Sector Enterprises and request State Public Sector Enterprises to ensure prompt payment of bills of MSMEs.

The government is planning to seek approval for extra spending worth 200 billion rupees ($4 billion) for the remainder of the fiscal year as part of a plan to boost the economy and help it counter the global slowdown. Total spending in the balance four months of 2008/09 fiscal year to March 31 is expected to be 3 trillion rupees. This total includes planned and current expenditure, already in the 2008/09 budget, as well as the additional spending being sought. Going ahead the Indian economy will continue to need stimulus in FY2010 also and this can be achieved by substantial increase in budget spending for next year. We view the RBI measures as positive wherein short term interest rates, especially, 1- 2 year would drop further on the basis of increase in liquidity in the system. The credit environment should improve significantly thus avoiding major defaults or concerns on credit quality although it is going to be slow recovery for the real estate sector in the short term.

We believe that while the governments stimulus package is a positive development and was keenly awaited, however we think in terms of fiscal measures this seems to be a 'sniper' and not a 'shotgun' approach. On the whole this package is geared towards helping producers especially the export sector to tide over the difficult time of the global credit crunch. However these export measures may only minimise some of the pain as global demand continues to be weak, and hence these measures will not be enough to undo the damage fully.

In case of infrastructure, the requirements are enormous. Against that, the amount provided is not much. The public sector is not in a position to do anything and the private sector has turned risk averse. Further it will take some time for the money to be actually lent. Hence on the whole while this package is welcome, a lot remains to be done. Some of the key sectors which are benefited partially from these measures include Auto's, Real Estate, Construction and Metals. We give a first cut view on the broad impact on these sectors from this stimulus package.

- Reliance Money Research Team

Fiscal Package Imapct

Automobile Sector

Impact of fiscal package on Automobile sector

Excise duty on automobiles cut by 4%

The Government of India has taken measures like reduction in Cenvat which will have definite positive impact on longterm automobile sector. The Cenvat has been cut by 4% in the ad valorem Cenvat rate will be effected for the balance part of the current financial year on all products other than petroleum and those where the current rate is less than 4%. Due to cut in Cenvat the new excise duty structure for automobile segments is likely to be as follows –

Segment	ED Pre-Budget 2008	ED Post-Budget 2008	ED Post June 2008	ED from Dec 2008
Two Wheeler	16%	12%	12%	8%
Three Wheeler	16%	12%	12%	8%
Small Cars	16%	12%	12%	8%
Hybrid Cars	24%	14%	14%	10%
Electric Cars	8%	-	-	-
Cars (1500cc-1999cc)*	24%	24%	24% + Rs.15,000	20% + Rs.15,000
Cars (>2000cc)*	24%	24%	24% + Rs.20,000	20% + Rs.20,000
Buses	16%	12%	12%	8%
Chassis	16% + Rs.10,000	12% + Rs.10,000	12% + Rs.10,000	8% + Rs.10,000

*Source: Reliance Money Research, ED – Excise Duty, *GOI changed ED w.e.f. June 13, 2008*

Few companies have already intended to pass on the benefits to end consumers

The government as a measure to ease out the declining sales volumes in the automobile industry has reduced Excise Duty on all the segments. Earlier the government had increased the specific duty on cars (1500cc and above). The reduction in excise duty is likely to boost some respite to automobile companies and the consumers. Few companies like Maruti Suzuki, Tata Motors, Ashok Leyland and M&M have already indicated that they would pass on the benefit to the end consumers. But we again take a overview over the major challenges in front of the automobile industry –

Inventories at dealers end are unlikely to get any benefit

Due to slowdown demand for trucks and cars has already come down

Price hikes done during H1FY09 by automobile companies are higher compared to likely benefits due to excise duty cut

1. The inventory levels across the segments have started rising and cut in excise duty is likely to help only to new production. The prices of vehicles (inventory) which is lying at dealers end is unlikely to get benefit due to excise duty cut. Automobile companies along with dealers are likely to take a hit on their P&L for compensating the cut in prices on inventories.
2. Interest rates are still hovering at higher levels. Two wheeler financing rates remain at 14-15% while for cars interest is still hovering around 17-18%. Although due to recent measures taken by RBI regarding softening of interest rates, interest rates are likely to come down, we feel stringent disbursal policies by financing institutions are likely to stay, mainly due to rising risk of delinquencies.
3. Due to slowdown in overall economy, consumers of automobile products have been deferring their purchase decisions and they would not return to market unless there will be improvement in overall situation.
4. Freight rates have already started declining on a month on month basis and cut in diesel prices is likely to put pressure on the fleet operators to reduce freights rates further. The slowed demand for trucks is also likely to impact the overall demand for trucks.
5. The cut in excise duty is unlikely to improve demand in the short term. Because of rising commodity prices, the automobile companies have already increased the prices of vehicles by 3% to 14% whereas the benefit from cut from excise duty will be in the range of 2-4%. We feel the prices of vehicles have gone up substantially (during last six months) compared to benefit which consumers are likely to get.

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Segment	Likely Benefit to Consumers	Increase in Net Realisations during H1FY09 over Q4FY08	
Two Wheelers	~2-4%	Bajaj Auto	~ 3%
		Hero Honda	~ 3%
		TVS Motor	~ 14%
Cars	~2-4%	Maruti Suzuki	~ 8%
		M&M	~ 4%
Commercial Vehicles	~2-4%	Tata Motors	~ 6%
		Ashok Leyland	~ 12%

Source: Reliance Money Research, realizations for M&M is only for automobile segment and realizations for Tata Motors is including cars

Cut in diesel prices is likely to create southward pressure for freight rates

6. Petrol prices and diesel prices have been cut by Rs.5 (~10%) and Rs.2 (~5%) respectively. This will help the fleet operators and consumers in terms of lower operating cost. But pressure to cut freight rates is likely to come in near future.
7. The softening interest rates are likely to give respite to automobile companies, but our feedback from various financing companies and dealers suggest that financing companies are still reluctant to offer loans to automobile consumers due to rising concerns of delinquencies.

We believe cut in excise duty would give some respite to automobile companies, but it is unlikely to trigger new vehicles demand. The positive impact due to cut in excise duty is likely to be minimal in near future. Slowing economic activity, declining freight rates, stringent financing policies, rising delinquencies and high interest rates still remain concerns for the sector. We continue to remain negative on the sector

Fiscal Package Imapct

Real Estate - Improvement in sentiment….

Monetary Measures Announced

- RBI is working on refinancing Facility for National Housing Bank (NHB) for the Real Estate Sector up to 4000 crs. The details will be announced shortly.
- Loans granted by banks to Housing Finance Companies (HFCs) for on-lending to individuals for purchase/construction of dwelling units may be classified under priority sector, provided the housing loans granted by HFCs do not exceed Rs.20 lakh per dwelling unit per family. This special dispensation will apply to loans granted by banks to HFCs up to March 31, 2010.
- Under the current guidelines, exposures to commercial real estate are not eligible for the exceptional regulatory treatment of retaining the asset classification of the restructured standard accounts in standard category; it has now been decided to extend exceptional/ concessional treatment to the commercial real estate exposures which are restructured up to June 30, 2009.
- Reverse Repo cut by 100 bps to 5% from 6%.
- Repo Rate Cut 100 bps to 6.5% from 7.5%

Loans granted by banks to Housing Finance Companies (HFCs) for on-lending to individuals for purchase/ construction of dwelling units may be classified under priority sector.

Fiscal Measures Announced

- Indication of increase in the plan expenditure towards construction of houses for the poor through the Indira Awas Yojana.
- Duty cuts for Steel (4 per cent reduction in ad valorem Cenvat from 14% to 10%) and cement

Public Sector banks to announce a package for home loan borrowers in two categories i.e. upto 5 lac and Between 5 - 20 lakh.

Effects of Fiscal and Monetary Policy on Real Estate Sector.

The reduction in the Repo/Reverse Repo Rates should result in a reduction in the marginal cost of funds to banks and enable them to improve the flow of credit to Real estate sector. Duty cuts for steel and cement to reduce cost of construction. As per media reports Cenvat cut to reduce steel products price by almost Rs. 1000-1500 tonne and cement prices (50 Kg. bag) by almost Rs. 8 – 10. The move to classify loans given by banks to HFCs (upto Rs.20 lakhs) into Priority sector lending will encourage banks to lend to HFCs. Now, with RBI allowing banks to treat restructured loans (extended to companies in Real Estate Sector) as a "Standard Account" instead of making high provisions by classifying them as non-performing assets will lead to lower NPAs for the sector. With measures announced (Fiscal and Monetary) demand for real estate is expected to increase for Lower Income Group (LIG) and Middle Income Group particularly in non metro cities.

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The above measures of low cost housing financing upto Rs. 20 lacs have not been taken positively by most of realty players. This is because non of the large players have low cost affordable flats upto Rs. 20 lacs and hence would not get any benefit here. Going ahead some more fiscal measures may be needed to accelerate the growth in realty space.

Fiscal Package Imapct

IIFCL to raise Rs. 10,000 crs through tax free bonds by March 31, 2009 to refinance bank lending of longer maturity eligible infrastructure projects.

Infrastructure - No immediate impact……

Fiscal Measures Announced

- IIFCL to raise Rs. 10,000 crs through tax free bonds by March 31, 2009 to refinance bank lending of longer maturity eligible infrastructure projects.
- IIFCL will be permitted to raise further resources by issue of such bonds depending on the need.

Effects of Fiscal Policy on Infrastructure Sector.

The funds raised by IIFCL will be used by it to refinance bank lending of longer maturity to eligible infrastructure projects, particularly in highways and port sectors. In this way it is expected that IIFCL resources used for refinance can leverage bank financing of double the amount. In particular, these initiatives will support a PPP programme of Rs.100,000 crore in the highways sector.

On the infrastructure front markets are expecting a $3 bn additional budgetary support from the government. Additionally there is a widespread expectation that another $10 bn stimulate package through forex loans would be announced soon. This in terms would benefit companies like Unitech, DLF and GMR.

Fiscal Package Imapct

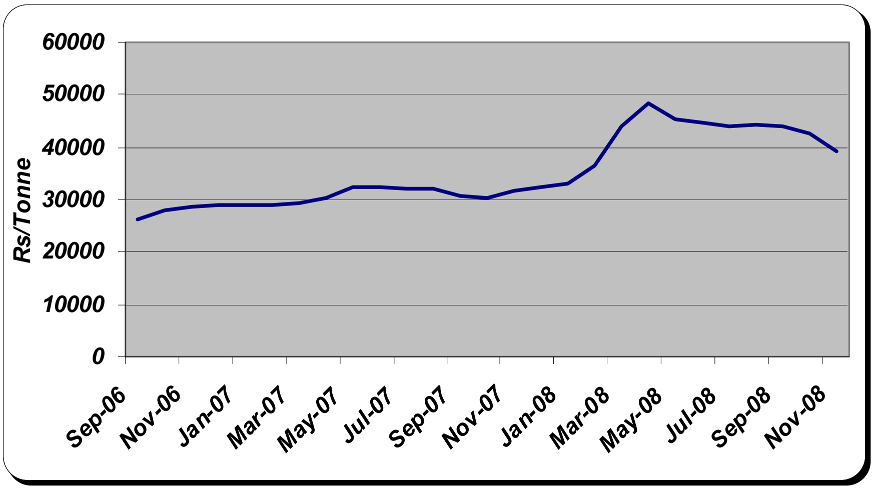
Metals Sector

TMT steel and structural steels and other long products used in construction industry would be the major beneficiaries of the this duty reduction as rest all the products are modvatable.

Direct Impact-

a) **Across the board cut in Excise/ Cenvat on all the products except petroleum products:** The three major rate slabs of central excise duty-of 14%,12%,and 8% and will now stand at 10%.8% and 4%. Steel products- currently attract an excise of 14% and will henceforth attract 10%. TMT steel and structural steels and other long products used in construction industry would be the major beneficiaries of the this duty reduction as rest all the products are modvatable- where the excise is refunded to manufacturers for value addition. The prices of the construction grade steel- which currently trades @Rs 39000 per tonne will further come off thus helping the increase in the volume of consumption. The other steel products will benefit from the 4% reduction in the slab rates across the board.

Price trends for TMT bars



Source : Reliance Money Research

Elimination of 8% export duty on export of Iron Ore fines and reducing the current 15% ad-valorem duty on Iron Ore lumps to 5%.

b) **Elimination of 8% export duty on export of Iron Ore fines and reducing the current 15% ad-valorem duty on Iron Ore lumps to 5%:** Around 86% of the iron ore exports are in the form of fines- the removal of 8% export tax will make the Indian ore prices competitive in the global market. The iron ore exports totalled 42 mn tonnes for the seven months ended Oct.'08. With the reduction in the in the export duty the revised export target of about 80-85 mn tonne of Iron ore is expected to be met.

Indirect Impact:

- **Across the board cut in Excise/ Cenvat on all the products:** A 4% cut in excise will enable the reduction in the prices thus enhancing the affordability of the goods. Steel and Aluminium is a major input for all the commercial goods like Automobiles, White goods etc. The expansion in demand of the aforementioned goods will enhance the consumption of Steel and Aluminium.
- **Additional planned expenditure of Rs 20,000 Cr will promote consumption of Steel- mainly the long products:** Construction sector which accounts for 60% of the steel consumption in India will benefit from the pumping in of Rs 20,000 Cr for infrastructure projects. In addition, the separate package of home loans up to Rs 20 lakhs is expected to boost the real estate industry which in turn will drive the demand for Steel and Aluminium.
- **4% cut in the excise duty and the cut in fuel prices is expected to drive the demand for Automobile:** Automobile segment- that contributes around 8% of the steel consumption- is expected to benefit from the stimulus thrown by the authorities. This indirectly will fuel the demand of Steel and Aluminium.

4% cut in the excise duty and the cut in fuel prices is expected to drive the demand for Automobile

Beneficiaries: SAIL, Tata Steel, JSW Steel, Hindalco, Nalco, Sesa Goa

Reliance Money Stock Rating

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

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