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Strategy
Asia | India

India Equity Strategy/Economics

FY18 Budget – Balanced with Capex Focus; Stay Constructive

Economics

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Economics View:

- **Balancing fiscal consolidation and stimulus:** The FY18 budget pegs fiscal deficit at 3.2% of GDP in FY18 vs. 3.5% in FY17. It falls short of the government's earlier roadmap of 3% but is better than our estimate of 3.4%. Going forward, the FRBM committee has suggested making debt/GDP ratio the most important metric and wants it to be brought down to 60% of GDP by 2023 (~67% now).

- **Revenue projections appear credible:** No change in LT capital gains tax was sentiment-positive; unchanged corporate tax rate for large companies and income tax tweaking were also in line with our expectations. Gross tax revenue growth of 12% in FY18 is in line with the nominal GDP growth and it appears that compliance-related gains have not been factored in. Non-tax revenues are a tad optimistic though.

- **Expenditure skew shifts back to capex:** The total expenditure growth projected for FY18 was quite moderate at 7%YoY and skewed more towards capital spend (11% YoY) than revenue spend (6% YoY). The skew suggests that govt. refrained from turning populist in this budget despite the upcoming assembly elections.

Rates Strategy:

- **Positive for rates – but limited room to rally:** Lower-than-feared fiscal deficit target and smaller market borrowing are positive for rates. Yields could push lower and the paid positions in the ND-OIS curve may lighten. That said, the room for rate easing is limited – 25bps cut more likely in April than the Feb policy.

Equity Research View:

- **Largely along expected lines** – The key provisions in the Union budget were largely in line: (a) income tax cut for the lowest slab (from 10% to 5%) and for small enterprises (30% to 25%), (b) rural/infra push – spending up c11% yoy, (c) medium term initiatives like digital, divestments, etc. No long-term capital gains on equities came in as a relief. The budget tries to balance multiple priorities – spur consumption/rural/infra trying to stick close to the targets on fiscal consolidation. Our view remains constructive – target of 30k for Sensex (+7%).

- **Digital, political party funding, divestments – eye on the future –** The push on digital and "less cash" continues with further initiatives. The FM also spoke about the divestments of various public sector enterprises. Initiatives on political funding should also be a medium-term positive. Initiatives with an eye on the future are highlighted in Figure 13. *(Continued on page 2)*

- **Key sectors/stocks which benefit –** (a) **Consumption** (rural-focused names to benefit more) – M&M, Maruti, Hero, Emami; (b) **LNG Gas** – Petronet, IGL, GSPL; (c) **Cement** – push on affordable housing and infra - Ultratech, Shree; (d) **Defence** – Bharat Electronics. Any pick-up in growth should also help **financials** – while PSU banks have rallied higher, the PSU bank recap provision at Rs100bn may constrain growth, in our view – we continue relatively to prefer private banks.

Economics

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Economics View: Balanced with Capex Focus

Midway between fiscal consolidation and stimulus

The finance minister projects the fiscal deficit to GDP ratio to come down to 3.2% in FY18 from 3.5% in FY17. It falls short of the government's earlier roadmap of 3% but is better than our estimate of 3.4%. Going forward, the FRBM committee has suggested making the debt/GDP ratio the most important metric and wants it to be brought down to 60% of GDP by 2023 (~67% now). To achieve this objective, the government will target the central fiscal deficit at 3% of GDP for three years beginning FY19.

Figure 1. Budget Snapshot – Rs bn, %YoY

Rs bn	FY16A	FY17BE	FY17RE	FY18BE	%YoY
a. Revenue receipts	11,950	13,770	14,236	15,158	6.5
Tax revenues	9438	10541	10888	12270	12.7
Non-tax	2513	3229	3348	2888	-13.7
b. Non-debt cap receipts	730	671	566	844	49.2
Recoveries of loans	308	106	111	119	7.8
Divestments	421	565	455	725	59.3
c. Total receipts (a+b)	12,680	14,442	14,801	16,002	8.1
d. Revenue expenditure	15378	17310	17346	18369	5.9
f. Capital expenditure	2530	2470	2798	3098	10.7
j. Total expenditure (d+f)	17,908	19,781	20,144	21,467	6.6
j. Fiscal Balance (c-j)	-5228	-5339	-5343	-5465	
% to GDP	-3.9	-3.5	-3.5	-3.2	
Revenue Balance (a-d)	-3427	-3540	-3110	-3212	
% to GDP	-2.5	-2.4	-2.1	-1.9	
Primary Balance (j-1)	-802	-412	-416	-539	
% to GDP	-0.6	-0.3	-0.3	-0.3	
GDP assumption	*135,761*	*150,581*	*150,761*	*168,475*	*11.8*

Source: Budget Documents, Citi Research

Revenue projections appear credible – tax relief for many

Tax projections driven by consideration of equitable distribution: Unchanged long-term capital gains tax sentiment positive, unchanged corporate tax rate for large companies and income tax tweaking were in line with our expectations. Sharp cut in corporate tax rate (from 30% to 25%) for companies with turnover < INR 500mn indicates the preference to grow MSMEs. Similarly the income tax adjustment was such that the benefits accrue more to the lower income segment while the tax burden of the higher income segment will go up. The proposed changes could increase the tax burden for 150,000 taxpayers (income > INR 0.5mn per annum) while it would benefit roughly 22.6mn people. The revenue foregone from direct taxes was INR 200bn, close to our estimate of INR 250bn. Major indirect tax changes were postponed keeping impending GST implementation in mind.

Figure 2. Trends in Revenues (Rs Bn)

Rs Bn	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17RE	FY18BE
Direct Tax	3,671	4,378	4,873	5,528	6,325	6,873	7,409	8,471	9,800
% YoY	14.9	19.2	11.3	13.4	14.4	8.7	7.8	14.3	15.7
% GDP	5.7	5.6	5.6	5.6	5.6	5.5	5.5	5.6	5.8
Corporation tax	2,447	2,987	3,228	3,563	3,947	4,289	4,532	4,939	5,387
% YoY	14.7	22.1	8.1	10.4	10.8	8.7	5.7	9.0	9.1
% GDP	3.8	3.8	3.7	3.6	3.5	3.4	3.3	3.3	3.2
Income tax	1,224	1,391	1,645	1,965	2,378	2,583	2,876	3,532	4,413
% YoY	15.4	13.6	18.3	19.5	21.0	8.6	11.3	22.8	24.9
% GDP	1.9	1.8	1.9	2.0	2.1	2.1	2.1	2.3	2.6
Indirect Tax	2,447	3,445	3,917	4,737	4,963	5,441	7,098	8,519	9,269
% YoY	-9.2	40.8	13.7	20.9	4.8	9.6	30.5	20.0	8.8
% GDP	3.8	4.4	4.5	4.8	4.4	4.4	5.2	5.7	5.5
Excise duty	1,030	1,377	1,449	1,758	1,695	1,881	2,881	3,874	4,069
% YoY	-5.2	33.7	5.2	21.3	-3.6	11.0	53.1	34.5	5.0
% GDP	1.6	1.8	1.7	1.8	1.5	1.5	2.1	2.6	2.4
Customs collections	833	1,358	1,493	1,653	1,721	1,880	2,103	2,170	2,450
% YoY	-16.6	63.0	10.0	10.7	4.1	9.3	11.9	3.2	12.9
% GDP	1.3	1.7	1.7	1.7	1.5	1.5	1.5	1.4	1.5
Service tax	584	710	975	1326	1548	1680	2114	2475	2750
% YoY	-4.1	21.6	37.3	36.0	16.7	8.5	25.9	17.1	11.1
% GDP	0.9	0.9	1.1	1.3	1.4	1.3	1.6	1.6	1.6
Gross Tax Collections	6,245	7,931	8,892	10,362	11,387	12,449	14,556	17,032	19,116
% YoY	3.2	27.0	12.1	16.5	9.9	9.3	16.9	17.0	12.2
% GDP	9.6	10.2	10.2	10.4	10.1	10.0	10.7	11.3	11.4
Net Tax Collections	4,565	5,699	6,298	7,419	8,159	9,036	9,438	10,888	12,270
% YoY	3.0	24.8	10.5	17.8	10.0	10.8	4.4	15.4	12.7
% GDP	7.0	7.3	7.2	7.5	7.2	7.2	7.0	7.2	7.3

Source: Budget Documents, Citi Research

Tax revenue expectations credible: Gross tax revenue growth of 12% in FY18 is in line with the nominal GDP growth and it appears to us that any positives from better tax-compliance have not been explicitly factored in. Income tax growth at 25% (23% in FY17) builds in some buoyancy from better tax collection/IDS1 but it is difficult to say how much has been budgeted from demonetization-led tax scrutiny. In our view, there is some scope for upside surprise in tax revenue collection; however, any near-term headwinds from GST implementation could be a balancing factor. In particular, service tax could be higher than budgeted, especially if digital payments increase tax compliance and the service tax rate goes up under GST. Excise duty growth expected at 5% for FY18 (34% in FY17) quite naturally bakes in the possibility that the petro-product excise windfall will dwindle in FY18.

Though some uncertainty exists around non-tax revenue projections

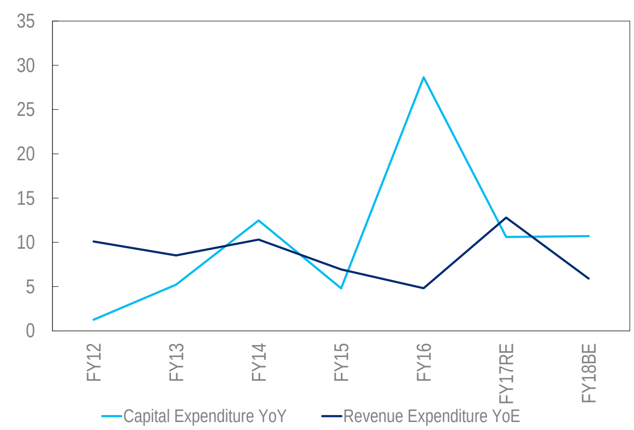
Budgeted divestment proceeds (Rs725bn) and RBI dividend (Rs749bn) appear to be optimistic. However, several suggestions are in place for higher divestment proceeds – improving revenue collection from strategic divestment of loss-making PSUs, listing of government-owned insurance companies and railways-linked companies, and a new ETF of PSUs. No specific revenue from additional telecom spectrum auction has been budgeted. Also, longer-term issues like monetization of land holdings were not discussed.

Expenditure Skew Shifts Back to Capex

Spending on rural/social and infra continues

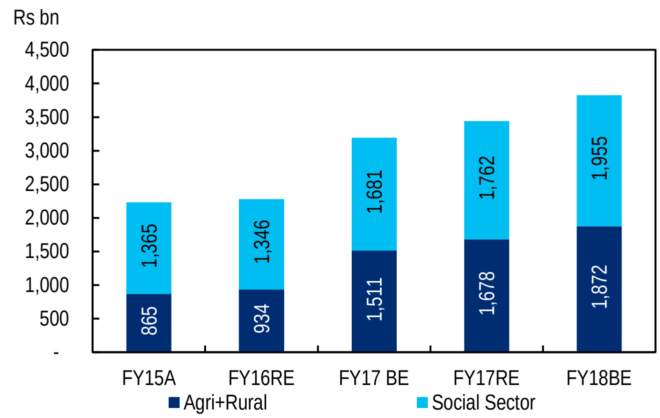
The total expenditure growth projected for FY18 was quite moderate at 7%YoY and skewed more towards capital spend (11% YoY) than revenue spend (6% YoY). This restores the quality of government expenditure, which deteriorated somewhat in FY17 on account of pay commission payouts. Also, in our view, this skew reflects that the government refrained from turning overly populist in this budget despite the upcoming assembly elections.

Figure 3. Govt. expenditure skew shifts back to Capex



Source: Budget Documents, Citi Research

Figure 4. Rural/Social Sector remains the focus area (Rs Bn)



Source: Budget Documents, Citi Research

Rural spending gets a 12% boost while infrastructure spending is budgeted at INR 3.96trn. Transport infra gets 61% of the overall infra spend, giving affordable housing infrastructure status can increase capex in that sector. It's interesting to note that the government is increasingly focused on streamlining expenditure into key flagship schemes rather than introducing new schemes.

Figure 5. Allocation for the flagship government schemes (Rs bn)

Scheme	FY17 BE	FY17 RE	FY18 BE	%YoY
MGNREGS	385	475	480	1%
Sarva Shiksha Abhiyan+ edun mission	280	282	296	5%
Pradhan Mantri Awas Yojna (PMAY)	201	209	290	39%
National Health Mission (NHM)	208	226	271	20%
Pradhan Mantri Gram Sadak Yojna	190	190	190	0%
Integrated Child Development Scheme	161	166	208	25%
Green Revolution+White Revolution	137	117	154	32%
Swachh Bharat Abhiyan (SBA)	113	128	162	27%
National Programme of Mid-day Meals	97	97	100	3%
Pradhan Mantri Krishi Sinchai Yojna	57	52	74	42%
National Rural Drinking Water Programme	50	60	61	1%
Employment gen other than MGNREGS	81	107	116	9%
National Livelihood Mission (NLM)	32	33	48	45%
Total	1992	2142	2451	14%

Source: Budget Documents, Citi Research

Some hits on reforms...: Plan to abolish the Foreign Investment Promotion Board (FIPB) which used to vet FDI proposals under the approval route would be the right step towards a more liberalized FDI regime. The anti-corruption stance of the government gets a further boost as it clamps down on cash funding of political parties (max Rs2,000 permitted now as a cash donation) and proposes to issue electoral bonds. Restricting any transaction above Rs0.3mn in cash would also promote digital/formal payment of large transactions. Expansion of National Agricultural Market to 585 mandis (from 250 now) and urging states to remove perishables from the APMC Act could help farmers in better price discovery. The spending on rural infrastructure – roads, irrigation, electrification, housing and sanitation – seems to be moving in the right direction and the government is keen to continue on that path.

Figure 6. Push for some of the Key Infrastructure Ministries – Roads, Railways, Power (Rs bn)

	FY15A	FY16RE	FY17BE	FY17RE	FY18BE	FY18YoY
Road and Highways	330	471	578	525	649	24%
Railways	301	320	450	462	550	19%
Petroleum, Natural Gas	603	313	292	302	292	-3%
Urban Development	132	180	245	325	342	5%
Telecommunications	109	203	184	243	267	10%
Power	132	80	123	105	139	32%
Atomic Energy	90	114	117	120	125	4%
Space	58	70	75	80	91	14%
Water Resources	55	70	62	48	69	44%
New Renewable Energy	5	3	50	44	55	25%
Civil Aviation	66	42	26	35	27	-23%
Shipping	10	14	15	15	18	20%
Coal	7	6	4	6	7	17%
Sub total	1900	1885	2221	2310	2631	14%

Source: Budget Documents, Citi Research,

….and some misses: Except for a broad push towards affordable housing which can create jobs, any new job creation program was missing in the budget. It talks about introducing some labor reforms during the course of the year which could be more in the form of simplification and rationalization. The allocation towards bank recapitalization (Rs100bn) was in line with the government's earlier plans but given the extent of the problem, the market was hoping for a stronger push or a new strategy.

Financing the deficit – Less Reliance on Market Borrowing

The fiscal deficit projected for FY18 (Rs5.46trn) is marginally higher than the FY17RE of Rs5.34trn. However, the financing pattern of FY17 deficit has changed substantially from what was budgeted. In the budget estimate ~82% of the deficit was likely to be financed through market borrowing but because of extremely high collections in small savings (Rs903bn vs. Rs221bn budgeted), only ~68% of the deficit had to be financed through market borrowing. The government is hoping that this trend will continue in FY18 as well and budgeting collection from small savings at Rs1trn. As a result, the proportion of deficit likely to be financed by market borrowings in FY18 will only be ~64%. A higher interest differential between bank deposits and small saving rates encouraged the large build-up in small savings in FY17 and it remains to be seen whether this trend will continue in FY18 as well. The Rs535bn budgeted under "other receipts" to fund the deficit is also unusually high.

Government's fiscal prudence is positive for fixed income. The better than feared deficit target and commitment to fiscal consolidation will keep hopes of a RBI rate cut alive. The effective gross issuance requirement of Rs5.8tn (lower than FY17's Rs5.82tn) should also calm sentiment in bond markets. The net market borrowing for FY18 at RS3.48trn looks lower because the government has explicitly planned to buy back RS750bn of securities in FY18. In fact, even for FY17 there is a plan of a Rs595bn buyback of securities which will bring down the net borrowing to Rs3.47trn, similar to the FY18 estimate. Plans for bond buybacks in the final two months of FY17 should also support sentiment. While the timing of RBI cuts remains uncertain, investors are now unlikely to question the possibility of one 25bp rate cut that is currently priced into the OIS curve. Yields are likely to push lower and the paid positions in the ND-OIS curve may lighten. Accordingly, we have closed our paid 5y INR ND-OIS position. That said, we recognize that room for a fixed income rally is limited as inflation likely is bottoming and global reflationary expectations strengthen. The budget reinforces our view of another 25bps cut in repo rate, but more likely in April policy than Feb.

INR may also find some breathing room but external factors likely will remain dominant. The positive equities sentiment in response to the budget may keep INR bears at bay for now. However, we believe that the medium-term trend remains dependent upon the broader USD trend, global risk sentiment and oil prices. The tailwinds from declining oil prices and widening real rates are now dissipating, and issues of competitiveness may soon arise. We are tactically neutral INR for now, and are no longer bullish for the medium term.

Figure 7. Financing of Fiscal Deficit – Net Market Borrowing to Decline (Rs bn)

INR bn	FY 2017-18	FY 2016-17 BE	FY 2016-17 RE
Fiscal deficit	5,465.32	5,339.04	5,342.74
Net small savings	1,001.57	221.08	903.77
Other forms of funding	981.48	866.15	966.78
Net bond issuance	3,482.26	3,501.81	3,472.19
Net short term issuance	20.02	166.49	186.30
Net issuance	3,502.28	3,668.30	3,658.48
Redemptions originally due in 2017-18	2,280.99		
Switches due by end-March 2017	405.10		
Buybacks due by end-March 2017	308.15		
Effective redemptions due in 2017-18	1,567.74	1,748.19	1,752.92
Buybacks scheduled for 2017-18	750.00	-	594.90
Effective gross issuance in 2017-18	5,800.00	5,250.00	5,820.00
Additionally: switches scheduled	250.00	750.00	405.10
Gross issuance including switches	6,050.00	6,000.00	6,225.10

Source: Budget Documents, Citi Research

Government Finances

Figure 8. Snapshot of Indian Government Finances (Rs Bn)

Rs bn, year end March	FY12	FY13	FY14	FY15	FY16	FY17RE	FY18BE
Revenue							
a. Gross Tax Revenue	8,892	10,359	11,387	12,449	14,556	17,032	19,116
% to GDP	10.2	10.4	10.1	10.0	10.7	11.3	11.4
% YoY	12.1	16.5	9.9	9.3	16.9	17.0	12.2
Corporation tax	3,228	3,563	3,947	4,289	4,532	4,939	5,387
Income tax	1,645	1,965	2,378	2,583	2,876	3,532	4,413
Excise duty	1,449	1,758	1,695	1,881	2,881	3,874	4,069
Import duty	1,493	1,653	1,721	1,880	2,103	2,170	2,450
Service Tax	975	1,326	1,548	1,680	2,114	2,475	2,750
Other Taxes	101	93	99	135	50	43	47
b. (-) Devolvement to States & UTs	2,594	2,944	3,229	3,413	5,119	6,145	6,846
c. Net tax revenues (a-b)	6,298	7,415	8,159	9,036	9,438	10,888	12,270
d. Non tax revenues	1,217	1,374	1,989	1,979	2,513	3,348	2,888
e. Net revenue receipts (c+d)	7,514	8,792	10,147	11,015	11,950	14,236	15,158
f. Non-debt capital receipts	369	410	419	515	730	566	844
Recovery of loans	189	151	125	137	308	111	119
Privatisation/Disinvestment	181	259	294	377	421	455	725
g. TOTAL REVENUES (e+f)	7,884	9,202	10,566	11,530	12,680	14,801	16,002
% YoY	-4.3	16.7	14.8	9.1	10.0	16.7	8.1
Expenditure							
h. Revenue expenditure	11,458	12,435	13,718	14,670	15,378	17,346	18,369
Interest (1)	2,732	3,132	3,743	4,024	4,426	4,831	5,231
Defence	1,030	1,113	1,244	1,367	1,501	1,750	1,825
Subsidies	2,179	2,571	2,546	2,583	2,578	2,605	2,723
Pensions	612	695	749	936	957	1,282	1,312
i. Capital expenditure	1,586	1,669	1,877	1,967	2,530	2,798	3,098
l. TOTAL EXPENDITURE (h+i) = (j+k)	13,044	14,104	15,594	16,637	17,908	20,144	21,467
% YoY	8.9	8.1	10.6	6.7	7.6	12.5	6.6
Deficit trends							
m. Fiscal Balance (g-l)	-5,160	-4,902	-5,029	-5,107	-5,228	-5,343	-5,465
% to GDP	-5.9	-4.9	-4.5	-4.1	-3.9	-3.5	-3.2
Revenue Balance (e-h)	-3,943	-3,643	-3,570	-3,655	-3,427	-3,110	-3,212
% to GDP	-4.5	-3.7	-3.2	-2.9	-2.5	-2.1	-1.9
PrimaryBalance (m-1)	-2,428	-1,770	-1,286	-1,083	-802	-512	-235
	-2.8	-1.8	-1.1	-0.9	-0.6	-0.3	-0.1
Financing the deficit							
Market borrowings (Net)	4,362	4,674	4,536	4,451	4,041	3,472	3,482
PPF & special deposits	108	109	98	119	119	130	140
Small savings	-103	86	124	322	525	904	1,002
Net external assistance	124	72	73	129	127	149	158
Others	828	471	391	-692	385	286	555
Cash Drawdown	-160	-510	-192	777	32	402	128
Total financing	5,160	4,902	5,029	5,107	5,228	5,343	5,465
Gross Borrowing (incl buyback/switch)	5098	5580	5641	5903	6233	6225	6050

Source: Budget Documents

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Equity Research View – Largely in Line

This budget was expected to focus on rural, infrastructure and direct taxes in the near term – it came in line with outlays on rural and infrastructure rising c11% YoY. The government also cut direct income taxes for the vast majority of the tax payers – should boost consumption, at the margin. The feared long-term capital gains taxes didn't materialize – causing relief to investors.

The budget maintained an eye to the future – the government announced a series of proposed legislative/policy reforms designed to push the digital economy, spur manufacturing and job creation, curb black money and promote financial inclusion. Finally, we are also constructive on the government's focus on a) improving targeting of government spending and b) improving/monitoring outcomes.

Consumption Stimulus

96% of domestic companies (MSMEs) and 99% of individual income tax filers (20mn) are expected to benefit from the cut in the corporate tax rate to 25% from 30% and the change in the lowest tax slab from 10% to 5% in personal income taxes (see Figure 9). The cuts in the income tax rate coupled with focus on rural spending (up ~11% YoY) in the budget should aid consumption recovery, in our view.

Figure 9. Major Tax Changes: Boost to consumption and smaller enterprises

Tax	Change
Corporate Tax	Corporate income tax rate for SMEs with annual turnover <Rs500mn cut to 25% from 30%
	96% of Indian corporates expected to benefit, as per the Finance Minister
Personal Tax	1. Personal Tax Rate for Rs0.25mn-Rs0.5mn cut to 5% from 10% earlier
	2. New surcharge of 10% for individuals with income between Rs5mn-10mn

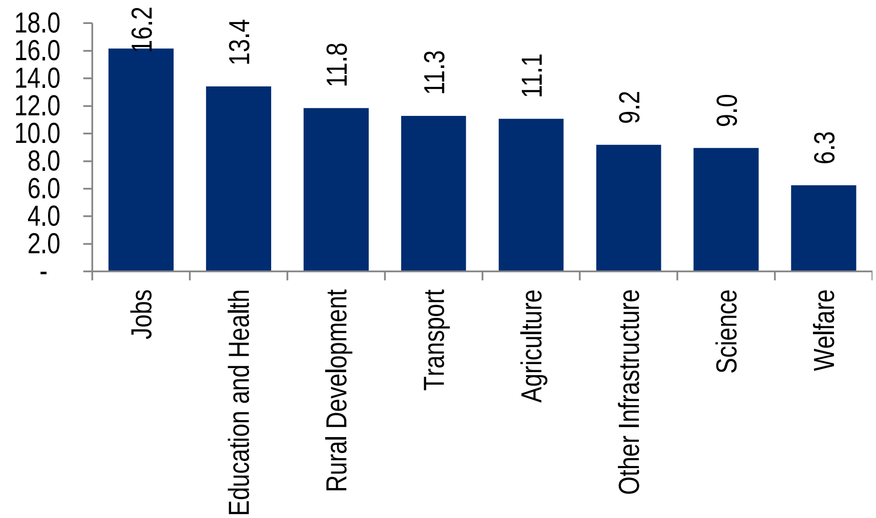
Source: Budget Speech, Citi Research

Figure 10. Impact on personal income taxes

Tax Slabs	Current income tax	Impact on Direct Tax
Rs0.25mn-Rs0.5mn	<25,000	50%
Rs 0.5mn-1mn	25,000-125,000	10-50%
Rs1mn-5mn	125,000-1.4mn	1-10%
Rs5mn-10mn	1.4-3mn	-10% - 0%
>Rs10mn	>3mn	<1%

Source: Government of India, Citi Research

Figure 11. YoY growth in allocation to various focus sectors (vs. FY17RE)



Source: Government of India, Citi Research

Focus of spending remains on Infrastructure

Figure 12. Focus on rural, infrastructure and overall capital spending

Sector	Outlay
Rural	Rs1.87tn (Up 24% vs FY17BE and Up 11% vs FY17RE)
	Rural Housing: Up 50% to Rs230bn
Infrastructure	Roads: Up 11% YoY to Rs650bn
	Railways: Up 19% YoY to Rs550bn (Metro: Up 15% YoY to Rs180bn)
	Total Transportation: Up 11% to Rs2.4tn
	Total Infrastructure: Up 11% to Rs4.0tn
Total Capital Expenditures	Up ~11% YoY (vs revised FY17E ests) and ~25% yoy (vs FY17E budgeted estimate)

Source: Government of India, Citi Research Note: FY17BE: Mar-16 Budgeted estimate for FY17 in last year's budget FY17RE: Feb-17 Revised estimate of actual spending in FY17

Eye to the future

Figure 13. Key Long-Term Reforms Announced

Reform Area	Announcement
Digital Economy	Launch of Aadhar Pay – merchant version of Aadhar Enabled Payment System, comprehensive payment regulation reforms
Labor	Announced proposal to rationalize labor reforms (70+ labor laws) into 4 codes
Disinvestments	To revise mechanism for listing of PSUs
FDI	FIPB to be abolished
Black Money	1. Disallow cash transactions > Rs300,000 Political Party Funding: 1. Cash donations to be capped at Rs2,000 2. To Amend RBI Act to allow issue of electoral bonds
Bankruptcy Reform	Specialized resolution mechanism to deal with bankruptcy in financial companies – Bill to be introduced in the current session of parliament
Financial Inclusion	Doubled lending target under Mudra Yojana for priority lending to SC/ST/Women/Minorities etc. to Rs2.4tn
Infrastructure	New Metro Rail Policy to be announced Affordable Housing to be accorded infrastructure status
Higher Education	UGC Reforms to give greater autonomy to quality institutions of higher education, new framework for outcome based accreditation

Source: Citi Research

Sectors/stocks

- **Autos/Consumer** – impetus to rural economy and agri sector in particular should help. Increase in disposable income is also a positive. Key ideas – **M&M, Maruti, Hero, Emami.** Modest excise duty increase is a positive for **ITC**.

- **Gas** – reduction in customs duties on LNG from 5% to 2.5% is a positive. We have a positive view on the space given the medium-term visibility of earnings. Key ideas – **PLNG, IGL, GSPL.**

- **Cement** – Multiple initiatives on housing, roads, etc., should help – (a) affordable housing to be given infrastructure status; (b) 100% deduction on profits for developing housing projects with carpet area <30/60 sq. m in metros/other locations; (c) 10 m houses to be constructed in rural areas; (d) increase in allocation to road transport and highways. Key ideas – **Ultratech, Shree.**

- **Defence –** Increased capital outlay (+21%) is a positive for **Bharat Electronics.**

- **Financials**– Rural/agri push and pickup in consumption should have a positive rub-off. Infrastructure status to affordable housing is also a positive although the restriction on set off of loss from house property against income against any other heads could be a negative. Push towards digital is also a structural positive. PSU bank recap is not enough to drive growth – we relatively prefer **private banks**.

Figure 14. Key Sector Announcements

Sector	Announcements	Impact	Positive /Negative /Neutral	Companies Impacted
Autos				
#1	Impetus to overall rural economy and agricultural sector in particular (higher agri credit, extension of interest waiver)	Boosts rural demand	Positive	M&M, Maruti, Hero MotoCorp
#2	Relaxation in tax burden at lower income group	Buoys disposable income	Positive	Maruti, Hero MotoCorp, Bajaj Auto
#3	Higher defence outlay	Will help in higher defence equipment demand	Positive	Bharat Forge, Ashok Leyland
#4	Increase in infrastructure related expenditure (including Make In India)	Higher infrastructure capex	Positive	Bharat Forge, Ashok Leyland, Tata Motors
Banking				
#1	Affordable Housing - Infrastructure status provided to affordable housing and the defined area has been changed from built up area to carpet area (size remaining same; 30 to 60 sq. mtr.)	Helps in decreasing borrowing costs for developers and increases the area of affordable housing by ~30%	Positive	LIC Housing Finance, HDFC, housing finance NBFCs
	Set off of loss from house property (let out) to be restricted to Rs0.2m vs. no limit earlier	Potential reduction in demand for houses for investment purposes (esp. higher ticket houses in metros)	Negative	Housing finance companies, Banks with large housing portfolios
#2	PSU Banks recapitalization - No additional capital infusion	Under capitalized banks need capital to meet Basel III requirements by March 2019	Negative	Public sector banks
#3	Promoting Digitalization - Banks will be encouraged to introduce 2 million Aadhar based PoS by September 2017; limit on cash transactions (Rs0.3m)	Will encourage formal financing channel	Positive	All banks
#4	Tax exemption on allowable provision for NPA from 7.5% to 8.5% of income	Helps reducing tax on the provisions set aside for NPA'S	Positive	Companies with asset quality challenges
#5	Listing and Trading of Security receipts issued by a securitization company or a reconstruction company in SEBI registered stock exchanges	Potential impetus for sales of NPLs to ARCs	Positive	Companies with asset quality challenges
#6	Systematically important NBFC's regulated by RBI and above a certain net worth will be categorized as QIBs and eligible for participation in IPOs	Will strengthen IPO market	Positive	
Cement				
#1	Affordable housing to be given infrastructure status	Lower cost of funding for developers leading to increase in affordable housing projects	Positive	All cement producers
#2	100% deduction of profits/gains for developing housing projects for carpet area <30/60sqm in metros/other locations and extend period of completion from 3 to 5 years	Better profitability leading to increase in affordable housing projects.	Positive	All cement producers
#3	10m houses to be constructed by FY19 in rural areas (already announced earlier)	Higher cement demand	Positive	All cement producers
#4	Additional Rs200m to be contributed to long term irrigation fund under NABARD.	Higher cement demand	Positive	All cement producers
#5	~24% increase in allocation to road transport and highways.	Higher cement demand	Positive	All cement producers
Consumer				
#1	Modest 6% increase in excise duties for cigarettes	Could support industry volumes	Positive	ITC, VST, Godfrey
Agriculture / Healthcare				
#1	Sops for Agriculture - Several announcements, including raise in agri credit, NABARD funding, dedicated micro irrigation fund, model law on contract farming, Fasal Bima Yojna etc.	Easier availability of credit and higher disposable income for farmers	Positive	All Agchem companies
#2	Status quo has been maintained in Pharma - No major announcement for Pharma and healthcare sector in the budget	Lower drug prices	Neutral	All Pharma companies

Source: Citi Research

Figure 15. Key Sector Announcements (contd.)

Sector	Announcements	Impact	Positive /Negative /Neutral	Companies Impacted
Industrials				
#1	Defence outlay(ex-pensions) has been increased 17%YoY to Rs2592bn. Defence capital outlay has been increased 21%YoY to Rs865bn	Will lead to increase in defence sector orders.	Positive	Bharat Electronics, L&T under our coverage
Infrastructure				
#1	Railways - a) has targeted investments of Rs1310bn in FY18; budgetary allocation has increased 19%YoY to Rs550bn. b) will implement end-to-end solutions for select commodity transport. c) has set up JVs with states; 70 projects have been identified for construction and development d) A new metro rail policy will be announced and a new metro rail act enacted	Will provide a boost to railway infrastructure.	Positive	L&T
#2	Road transport and highway outlay has been increased 24%YoY to Rs649bn	Will provide an impetus to road award/construction activity.	Positive	Road EPC companies/L&T
#3	Select airports in tier 2 cities will be taken up for operation and maintenance under PPP mode	Will strengthen airport infrastructure	Positive	GMR
#4	A programme for development of multi-modal logistics parks, together with multi-modal transport facilities will be drawn up and implemented	Will strengthen logistics infrastructure	Positive	
#5	The required mechanism for streamlining resolution of disputes in infra related construction contracts would be instituted as a part of the Arbitration and Conciliation Act 1996; an amendment bill would be introduced for the same	Will fasten dispute resolution	Positive	All infrastructure companies which have pending disputes
#6	The interest paid by an Indian company or permanent establishment of a foreign company, in excess of 30% of EBITDA, or interest paid to its associated enterprise, whichever is less, shall not be allowed as deduction in computing its taxable profit. It has also been proposed to allow carry forward and set off of the interest so disallowed for 8 assessment years	Profitability of some infrastructure companies to be impacted.	Negative	Some infrastructure companies may be impacted.
IT				
#1	Measures to boost Digital Economy like proposal to create Payments Regulatory Board, launching Aadhar Pay, new schemes to promote usage of BHIM etc	Greater quantum of work from India	Positive	Companies with relatively greater focus on India like Wipro, L&T Infotech
#2	Measures focused on education and skill building (SWAYAM platform, setting up National Testing Agency, etc)	Reforms are longer-term positive for education and skill building	Positive	All sector companies
Metals and Mining				
#1	Import duty on Nickel (currently 2.5%) removed	Lower costs for stainless steel producers	Positive	Positive for stainless steel producers (1-2% of SAIL's volumes)
#2	Import duty on HRC steel used in the manufacture of tubes/pipes has been reduced from 12.5% to 10%	Lower cost of imported HRC	Neutral	Limited impact for major steel producers
#3	15% export duty has been introduced on aluminum ores including laterite (Not bauxite as bauxite already attracts 20% export duty)	Lower exports of aluminium ores	Neutral	Negligible impact for Indian aluminium producers
#4	CVD @ 12.5% imposed (nil earlier) on silver (>99.9% silver content)	Higher silver prices	Positive	Slight positive for Hindustan Zinc as silver accounts for ~20% of EBITDA

Source: Citi Research

Figure 16. Key Sector Announcements (contd.)

Sector	Announcements	Impact	Positive /Negative /Neutral	Companies Impacted
Oil and Gas				
#1	Reduction in customs duty on LNG from 5% to 2.5%	Cost of imported LNG will fall	Positive	Companies in the LNG value chain such as importers (PLNG, GAIL), transporters (GSPL, GAIL), and distributors (IGL, MGL)
#3	Proposal to create integrated PSU oil major	Too early to determine. In the past, nothing fructified of such proposals given complexity. Negatives (integration issues, not good for competition/customers) outweigh positives (size & scale)	Too early to determine	
#4	Enhance capacity of strategic crude oil reserves (from 3 to 5 facilities, taking total capacity to 15.33 MMT)	Improves national energy security at the margin	Neutral	None
Real Estate				
#1	Affordable housing to be given infrastructure status	Lower cost of funding	Positive	None - large listed developers do not cater to this segment
#2	100% deduction of profits/gains for developing housing projects for carpet area <30/60sqm in metros/other locations and extend period of completion from 3 to 5 years	More projects come under the purview as definition changed from built up area to carpet area	Positive	None - large listed developers do not cater to this segment
#3	NHB to refinance individual housing loans of Rs200bn and interest subvention for housing loans announced by PM	Boosts end user demand	Positive	None - large listed developers do not cater to this segment
#4	Restricts set off of loss from second house property to up to Rs0.2mn - loss not so set off allowed to be carried forward for set off against house property income for 8 AY	Puts pressure on investor-led demand	Negative	All developers, especially those with greater exposure to NCR/Mumbai with relatively higher investor demand
#5	Period for availing LTCG benefit for land/property reduced to 2 years from 3 years	Marginally positive for investment demand	Marginally positive	All developers, especially those with greater exposure to NCR/Mumbai with relatively higher investor demand
Telecom				
#1	Government has budgeted revenue of Rs443bn from the telecom sector	This implies no new spectrum auction planned during the year	Positive	Operators B/S are already stretched so any auction would have been a negative. Positive for Airtel, Idea
#2	Incentive schemes for electronic manufacturing. The custom duty on PCBs for use for manufacture of mobile phones increased to 2% from 0% earlier	Encourage domestic manufacturing	N/A	N/A
Internet				
#1	Introduction of Aadhar enabled Payment System	Encourage digital payment	N/A	N/A
#2	High speed broadband connectivity in more than 150k gram panchayats	Encourage data usage	N/A	N/A
#3	Relaxation of condition to carry forward losses in start-ups. Profit exemption available to start-ups for 3 years out of 5 years is changed to 3 out of 7 years. Condition of continuous holding of 51% of voting rights has been related subject to the original promoters continuing in the company	Encourage entrepreneurship	Positive	All internet start ups
#4	Referral bonus scheme to promote for individuals, cashback scheme for merchants to use BHIM app	Encourage digital payments	N/A	N/A
Utilities				
#1	100% rural electrification target to be met by 1st May 2018.	Will support power demand growth.	Positive	All sector companies
#2	Allocation under IDPS and DDUGJY has been increased to Rs106bn from Rs79bn.	Will support power demand growth.	Positive	All sector companies
#3	The second phase of solar park development for additional 20GW solar capacity will be taken up.	Will support renewable energy generation in India	Positive	L&T

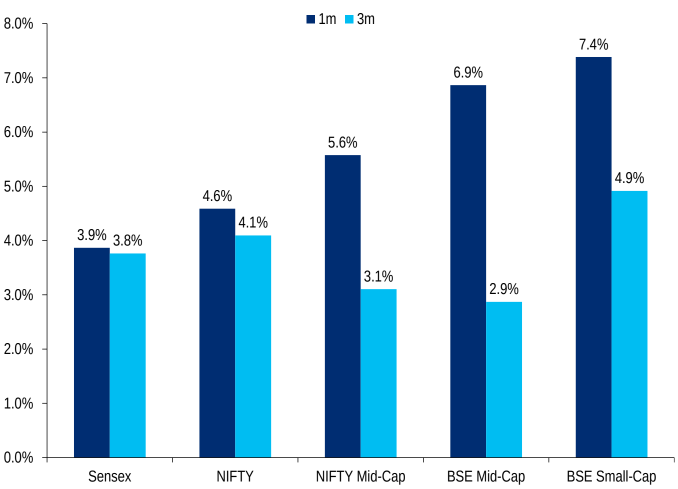
Source: Citi Research

Markets: Initial reaction positive

Indian equities have done well in the run-up to the budget this year – Sensex is up c4% in the last one month and was up ~2% on the budget day – the mid-cap/small-cap indices have done better and among sectors, cyclicals (Metals, Consumer Durables and Banks) have outperformed. MSCI India has been flat vs. MSCI EM and has O/P against MSCI World in the last 1m (3m: U/P vs. both).

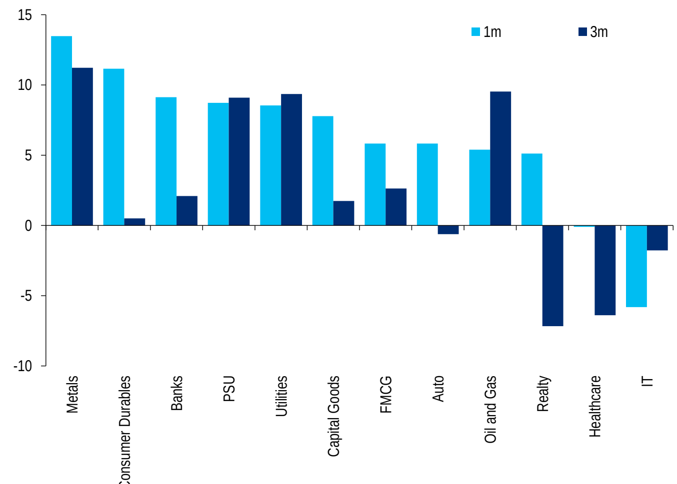
Historically, market performance following the budget has been mixed – in fact, in the last five years, Sensex has delivered significant positive returns in only FY17 (Figure 21 - broader EM rally coincided). Capital Goods, Autos, IT and Healthcare sectors have the best 1m post budget average returns over the past 15 years. Banks and Energy have fared the worst (see Figure 20).

Figure 17. Performance of benchmark indices going into the budget



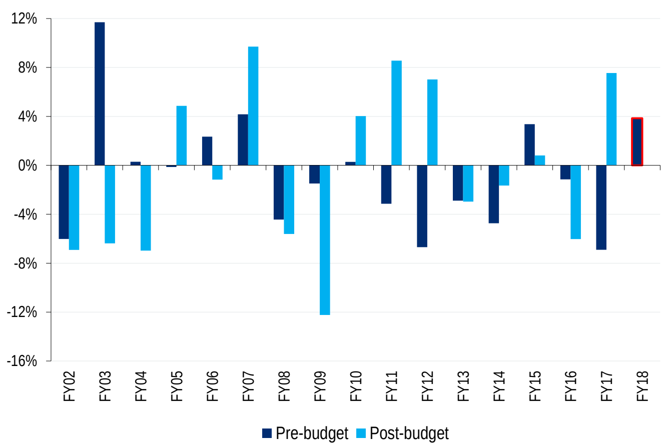
Source: Bloomberg and Citi Research

Figure 18. Sector performance going into the budget



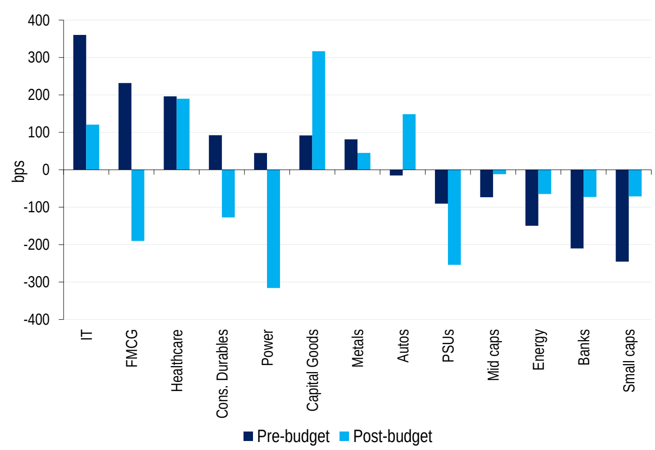
Source: Bloomberg and Citi Research

Figure 19. Sensex 1m performance historically in the run up to/post budget



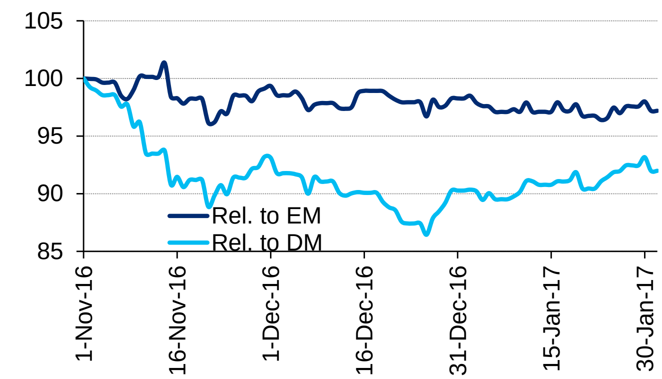
Source: Bloomberg and Citi Research

Figure 20. Sectors performance historically in the run-up-to/post budget



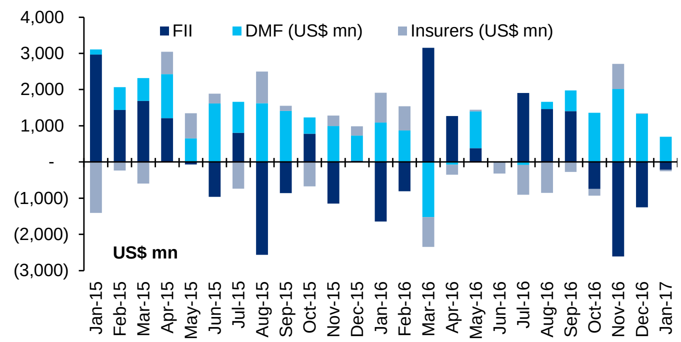
Source: Bloomberg and Citi Research

Figure 21. MSCI India performance relative to EM/DM indices



Source: Bloomberg and Citi Research

Figure 22. FII/DII Flow Trends



Source: Bloomberg and Citi Research

Companies: Ashok Leyland (ASOK.BO; Rs92.15; 1); Bajaj Auto (BAJA.BO; Rs2,856.65; 3); Bharat Electronics (BAJE.NS; Rs1,568.40; 1); Bharat Forge (BFRG.BO; Rs970.05; 2); Bharti Infratel (BHRI.BO; Rs295.30; 1); Bharti Airtel (BRTI.BO; Rs345.05; 1); Eicher Motors (EICH.BO; Rs24,007.95; 1); Emami (EMAM.BO; Rs1,106.15; 1); Exide Industries (EXID.BO; Rs202.95; 1); GAIL (GAIL.BO; Rs484.75; 3); Godfrey Phillips India Ltd (GDFR.NS; Rs1,024.95; Not Rated); GMR Infrastructure (GMRI.BO; Rs13.08; 2); Gujarat State Petronet (GSPT.BO; Rs156.25; 1); Housing Development Finance (HDFC.BO; Rs1,414.95; 1); Hero MotoCorp (HROM.BO; Rs3,284.10; 2); Hindustan Zinc (HZNC.BO; Rs305.65; 1); IDEA Cellular (IDEA.BO; Rs107.45; 3); Indraprastha Gas (IGAS.BO; Rs960.80; 1); ITC (ITC.BO; Rs269.70; 1); Larsen & Toubro (LART.BO; Rs1,490.75; 1); LIC Housing Finance (LICH.BO; Rs570.20; 2); L&T Infotech (LRTI.BO; Rs664.80; 2); Mahindra & Mahindra (MAHM.BO; Rs1,296.90; 1); Mahanagar Gas (MGAS.BO; Rs883.40; 2); Maruti Suzuki India (MRTI.BO; Rs6,172.85; 2); Oil India (OILI.BO; Rs331.35; 3); Oil & Natural Gas (ONGC.BO; Rs200.25; 2); Petronet LNG (PLNG.BO; Rs387.65; 1); Steel Authority of India (SAIL.BO; Rs65.70; 3); Shree Cement (SHCM.BO; Rs15,951.15; 1); Tata Motors (TAMO.BO; Rs541.70; 1); UltraTech Cement (ULTC.BO; Rs3,783.25; 1); VST Industries Ltd (VSTI.NS; Rs2,458.85; Not Rated); Wipro (WIPR.BO; Rs455.25; 3)

Appendix A-1

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Data current as of 31 Dec 2016	Buy	Hold	Sell	Buy	Hold	Sell
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% of companies in each rating category that are investment banking clients	65%	61%	60%	72%	63%	50%

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