FY15 UNION BUDGET PREVIEW

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Focus to shift to quality of consolidation

India Equity Research | Economy

Two years ago the fiscal deficit was precariously approaching 6% of GDP, jeopardizing macro-economic stability. The government was forced to undertake sharp fiscal squeeze through ad hoc cuts in plan expenditure. While this strategy served well in more urgent times, it is time to review it. First, the fiscal situation is not as alarming as it was two years back, so fiscal targets need not be as aggressive. Second, in a weak economy, ambitious fiscal targets are not only hard to achieve but also ill-suited. Thus, the government should scale back the interim budget fiscal target of 4.1% of GDP. Third, the new government enjoys rich political capital, and therefore should target more difficult areas of spending cuts such as under-recoveries in LPG and kerosene while reviving Plan expenditure.

Further, the Union Budget should be used to set the reforms agenda for the next few years. GST, power distribution, private participation in coal mining and liberalising labour laws are some of the critical and long-pending reforms that will likely be the priority of the government.

Union Budget 2014-15: Aggressive fiscal target unwarranted

India's fiscal vulnerability has reduced markedly over the past two years. Surely, ad hoc cuts in Plan expenditure may not be the best way to rein in deficit, but reduced deficit does give the new government a chance to pause and undertake course correction. Fiscal strategy should now shift from chasing aggressive targets to improving quality of expenditure. In a weak economy, when tax revenues are sluggish, ambitious fiscal targets are hard to achieve and ill-suited for the economy. Thus, the government should scale back interim budget fiscal target of 4.1% of GDP, continue to rationalise subsidies (and reduce arrears) and revive Plan expenditure, while laying out a credible fiscal consolidation path over next 2-3 years.

Fiscal math: Quality to prevail over quantum

In last two years, Plan expenditure has been compressed by 0.6% of GDP (accounting for 50% of the fiscal consolidation) while subsidy compression has been marginal. This needs to change. Given that government is free of coalition compulsions, it should initiate rationalization of LPG and kerosene prices. Meanwhile, on the revenues front, government could be aggressive with disinvestment targets given buoyant market sentiments, although gross tax revenue target of ~20% YoY laid out in the interim budget is clearly aggressive and needs to be scaled back.

Policy reforms: Setting the agenda for next few years

The government has won a decisive mandate on the agenda of development. It will use the occasion to further the reform process in critical areas - GST, power distribution, private participation in coal mining, etc. With regards to sectors, there could be hike in excise duty on cigarettes and for banking sector, government stance on the PJ Nayak Committee recommendations will be keenly watched. Oil & gas sector can get a big boost if subsidy rationalisation is initiated for LPG and kerosene.

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Union Budget 2014-15 will be the new government's first budget. The Prime Minister has won a historic mandate on the development agenda and is essentially free from coalition compulsions. Therefore, apart from the fiscal stance, the Budget will also set the policy reform agenda for the next few years. It is likely to enumerate the government's priority areas and also a broad roadmap in terms of what can be expected in the near to medium term. This makes the forthcoming Union Budget extremely crucial.

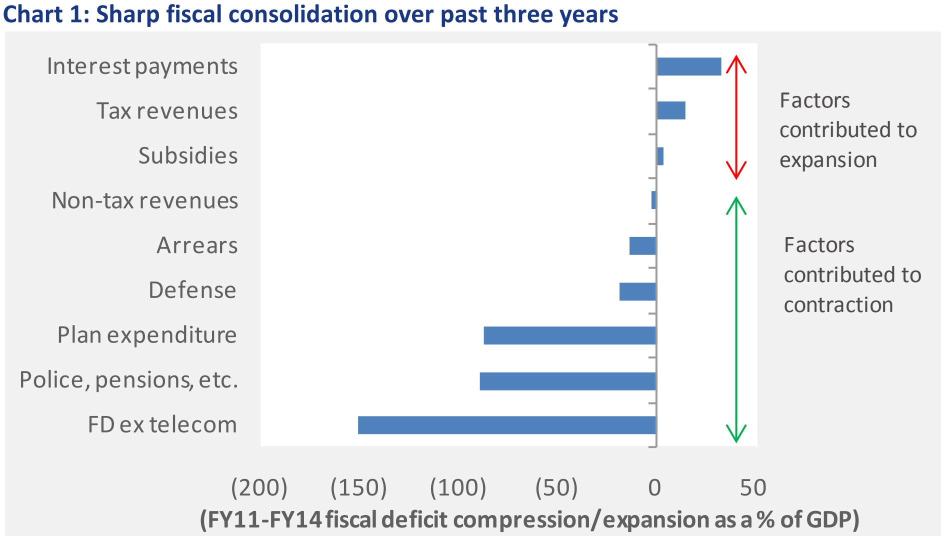
From the fiscal stance point of view, we believe aggressive fiscal targets are unwarranted at this juncture; rather, the focus should shift towards improving the quality of expenditure, which has worsened considerably over the past two years in a bid to compress the fiscal deficit amidst increasing macro-vulnerability. Economy is far better placed now than two years ago. This should give the new government room to pause and chart out its fiscal strategy. On the policy reforms front, one expects the Prime Minister to start spending his immense political capital on reviving critical and long-pending reforms. After all, he has already stated that in order to restore the country's economic health, bitter pills may be needed.

In this note, we discuss the fiscal progress over the past two years, where we stand now and what is the way forward. At the same time, we highlight and elaborate on some of the critical areas of reforms where the government is making the right noises and the Budget could provide a broad roadmap.

Union Budget FY15: Aggressive consolidation not warranted

Over the past three years, fiscal deficit (excluding telecom) as a percentage of GDP has been compressed by ~150bps amidst sharp slowdown in the economy. The compression's entire brunt was borne by expenditure cuts. In fact, even after accounting for arrears, government expenditure as a percentage of GDP is now back to pre-stimulus (FY08) levels. Tax revenue, however, has been lagging woefully. What is concerning is that it is the Plan expenditure (development-oriented) has borne the maximum brunt of fiscal compression (past two years' CAGR mere ~5%). On the other hand, interest payments as a percentage of GDP expanded the maximum—up ~30bps.

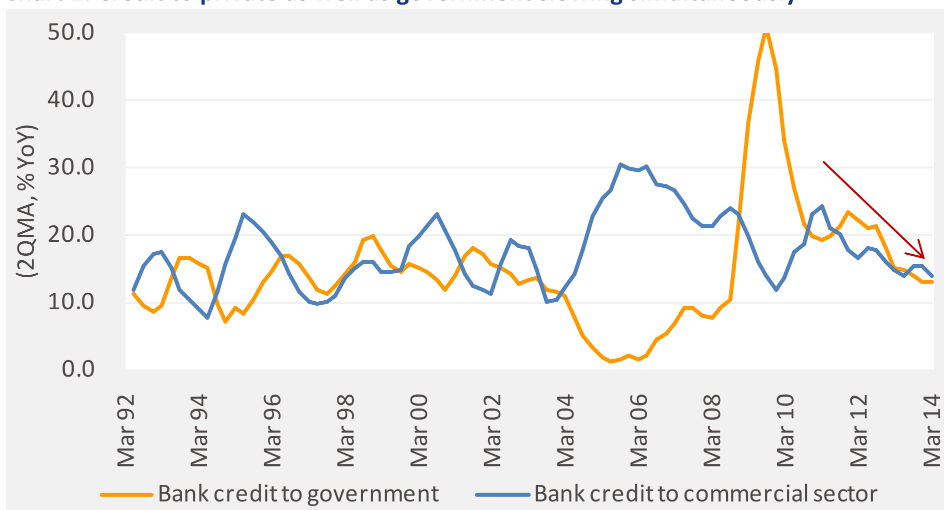
Chart 1: Sharp fiscal consolidation over past three years



Source: CGA, Edelweiss research

Usually, such sharp fiscal consolidation amidst growth downturn results in monetary policy being accommodative, so that the balance could be restored between consumption and investment. However, persistently high inflation due to exogenous factors ***(refer our Economy note 'Labyrinths of recovery', dated June 5, 2014, for more details)*** has forced a tight monetary policy stance on a weakening economy. As a result of this macroeconomic dynamic, credit to the private sector as well as government has been slowing simultaneously for the past eight quarters—a never before phenomenon in the post liberalisation era.

Chart 2: Credit to private as well as government slowing simultaneously



Source: CMIE

The tightening mode of both the macro-economic levers viz., fiscal and monetary, has resulted in one of the most pronounced slowdowns in recent times, with sub-5% real GDP growth for two consecutive years—first time in 25 years. This pronounced slowdown has deeply impacted the corporates. A combination of weakening demand, high inflation, high cost of capital and tight liquidity has saddled the manufacturing sector with large idle capacities, construction sector with stretched balance sheets and banking sector with high NPAs.

Given this dynamic and the fact that India's fiscal situation is not that worrisome as it was two years ago, we strongly believe that the government needs to pause and reorient its fiscal strategy towards improving the quality of expenditure. Setting ambitious fiscal targets in a slowing economy and then trying to achieve them via ad hoc cuts in Plan expenditure may have been necessary in the past two years, but incrementally, such a strategy is ill-suited to the current domestic economic conditions.

Thus, the government should scale back interim budget target of 4.1% of GDP, continue rationalisation of subsidies (and reducing arrears) and revive Plan expenditure. Also, it is critical that the government provides a credible roadmap for fiscal consolidation over the coming three years.

Fiscal math: Quality to prevail over quantum

Looking at the economic situation, it is clear that the government cannot rely heavily on sharp revival in tax revenue, although this year, prospects of raising revenue from non-tax sources such as disinvestment are much brighter compared to last year. On the expenditure front as well, the key lever is essentially subsidy because there is precious little the government can do about interest payments and salaries/pensions. Also, it will not want to compromise defence expenditure and at the same time, squeezing Plan expenditure for the third year running is not an advisable strategy.

Hence, one should focus on the quality of fiscal consolidation rather than quantity.

Table 1: Summary of fiscal deficit projections

Particulars (as a % of GDP)	FY15 Edel estimate	FY15 Interim estimate	FY14(RE)	FY13 (Actual)	FY12 (Actual)	FY11 (Actual)
Total revenues	**9.4**	**9.6**	**9.3**	**9.1**	**8.8**	**10.6**
Tax revenue (net)	***7.4***	***7.7***	***7.2***	***7.3***	***7.0***	***7.3***
Gross Tax revenue	10.3	10.7	10.0	10.2	9.9	10.2
Income tax	2.2	2.4	2.1	2.0	1.8	1.8
Corporate tax	3.5	3.5	3.5	3.5	3.6	3.8
Customs tax	1.5	1.6	1.5	1.6	1.7	1.7
Excise duties	1.5	1.6	1.5	1.7	1.6	1.8
Service tax	1.5	1.7	1.4	1.3	1.1	0.9
Less: Transfer to states	2.9	3.1	2.8	2.9	2.9	2.9
Non-Tax Revenue	***2.0***	***1.9***	***2.1***	***1.8***	***1.8***	***3.3***
Dividends	0.6	0.6	0.8	0.5	0.6	0.6
Telecom and 3G	0.3	0.3	0.4	0.2	0.2	1.5
Disinvestment	0.5	0.4	0.2	0.3	0.2	0.3
Total Expenditure	**13.9**	**13.7**	**13.8**	**13.9**	**14.5**	**15.4**
Plan expenditure	***4.4***	***4.3***	***4.0***	***4.1***	***4.6***	***4.9***
Non-Plan expenditure	**9.5**	**9.4**	**9.8**	**9.9**	**9.9**	**10.5**
Subsidies, of which	2.0	2.0	2.3	2.5	2.4	2.2
Food subsidy	0.9	0.9	0.8	0.8	0.8	0.8
Fertiliser subsidy	0.6	0.5	0.6	0.6	0.8	0.8
Petroleum subsidy	0.4	0.5	0.8	1.0	0.8	0.5
Interest Payments	3.4	3.3	3.3	3.1	3.0	3.0
Defense	1.8	1.7	1.8	1.8	1.9	2.0
Others	2.4	2.3	2.4	2.4	2.6	3.3
Fiscal Deficit	**4.5**	**4.1**	**4.5**	**4.9**	**5.7**	**4.8**

Source: Budget documents

Note: For INR bn and YoY numbers, please refer annexures

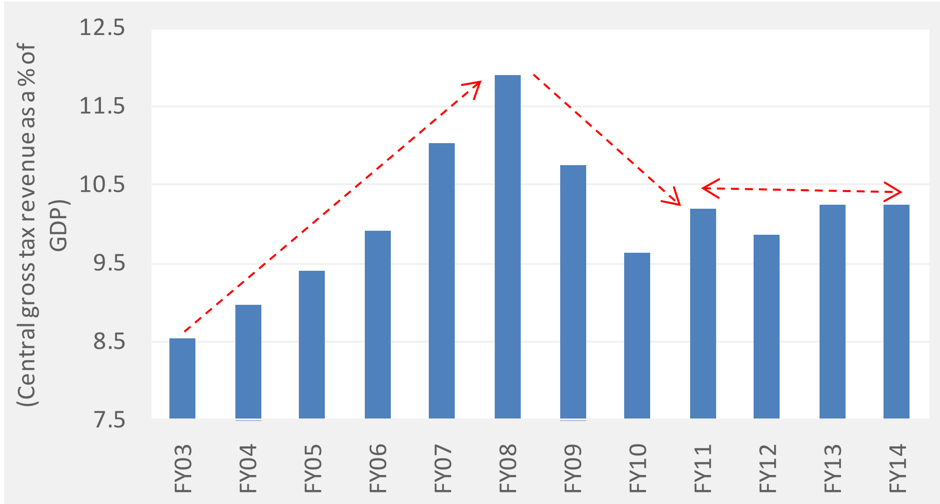
Revenue

Tax revenue: Interim budget targets need to be scaled back

Tax revenue as a percentage of GDP has been largely stagnant at ~10% over the past three-four years. Consolidation on the fiscal front has proceeded largely through expenditure slowdown. On the tax revenue front, while income tax growth has been fairly stable, corporate tax collections suffered due to declining profitability amidst weak demand and pricing power. On the indirect taxes front, slowdown in trade and industrial production was clearly reflected in custom duties and excise collections, respectively. We do believe that FY14 marks the low point of tax revenue and in the coming year (FY15), tax collections will improve in line with the expected improvement in economic activity.

However, tax revenue projections made in the interim budget are aggressive (at 20% YoY against ~10% realised in FY14) and unlikely to be met; therefore, they need to be scaled down to improve credibility of the fiscal math.

Chart 3: No increase in tax revenues (as % of GDP) over past four years



Source: CMIE

Non-tax revenue

Over the past couple of years, non-tax revenue as a percentage of GDP has jumped 30bps, helping the government ensure fiscal consolidation. Amongst components, dividends and telecom auctions have increased, while owing to volatile and subdued markets, the disinvestment programme has taken a backseat. Going into FY15, we expect dividends to normalise and telecom auction to fetch the same amount as last year. Disinvestment will, however, be the primary lever. Owing to buoyant markets, we expect disinvestment to be the predominant source and expect it to increase from INR250bn (0.2% of GDP) in FY14 to INR600-650bn (0.5% of GDP) in FY15E.

Expenditure

Subsidy: Rationalisation will continue; could even see positive surprises

PM Modi has been hinting at the need of taking tough decisions to restore the economy's health. We have already seen large hikes in railway fares even before the Railway Budget. Among the central government's big expenditure items, it is the subsidy expenditure where the finance minister has some leeway. Other items within non-Plan expenditure such as interest payments, defence expenditure, salaries & pensions, etc., do not offer much scope. Even in Plan expenditure, it is not advisable to squeeze the expenditure for third year running.

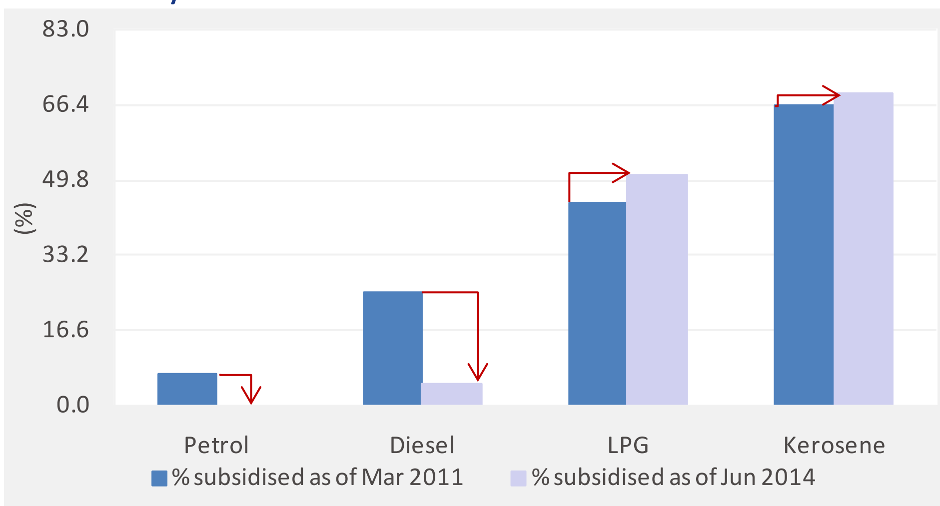
In such a scenario, continued subsidy rationalisation is critical. Some of the measures which may be undertaken are:

- Diesel price hikes are likely to continue at INR0.50/month. The quantum may be increased given that the INR and crude oil prices have moved adversely in recent weeks.

Currently, with the USD/INR assumption of 58 and crude oil prices of USD110/barrel for FY15, government sharing of under-recoveries could be ~INR450bn (0.4% of GDP). Also, we anticipate that to improve credibility of fiscal numbers, the government may decide to reduce outstanding arrears on the oil front. As of March 2014, the arrears stand at INR350bn, and, in our view, the government may decide to reduce the same by INR100bn. Thus, we expect FY15 oil subsidy burden to be around INR550bn (0.5% of GDP).

What can make a significant difference is if the government decides to rationalise other fuel subsidies such as LPG and kerosene. This can include reducing the number of subsidised cylinders per person or increasing the price of LPG in modest tranches periodically, something which we have seen in the case of diesel. Even kerosene prices may be hiked, something which has not happened in the past three years. Such measures can significantly reduce the oil subsidy burden. But politically, it may not be easy given that households are already subjected to high food inflation and regular price hikes in petrol, diesel, electricity and railway fares.

Chart 4: Subsidy rationalisation should now shift to LPG and kerosene



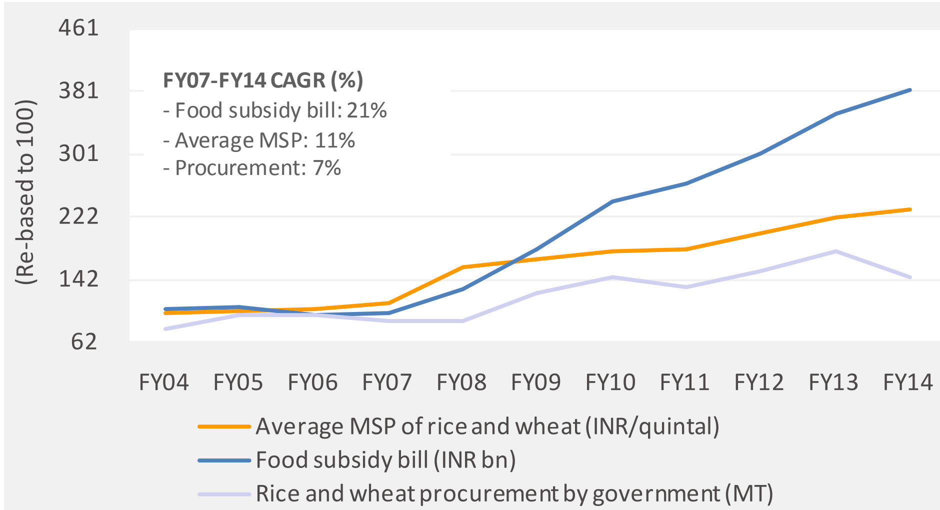
Source: Petroleum ministry

- On the fertiliser front, there are expectations of a urea price hike (prices of complex fertilisers are already decontrolled), but given the rising monsoon risk, we are not betting on it. In fact, if natural gas prices are hiked, the subsidy burden will only increase. Every USD1 hike in natural gas price will increase the fertiliser subsidy by INR25bn.

- Over the past seven years, the food subsidy bill has posted 21% CAGR. While increasing coverage under the public distribution system may have played a role, a combination of increasing scale of procurement and continued rise in cereal MSPs (CAGR of 12% in past seven years) has led to mounting food subsidy burden.

Going ahead, the pace of MSP hikes is likely to be moderated (government seems to be serious about controlling food inflation). If so, growth in food subsidy burden could slow down.

Chart 5: High MSPs and high procurement policy have led to high food subsidy



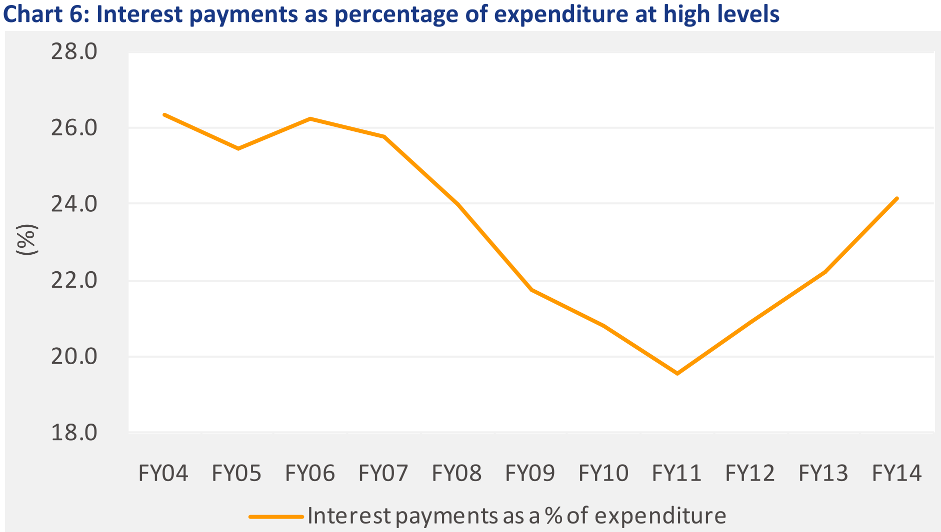
Source: CMIE, Food corporation of India

Overall, on the subsidy front, the government will continue to gradually rationalise prices. Any rationalisation in LPG and kerosene will be a significant positive. However, in the near-term, two risks are mounting—weak monsoon and further spike in crude oil prices due to tensions in Iraq. In case monsoon turns out to be weak, the government may have to support farmers through loan restructuring, diesel subsidy etc. At the same time, rising crude oil prices would mean that larger price hikes may be required.

Interest payments: Fastest growing component

It is one of the fastest growing components of government expenditure in recent years. While the high fiscal deficit kept the size of government borrowing high, elevated interest rates also contributed to the interest burden. For example, in FY14, while the central government's outstanding debt increased ~13% YoY, interest payments rose by 20%. This will begin to ease once the monetary cycle reverses and tax revenue starts to recover.

Chart 6: Interest payments as percentage of expenditure at high levels



Source: CMIE

Plan expenditure: No room for further squeeze

Plan expenditure has borne the maximum brunt of the past two years' fiscal consolidation process. For example, past two years' CAGR in Plan expenditure was just 5% compared to overall expenditure CAGR of 10% and nominal GDP CAGR of 12%. Several vital areas of expenditure such as roads, irrigation, education, health, among others, have seen slow expansion. Cutting Plan expenditure in an ad hoc manner may still be necessary when fiscal deficit was elevated (approaching 6% of GDP) and macroeconomic stability was at risk; but, it should not be the strategy now when fiscal deficit has been reined back substantially. Squeezing development (Plan) expenditure for the third year running will definitely impact the economy's medium-term growth prospects. Therefore, we believe, Plan expenditure growth of ~23% YoY assumed in the interim budget is necessary.

Table 2: Sharp squeeze in Plan expenditure over past couple of years

Particulars	FY14 Revised estimates (INR bn)	FY14 Revised estimates (as a % of GDP)	% cut from BE FY13	FY14	FY12-FY14 (CAGR, %)
Nominal GDP					**12.3**
Total Expenditure*	**15,635**	**13.8**	**(4.0)**	**(6.1)**	**9.5**
Plan Expenditure*	**4,531**	**4.0**	**(20.6)**	**(18.4)**	**4.8**
Education	567	0.5	(1.4)	(8.0)	4.2
Rural Development	388	0.3	(10.3)	(9.3)	1.6
Urban dev.	301	0.3	(9.5)	(16.0)	6.0
Roads	297	0.3	(40.8)	(28.2)	(14.0)
Railway	270	0.2	0.5	3.8	8.3
Health	234	0.2	(15.2)	(20.6)	0.5
Women & child dev	180	0.2	(5.5)	(8.9)	4.2
Agri and irrigation	179	0.2	(7.4)	(9.9)	3.8
Transfer to states	966	0.9	(16.2)	(29.1)	(3.6)
Non-Plan Expenditure*	**11,104**	**9.8**	**4.9**	**0.0**	**11.6**
Interest payments	3,775	3.3	(2.1)	1.8	17.6
Subsidies	2,562	2.3	30.2	10.9	8.4
Oil	854	0.8	122.3	31.4	11.7
Fertilizer	674	0.6	7.6	2.2	(1.9)
Food	927	0.8	13.3	3.0	12.8
Defense	2,035	1.8	(6.0)	(0.1)	9.1
Pensions	741	0.7	10.0	4.7	10.0
Transfer to states	931	0.8	(19.6)	8.2	26.9

Source: Budget documents

*Note: * Actual numbers reported by CGA while the sub-categories are from the interim budget*

Bank re-capitalisation: Need of the hour

Given the rising stress in the banking sector amidst continued economic slowdown, recapitalisation of public sector banks (PSBs) has become critical. The government has been pumping money into the banking system, but only so much. In FY14, it provided INR140bn towards recapitalisation of PSBs and in FY15 (interim budget), it provided only INR112bn. There is not much room for the new government to increase it meaningfully. Therefore, PSBs will have to rely on capital markets. In this regard, the government may accept recommendation of the PJ Nayak Committee of transferring entire government shareholding in PSBs to a special vehicle (similar to holding company), which can then raise money for various PSBs. Eventually, this set up may also lead to reduced interference from the government in the management of banks.

Reforms: Time to spend political capital

Rather than just an exercise in fiscal math, the new government's first Union Budget will be widely seen as the guidepost for the policy reform agenda over the next few years. This is especially so because the government is rich with political capital. The electoral mandate has been essentially won on the agenda of development and the Prime Minister is largely free of coalition compulsions. As this has not happened in a long time in India, the opportunity is historic.

Of course, the government is not expected to set detailed policies in the budget, but it is critical that it highlights a few of its priority areas and presents a broad roadmap in achieving the same. Below we list a few areas which are long-pending, critical to restore economic health of the country and where the government is making the right noises:

- **Goods and Services Tax: States need to be compensated**

  Migrating from the current complex and multi-layered system of indirect taxation to a more simplified destination-based Goods and Services Tax (GST) will be the single biggest fiscal reform in the country. It will widen the tax base, improve tax compliance and by eliminating the cascading effect of multiple taxes, reduce transaction costs of businesses, rendering them more competitive.

  It is a long-pending reform and requires Constitutional Amendment to be passed in both Houses of the Parliament and also 50% of states. The new government, therefore, needs to table a revised Constitutional Amendment Bill in the Parliament (earlier one has lapsed with dissolution of Lok Sabha). The key challenge will be to bring all the states on board and for that a few issues need to be resolved:

  - Sharing of power between the Centre and states in the GST Council. States want equal authority.
  - Another issue is of compensation to states for phasing out CST for FY11-13. The total compensation amount agreed upon is ~INR340bn and in FY14 Union Budget, the Finance Minister did provide INR93bn as a first tranche to states. However, as per the interim budget, only about ~INR19bn has been given to states. Therefore, if the new government wants to take states on board on this front, the Union Budget should provide for that compensation.

- **Labour Laws: Rajasthan has made a good beginning**

  Stringent labour laws are one of the important impediments to industrial activity as they discourage economies of scale. Again, this has been a long-talked about reform, but little progress has been made, perhaps because it is also a politically sensitive issue. Given that the NDA government's key priority area is to create jobs and boost the manufacturing sector, there are expectations that the government will relax some of these labour laws, especially for the National Investment and Manufacturing Zones (NIMZs). These are integrated industrial townships envisaged in the National Manufacturing Policy and early this year, the government has given in-principle approval to a few NIMZs. Accordingly, the Union Budget may provide some hints with regards to the same.

It may be noted that labour laws fall under the Concurrent List (Centre alone cannot formulate policies). What is encouraging is that Rajasthan (BJP ruled state) has approved some relaxation to existing laws under Factories Act and Industrial Dispute Act and the same has been sent to the President for approval. The central government needs to encourage states on this front.

- **Subsidy reforms: Cutting unpaid bills, targeting LPG and kerosene**

  Subsidy is the area where the new government has maximum leeway and will be seen as the most credible sign of the government's commitment towards restoring fiscal health of the economy. It will also be received favourably by investors, ratings agencies and even RBI. It is possible that the government may go aggressive on the subsidy rationalisation front by focusing on LPG and kerosene. It may announce a diesel-like formula of periodic hike of small magnitude. If this happens, it will be a big positive

- **Coal/power sector: Enhancing role of private sector in coal mining**

  There are essentially two issues. First, Coal India's production remains sluggish (despite India having large coal reserves) leading to idle capacity in the power sector. Second, in the power sector, transmission and distribution is ridden with losses and investment in this area has lagged way behind investment in power generation. After all, President Pranab Mukherjee did mention in his address to the joint session of the Parliament that, "Reforms in the coal sector will be pursued with urgency for attracting private investment in a transparent manner."

There are three broad proposals:

- Amend the Coal Mines (Nationalization) Act to end the monopoly of Coal India and permit private sector participation. The Bill to this effect was introduced in 2000, but was held up because of political issues. Currently, private players are allowed in the sector only in case of captive coal mines, but there are no private merchant miners.
- Privatise Coal India.
- Split Coal India into 3-4 entities, which can then compete against each other.

The key challenge which the government will face is that Amendment to the act requires Parliament's approval. Also, dealing with Coal India's labour union will be critical.

On the power distribution front, the government may follow the Gujarat model—separate the feeder lines for agriculture (subsidised) and households (non-subsidised)—which ensures better supply of power to respective sectors. Gujarat's distribution companies are making profits while those of other states are making large losses. However, since power distribution is a state subject, Centre can only incentivize state governments to undertake such measures and invest in transmission and distribution.

Sector-wise expectations

Given below is the summary of sector wise expectations

Table 3: Sector-wise expectations

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
Auto	Outline a new policy/ incentive scheme to replace old vehicles (more than 15 years) to support demand	Incentive scheme, if announced, can boost demand, especially in CVs	Strict implementation remains the key, positive for CVs

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
BFSI	Give a road map for reduction of government stakeholding in PSU banks and improved govermance (in line with what was suggested in PJ Nayyar committee report)	Improving governance of public sector undertakings (PSUs): Mr. Narendra Modi is known to improve governance of PSUs by eliminating government interference in their functioning; Gujarat being a good example. Therefore, it is widely expected that he will work towards reducing government interference in public sector banks (PSBs). There is also a possibility of reducing government stake below 51% in PSBs	This if implemented will be positive for PSU banks who have been operating under capital constraints
	Give a road map for solution to asset quality problem for banking system	We expect them to announce few reforms with respect to setting up of National ARC and increasing powers of DRT and SARFESI	Given the performance of the banks has been marred by plaguing asset quality issues , any announcement in that regard will be a positive for banks.
	Increment in FDI limit in insurance space	Incease FDI limit from 26% currently to 49%.	This will provide capital for the insurance companies which augurs well for the sector
	Some tax sops with regard to affordable housing	Given Vision of M. Narendra Modi to provide affordable housing for all by 2020 we expect some tax sops to be provided	This will be positive for HFCs in general moreso for players like REPCO etc.

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
Capital Goods	Anti dumping duty on power equipments	Low probability of levying anti dumping duty on the power equipment given surplus capacity in the domestic market and still low demand of new power plants.	Sentimentally negative for BHEL , L&T, thermax etc. if the duty is not imposed
Defence	Infrastructure status for defence industry including increasing FDI in defence and clarity on defence export policy to promote defence exports	Tax benefits for defence manufacturing in India	Positive for Bharat Electronics, Astra Microwave, L&T, Pipavav Defence etc.

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
Cement	Reduction in the rate of excise duty on cement and simplification of the duty structure to specific rate per MT as against the current complex structure of charging it on ad-valorem cum specific duty basis and further relating it to the declared MRP.	No change	No Impact
	Abolition of import duty on pet coke and levy of customs duty on cement imports.	No change	No Impact
	Classify cement as 'Declared Goods' under section 14 of the Central Sales tax Act to put it on equal footing with other core sector goods like coal and steel.	No change	No Impact

Table 3: Sector-wise expectations (Contd...)

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
Consumer Goods	No increase in excise duty on cigarettes.	We expect increase in execise duty by 8-10% for cigarettes. But recent concerns of the Health Minister on tobacco consumption in India indicates a sharper excise hike on cigarettes.	The hike will be sentimentally negative for all cigarette companies, especially the smaller players as this will become the third consecutive year of harsh Budget for cigarettes. ITC will need to take price hike to maintain EBIT margin and may face some negative impact on volumes.
	GST deadline to be announced	We expect GST deadline to be set though implementation is the key.	GST will help simplify tax structure, reduce significance of unorganised players, making inventory planning more robust and reduce black marketing.
	Including Seemandhara in tax exemption zones.	So as to promote manufacturing and development of the region it is likely to include Seemandhara in tax exempt zones.	Companies may set up factories in the region to benefit from tax exemption.
	Initiatives on infrastructure development.	Going by manifesto to develop 100 smart cities will expect increase in infrastructure development policies.	Urban growth which has lagged rural growth for past couple of years will gain momentum benefiting companies like Asian Paints, Colgate, Marico, Pidilite which have higher urban saliency in terms of sales.
	Rural initiatives on income generation.	We expect this to continue, though growth could moderate.	Companies with higher rural exposure like HUL which will face demand pressure.

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
IT	Restoration of STPI benefits	Restoration of tax benefits or at least clarity in SEZ revenue classification will ensure a hassle-free business environment	Will smoothenthe executiona and a positive impact of margin.
	Relief from applicability of both service tax and VAT on software licences	New Government's aim to reduce hurdles this could be implemented.	Lower tax burden and elimination of operational hurdles for IT companies

Pharma	Rolling out of universal access program to essential medicines with an outlay of INR5,000-6,000 crores p.a. (0.1% of GDP)	Important to see if private sector players would be part of the procurement for access to essential medicines	Over long term focus will be increase healthcare expenditure as % of GDP; Overall positive and would boost growth
	Increase weighted deduction on R&D to 300% from current 200%		Psotive for the industry, which is slated to commit higher investment into R&D pipeline
	Revisit the MAT currently being levied on SEZs, given industry has very high investment with SEZs		Positive for sector
	Remove excise duty disparity between API and formulations	Likely in order to reduce disparity in the MODVAT structure	Postive for the industry
Healthcare (hospitals)	Increase of exemption limit under section 80D for health insurance	Likely	Postive for sector and would lead to increase in patient volumes in organized sector
	Priority sector status to healthcare including hospitals and diagnostics		Increased availability of funds for to meet high unmet demand for healthcare infrastructure

Table 3: Sector-wise expectations (Contd…)

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
Media	Abatement for payment of service tax and entertainment tax.	Whenever GST is implemented, service tax and entertainment tax should be subsumed under GST. Any announcement regarding the timelines of implementation of GST would be a welcome step.	If GST is implemented, this will be a huge positive for DTH, cable companies and multiplexes.
	Reduction of 10% customs duty on digital head-ends and set top boxes.	This is unlikely given the emphasis of the government on domestic procurement of set-top boxes.	If implemented, this will be a positive for DTH and cable companies. In spite of inferior quality, due to lack of economies of scale, prices of domestic STBs are higher than imported STBs.

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
Metals and Mining	Steel players - increase in import duty to 10% from 7.5%	Low probability	Any import duty increase to give better pricing power for steel producers
	Steel players - Removal of steel imports from free trade agreements (FTA)	Possible	Beneficial to most steel producers especially flat steel producers viz. JSW Steel, Bhushan Steel, Uttam Galva
	Steel players - Reduce import duty on iron ore from 2.5% to nil	Possible	Non-captive steel players benefited (JSW Steel, Bushan Steel, Essar Steel, RINL)
	Steel players - Rationalisation of excise duty (e.g. Lower duty for steel supplied to infrastructure projects)	Low probability	Better demand for steel producers
	Iron ore miners - reduction in export duty (currently 30%)	Low probability	Positive for iron ore miners and negative for steel producers.
	State govt(s) - increase in royalty rates	Low probability	Negative for metal producers, especially captive miners
	State govt(s) - formation of SPV with funding through levy of 10% of realisation	Low probability	Negative for both metals and mining companies

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
Oil & Gas	Hike in crude oil import duty from 0% to 5%	Low probability of this being implemented as this would push-up inflation given that India imports about 3/4ths of its crude oil requirements	Positive for crude oil producers, Cairn India, ONGC and OIL India given import parity pricing. Hurts GRMs of RIL, Essar Oil, IOCL, HPCL, BPCL, if there is no corresponding increase in import duty of refined products
	Freeing of diesel prices	Unlikely to be directly part of the budget, but the government is likely to indicate a continuation of the current Rs 0.5/month hikes to eliminate subsidy burden over 4-5 months.	HPCL, BPCL, IOCL, ONGC, OIL India's profits may increase by 20-50% given reduction of under-recovery.
	Hike in LPG prices by Rs 50/cylinder and a Rs 2-3/litre hike in kerosene prices	A roadmap to subsidy reduction may be likely.	Minor positive for HPCL, BPCL, IOCL, ONGC, OIL India.
	Excise duty changes	We feel the government may change from Rs 3.56/litre specific excise duty on diesel to ad valoram in order to align its interest with diesel price hikes. Net result may be a Rs 1-2/litre increase in diesel prices.	Negative impact for HPCL, BPCL, IOCL, ONGC, OIL India, if they are not allowed to pass on the hike in excise duty.

Table 3: Sector-wise expectations (Contd…)

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
Real Estate	Tax-breaks for Real Estate Investment Trusts (REIT), post which Sebi would issue the final guidelines for REIT in India.	We expect corporate taxation on REIT's to exempt, making the vehicles tax pass-through. This would pave the way for issue of final REIT guidelines in India.	We expect the REIT legislation to compress the cap rates of rental assets by 150-200bps and hence positively impact its capital values, apart from providing additional source of funding to developers. DLF (BUY), Oberoi (BUY) and Brigade (BUY) have exposure to rental assets.
	Tax breaks for Special economic zones (SEZ) developers and units from the levy of minimum alternate tax (MAT).	Unlikely	Would be a postiive for developers with SEZ developments. Mahindra Lifespace would be the key beneficiary in our coverage universe.
	Tax exemptions for Affordable housing. Re-introduction of Section 80 IB (10), giving 100% exemption to small area housing of upto 1000sft.	Likely	Would be a postive for developers in the affordable housing segment. Would also benefit developers in the Mubai market where sub 1000sft market is substantial. Likely beneficiaries are Mahindra Lifespace and Oberoi Realty.
	Increase in income tax rebate on interest costs to INR0.25mn from INR0.15mn earlier	Unlikely	Would enhance affordability and hence demand for residentail developments. While the entire sector will stand to gain, Sobha Developers, and DLF are likely to be the biggest beneficiaries of the development.
	Infrastructure status to the real estate sector	Unlikely	Infrastructure status would be a postive for the sector as a whole in terms of availability of bank funding and further relaxation of FDI limits.
	Restoration of STPI benefits	Restoration of tax benefits or at least clarity in SEZ revenue classification is expected	Restoration of STPI benefits will negatively impact SEZ Developers. However, if clarity in SEZ revenue clarifications come in, it will positively impact SEZ developers. Key players in the space are DLF, Mahindra Lifespaces

Sector	Industry/market wishlist	Edelweiss expectations	Impact on sector/company
Retail	Easing import duty on gold.	We expect import duty on gold to be reduced to 7-8% from current 10%.	Positive for organised players like Titan, TBZ, PC Jewellers as players with access to cheaper smuggled gold selling at discount to market rates will lose this advantage.
	An upward revision in the income tax exemption limit.	We expect an increase as it would be a step forward towards direct tax code.	We expect this step to marginally increase disposable income of the urban poor/urban middle class which will help boost Consumer spending to some extent.
	GST deadline to be announced	We expect GST deadline to be set though implementation is the key.	GST will help simplify tax structure, reduce significance of unorganised players, making inventory planning more robust and reduce black marketing.

Annexure I

Table 1: Fiscal deficit at a glance

Particulars (INR bn)	FY15 Edel	FY15 Interim	FY14(RE)	FY13 (Actual)	FY12 (Actual)
TOTAL REVENUES	**11,924**	**12,346**	**10,553**	**9,198**	**7,884**
Tax revenue (net)	***9,362***	***9,864***	***8,160***	***7,403***	***6,298***
Gross Tax revenue	13,094	13,792	11,388	10,362	8,892
Income tax	2,829	3,065	2,378	2,015	1,645
Corporate tax	4,491	4,510	3,947	3,563	3,228
Customs tax	1,890	2,013	1,721	1,653	1,493
Excise duties	1,899	2,006	1,695	1,765	1,449
Service tax	1,884	2,155	1,546	1,326	975
Less: Transfer to states	3,732	3,928	3,228	2,960	2,594
Non-Tax Revenue	***2,562***	***2,482***	***2,393***	***1,795***	***1,586***
Dividends	772	772	904	538	506
Telecom and 3G	390	390	409	189	174
Disinvestment	650	569	276	259	181
TOTAL EXPENDITURE	**17,625**	**17,632**	**15,635**	**14,104**	**13,044**
Plan expenditure	***5,553***	***5,553***	***4,531***	***4,136***	***4,124***
Non-Plan expenditure	***12,072***	***12,079***	***11,104***	***9,967***	***8,920***
Subsidies, of which	2,550	2,557	2,562	2,571	2,179
Food subsidy	1,150	1,150	927	850	728
Fertiliser subsidy	750	680	674	656	700
Petroleum subsidy	550	634	854	969	685
-Interest Payments	4,270	4,270	3,775	3,132	2,732
-Defense	2,240	2,240	2,035	1,818	1,709
-others	3,012	3,012	2,732	2,447	2,300
FISCAL DEFICIT	**5,701**	**5,286**	**5,081**	**4,906**	**5,160**
Nominal GDP	**126,609**	**128,400**	**113,551**	**101,133**	**90,097**

Source: CMIE, Budget documents, CGA

Annexure II

Table 1: Fiscal deficit at a glance

Particulars (YoY)	FY15 Edel	FY15 Interim	FY14(RE)	FY13 (Actual)	FY12 (Actual)
TOTAL REVENUES	**13.0**	**17.0**	**14.7**	**16.7**	**(4.3)**
Tax revenue (net)	***14.7***	***20.9***	***10.2***	***17.5***	***10.5***
Gross Tax revenue	15.0	21.1	9.9	16.5	12.1
Income tax	19.0	28.9	18.0	22.5	18.3
Corporate tax	13.8	14.3	10.8	10.4	8.1
Customs tax	9.8	17.0	4.1	10.7	10.0
Excise duties	12.1	18.4	(4.0)	21.8	5.2
Service tax	21.9	39.4	16.6	36.0	37.3
Less: Transfer to states	15.6	21.7	9.1	14.1	16.2
Non-Tax Revenue	***7.1***	***3.7***	***33.3***	***13.2***	***(37.5)***
Dividends	(14.6)	(14.6)	68.2	6.2	5.5
Telecom and 3G	(4.7)	(4.7)	116.2	8.6	(85.6)
Disinvestment	135.9	106.6	6.4	43.1	(20.8)
TOTAL EXPENDITURE	**12.7**	**12.8**	**10.9**	**8.1**	**8.9**
Plan expenditure	***22.6***	***22.6***	***9.5***	***0.3***	***8.8***
Non-Plan expenditure	***8.7***	***8.8***	***11.4***	***11.7***	***9.0***
Subsidies, of which	(0.5)	(0.2)	(0.3)	18.0	25.7
Food subsidy	24.0	24.0	9.1	16.7	14.1
Fertiliser subsidy	11.2	0.8	2.8	(6.3)	12.4
Petroleum subsidy	(35.6)	(25.7)	(11.8)	41.5	78.5
-Interest Payments	13.1	13.1	20.5	14.7	16.7
-Defense	10.1	10.1	11.9	6.4	10.9
-others	10.2	10.2	11.6	6.4	(10.4)
FISCAL DEFICIT	**12.2**	**4.0**	**3.6**	**(4.9)**	**38.1**
Nominal GDP	**11.5**	**13.1**	**12.3**	**12.2**	**15.7**

Source: CMIE, Budget documents, CGA

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Recent Research

Date	Title	
17-Jun-14	**Economy**	Government acts to curb price rise
16-Jun-14	**WPI Inflation**	Jumps, primarily led by food and fuel
12-Jun-14	**IIP**	Expansion mainly led by capital goods
12-Jun-14	**CPI Inflation**	Eases, as expected

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