CRISIL RESEARCH

Union Budget 2008-09

Analysis and Outlook

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CRISIL RESEARCH

CRISIL RESEARCH

Contents

Continued...

Contents

...continued

Capital markets

Data notes

1) All domestic prices are ex-factory prices, unless indicated otherwise.
2) All international prices are cif prices, unless indicated otherwise.
3) Wherever the domestic prices are ex-factory prices, the landed costs do not include CVD. Wherever the domestic prices are market prices, the landed costs include CVD.
4) The customs and excise duty rates mentioned in the tariff tables for each sector are effective duty rates, after including the education cess applicable for the year.
5) Landed cost is gross of special CV duty of 4 per cent wherever applicable. However, the effective landed cost for intermediate products will be MODVATable and will hence not include the impact of this duty.

Foreword

Many things for many people

There were many expectations from the budget from many sides. From an economic perspective, the continuing commitment to fiscal discipline in terms of compliance with the Fiscal Responsibility and Budget Management (FRBM) Act was an important requirement to be fulfilled by the Finance Minister. Looking beyond the immediate, the process of transition to the Goods and Services Tax (GST) was expected to be firmly set in motion. Although there is no cause for panic on the growth front, concerns about a slowdown, particularly in the manufacturing sector, have been visible in recent months. The ruling coalition has been emphasizing inclusive growth as its paramount objective and this had to be given visible and credible impetus in the Budget. And, of course, this is almost certain to be a pre-election budget, so political associates had to be kept happy.

A strong economy, further reinforced by unprecedented revenue buoyancy, provides the Finance Minister a lot of room to manoeuvre. And, in this Budget, he has used it extremely well. With respect to fiscal discipline, not only has he met the target, he has also left some room to accommodate the likely impact of the Sixth Pay Commission recommendations. He has also squarely addressed the rising anxieties about off-budget liabilities by at least bringing them out into the open and allowing us to assess their full impact on the fiscal position. While not insignificant, as our analysis shows, this impact is not dramatic either.

The critical social sectors, namely, health and education, have also received considerable attention in the Budget. However, in proportionate terms, the increases are not very different from previous years and the old problems of using decrepit delivery mechanisms will continue to hinder achievements in these sectors. Of course, there are some innovative measures in the educational field, with respect to marketable skill creation, for example, which do reflect a welcome change in direction. Also, there is a significant emphasis in expanding higher education capacity, which will go down well with a growing and increasingly aspirational middle class.

Infrastructure has also received attention, across the range of sectors - highways, power and the integrated rural and urban infrastructure missions. The overall availability of resources for these sectors has been enhanced by tapping into extra-budgetary resources, which opens up the opportunity for private participation and market discipline.

Foreword

Populism has been brought in as well, some harmless, some potentially not. Raising the income tax exemption limit as well as adjusting the rate slabs will make a lot of people, mostly young, happy. The revenue impact will be offset in just a few years as rapidly rising incomes take these people into either the first tax bracket or higher ones in short order. On the other hand, the loan waiver for farmers, whose burden falls entirely on the banking system, is a clear triumph of politics over economics.

Taking everything into consideration, though, this is a very good budget, satisfying many while doing relatively little damage.

Dr Subir Gokarn

Chief Economist, Standard & Poor's Asia Pacific

Economy

Economy

Highlights

- Nominal GDP growth is assumed to be 13 per cent in 2008-09
- Along with the RBI, the finance ministry would work to moderate capital flows
- Revenue deficit for 2008-09 is 1 per cent of GDP, a decline of 0.4 percentage points from 2007-08 revised estimates
- Fiscal deficit to be less than the FRBM mandate - 2.5 per cent of GDP
- Tax/GDP increases from 9.2 per cent in 2004-05 to 12.5 per cent in 2007-08
- 43 per cent and 27.1 per cent growth in personal income tax and corporate tax, respectively in 2007-08.
- National Rural Employment Guarantee Scheme (NREGS) to be implemented in all 596 rural districts with a provision of Rs 160 billion
- JNURM allocation increased by 25.2 per cent – to Rs. 54.8 billion
- Allocation for Bharat Nirman to be raised to Rs 31,280 crores
- Huge bonanza for education sector – 16 central university, 3 IITs, 2 IISERs and 2 schools of planning and architecture
- Health insurance for unorganised sector – Rs 30,000 for every BPL unorganised sector worker
- Public Distribution Scheme (PDS) through smart cards to be launched on a pilot basis in Haryana and Chandigarh
- Exchange traded currency and bond market to get a boost through further institutional arrangement
- Tax of short term capital gains increased to 15 per cent from 10 per cent
- No change in peak customs duty while general CENVAT reduced from 16 to 14 per cent
- No change in the peak rate of customs duty
- Automobile industry to get a boost through reduction in excise duty
- Banking cash transaction tax withdrawn from April 1,2009
- Commodities transaction tax to be introduced on the lines of securities transaction tax
- Income tax slabs changed. New slabs will be: 10 per cent for Rs 1.5 lakhs — Rs 3.0 lakhs, 20 per cent for Rs 3.0 lakhs — Rs 5.0 lakhs and 30 per cent for income above Rs 5.0 lakhs.
- Threshold limit for exemption from personal income tax increased to Rs. 1.5 lakh, for women it is Rs 1.8 lakh
- Complete loan waivers for marginal and small farmers that were overdue till December 31, 2007 and one time settlement scheme for other farmers with 25 per cent rebate
- Central Plan Scheme Monitoring System (CPSMS) to be put in place under the aegis of the Planning Commission for the effective monitoring, evaluation and accounting of various central and state level plans.

Detailed ecomonic analysis

Outlook 2008-09

	Parameter	Forecast	Rationale
Growth	Agriculture	3.0	We expect the Indian economy to grow around 8.5 per cent during 2008-09 compared to 8.7 per cent (CSO, advance estimate) during 2007-08 as the monetary tightening undertaken over the last 2 years and world economic slowdown is expected to moderate the overall demand situation. Fiscal stimulus provided in the budget would to some extend support the demand. Hence, overall GDP growth is likely to slow down marginally.
	Industry	8.3	
	Services	10.3	
	Total	8.5	
Inflation	WPI-Average	4.5-5.0	Upward pressures particularly from rising international oil and firm food prices are likely to push up inflation next year compared to this current year.
Interest rate	10-year G-Sec (Year-end)	7.5 – 7.7	We expect the RBI to cut the policy interest rates in the next fiscal year as economic growth slows down. As a result the market rates would come down compared to the current year and we expect the 10-year G-sec rate to stay within the range of 7.5 to 7.7 per cent.
Exchange rate	Re / US $ (Year-end)	38.5-39.0	Indian economy is expected to continue to attract foreign inflow as it presents an attractive investment opportunity relative to most other countries. The RBI would continue to intervene in the market to curb volatility and try to moderate the appreciating pressure.
Fiscal deficit	Fiscal deficit (as a % of GDP)	2.5+1.0	Although the official target of 2.5 of GDP might well be achieved, the off-budget items will significantly push up the true fiscal deficit.

Detailed economic analysis

Review 2007-08

Growth: Marginal moderation in growth

After two years of over 9.0 per cent GDP growth rate, economic growth is expected to slow down to 8.7 per cent in the current fiscal. Although the economy grew at 9.3 per cent in the first quarter of the year, in the second and third quarters GDP growth at factor cost slowed down to 8.9 per cent and 8.4 per cent, respectively. In spite of an impressive Kharif season, agriculture is expected to grow only at 2.4 per (CSO advance estimates). The production of certain industrial sectors slowed down due to a decline in consumer demand as a result of the monetary tightening measures of the RBI and exports demand slowdown as a result of the appreciation of the currency.

Inflation: Supply-side concerns to persist

Inflation based on wholesale price index, stayed within the RBI's target range of 5 per cent for this fiscal, following monetary tightening measures. With the exception of July, inflation fell every month till November. Subsequently, inflation moved in the upward direction. The average inflation for the year is expected to settle at 4.4 per cent in 2007-08 as compared to 5.4 last year. A favourable monsoon, together with measures like duty cuts, and a ban on exports and future trading of crops helped ease supply and prices of food articles. The prices of the fuel group, although kept decelerating during the first half of the fiscal, started to pick up in response to the surge in international crude oil prices.

Interest rates: Softening of rates expected

Apart from the CRR hike by 150 bps to 7.5 per cent and increase in the repo rate by 25 bps to 7.75 per cent, the other policy rates, viz, reverse repo and bank rate were kept unchanged at 6.0 per cent during 2007-08. In addition, the ceiling on the MSS, necessary for sterilisation operations, was also raised for four times to Rs 2,500 billion. These steps were clearly indicative of the monetary tightening stance of the RBI in the wake of excess liquidity. As a result, the liquidity overhang eased partially and hence resulted in the hardening of the yields across all categories.

Fiscal: The FRBM target in reach

As a result of the buoyant tax scenario fiscal deficit at 3.1 per cent of GDP for 2007-08; 0.2 percentage points lower-than-expected, the revenue deficit target of 1.5 per cent of GDP will also be achieved. However, the reported fiscal deficit underestimates the true size of the deficit as a result of treating certain expenditure as off-budget. As for tax collection, direct taxes are likely to grow more- than-expected, though the buoyancy in indirect taxes except that in service tax has declined.

Exchange rate: Appreciating trend to continue at a slower pace

Robust capital flows boosted the equity market during 2007-08, although the volatility of the market indices increased significantly. The rupee appreciated considerably the first half of the year as the RBI found it difficult to check the rate of appreciation in the light of deluge of capital flows. In the second half

of the fiscal however, once the MSS ceiling was raised, the RBI could intervene significantly and sterilise excess liquidity. As a result, the rupee moved within a narrow range. The RBI has also been resisting depreciating pressure on the currency in recent weeks.
Detailed economic analysis

Overall fiscal trends

The positive impact of buoyant tax collection - with significantly higher than expected revenues - is clearly visible in the revised fiscal accounts for 2007-08. As a result, fiscal deficit at 3.1 per cent of GDP is expected to improve upon the budgeted target of 3.3 per cent for the current fiscal. The fiscal numbers look good, compared with budget estimates, largely due to considerably higher corporation and personal income tax collection. Personal income tax revenue saw unprecedented growth of over 43 per cent and corporate tax collection grew by over 27 per cent in 2007-08. Although the advanced estimates of CSO peg GDP growth at 8.7 per cent in 2007-08 - marginally lower than what the government had anticipated, the tax collection continued to grow. The growth momentum picked up in 2003-04 and, since then, has remained on course. The economy clocked an average 8.75 per cent during 2003-04 to 2007-08. This has resulted in considerable revenue buoyancy for the government - both via the direct and indirect tax route.

Although industrial growth slowed down in 2007-08 as compared to the previous fiscal, a key source of indirect tax revenue for the central government, gross tax revenue grew by 25 per cent this year. However, additional service segments are now being brought into the services tax fold, the service tax collection grew by 32.6 per cent this fiscal.

Since 2003-04, central government finances have improved gradually. On the expenditure side, non-plan expenditure overshot by 5.6 per cent, while planned spending was 1.2 per cent higher than that budgeted. Although revenue and fiscal deficit as a percentage of GDP fell as compared to last year, in absolute terms revenue deficit was around 11 per cent more than that budgeted. Fiscal deficit also exceeded the budget target by 4.8 per cent. Similarly, the trends in revenue and capital expenditure are not particularly encouraging. While revenue expenditure overshot the budget target by 3.8 per cent, capital expenditure fell short by 1.2 per cent.

Detailed economic analysis

Table 1: Per cent Deviation from the Budgeted

	Fiscal Deficit	Revenue Deficit	Plan xpenditure	Non-Plan Expenditure	Total Expenditure	Gross Tax Revenue	Industrial Growth
2000-01	6.8	10.1	-6.2	-3	-3.8	-2.5	5
2001-02	21.2	27.1	6.4	-5.1	-3.4	-17.5	2.7
2002-03	-3.1	13.1	-1.8	-2.7	-2.4	-8.3	5.8
2003-04	-19.8	-12.5	1.1	9.8	7.4	1.1	7
2004-05	-8.9	2.8	-9.1	10	4.2	-4	8.4
2005-06	-3.1	-3.2	-2	-1.4	-1.6	-1	8.2
2006-07	-4.1	-5.3	-1.7	5.7	3.4	5.8	10
2007-08	-4.8	-11.2	1.2	5.6	4.2	6.8	8.7

Note

2007-08: Computed from the Revised Estimates

Source: Union Budget various issues

The following table presents the key budgetary arithmetic for 2008-09. One of the notable features here is that the primary surplus (fiscal deficit - interest payments) continues to increase and is expected to be 1.1 per cent of GDP next year.

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Table 2: Budget 2008-09 at a Glance

(Rs billion)	2006-07 Actuals	2007-08 BE	2007-08 RE	2008-09 BE
1. Revenue Receipts	4343.9	4864.2	5250.98	6029.35
2. Tax Revenue (net to centre)	3511.8	4038.7	4317.73	5071.5
3. Non-Tax Revenue	832.1	825.5	933.25	957.85
4. Capital Receipts (5+6+7)	1490.0	1941	1842.75	1479.49
5. Recoveries of Loans	58.9	15	44.97	44.97
6. Other Receipts	5.3	416.5	361.25	101.65
7. Borrowings and other liabilities	1425.7	1509.5	1436.53	1332.87
8. Total Receipts (1+4)	5833.9	6805.2	7093.73	7508.84
9. Non-Plan Expenditure	4135.3	4754.2	5018.49	5074.98
10. On Revenue Account	3721.9	3835.5	4129.75	4483.52
of which				
11. Interest Payments	1502.7	1590	1719.71	1908.07
12. On Capital Account	413.4	918.8	888.74	591.46
13. Plan Expenditure	1698.6	2051	2075.24	2433.86
14. On Revenue Account	1424.2	1743.5	1756.11	2097.67
15. On Capital Account	274.4	307.5	319.13	336.19
16. Total Expenditure	5833.9	6805.2	7093.73	7508.84
18. Revenue Expenditure	5146.1	5579	5885.86	6581.19
19. Capital Expenditure	687.8	1226.2	1207.87	927.65
20. Revenue Deficit	802.2	714.8	634.88	551.84
As a percentage of GDP	1.9	-1.5	1.4	1.4
21. Fiscal Deficit	1425.7	1509.5	1436.53	1332.87
As a percentage of GDP	3.5	3.3	3.1	2.5
22. Primary Deficit	-77.0	-80.5	-283.18	-575.2
As a percentage of GDP	-0.2	-0.2	-0.6	-1.1

Source: Union Budget 2008-09

Rolling fiscal targets

The Medium Term Fiscal Policy Statement presented along with the budget gives three-year rolling targets for key fiscal indicators. These have been derived on the basis of assumptions on growth and the policy stance of the government. Table 3 compares the rolling targets set in the budget since 2005-06 and the subsequent revisions in them.

Table 3: Slippage in FRBM targets

Targets	2007-08	2008-09	Targets for	
			2009-10	2010-11
Fiscal Deficit				
Budget 2005-06	3.1	--	--	
Budget 2006-07	3.4	3	--	
Budget 2007-08	3.3	3	3	
Budget 2008-09	3.1	2.5	3	3
Revenue Deficit				
Budget 2005-06	1.1	--	--	
Budget 2006-07	1.1	0	--	
Budget 2007-08	1.5	0	0	
Budget 2008-09	1.4	1	0	0
Tax/ GDP				
Budget 2005-06	12.6	--	--	
Budget 2006-07	11.5	11.8	--	
Budget 2007-08	11.8	12.3	12.7	
Budget 2008-09	12.5	13	13.5	14
Debt/ GDP				
Budget 2005-06	67.3	--	--	
Budget 2006-07	64.4	63.1	--	
Budget 2007-08	61.4	58.6	56	
Budget 2008-09	63.8	59.6	55.7	52.3

Source: Union Budget various issues

The initial slippage in rolling deficit targets, especially in revenue deficit, anticipated since 2005-06, is evident from Table 3. The rolling indicators set in the 2005-06 budget had targeted the revenue deficit to fall to 1.1 per cent of GDP by 2007-08, but the 2006-07 budget had a more realistic revenue deficit target of 1.5 per cent for the same year. The revised estimates for 2007-08 show an improvement in the revenue deficit over the budgetary target. For the next fiscal, the revenue deficit of 1 per cent is set down in this budget. Under the FRBM act, the revenue deficit was to be eliminated by the next fiscal. However, the Finance Minister now expects the elimination of revenue deficit by 2009-10. The budget aggressively targets the reduction in fiscal deficit to 2.5 per cent of GDP as compared to the FRBM target of 3.0 for 2008-09. The fiscal deficit is expected to rise to 3.0 per cent after the next fiscal.

There are significant concerns expressed over the true impact of off-budget expenditure such as oil bonds and the implementation of the recommendations of the 6th Pay Commission (expected to be submitted in April 2008) on fiscal deficit. These issues have been analysed in box 1 and box 2 below.

Detailed economic analysis

Box 1: Underestimation of fiscal deficit

With the fiscal deficit on a declining trend since process of fiscal consolidation began in 2003-04, the government looks on target to achieve the FRBM targets by 2008-09. But there is more to the story then what just meets the eye. The reported fiscal deficit numbers does not take into account the non-cash transfers in the form of bonds issued to oil, food and fertilizer companies. To compensate these companies for selling their products below cost, the government has been issuing special bonds to them. These bonds are off balance sheet and do not bloat the fiscal deficit.

The Central Government has also been periodically issuing special bonds (table 4) to

1) the oil marketing companies (since 1997-98),
2) the Food Corporation of India (FCI) (in 2006-07) and
3) fertiliser companies (in 2007-08)

The pressure to achieve the FRBM target has given the government the incentive to push such items off-balance sheet. Officially, the issuance of these four types of bonds is considered to be fiscal deficit neutral since they do not involve cash flow and are, therefore, not treated as part of fiscal deficit, although their interest payments are included in the revenue expenditure. In the budget of 2008-09, the government partly recognised that these bonds have fiscal implications as they add to the fiscal liabilities of the government and therefore listed the actual figures of oil and fertilisers bonds for the current fiscal, as off now, in the budget at a glance.

During 2007-08, special bonds amounting to Rs 75 billion and Rs 234.6 billion, respectively, are envisaged to be issued to fertiliser companies and oil marketing companies. As per our estimates, a transparent issuance of debt through budget would have pushed up the fiscal deficit by 0.7 per cent of GDP in 2007-08. Further, the value of outstanding bonds (based on the last two years for oil bonds) implies that the figure for the debt/GDP would be underestimated by 1.7 per cent this year.

Fiscal consolidation is therefore, subject to downside risks if international commodity and oil prices continue to increase. The bond issues will further, and inflate the true fiscal deficit numbers.

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Table 4: Current off-budget bonds (Rs billion)

	2006-07	2007-08 (P)	2008-09 (E)	2007-08 Outstanding
Oil bonds	241.2	234.6	309.6	475.8
Fertiliser bonds	--	75	183.7	75
FCI bonds	162	--	--	162
Total	403.2	309.6	493.3	

Source: RBI, CRISIL Estimates

Table 5: Understatement of Fiscal Deficit and Debt

	Fiscal deficit			Debt/GDP
% GDP	**2006-07**	**2007-08**	**2008-09**	**2007-08**
FRBM target	3.8	3	3	
Budget estimate	3.8	3.3	2.5	
Fiscal deficit/debt*	3.5	3.1		63.8
Understatement of Deficit/debt	1.1	0.7	1	1.7
True Fiscal deficit/debt	4.6	3.8	3.5	65.5

Note:* actual for 2006-07, revised for 2007-08

Source: Budget documents and CRISIL estimates

Box 2: The impact of the Sixth Pay Commission

The Sixth Pay Commission (SPC) was set up in October 2006 under the chairmanship of Justice B.N. Srikrishna to revise the salary structure of central government employees and pensioners. The report is likely to be submitted by April 2008. There have been concerns by many regarding the impact of its implementation on the fiscal health of the Centre as also the states, since the states too usually follow suite.

The financial impact of FPC, implemented in 1997-98, on the Central exchequer was estimated at Rs 170 billion. The impact was severe on the states' finances during the period 1997-98 and 1999-2000 with the consolidated fiscal deficit rising to 9.9 per cent of GDP in 2001-02 from 6.3 per cent in 1996-97, and the revenue deficit up to 7.0 per cent of GDP from 3.5 per cent over the same period. But the disaster did not occur only because of the implementation of the hikes in salaries but also because there were certain other recommendations, none of which were implemented. These recommendations included slashing the government workforce by 30 per cent; abolishing 350,000 vacant posts, and reducing the number of pay scales from 51 to 34.

Continued...

Detailed economic analysis

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However, the government appears to be optimistic this time and feels that the fiscal scenario is in much better shape as even the states are flush with cash. Unlike the situation that prevailed at the time of the FPC, the SPC would be implemented when the economy is on a high growth trajectory and tax collection is buoyant. The tax-GDP ratio of the Centre has increased from 8.8 per cent in 2002-03 to 11.3 per cent in 2006-07. According to the RBI, such level of tax buoyancy would absorb the impact of SPC without impairing the process of fiscal consolidation.

Table 6: Likely Impact of Sixth Pay Commission

	Wages , Salaries and Pension	
	In Rs. billion	As percent to GDP
2002-03	706.5	2.9
2003-04	734.8	2.7
2004-05	808.2	2.6
2005-06	876.6	2.5
2006-07	941.1	2.3
2007-08	1005.3	2.1
2008-09	1357.2*	2.6#

Source: An Economic and Functional Classification of the Central Government Budget, Government of India., * Increase in 'Wages, Salaries and Pension' in SPC assumed to be similar to FPC in proportionate terms, # GDP assumed to grow by nominal rate of 13 percent, over the advance estimate of 2007-08.

Despite such optimism, it would be interesting to estimate the likely impact of SPC on government finances. Table 6 gives the likely impact of SPC on the Central government expenditures. The 'wages, salaries and pension' component of the government expenditure, as a percentage of GDP, rose from 2.7 per cent in 1996-97 to 3.3 per cent in 1997-98, when the FPC was implemented. This amounts to an increase of 35 per cent in the wage bill. Assuming the same increase in the wage bill for 2008-09, the wages, salaries and pension of central government as a percentage of GDP are expected to increase from 2.1 per cent in 2007-08 to 2.6 per cent in 2008-09. This translates to an additional burden of 0.5 per cent of GDP, which is substantial.

It is therefore important that while accepting recommendations of SPC, the centre must remain vigilant. As for the states, the RBI, in its latest report on State Finances, has suggested the states to base their decisions relating to salary levels, after due consideration to their fiscal capacity, employee strength, size of population and the required complementary expenditure for productive employment.

Detailed economic analysis

The revenue arithmetic

Revenue targets in 2008-09

The budget assumes a nominal growth of 17.5 per cent in gross revenues in 2008-09 over a high growth of 25 per cent in 2007-08. This raises the tax/GDP ratio from 12.5 per cent in 2007-08 to 13.5 per cent in 2008-09. Table 7 documents the share of major taxes in the gross tax revenues, their performance in 2007-08 and expectation in 2008-09.

Table 7: Tax Revenues of Central government

Tax Heads	% Share	% Growth	
	2007-08	07-08/06-07	08-09BE/07-08
Gross Tax Revenue	100	25.1	17.5
Excise	21.9	9.1	7.8
Corporate	31.8	27.1	21.6
Customs	17.2	23.2	18.0
Income Tax	20.2	43.4	16.9
Service	8.6	32.6	27.4
Other Taxes	0.3	2.7	7.7
Net tax revenue (Centre)	73.8	24.8	17.5

Source: Budget 2008-09

The revenue buoyancy projected in 2008-09 relies on the performance of income tax, corporate tax, custom duties. In 2008-09, increases of 17.0 per cent, 21.6 per cent and 18.0 per cent have been budgeted in income, corporate, custom duties, respectively. The overall revenue receipts (net to the centre) are budgeted to grow by 17.5 per cent in 2008-09, as against the observed growth of around 25 per cent in the previous year. One important change in the structure of tax revenues in the last couple of years has been the emergence of corporate tax as the single largest component of overall tax collections. Prior to that, union excise duty was the single biggest source of tax revenue for the government. The assumed moderation in tax revenue growth appears quite realistic given that the base was high and the overall growth too is expected to moderate in 2008-09.

Overall tax buoyancy has improved significantly since 2003-04. Box 3 examines the recent shifts in tax buoyancy in relation to GDP growth.

Detailed economic analysis

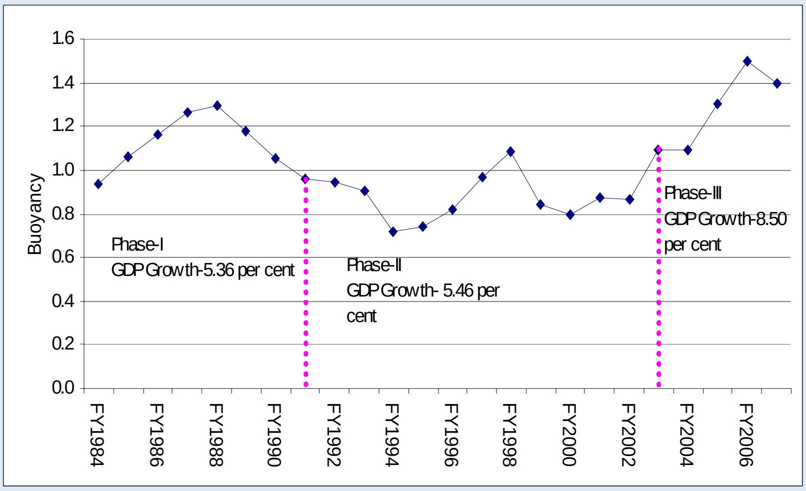
Box 3: Tax buoyancy

Higher growth besides being a positive for the economy also results in higher tax collection for the government. However, whether the higher growth is translating into adequately high tax revenue is measured by what is technically called tax buoyancy.

Tax buoyancy is expressed as 'percentage change in tax revenues per unit percentage change in tax-base' (i.e., GDPMP at current price in our case). When tax-buoyancy is greater than one, it implies growth in tax collection is more than the growth in GDP.

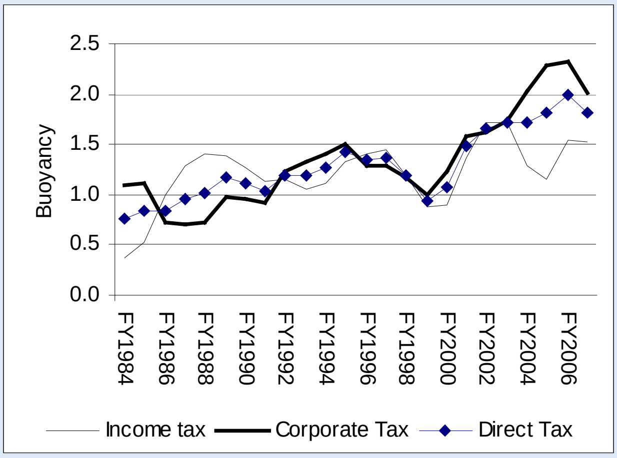
Based on the rolling regression estimate of GDP on tax revenue (both converted to log) Fig 2 and 3 show the percentage change in tax revenue in response to a percentage change in GDP.

Figure 1: Gross Tax Buoyancy and Economic Growth



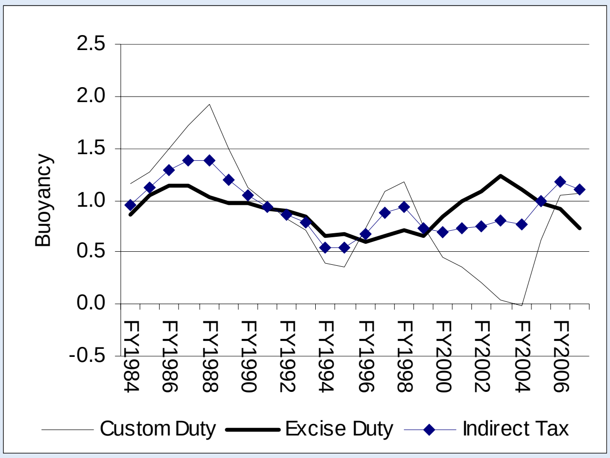
Source: CRISIL estimates

Figure 2: Tax buoyancy – Direct taxes



Source: CRISIL estimates

Figure 3: Tax buoyancy – Indirect taxes



Source: CRISIL estimates

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Commensurate with the growth pattern, the gross tax buoyancy has increased significantly in recent years, ending the decade long (1991-2002) sluggish movement (see fig 1: with vertical lines demarcating different growth phases). While the direct tax buoyancy, barring the second half of nineties, has largely improved, the same cannot be said of indirect tax.

Within direct tax, the buoyancy of both income tax and corporate tax has improved over the years. In general income tax, buoyancy has been above unity in most years during the post reforms period but has gathered momentum since 2001. Much of the buoyancy could be attributed to the rationalization of income tax rate over the years, in particular of the steps taken during 1997-98, when the government went a step ahead of Tax Reforms Committee's recommendations and reduced the personal income tax rate to 10-20-30 per cent. In addition to this, the toning up of tax administration, simplification of tax filling and of course rising incomes has also helped in improving the income tax buoyancy.

On the other hand, despite some dissimilarity during the eighties, corporate taxes now show a similar trend in buoyancy as exhibited by the income tax. From a low level of unity in 1999, the corporate tax buoyancy reached its peak of 2.32 in 2006 before declining somewhat to 2.01 in 2007. Again like income tax, most of the credit goes to corporate tax reform, which reduced the rate from 60 per cent during mid-70s (and differential treatment to widely-held and closely-held) to 35 per cent at present. However, the recent spurt in tax buoyancy is clearly linked to the phenomenal corporate growth and increased profit margin.

Custom and excise duties are two major components of indirect taxes. Fig 2 shows that there is no similarity in the buoyancy of both taxes, even though primarily the base of both the taxes is industrial activity. Also, buoyancy of both the taxes, despite a higher industrial growth in last few years, is quite low as compared to the direct taxes. However, it (in particular customs duty) has shown some improvement in the last two years.

It may be worthwhile to point out that the share of customs duty in overall gross tax revenue has also declined substantially (e.g., 25 per cent during 1980 to 17 per cent during 2006-07). The decline in the share and buoyancy of customs duty is largely policy induced as the government brought down the peak customs duty from 220 per cent in 1991 to 10 per cent for non-agricultural products at present, besides allowing various types of duty exemptions.

...continued

Detailed economic analysis

...continued

The excise duty buoyancy has deteriorated significantly since the beginning of 1990s. The share of excise duty, which was 50 per cent during 2006-07 has come down to 26 per cent during 2007-08. Of late though excise buoyancy had improved to some extent, however it has slipped again to less than 1 during the last 3 years. While monitoring and enforcement remain an area of concern so far as collection of duty is concerned, it is due to a plethora of rebates and exemptions that despite reduction in excise duty rates and increased manufacturing activities, neither the share nor the buoyancy of excise revenues has increased.

Table 8: Tax Buoyancy

	Gross Tax	Tax Buoyancy		Indirect Tax
		Direct Tax		
		Corporate Tax	Income Tax	Custom+Excise
1993-94 to 1996-97	1.13	1.35	1.55	1.06
1997-98 to 2001-02	0.71	1.54	1.61	0.60
2002-03 to 2004-05	1.34	2.65	1.22	0.86
2005-06 to 2007-08	1.71	2.45	3.13	0.96

Source: CRISIL estimates

Table 8 shows the buoyancy calculation on the basis of annual compound growth rate of tax revenue and GDP. The story remains more or less unaltered as gross tax shows higher buoyancy during the most recent period. While corporate and income tax remained buoyant in this period, income tax buoyancy clearly exceeds the corporate tax buoyancy due to a dramatic growth in personal income tax revenue in 2006-07 and 2007-08. As discussed above, though indirect tax buoyancy has improved in recent years, it is less than desired.

Growth assumptions

The budget assumes nominal GDP growth of 13 per cent for 2008-09. Under the assumption of 4.5 per cent inflation, real GDP growth in this scenario would be 8.5 per cent. Under the assumption of normal monsoons and only a marginal slowdown in industry and services, 8.5 per cent growth remains within reach.

Neither the budget nor the three accompanying documents provide sectoral growth patterns, which are critical for judging the veracity of revenue buoyancy assumed in the 2008-09 budget. Under the assumption of normal monsoons, the GDP in agriculture can be assumed at its long term average growth of 3 per cent per annum. Assuming the buoyancy in services to moderate marginally as a result of slowdown in global demand, about 10.3 per cent growth is feasible. The industrial growth required to deliver about 8.5 per cent real GDP growth during 2008-09 would be around 8.3 per cent.

Table 9 documents the expected shortfall in gross tax revenues under alternate assumptions of industrial growth. The estimates of gross tax revenues (except the revenues from the services sector) have been computed based on the ratio of tax collections to nominal industrial GDP for 2007-08. The service sector revenues have been assumed at the same level as budgeted. We get a revenue shortfall Rs 333 billion and Rs 281 billion for industrial growth of 8.3 per cent and 8.7 per cent, respectively. As the implicit industrial growth in the budget is approximately 8.5 per cent, revenue short fall is expected. However, if the industry maintains its current momentum the revenue targets set in the budget would be met.

Table 9: Tax revenues and Industrial Growth 2007-08

Industrial Growth	Industrial Inflation	Nominal Industrial Growth	2008-09 Gross Tax Revenue (EST)	Gross Tax Revenue (BE)	Expected Shortfall
7.5	4.5	12.0	6497	6877	380
8.3	4.5	12.8	6544	6877	333
8.7	5.0	13.7	6596	6877	281
9.2	5.3	14.5	6642	6877	235

Source: CRISIL Simulations

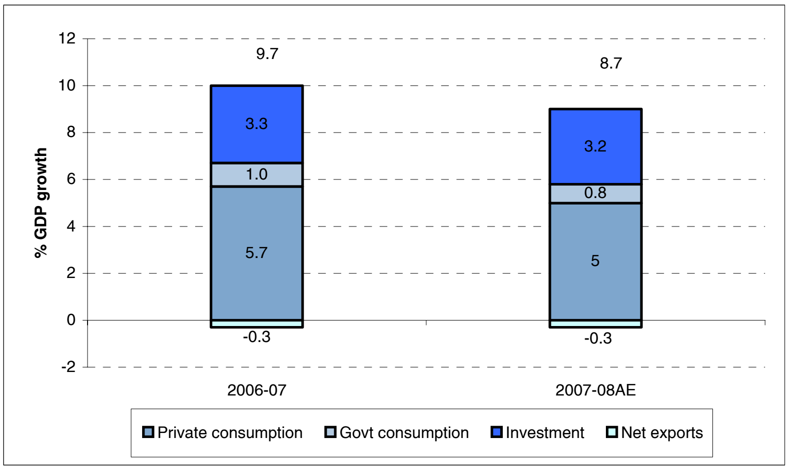
Theme 1: What has the budget done for growth?

Given the current domestic and international economic scenario, a further moderation of growth is expected in 2008-09. Since the parliamentary election is due in the current year, it is no surprise that the government initiated measures to sustain the growth rate of the economy. The budget in particular has provided support to education and agriculture sectors. The budget also recognised that inflation remains a concern as the supply-side pressures in the form of international oil price and food price continue to increase. The policy challenge would be to ensure that the economy retains its current growth trajectory, without letting inflation get out of control.

An analysis of the components of aggregate demand in recent years indicates that it has been driven predominantly by a sharp increase in domestic consumption (C) and private and public investment (I). During the current fiscal however, private consumption has been a drag on GDP growth. Out of 1 percentage point decline in GDP growth at factor cost this fiscal, a reduction of 0.7 percentage points is expected to come from the slowdown in private consumption growth. In contrast, a decline of only 0.2 percentage points in GDP growth will come from investment. Further, as compared to 2003-04, the contribution of investment to GDP growth has increased substantially, as shown in the figure below. While exports have grown consistently, imports have grown even faster, which means the 'net exports' component of aggregate demand is negative. However, in spite of the sharp appreciation of the rupee during the current fiscal the contribution of net exports to GDP growth has remained constant at -0.4 percentage points.

Detailed economic analysis

Figure 4: Demand side drivers (point contribution to GDP growth at 1999-00 prices)



Source: CRISIL estimates from CSO data

1) Domestic consumption:

A) Private consumption

During the last four years of blistering growth, increase in private consumption has made most important contribution to aggregate demand. The main drivers of domestic consumption during the current growth phase have been

- A burgeoning middle class estimated at 250 million.
- Significantly higher wages, especially in IT and IT-enabled services (ITES), financial services, back-office services.
- Increase in supply and demand of consumer goods and services

In addition to the above factors, until 2006-07, macroeconomic policies such as relatively low interest rates and lower taxes encouraged consumption by reducing the cost of borrowing and increasing disposable income. During 2007-08 however, the picture changed as monetary tightening measures in the form of increase in interest rates and CRR were put in place by the RBI to control inflation and inflationary expectations. As a result, the cost of borrowing went up and the demand for interest sensitive sectors such as automobiles fell. The growth rate of bank credit for purchasing consumer durables declined from 11.2 per cent (y-o-y November 06) to 4.4 per cent (y-o-y November 2007). Correspondingly, the growth rate of production of consumer goods declined from 10.2 per cent (April-December 2006) to 5.9 per cent (April-December 2007). Overall, the slowdown in consumption growth is likely to result in a 0.7 percentage point decline in GDP growth out of a total of 1 per cent decline that is expected in GDP growth this year as compared to the last.

The changes in the personal income tax structure and an increase in the threshold level for income tax in the budget of 2008-09 would boost disposable income for taxpayers. This measure should help boost consumption spending next year.

B) Government consumption

Government consumption as a share of GDP at factor cost (constant prices) is expected to slow down marginally this year to 10.4 per cent compared to the 10.7 per cent last year. The most encouraging feature of government finances in recent years has been an improvement of government savings and the increasing fiscal responsibility it has exhibited. The reported fiscal deficit is estimated at .3.2 per cent of GDP for 2007-08 and the government intends to lower it further to 2.5 per cent of GDP during 2008-09: 0.5 per cent less than the FRBM target. However, as noted before, fiscal deficit does not take into account the off-budget items of government expenditure. As a proportion of GDP, interest payments are expected decline from 3.6 per cent in 2006-07 to 3.4 per cent in the current fiscal. As a proportion of GDP, subsidies are expected to fall from 1.3 per cent in 2006-07 and 1.1 per cent in 2007-08 (BE).

2) Investment

The trend of increasing investment in the economy relative to GDP, both public and private, continues unabated. Gross Domestic Capital Formation (GDCF) at constant market prices for 2007-08 is estimated at 36.0 per cent of GDP, as compared to 33.8 per cent for the previous year. At current market prices, the ratio was 35.9 in 2006-07 and is estimated to be 38.0 in 2007-08. Correspondingly, Gross Domestic Savings rose to 34.8 per cent of GDP at current prices during 2006-07, leading to a savings-investment gap of -1.1 per cent of GDP.

The improvement in investment was driven by a significant increase in the private corporate sector investment, which has doubled as a share of GDP in a matter of four years - from 6.6 per cent in 2003-04 to 14.5 per cent in 2006-07. It is encouraging that the efficiency with which capital is being used is increasing. Rising investment, along with the efficiency with which it is being used augurs well for the economy. Over the same period, government investment increased from 6.3 per cent of GDP to 7.8 per cent.

It is notable that private corporate sector investment started to rise rapidly after the public saving record began to improve and freed up resources for private investment. Also, corporate profits grew as domestic demand and economic growth improved consistently in recent years. It appears however, going forward, growth of capital formation will slow down as GDP growth slows down. The y-o-y growth rate of real gross fixed capital formation peaked in 2004-05 at 18.9 per cent. Since then it has fallen to 15.1 per cent in 2006-07, though it is expected to increase marginally to 15.7 per cent.

3) Trade

As a percentage of GDP, net exports in goods and services have remained steady over 2007-08, albeit, contributing negatively. In real rupee terms, export and import growth has slowed down to 6.4 per cent each during 2007-08 from an average of over 20 per cent growth in exports and over 22 per cent in imports over the last three years. While traditionally India has run a trade deficit, in the fiscal years 2002-2005, the situation reversed and in real rupee terms net exports of goods and services contributed positively. This was primarily owing to robust growth in services surpluses even as growth in merchandise net exports remained steady.

Detailed economic analysis

As the economy gained further momentum, demand for imports also rose rapidly and subsequently the trade of goods and services balanced again in the negative zone in the last two fiscals. The net exports to real GDP ratio was -4.2 per cent in 2006-07 and is estimated to be around -4.1 per cent in 2007-08. This trend is likely to persist in 2008-09 as well, as moderation in global economy and high value of rupee will lower the demand for exports of goods and certain services. In nominal terms, in the current fiscal we expect exports to cross the revised target of $140 billion for merchandise exports, growing at an average of 17.5 per cent. On-going investment activity on the domestic front will encourage imports though the growth rate is expected to soften, with the upward risk from uncertainty in oil prices.

Summary

- The economy will continue to grow over 8 per cent in 2008-09, but moderation in the current fiscal is expected.
- Addressing supply-side inflation concerns will be of crucial importance.
- Investment, both public and private will continue to increase as a share of GDP, but their growth rate would moderate
- Further growth can be sustained only with addressing infrastructural bottlenecks and skilled labour supply shortfall, which are posing supply-side constraints on growth.
- Public investment in agriculture and in rural development, particularly in the health and human services and infrastructure sector will need to be increased further to reduce infrastructural bottlenecks and make growth more inclusive.

Theme II - Infrastructure - Where are we?

Unprecedented robust growth in the last half-decade despite inadequate infrastructure underlines the urgent need for speed in meeting large infrastructure requirements of the nation. The service and industrial sectors' ability to overcome major infrastructure bottlenecks so far has resulted in an average 8.7 per cent growth in the period. Of course, had growth in infrastructure over the past few years been faster, the overall rate of growth would have notched up even more. But is this sustainable? Perhaps not, as the opportunity cost of lack of sufficient infrastructure could be as severe as loss of competitiveness for business of all sizes in every segment, due to high transaction and transport costs. Moreover, it diminishes domestic business climate and impedes accessibility to domestic and international markets. But how far has this year's budget gone to address this requirement?

Despite repeated focus on lack of infrastructure over the last few years, Union Budget 2008-09 fails to provide adequate thrust to the sector. Although the total plan outlay has increased by 23 per cent over that of last fiscal year's and 29.5 per cent higher than revised estimates of 2007-08, budgetary support has been notched by a mere 6 per cent. Much of the increment will come in from internal and extra budgetary resources. As shown in table 10 below, this rise in IBER is concentrated in the Ministries of Railways and Power. However, some new initiatives have been undertaken in few sectors. These we outline below.

Table 10: Growth in Plan Expenditure (y-o-y%)

	2007-08 RE			2008-09 BE		
Ministry/Department	**Budget support**	**IEBR**	**Total**	**Budget support**	**IEBR**	**Total**
Ministry of Power	-7.4	27.7	21.2	9.4	24.5	22.0
Department of Shipping	0.0	11.9	9.4	-20.9	71.1	54.7
Department of Road Transport and Highways	8.7	-40.3	-2.8	7.6	96.2	20.3
Ministry of Railways	3.5	27.4	19.9	3.1	26.7	21.3
Total	3.7	21.3	14.9	5.9	30.9	23.2

Note: IEBR = Internal and Extra Budgetary Resources

Source: Calculated from budget 2008-09

The primary vehicles of the government to address infrastructure insufficiencies are the Jawaharlal Nehru National Urban Renewal Mission and the Bharat Nirman Scheme in the urban and rural areas, respectively. The first scheme appears to have been particularly successful and has also been instrumental in driving reforms in urban governance and urban-related laws. The new budget has enhanced the allocation by 25.2 per cent to Rs.68.66 billion in 2008-09, given the success of the mission. The second scheme has also performed impressively during 2007-08. Including the North Eastern Region (NER) component, the allocation to the scheme has been raised by Rs.66.8 billion (or 27 per cent) to Rs 312.8 billion from that in fiscal 2007-08. Budgetary allocations and consequent impact for specific sectors has been outlined below:

A) Power

The National Electricity Policy 2005 recognises electricity as a "basic human need" and targets a rise in per capita availability from 631 units to 1,000 units per annum by the end of 2012. The 11th five-year plan proposes an ambitious capacity addition target of 78,577 MW to fulfill this objective; which is more than the total capacity added in the previous three Plans. Central and State government capacity additions are targeted at a total of 67,817 MW and private sector to meet the rest 14 per cent of the addition. Currently, the Commercial Operation Date (COD) on about 10,000 MW is expected to be achieved by March 2008. However, in both the 9th and 10th five-year plans, the capacity additions were way behind target. In spite of significant past reforms and impending high targets, the energy availability in April-December 2007 was at 4,97,793 MU or 45,601MU short of the requirement. Peak-time energy deficit was 14.8 per cent of the peak-time demand, trending further upward. These trends underscore the urgent need to address the supply-demand imbalance and calls for further reforms and fiscal allocations in the sector.

To address these constraints, the new budget has raised total plan outlay by 22 per cent, but budgetary support by only 9.4 per cent. Emphasis is laid on the poor state of transmission and distribution (T&D) of power, considered the main culprit of the weak state of the sector. Although, the budget emphasises huge investment requirements in the sector, it underscores the need for supplementary fundamental reforms. It proposes to create a national fund for T&D reform, but the details of the same have not been released yet. In addition, it mentions that the fourth Ultra Mega Power Project (UMPP) in Jharkhand will be awarded shortly, having completed 2 others successfully by the time of previous year's union budget. This is part of a previous Government of India initiative to develop nine coal-based UMPPs with minimum 4,000 MW capacity. Five more UMPPS are expected to be brought under the bidding process, provided the State government support comes through with little delay. Budget for the Accelerated Power Development & Reforms Project is unchanged at Rs 8 billion in 2008-09 as compared to the allocation in the last budget, though it is double the revised estimate of that period.

B) Road transportation

National Highways (NHs) account for about 40 per cent of the total traffic on Indian roads. However, they are only about 2 per cent of the total length of roads, which underscores the massive need for NH development. The National Highway Development Programme (NHDP) to construct 33.1 thousand kilometers is under implementation, of which 24 per cent of the project has been completed. The completion ratio in the Golden Quadrilateral is 96.5 per cent and in the North-South & East-West Corridor project is 23.4 per cent. Special attention is being paid to SARDP-NE, programme devised for the North Eastern region. With the target of 300kms in 2008-09 as compared to 180 kms achieved in 2007-08, the allocation has been boosted by the 19 per cent to Rs 129.6 billion. While most of the project has been financed by the government and through loans from mutli-lateral organisations, the sub-projects under the Phase 3 & 4 of the project would be taken up on PPP basis (BOT mode).

C) Ports and Shipping

Ports play a critical role in international trade and consequently are crucial to the development of the economy. Maritime transport accounts for about 95 per cent of the country's foreign trade in terms of volume and 70 per cent in terms of value. There are 12 major ports and 187 minor/intermediate ports located along the 7,517 kms long coastline of India, with the major ports handling three-fourths of the sea-borne traffic. Significant constraints have emerged in the sector, with turnaround time much higher than that of some other international ports and marginally higher in April-October period compared to previous two years. While the cargo traffic handled by the ports is growing at a robust pace, inadequate linkage to the hinterland and pace of cargo evacuatations are accentuating the need for capacity addition. The Union Budget has raised the total outlay to the ministry by a significant 54 per cent - slightly higher than the 52 per cent increase in 2007-08 budget. However, in terms of budgetary support the amount has reduced by 21 per cent.

D) Rural infrastructure

Rural infrastructure has gained impetus under the Bharat Nirman scheme - an asset-creating plan with multiple schemes under it. At the current pace, 290 habitations are provided with drinking water and 17 habitations are connected through an all-weather road per day. Further, 52 villages are provided with telephones and 42 villages are electrified and 4,113 rural houses are completed per day. The rural electrification scheme of the government launched in April 2005 - the Rajiv Gandhi Grameen Vidyutikaran Yojana to electrify all villages and provide electricity to all households in the country in the next 5 years, will continue. The initial outlay (capital subsidy) of Rs 280 billion has been granted and 27 States and their utilities have signed up a MoA to implement the programme. At present, 235 projects are under implementation covereing 67,012 unelectrified villages and 8.3 million BPl households. The allocation to the scheme has been raised by to Rs 55 billion. In addition, allocation to Rajiv Gandhi Drinking Water Mission to supply safe drinking water to uncovered and slipped back habitations has been enhanced to Rs 73 billion as against Rs 65 billion in 2007-08. A new sub-head to install a standalone system to provide potable water to each school in water-deficient habitations has been introduced, and an initial allocation of Rs 20 million has been made. Further, allocation to the Total Sanitation Campaign has been raised to Rs 12 billion. Finally, the Rural Infrastructure Development Fund (RIDF) - the primary tool to channelise bank funds for financing rural infrastructure, has been increased to Rs 140 billion, from Rs 120 billion last budget, with a new separate window for rural roads with a corpus of Rs 40 billion.

Future of public-private partnership (PPP)

The development of infrastructure facilities hinges on the ability of the government to attract private capital under the public private partnership (PPP) projects. The budget states that this model has enabled greater private participation in the creation and maintenance of infrastructure. While the pace of PPP projects is clearly very slow, various steps have been taken in this direction. India Infrastructure Company Limited to provide long-term tenor debt to infrastructure projects to the deploy funds to the tune of $5 billion has been set up and scheme to provide financial support via Viability Gap Funding has been set up. Initial steps have been taken to use foreign exchange reserves for building infrastructure through IIFCL. The RBI has given "in-principle" approval to invest $5 billion in the securities of the special purpose vehicle set up for this purpose. Till date, total 221 PPP projects have been undertaken in the country, with value of contracts at Rs 1,295.7 billion. No significant measure has been introduced in this budget.

Theme III - Social welfare

The expanding role and contribution of social welfare in strengthening the economic development of a country needs no elaboration. Therefore, quite rightly various governments have put emphasis on this sector and the expenditure on social sector has consistently gone up over the years. As percentage of total central government expenditure, expenditure on social services and rural development has increased from 9.6 per cent in 2001-02 to 15.9 per cent in 2008-09 (BE). Last fiscal was marked by the launch of some major initiatives such as Aam Admi Bima Yojana, Rashtriya Swasthya Bima Yojana and National Old Age Pension Scheme. Great emphasis was also laid on the speedy implementation of already launched programmes like National Rural Employment Guarantee Scheme (NREGS), Bharat Nirman, Natioanl Rural Health Mission (NRHM) and Jawaharlal Nehru National Urban Renewal Mission (JNNURM).

This year the emphasis is clearly on the ongoing programmes rather than launching new schemes. While the Finance Minister has increased the allocation to most of its flagship programmes for the year 2008-09, the y-o-y growth in the budgetary support is not as huge as it was in the last budget. For the year 2008-09, the budget support, together with internal and extra budgetary resources (IEBR), for social sector and rural development increased by only 19.3 percent, as compared to a substantial 30.3 per cent during 2007-08 (Table 8).

Table 11: Year-on-year growth in plan expenditure

	2007-08 RE			2008-09 BE		
	Budget Support	IEBR	Total	Budget Support	IEBR	Total
Ministry of Health and Family Welfare	29.49		29.49	15.12		15.12
Ministry of Rural Development*	20.54		35.06	15.97	55.56	20.31
Department of School Education and Literacy /1	29.56		29.56	20.77		20.77
Department of Higher Education /2	-9.83		-9.83	17.23		17.23
Ministry of Women and Child Development /3	19.69		19.69	24.29		24.29
Ministry of Urban Development	71.47	40.51	57.31	8.70	3.93	6.05
Ministry of Housing and Urban Poverty Alleviation /4	21.95	27.25	26.82	70.00	21.62	25.13
Total	23.77	104.78	30.30	17.80	29.04	19.31

* There was no IEBR spending in 2006-07, but a substantial support was given in 2007-08.

Source: Calculated from Budget 2007-08

Employment

The share of expenditure on labour and employment in total non-plan expenditure on social services has not been quite impressive for the last two years. From 23.4 per cent in 2006-07, it has come down to a mere 14.1 per cent in 2008-09. Instead, the focus has been more on education and skill development and appears to be appropriate as well. An educated and skilled human resource would be more employable as compared to the one who is uneducated and unskilled.

National Rural Employment Guarantee Scheme (NREGS), one of the flagship programmes of the government, is marked as one of the most ambitious programmes ever. Initially started in 200 districts of India, it is proposed to be implemented in all 596 districts of the country now. An allocation of Rs 160 billion has been provided under this programme in 2008-09, with an assurance of an additional allocation, if demand arises. Besides, the government proposes to launch a world-class skill development programme during 2008-09 to address the challenge of imparting the skills required by a growing economy. To address this, it has proposed to establish a non-profit corporation, with a capital allocation of Rs.150 billion. This initiative will under public private partnership mode with additional capital coming form private, bilateral and multilateral sources.

Education

Among other social sectors, education is the only privileged sector to have received allocation with the y-o-y growth rate much higher than that of the previous year. The support towards Department of Higher Education grew by 17.2 per cent as compared to a negative growth of 9.8 per cent previous year.

The total allocation on education sector has been increased by 20 per cent for the year 2008-09 over the previous year. Sarva Shiksha Abhiyan (SSA) has received an allocation of Rs 131 billion, 20 per cent higher than that allocated last year. The focus of SSA is to shift from access and infrastructure at the primary level to enhancing retention; improving quality of learning; and ensuring access to upper primary classes. Other schemes like Mid-day meal scheme and establishing quality schools for SCs and

STs have also got substantial allocation. For higher education, the government proposes to establish 16 Central Universities, starting from 2008-09 and introduce a scheme called Innovation in Science Pursuit for Inspired Research (INSPIRE) under Ministry of Science and Technology.

Health

The budget proposes to increase the allocation to the health sector by 15 per cent over the previous year. It continues to lay emphasis on providing a fully functional; community owned and decentralised health delivery system. National Rural Health Mission (NRHM), a key initiative by the government, has received an allocation of Rs 120 billion. Other major programmes to be started this fiscal year in a big way are Rashtriya Swasthya Bima Yojana and National Programme for the elderly. The former is exclusively for the worker belonging to the unorganised sector falling below poverty line.

A Summary assessment

While the Union Budget 2008-09 has laid emphasis on improving education, infrastructure and agriculture section, the key again would be how effective is the implementation. On the positive note the Finance Minister spelt out a need to monitor and evaluate carefully the outcomes of the centrally funded schemes. This move by the government is much welcome.

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CRISIL RESEARCH

Industry

Industry

Overall sectoral impact

Industry	Effect

Auto components & Tyres — **Marginally positive**

The reduction in excise duty rate from 16 per cent to 14 per cent would be positive for some auto component manufacturers. While the benefit from reduction in duties would be entirely passed on to OEMs, components deriving higher proportion of sales from the replacement segment, such as bearings, batteries, brake linings, would retain the benefit. The tyres sector is also expected to benefit from the excise duty cut, since over 60 per cent of the sales are to the replacement segment. The thrust to small car and two-wheeler demand, due to the reduction in excise duty, will have a positive impact on component sales to OEMs.

Automobiles — **Marginally positive**

We expect two-wheeler demand to benefit from the increase in disposable income due to alteration in income tax slabs and the cut in excise duty, which is likely to be passed on due to intense competition. We expect small car manufacturers also to pass on the benefit, resulting in a marginally favourable impact on demand. However, commercial vehicle manufacturers may increase their margins by retaining the benefit. The waiver of loans for small and marginal farmers will have a neutral impact on tractor sales.

Banking and Finance — **Neutral**

The emphasis is on agricultural banking. The loan waiver of Rs 500 billion and the one time settlement scheme of Rs 100 billion are expected to provide relief to debt-burdened farmers. Banks will be positively impacted if the government funds the waiver in some manner or else bank margins will suffer. The reduction in growth target (17 per cent y-o-y) for farm credit will help banks consolidate their origination systems for farm loans. The addition of 250 rural household accounts, annually, at each rural and semi-urban branch, envisaged for scheduled commercial banks, including RRBs, will extend their reach to uncovered sections. Further, measures to expand the market for corporate bonds would help increase liquidity and market-driven price discovery.

Cement — **Neutral**

In the Union Budget 2008-09, the excise duty on bulk cement has been revised from Rs 400 per tonne in 2007-08 to Rs 400 per tonne or 14 per cent ad-valorem, whichever is higher. The average all-India retail price of cement is Rs 230 per bag, whereas bulk cement sells at discount of Rs 10-16 per bag owing to savings on excise and packaging cost. This proposal is expected to increase the cost of cement for bulk consumers, who account for an estimated 10-15 per cent of total cement consumption. The cement industry will not be affected, as producers will be able to pass on this increase to customers, which include ready-mix concrete producers, infrastructure companies and large builders.

Further, the excise duty on clinker has been hiked from Rs 350 per tonne in 2007-08 to Rs 450 per tonne in 2008-09. This will also have a neutral impact on cement industry, as players possess the flexibility to pass on any increase in cost to end consumers.

CRISIL RESEARCH

Overall sectoral impact

Industry	Effect

Construction — **Marginally positive**

The government has increased the outlay in key infrastructure sectors such as roads, urban infrastructure and irrigation. Under roads, led by National Highways Development Programme, the budget allocation has been increased by 19 per cent from Rs 108.67 billion in 2007-08 to Rs 129.66 billion in 2008-09, much higher than the 9 per cent growth in allocation of the previous year. The central assistance under Jawaharlal Nehru Urban Renewal Mission has also been increased by 25 per cent - from Rs 54.82 billion in 2007-08 to Rs 68.66 billion in 2008-09. Further, the annual outlay under the 'Accelerated Irrigation Benefit Programme' has been raised from Rs 110 billion to Rs 200 billion. These increased allocations would augur well for construction companies in terms of healthy order book growth and better revenues. CRISIL Research estimates suggest that these allocations would translate into construction investments of Rs 290.86 billion in the segments of roads, urban infrastructure and irrigation.

Fertilisers — **Neutral**

The reduction in customs duties on phosphoric acid (from 7.5 per cent to 5 per cent) and sulphur (from 5 per cent to 2 per cent) is marginally positive for the industry. However, the budgetary allocation for fertiliser subsidy has been increased marginally from Rs 305 billion in 2007-08 to Rs 310 billion in 2008-09, even as the subsidy bill for 2008-09 is estimated to be around Rs 500 billion. Thus, this could result in arrears if the balance subsidy is not provided in time, straining the working capital of fertliser companies. The greater thrust on agricultural credit and irrigation will boost fertiliser consumption in the long run.

Hotels — **Neutral**

The impact of the Union Budget 2008-09 on premium hotels sector is neutral. A 5-year tax holiday has been announced for two-, three- and four-star hotels that are established in specified districts that have UNESCO-declared 'World Heritage Sites' (there are 27 such sites in India). The above-mentioned hotels should be constructed and begin functioning between April 1, 2008 and March 31, 2013.

Household Applicances — **Positive**

The alteration in income tax slabs will lead to a significant reduction in tax liability for the salaried-class (especially for income up to Rs 5 lakh), inducing higher demand for household appliances. Reduction of basic excise duty from 16 per cent to 14 per cent is unlikely to benefit the household appliances industry, as a significant part of the production of major manufacturers comes from excise-free zones. The resultant reduction in CVD will have negligible effect on the industry, due to unique product specifications (such as size) and competitiveness of the domestic industry in terms of cost, brand perception and distribution network.

Housing — **Neutral**

There were no major announcements for the housing sector in the Union Budget 2008-09. The subsidy towards housing for the people below the poverty line in rural areas, under the Indira Awas Yojna, has been enhanced. However, this proposal will not impact the organised housing sector.

Overall sectoral impact

Industry	Effect

Information Technology — **Marginally negative**

The budget focuses on building the talent pool of the country and the IT sector, being a major recipient of the knowledge resources, is expected to benefit in the long run. However, the excise duty increase from 8 per cent to 12 per cent on packaged software and the addition of customised software in the service tax net, is expected to negatively affect application development players in the domestic software industry. Maintenance service providers will not be impacted. With no comment on extension of the IT Tax exemption (under section 10A and 10B), the overall impact is expected to be marginally negative for the IT sector.

Media and Entertainment — **Neutral**

The overall impact on the media and entertainment industry is expected to be neutral. The customs duty on certain parts of set-top boxes such as switched mode power supply (SMPS) power board and infra red (IR) module has been reduced from 7.5 per cent to nil. The reduction rationalises the differential between importing raw material for set-top box manufacturing and importing the finished set-top box, which attract zero customs duty. This move is expected to boost the domestic manufacturing of set-top boxes.

Non-ferrous Metals — **Neutral**

The reduction in CENVAT rate on all goods, from 16 per cent to 14 per cent, will result in decline of around Rs 2,000 per tonne in aluminium and zinc prices, and Rs 5,000-6,000 per tonne in copper prices, notwithstanding the future trend in international prices. However, it will not have a significant impact on the sectors, as these items are sold to industrial buyers only. The excise duty on aluminium, copper and zinc sold is MODVAT'able, and hence, the buyer industry's cost remains unchanged.

Customs duty on aluminium scrap, used in manufacturing recycled aluminium, has been reduced from the existing 5 per cent to zero. The share of recycled aluminium in the domestic aluminium industry is low; consequently, the cut is unlikely to have any significant impact on the industry.

Oil and Gas — **Marginally positive**

The imposition of a 5 per cent customs duty on naphtha for the manufacture of polymers is expected to marginally improve refining profits (Rs 7-8 billion). Further, a reduction of 2.5 per cent in customs duty on project imports is likely to reduce capital costs of players in the industry. The replacement of ad-valorem portion of the excise duty (6.2 per cent) on unbranded petrol and diesel by an equivalent specific duty of Rs 1.35 per litre will be revenue neutral. However, this is expected to act as a cushion against the cascading effect of any change in international prices on domestic prices for the consumer. Other changes such as the reduction in peak excise duty (by 2 per cent) and CST (by 1 per cent) are also expected to be revenue neutral for the sector, as they are likely to be passed on to the customer.

Overall sectoral impact

Industry	Effect

Paper — **Neutral**

The excise duty on paper, paper board and articles manufactured out of non-conventional raw materials is reduced from 12 per cent to 8 per cent. Further, the excise duty on clearances upto 3,500 MT is reduced from 8 per cent to nil. Excise duty has also been cut from 12 per cent to 8 per cent for most of the varieties of paper. These measures can potentially result in a decline in domestic prices by around Rs 1,500 to Rs 2,000 per tonne, notwithstanding the future trend in international prices. While prices of high grade varieties such as coated paper will decline due to decline in landed cost of imports, prices for other varieties of paper will decline with small players in the industry passing on the benefit from the excise cut to their buyers. The decline in prices will not have an adverse impact on margins of the players.

Petrochemicals — **Neutral**

The customs duty on all petrochemical products (basic and polymers) remains unchanged. However, customs duty on naphtha for petrochemicals use has been increased from zero to 5 per cent. This will negatively impact naphtha-based crackers (70 per cent of total capacity). Conversely, excise duty (CENVAT) has been reduced from 16 per cent to 14 per cent and central sales tax has been reduced by 1 per cent. This is expected to be passed on to the end consumers, and hence, aid demand growth. CRISIL Research therefore believes that the overall impact of these changes will be neutral on the industry.

Pharmaceuticals — **Marginally positive**

The budget will have a marginally positive impact on the pharmaceuticals sector. The cut in excise duty on pharmaceutical products, from 16 per cent to 8 per cent, will reduce the burden on players. However, as most large and mid-sized players have set up manufacturing facilities in excise-free zones, the overall impact will be marginal. The 125 per cent deduction on R&D outsourcing expenditure will increase the competitiveness of Indian players. The reduction in customs duty on select life saving bulk drugs, from 10 per cent to 5 per cent, will be marginally positive. Increase in outlay for HIV treatment will be positive and will benefit players such as Cipla, GlaxoSmithKline and FDC.

Power — **Neutral**

There were no major announcements impacting the power sector. On the generation front, the government expects to award the Tilaiya (Jharkhand) UMPP in 2008-09. The basic custom duty on project imports has been reduced from 7.5 per cent to 5 per cent. However, the exemption on additional duty of 4 per cent has been withdrawn (other than mega power projects), resulting in a neutral impact. The budgetary allocation for APDRP programme has been maintained at Rs 8 billion. To address the concern of higher losses at the transmission and distribution level and for the development of the sector, the government has proposed to set up a National Transmission and Distribution Fund.

Overall sectoral impact

Industry	Effect

Roads **Neutral**

The Government has enhanced the allocation for National Highway Development Programme (NHDP), from Rs 109 billion in 2007-08 to Rs 130 billion in 2008-09, an increase of 20 per cent on year-on-year (y-o-y). Although, this is higher than the increase of 9 per cent, y-o-y, in 2007-08 (allocation of Rs 99 billion in 2006-07), it is in line with the stated requirement of Rs 1.6 trillion for the phases in action of NHDP for the next 5 years.

In spite of the Union Budget stating that under Bharat Nirman (PMGSY) programme, 17 habitations are connected through all-weather roads each day, as against the target set of 20,071 habitations for 2007-08, only 17 per cent had been achieved until December 2007.

Steel **Neutral**

Reduction in the CENVAT rate on all goods from 16 per cent to 14 per cent is likely to result in a decline in steel prices by around Rs 500 per tonne, notwithstanding the future trend in international prices. However, the impact of the same on the industry is neutral, as the excise duty on most of the steel sold is MODVAT'able, and hence it does not impact the buyer industry's cost, except where the output is directly used by the retail buyer. Retail buyers purchase around 60 per cent of the galvanised steel sold in the domestic market. Similarly, some quantity of long products, primarily bars and rods, is bought for use in self-developed housing projects.

The customs duty on melting scrap is reduced from existing 5 per cent to nil. Since the share of imported melting scrap in the total raw material mix of the industry is low, the measure is not likely to have any significant impact on the industry.

Sugar **Marginally negative**

The impact of the Union Budget 2008-09 on the sugar sector is likely to be marginally negative. The imposition of a commodities transaction tax for transactions in commodities futures is expected to marginally increase the hedging cost of sugar companies. Also, through a pre-budget notification on 25 February 2008, the excise duty on sugar has been increased from Rs 875.5 per tonne to Rs 978.5 per tonne. The cess component of the excise duty on sugar has been hiked from Rs 140 per tonne to Rs 240 per tonne while the basic excise duty on sugar has been left unchanged at Rs 710 per tonne. The proceeds collected from the imposition of the cess will be transferred to the Sugar Development Fund, which will be mainly used for extending loans to mills at subsidised interest rates. We expect that the margins of sugar companies will be under pressure as they will not be able to pass on the increase in the excise duty to consumers, given the oversupply situation currently prevailing in the market.

Overall sectoral impact

Industry	Effect
Telecom	**Neutral**

The overall impact on the telecom sector is expected to be neutral. The excise duty cut on wireless data card from 16 per cent to zero is marginally positive, as the effective duty would reduce from 21.65 per cent to 4.00 per cent. With an average handset priced at Rs 2,500, the 1 per cent National Calamity Contingent Duty (NCCD) would have a negligible impact; hence, the penetration of cellular services will not be affected. The reduction in customs and excise duties on convergence products would benefit services like Voice over Internet Protocol (VoIP) services. The establishment of 100,000 broadband Internet-enabled common service centres in rural areas and state wide area networks (SWAN) is expected to increase the penetration of broadband services in the hinterland.

Textiles — **Positive**

The budget measures are largely positive for the textiles sector. The Union Budget 2008-09 has maintained the provision for the scheme for integrated textile parks (SITP) at Rs 4.5 billion in 2008-09. The allocation of funds under TUFS has been enhanced from Rs 9.1 billion in 2007-08 to Rs 10.9 billion in 2008-09. This will continue to help attract investment flows into the sector by subsidising the interest costs on borrowings for expansions and new projects. The identification of Bhiwandi and Erode for development as mega-clusters will support the modernisation and improvement in the infrastructure of these two key powerloom (weaving) clusters, which contribute significantly to India's fabrics production.

Overall company impact

Company	Impact	Industry
ACC	↔	Cement
Adlabs Films Ltd	↔	Media and entertainment
Akruti City Ltd	↔	Housing
Alok Industries Ltd	↑	Textiles
Andhra Pradesh Paper Mills Ltd	↔	Paper
Apollo Tyres Ltd	↑	Autocomponents & tyres
Arvind Mills Ltd	↑	Textiles
Ashok Leyland Ltd	↑	Automobiles
Aurobindo Pharma Ltd	↑	Pharmaceuticals
Bajaj Auto Ltd	↑	Automobiles
Bajaj Hindustan Ltd	↓	Sugar
Balaji Telefilms Ltd	↔	Media and entertainment
Ballarpur Industries Ltd	↔	Paper
Balrampur Chini Mills Ltd	↓	Sugar
Bannari Amman Sugars Ltd	↓	Sugar
Bharat Petroleum Corpn Ltd	↑	Oil and gas
Bharti Televentures Ltd	↔	Telecom services
Ceat Ltd	↑	Autocomponents & tyres
Chambal Fertilisers & Chemicals Ltd	↔	Fertilisers
Chemplast Sanmar Ltd	↔	Petrochemicals
Chennai Petroleum Corpn Ltd	↑	Oil and gas
Cipla Ltd	↑	Pharmaceuticals
Coromandel Fertilisers Ltd	↔	Fertilisers
DCW Ltd	↔	Petrochemicals
DLF Universal Ltd	↔	Housing
Dr Reddy's Laboratories Ltd	↑	Pharmaceuticals
EID Parry Ltd	↓	Sugar
EIH Ltd	↔	Hotels
Entertainment Network (India) Ltd	↔	Media and entertainment
Essar Steel Ltd	↔	Steel
Finolex Industries Ltd	↔	Petrochemicals
First Source Ltd	↔	Information Technolegy

Continued...

Overall company impact

...continued

Company	Impact	Industry
GAIL India Ltd	↔	Oil and gas
Gammon India Ltd	↑	Construction
GlaxoSmithKline Pharmaceuticals	↑	Pharmaceuticals
Gokaldas Exports Ltd	↑	Textiles
Goodyear India Ltd	↑	Autocomponents & tyres
Gujarat Ambuja Cement Ltd	↔	Cement
Gujarat Narmada Valley Fertilizers Company Ltd	↔	Fertilisers
Gujarat State Fertilisers Company Ltd	↔	Fertilisers
Haldia Petrochemicals Ltd	↓	Petrochemicals
HCL Technologies Ltd	↓	Information Technolegy
HDFC Ltd	↔	Banking and finance
HDFC Bank Ltd	↓	Banking and finance
Hero Honda Motors Ltd	↑	Automobiles
Himachal Futuristic Communications Ltd	↔	Telecom services
Hindalco Industries Ltd	↔	Non ferrous metals
Hindustan Construction Co Ltd	↑	Construction
Hindustan Copper Ltd	↔	Non ferrous metals
Hindustan Organic Chemicals Ltd	↔	Petrochemicals
Hindustan Petroleum Corpn Ltd	↑	Oil and gas
Hindustan Zinc Ltd	↔	Non ferrous metals
Hotel Leelaventure Ltd	↔	Hotels
HT Media Ltd	↔	Media and entertainment
ICICI Bank Ltd	↓	Banking and finance
IG Petrochemicals Ltd	↔	Petrochemicals
India Cement Ltd	↔	Cement
Indian Hotels Ltd	↔	Hotels
Indian Oil Corpn Ltd	↑	Oil and gas
Indo Rama Synthetics (India) Ltd	↔	Textiles
Infosys Technologies Ltd	↓	Information Technolegy
Ispat Industries Ltd	↔	Steel
ITI Ltd	↔	Telecom services
IVRCL Infrastructures & Projects Ltd	↑	Construction

continued...

Overall company impact

...continued

Company	Impact	Industry
JBF Industries Ltd	↔	Textiles
JK Industries Ltd	↑	Autocomponents & tyres
JK Paper Ltd	↔	Paper
JSW Steel Ltd	↔	Steel
Larsen & Toubro Ltd	↑	Construction
LG Electronics India Ltd	↑	Household appliances
LIC Housing Finance Ltd	↔	Banking and finance
Mahanagar Telephone Nigam Ltd	↔	Telecom services
Mahindra & Mahindra Ltd	↔	Automobiles
Mahindra Gesco Developers Ltd	↔	Housing
Mangalore Refinery & Petrochemicals Ltd	↑	Oil and gas
Maruti Suzuki Ltd	↑	Automobiles
MIRC Electronics Ltd	↑	Household appliances
MRF Ltd	↑	Autocomponents & tyres
Mukta Arts Ltd	↔	Media and entertainment
Nagarjuna construction Co Ltd	↑	Construction
National Aluminium Company Ltd	↔	Non ferrous metals
National Thermal Power Corp Ltd	↔	Power
New Delhi Television Ltd	↔	Media and entertainment
Nicholas Piramal India Ltd	↑	Pharmaceuticals
Oil and Natural Gas Corpn Ltd	↑	Oil and gas
Orchid Pharmaceuticals Ltd	↑	Pharmaceuticals
Petronet LNG Ltd	↔	Oil and gas
Pfizer Ltd	↑	Pharmaceuticals
Phillips Carbon Black Ltd	↔	Petrochemicals
Power Grid Corporation of India Ltd	↔	Power
Punjab National Bank	↓	Banking and finance
PVR Ltd	↔	Media and entertainment
Pyramid Saimira Theatre Ltd	↔	Media and entertainment
Ranbaxy Laboratories Ltd	↑	Pharmaceuticals
Rashtriya Chemicals and Fertilisers Ltd	↔	Fertilisers
Reliance Energy Ltd	↔	Power
Reliance Industries Ltd	↔	Petrochemicals
Reliance Infocomm Ltd	↔	Telecom services
RSWM Ltd	↑	Textiles

continued...

Overall company impact

...continued

Company	Impact	Industry
Samsung India Electronics Ltd	↑	Household appliances
Samtel Color Ltd	↑	Household appliances
Saregama India Ltd	↔	Media and entertainment
Schenectady Herdillia Ltd	↔	Petrochemicals
Seshasayee Paper and Boards Ltd	↔	Paper
Shree Cement Ltd	↔	Cement
Shree Renuka Sugars	↓	Sugar
Sobha Developers Ltd	↔	Housing
State Bank of India Ltd	↓	Banking and finance
Steel Authority of India Ltd	↔	Steel
Sterlite Industries (India) Ltd	↔	Non ferrous metals
Sun TV Ltd	↔	Media and entertainment
Supreme Petrochem Ltd	↔	Petrochemicals
Suzlon Energy Ltd	↔	Power
Tamil Nadu Newsprint and Papers Ltd	↔	Paper
Tamil Nadu Petroproducts Ltd	↔	Petrochemicals
Tata Chemicals Ltd	↔	Fertilisers
Tata Motors Ltd	↑	Automobiles
Tata Power Company Ltd	↔	Power
Tata Steel Ltd	↔	Steel
Tata Consultancy Services Ltd	↓	Information Technolegy
Thirumalai Chemicals Ltd	↔	Petrochemicals
Ultratech Cement Ltd	↔	Cement
Unitech Ltd	↔	Housing
Vardhaman Textiles Ltd	↑	Textiles
Videsh Sanchar Nigam Ltd	↔	Telecom services
Welspun India Ltd	↑	Textiles
Whirlpool of India Ltd	↑	Household appliances
Zee Entertainment Enterprises Ltd	↔	Media and entertainment
Zenith Computers	↑	Information Technolegy
Zodiac Clothing Co. Ltd	↑	Textiles
Zuari Industries Ltd	↔	Fertilisers

Auto components & Tyres

Auto components industry estimated to grow by 10 per cent in 2007-08

- In 2006-07, the auto component industry grew by 23 per cent to attain a size of Rs 560 billion, in production value terms. The original equipment manufacturer (OEM) offtake, which constitutes 70 per cent of the production, grew by 23 per cent, because of an upturn in the commercial vehicle segment and robust demand in cars and utility vehicles. With rupee appreciation, exports growth has slowed down to 12-15 per cent in 2007-08 as compared to a 30 per cent growth for the last few years (2002-03 to 2006-07).
- A substantial increase in prices of major raw materials like steel, aluminium and iron has led to a fall of over 120 bps in operating margins over the last 2 years. The players have been unable to pass on the hike in raw material prices fully to the OEMs, thus leading to a pressure on margins. In 2006-07, on an average industry operating margins were at 14.5 to 14.8 per cent.
- In 2007-08 and 2008-09, the auto component industry is estimated to grow by 10 per cent and 15-20 per cent, respectively, in production value terms. A decline in offtake from the commercial vehicle segment and a stable growth in cars and utility vehicles have led to the lower offtake in 2007-08. However, we expect growth rates to improve in 2008-09.
- Raw material costs are expected to remain firm in 2007-08 and hence, margins will continue to remain under pressure. Nine monthly results for 2007-08 indicate a fall in operating margins of 60-80 bps with raw material prices remaining firm.

Tyres offtake growth in 2007-08 estimated at 6 per cent

- CRISIL Research estimates overall tyre off-take to grow at 6 per cent in 2007-08. The slowdown in growth is attributed mainly to estimated decline in OEM demand in MHCV segment and MHCV tyre exports due to increasing radialisation in export markets.
- Natural rubber prices decreased by about 9 per cent in the first half of 2007-08, but increased by around 10 per cent in the third quarter. We expect average natural rubber prices in 2007-08 to be at the same level as 2006-07.
- Operating margins improved significantly in the first half of 2007-08 due to higher price revisions and decline in natural rubber prices. Despite a subsequent increase in natural rubber prices, we estimate a 200 bps improvement in operating margins in 2007-08 over previous year.

Auto components & Tyres

Auto parts: Tariffs

(per cent)	**Customs**		**Excise**	
	2007-08	**2008-09**	**2007-08**	**2008-09**
Engine and Engine Parts [1]				
Two-wheelers and Four-wheelers	7.7	7.7	16.5	14.4
Drive transmission, steering, suspension and braking parts [2]				
Two-wheelers and Four-wheelers	10.3	10.3	16.5	14.4
Electrical Parts	7.7	7.7	16.5	14.4
Raw Materials for auto components	5.2	5.2	16.5	14.4

Note: Raw materials for autocomponents include: GP/GC steel, HR steel, Aluminium, Copper , Lead
HR: Hot rolled; GC: Galvanised coil; GP: Galvanised plate.

[1] Except for parts such as silencer, exhaust pipes and radiators, on which the duty is at 10.3 per cent

[2] Except for parts such as couplings and seals, on which the duty has been reduced to 7.73 per cent

Note:

Duty free imports from Thailand are allowed on engine parts, helical springs, ball bearings, lighting equipment and gear boxes under the FTA.

Source: CRISIL Research

Tyres: Tariffs, prices and landed costs

	Tariffs (per cent)				**Prices (January 2008)**		**Landed costs (Rs/tonne)**	
	Customs		**Excise**		**Domestic**	**International**	**Pre-budget**	**Post-budget**
	2007-08	**2008-09**	**2007-08**	**2008-09**	**(Rs/tonne)**	**($/tonne)**		
New tyres	10.3	10.3	16.5	14.4	-	-	-	-
Used/retreaded tyres								
Truck and bus	10.3	10.3	16.5	14.4	-	-	-	-
Car cross ply/ radials	10.3	10.3	16.5	14.4	-	-	-	-
Raw materials for tyres								
Natural rubber	20.6	20.6	-	-	94,421	2,625	125,689	125,689
SBR (1502)	10.3	10.3	16.5	14.4	-	1,900	84,306	84,306
PBR (1220)	10.3	10.3	16.5	14.4	84,000	2,150	95,399	95,399
NTC fabric	10.3	10.3	16.5	14.4	n.a.	3,800	189,911	189,911
Carbon black (N330)	5.2	5.2	16.5	14.4	75,064	n.a.	n.a.	n.a.

NTC: Nylon tyre cord; PBR: Polybutadiene rubber; SBR: Styrene butadiene rubber

n.a: Not available

Note:

1) For natural rubber, there is a cess of Rs 1.50 per kg in lieu of excise duty.
2) For NTC fabric, an additional excise duty of Rs 10 per kg is chargeable.
3) China and South Korea enjoy preferential rate of customs duty of 8.9 per cent on tyres under Asia- Pacific Trade Agreement
4) New tyres include the following categories: Truck & bus, Light truck, Car (Cross Ply and Radial), Tractor Front, Tractor Rear, Tractor Trailor, Moped, Scooter and Motorcycle.

Source: CRISIL Research

Auto components & Tyres

Auto components to benefit mainly through budget thrust to OEMs

Auto parts: Company impact

Company	Impact	Impact factors
Bharat Forge Ltd	↑	C
Bosch Ltd	↑	C
Amtek Auto Ltd	↑	C
Sona Koyo Steering Systems Ltd	↑	C
Sundaram Fasteners Ltd	↑	C

Source: CRISIL Research

Tyres: Company impact

Company	Impact	Impact factors
Apollo Tyres Ltd	↑	B,C
Ceat Ltd	↑	B,C
Goodyear India Ltd	↑	B,C
JK Industries Ltd	↑	B,C
MRF Ltd	↑	B,C

Source: CRISIL Research

Impact factors

A. Excise duty has been cut on auto components from 16 per cent to 14 per cent. While the benefit from reduction in duties would be entirely passed on to OEMs, components deriving higher proportion of sales from the replacement segment, such as bearings, batteries, brake linings, will see margin improvement, as they would retain the benefit.

B. The excise duty cut on tyres from 16 per cent to 14 per cent will profit tyre manufacturers as more than 60 per cent of the sales are derived from replacement segment where the benefit from excise duty cut is not expected to be passed on.

C. The expected increase in demand for small cars and two-wheelers, on account of a cut in excise, will have a positive impact on sales of auto components and tyres to OEMs.

CRISIL RESEARCH

Automobiles

Divergent growth trends across segments

- In 2007-08, the total automobiles market size (including exports) is expected to touch Rs 1,290 billion, a growth of 4.3 per cent over 2006-07.
- Tighter credit disbursement and rising interest rates have resulted in a drop in sales of two-wheelers and tractors. Commercial vehicles have witnessed a mixed trend - while MHCV sales have registered a decline, LCVs are reporting strong growth. Growth continues to be healthy for cars and UVs as well due to rising incomes and new model launches.
- Margins of two-wheelers and tractors have come under pressure due to a decline in volume, rise in input costs and impact of rupee appreciation on export realisations. Car manufacturers reported a marginal decline in margins primarily on account of rising input costs. However, commercial vehicle manufacturers have shown an improvement in margins due to an increase in product prices.
- In 2008-09, automobile sales are expected to grow by around 12 per cent in value-terms, driven mainly by favourable demographic trends, anticipated growth recovery in commercial vehicles and robust export growth.

Product category	Volume growth %	2007-08 (E) Growth drivers	Volume growth %	2008-09 (E) Growth drivers
Cars & utility vehicles	12	Income growth, rising consumer spending and new model launches.	16 to 18	Robust growth in exports and new model launches.
Two-wheelers	-8	Slowdown in disbursements and rise in overall interest rates.	5 to 7	Marginal growth in motorcycles on a reduced base and growth in ungeared scooters due to increasing consumer preference.
Commercial vehicles	5	Growth in redistribution segment, sustained economic growth, and increased demand from construction and mining activities.	10 to 11	Lower base of 2007-08, continuation of high growth in redistribution segment and demand from construction and mining activities.
Tractors	-2	Tightening of credit by financial institutions and inventory correction.	0	Rising share of exports in total sales.

E: Expected growth

Source: CRISIL Research

Automobiles

Automobiles: Tariffs

(per cent)	Customs		Excise	
	2007-08	2008-09	2007-08	2008-09
New cars				
-Completely knocked down units (CKD)	10.3	10.3	-	-
-Semi-knocked down units (SKD)	61.8	61.8	-	-
-Specified small cars[1]	61.8	61.8	16.5	12.4
-others	61.8	61.8	24.7	24.7
Second hand cars	103.0	103.0	24.7	24.7
Utility vehicles				
-6-12 seater	10.3	10.3	24.7	24.7
-12 seater and above[2]	10.3	10.3	16.5	14.4
Two-wheelers	61.8	61.8	16.5	12.4
Trucks (LCVs & MHCVs)	10.3	10.3	16.5	14.4
Buses (LCVs & MHCVs)	10.3	10.3	16.5	12.4
Tractors	20.6	20.6	-	-
Steel items	5.2	5.2	16.5	14.4
Pig iron	5.2	5.2	16.5	14.4
Engine & engine parts	7.7	7.7	16.5	14.4
Drive transmission, steering, suspension & braking parts	10.3	10.3	16.5	14.4
Electrical parts	7.7	10.3	16.5	14.4

[1] Specified small cars include cars with length not exceeding 4,000 mm and engine capacity not exceeding 1,200 cc for petrol cars and 1,500 cc for diesel cars.

[2] Excluding driver

LCV: Light commercial vehicles; MHCV: Medium and heavy commercial vehicles

Source: CRISIL Research

Positive impact; neutral for tractors

Company	Impact	Impact factors
Maruti Suzuki Ltd	↑	A,B
Tata Motors Ltd	↑	A,B
Ashok Leyland Ltd	↑	A
Bajaj Auto Ltd	↑	A,B
Hero Honda Motors Ltd	↑	A,B
Mahindra & Mahindra Ltd	↔	A,B,C

Source: CRISIL Research

Impact factors

A. The cut in excise duty on two-wheelers and small cars, from 16 per cent to 12 per cent, will have a marginally favourable impact on demand since we expect manufacturers to pass on the benefit to end-customers. Excise duty cut on commercial vehicles from 16 per cent to 14 per cent, and buses from 16 per cent to 12 per cent, will increase the margins of commercial vehicle players since they are likely to retain the benefit.

B. We expect two-wheeler and cars demand to rise on account of the increase in disposable income due to alteration in income tax slabs.

C. The waiver of loans for small and marginal farmers will have a neutral impact on tractor sales.

Banking and finance

Falling rates and upside to loan growth to be dominant themes for 2008-09

- Growth in bank credit moderated in line with policy intent. Non-food credit growth of scheduled commercial banks (SCBs) decelerated from 31.9 per cent on January 5, 2007 to 28.4 per cent at the end of March 2007, and further to 22.2 per cent on January 4, 2008. During the same period, growth in bank credit to the commercial sector slowed from 28.0 per cent to 25.4 per cent, and further to 20.2 per cent. Around 43 per cent of incremental non-food credit (y-o-y) was absorbed by industry while agriculture, personal loans and services accounted for around 12 per cent, 23 per cent and 22 per cent, respectively.
- Growth in bank deposits, led by time deposits, remained buoyant. Aggregate deposits of SCBs accelerated from 21.5 per cent on January 5, 2007 to 22.1 per cent at the end of March 2007, and further to 23.8 per cent on January 4, 2008. Growth in time deposits increased from 21.8 per cent to 23.2 per cent, and further to 25.3 per cent during the same time period. Conversely, growth in demand deposits decelerated from 19.9 per cent to 16.7 per cent, and further to 15.6 per cent. The higher order of increase in time deposits can be attributed to robust economic activity, increase in interest rates on bank deposits, unchanged interest rates on postal deposits, and extension of tax benefits under Section 80C for bank deposits with maturity of 5 years and above.
- Deceleration in credit growth coupled with the acceleration in deposits growth led to a decline in the incremental credit-to-deposit ratio (y-o-y) of SCBs to 63.3 per cent as on January 4, 2008 from 93.7 per cent a year ago. At the end of March 2007, the incremental credit-to-deposit ratio was around 86.0 per cent (y-o-y) as compared with 110.0 per cent at the end of March 2006. The fall in the incremental credit-to-deposit ratio tends to put pressure on the effective spreads for banks.
- Liquidity in the banking sector remains comfortable with deposit growth exceeding loan growth. Over the better part of 2007-08, deposit growth has been running ahead of the RBI's 2007-08 projection of Rs 4,900 billion, mainly driven by aggressive rate setting by banks. There is a visible slowdown in credit growth, largely due to a deceleration in demand from interest-rate sensitive sectors, including housing and other retail credit. Hence, the case for easing of interest rates remains strong. Over the past quarter, many banks reduced their lending rates by 25-50 bps. Interest rates in the auto finance and housing finance segments have been on a decline over the last couple of months. In early February 2008, many nationalised banks announced a 25-50 bps cut in their benchmark prime lending rates (BPLRs). Going forward, the pressure to cut lending rates further may be necessitated by credit growth slowing further below deposit growth. However, the evolving banking system dynamics will eventually determine the direction of lending rates for banks.
- CRISIL Research expects non-food credit to grow at 23-25 per cent in 2007-08.
- Some of the large banks have cut their retail deposit rates by 25-50 bps, but they still remain higher than the preceding year's levels. CRISIL Research believes that there still remains scope for banks to further reduce their deposit as well as lending rates without the RBI cutting policy rates. However, the last quarter of every fiscal witnesses a rush to shore up the balance sheet size to meet year-end targets. If this happens, the cost of funds may increase to higher levels along with pressure on margins. This coupled with deceleration in credit demand might compel banks to rethink their deposit growth strategies. CRISIL Research expects term deposits of SCBs to grow by 23-25 per cent, while aggregate deposits are forecast to increase by 21-23 per cent in 2007-08.

Banking and finance

- We believe the key themes likely to dominate the Indian banking sector in 2008-09 will be:
  - Fall in interest rates after the busy season ending March 2008; this should be the key theme across the banking and financial services space.
  - Pick-up in credit growth driven by capital expenditure and infrastructure spends.
  - Greater dominance of emerging financial services segments such as insurance, retail broking and asset management that have already registered strong growth in 2007-08.

Banking and finance

Overall negative; rural thrust with focus on agricultural banking

Company	Impact	Impact factors
State Bank of India	↓	A, C
Punjab National Bank	↓	A, C
ICICI Bank	↓	A, C
HDFC Bank	↓	A, C
HDFC	↔	
LIC Housing Finance	↔	

Source: CRISIL Research

Impact factors

A. Debt waiver and debt relief

The entire loan waiver of Rs 500 billion for marginal farmers (i.e. holding up to 1 hectare) and small farmers (1-2 hectares), and the one-time settlement scheme of Rs 100 billion for other farmers, are expected to provide relief to farmers. With the implementation of the debt waiver by the first quarter of 2008-09, banks will have to bear a one-time write-off charge, which would negatively impact their bottomlines. However, the manner of its reimbursement by the government, which is still unclear, will determine the extent to which this impact is mitigated.

B. Farm credit target

For 2008-09, banks have been directed to lend Rs 2,800 billion to the farm sector - a 17 per cent increase over the previous year. The reduction in the targeted growth rate over the previous year will give banks a breather to consolidate their origination systems for farm credit.

C. Directed lending

- The scope of the Differential Rate of Interest (DRI) scheme to the weaker sections of the community has been expanded in terms of the eligibility criteria of the borrower (annual family income of Rs 18,000 in rural areas and Rs 24,000 in urban areas). DRI loans are provided at subsidised interest rates - as low as 4 per cent. This could hurt the profitability of banks as such loans would typically have a negative carry.
- Short-term crop loans will continue to be disbursed at 7 per cent per annum and the interest subvention will also remain at 2 per cent. As the cost of funds has gone up by 100-125 bps since the scheme was introduced, the unchanged interest subvention could hurt the profitability of banks.

D. Financial inclusion

The requirement to add 250 rural household accounts, annually, at each rural and semi-urban branch, envisaged for scheduled commercial banks, including regional rural banks (RRBs), is a step towards more inclusive financial services growth. Further, the expansion of branch networks in rural areas / minority section-dominated areas is also aimed at financial inclusion. This expanded pool of borrowers would provide relatively lower spreads and hence impact profitability of banks.

E. Corporate bonds

The proposal towards creating an exchange-traded market for corporate bonds, including currency and derivatives markets will help develop a market-based system for classifying financial instruments based on their complexity and implicit risks. It will also increase liquidity and aid market-driven price discovery. The tradability of corporate bonds will benefit infrastructure companies, which typically raise bonds to finance long-gestation projects.

F. Banking cash transaction tax

The proposal to withdraw the banking cash transaction tax (BCTT) with effect from April 1, 2009 on cash withdrawals will help in streamlining the back-office operations at banks. The BCTT, a financial discipline measure, was introduced to monitor large-ticket cash withdrawals of customers from banks. The finance minister seems to indicate that the Government has achieved the underlying policy intent of widening the information system of the Income Tax Department.

Cement

Healthy demand growth to sustain

- Cement demand increased by 9.8 per cent year-on-year (y-o-y) basis during April-November 2007 due to inflow of healthy investments in its end-user segments, namely, housing, infrastructure and commercial construction. CRISIL Research expects demand for cement to rise by 9 per cent CAGR over the next 4 years.
- The tight demand-supply situation has resulted in healthy operating rates in the cement industry; the sector is currently operating at over 90 per cent utilisation rates. CRISIL Research expects operating rates to start softening from the fourth quarter of 2008-09, as large cement capacities are expected to be commissioned simultaneously.
- Cement prices rose from Rs 203 per bag in April-December 2006 to Rs 231 per bag in April-December 2007, registering an increase of 14 per cent (y-o-y). The southern region witnessed the highest increase (17 per cent y-o-y), followed by the eastern and western regions (13 per cent y-o-y each).
- In the last business cycle, cement manufacturers had resorted to large borrowings to fund their capital expenditure plans. In contrast, this time around, producers are financing their expansions through internal accruals.

Cement: Tariffs

(Per cent)	Customs		Excise		Abatement rate	
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
Portland cement[1,2]	0.0	0.0	360 - 618	360 - 618	0.0	0.0
White cement	10.3	10.3	16.5	16.5	35.0	35.0
Cement clinker[1]	10.3	10.3	361	464	0.0	0.0
Limestone, Gypsum, Non coking coal	5.2	5.2	0.0	0.0	0.0	0.0
Pet coke	5.2	5.2	16.5	14.4	0.0	0.0

[1] Excise duty for portland cement and cement clinker is in rupees.

[2] There is a three tier excise duty structure on cement industry for large cement plants.
MRP < Rs 3,800 / tonne - excise Rs 350 / tonne, MRP > Rs 3,800 / tonne but < Rs 5,000 / tonne - excise 12%, MRP > Rs 5,000 / tonne - excise Rs 600. An education of cess of 3 per cent will be applicable in all cases.

Source: CRISIL Research

Increase in excise duty on bulk cement and clinker to have neutral impact

Company	Impact	Impact factors
ACC	↔	A, B
Gujarat Ambuja Cement Ltd	↔	A, B
India Cement Ltd	↔	A, B
Shree Cement Ltd	↔	A, B
Ultratech Cement Ltd	↔	A, B

Source: CRISIL Research

Impact factors

A. In the Union Budget 2008-09 the excise duty on bulk cement has been revised from Rs 400 per tonne in 2007-08 to Rs 400 per tonne or 14 per cent ad-valorem, whichever is higher. This proposal is expected to increase the cost of bulk cement for consumers such as ready-mix concrete producers, infrastructure companies and large builders, who account for an estimated 10-15 per cent of total cement consumption. The impact on the cement industry will be neutral, as producers will be able to pass on this increase to customers.

B. Further, excise duty on clinker has been hiked from Rs 350 in 2007-08 to Rs 450 in 2008-09 per tonne. This will also have a neutral impact on the industry, as players currently possess adequate pricing flexibility to pass on the increase to end-consumers.

Construction

Construction margins to remain stable in the medium term

- CRISIL Research expects construction industry margins to remain stable in the medium term. The stability in margins emanates from the trend expected in the construction industry's turnover mix. The increasing share of high margin segments such as urban infrastructure and industrial segment in the turnover mix will mitigate the negative impact on margins caused by declining share of power segment.
- Total construction investments (infrastructure and industrial) are expected to grow from Rs 2,151 billion in the past 2 years (2005-06 to 2006-07) to Rs 3,034 billion over the next 2 years (2007-08 to 2008-09), recording a Trend Annual Growth Rate (TAGR) of 19 per cent. Industrial investments, led by oil and gas and metals, likely to grow at a TAGR of 36 per cent, will maintain the growth momentum of the industry. On the other hand, roads and urban infrastructure led by the National Highway Development Programme (NHDP) and Jawaharlal Nehru National Urban Renewal Mission (JnNURM), will mainly fuel investments in the infrastructure sector.
- During the 9 months ended December 2007, construction companies have witnessed robust growth in revenues, accompanied by healthy growth in margins. The topline grew by 46 per cent on a year-on-year (y-o-y) basis guided by strong order book positions across construction companies. Operating margins improved by 200 basis points to close at 11 per cent, while net margins remained stable at 6 per cent. CRISIL Research expects the industry to continue delivering healthy growth on the back of increased thrust on investments and higher operating efficiencies.

*(TAGR: [(Investments in the future 2- year block period) / (Investments in past 2 - year block period) ^ (1/2) * 100-100]*

For evaluating corporate performance, we have considered the following eight companies: Gammon India Ltd, Hindustan Construction Co Ltd, IVRCL Infrastructures and Projects Ltd, Larsen &Toubro Ltd, Nagarjuna Construction Co Ltd, Patel Engineering Co Ltd, Punj Lloyd Ltd and Simplex Infrastructures Ltd.

Marginally positive impact on the sector companies

Company	Impact	Impact factors
Larsen & Toubro Ltd	↑	-
Hindustan Construction Co Ltd	↑	-
IVRCL Infrastructures & Projects Lt	↑	-
Nagarjuna construction Co Ltd	↑	-
Gammon India Ltd	↑	-

Source: CRISIL Research

Impact factors

A. The government has increased the outlay in key infrastructure sectors such as roads, urban infrastructure and irrigation.

- The budget allocation, under roads, led by National Highways Development Programme, has been increased by 19 per cent from Rs 108.67 billion in 2007-08 to Rs 129.66 billion in 2008-09. The allocation has increased at a much higher rate as compared to 9 per cent increase witnessed in 2007-08.

- The central assistance under Jawaharlal Nehru Urban Renewal Mission has also been increased by 25 per cent - from Rs 54.82 billion in 2007-08 to Rs 68.66 billion in 2008-09.

- Further, the annual outlay under the 'Accelerated Irrigation Benefit Programme' has been raised from Rs 110 billion to Rs 200 billion.

- These increased allocations would augur well for construction companies in terms of healthy order book growth and higher revenues.

- CRISIL Research estimates suggest that these allocations would translate into construction investments of Rs 290.86 billion in roads, urban infrastructure and irrigation segments.

Fertilisers

Rising raw material costs affected profitability; subsidy bill to remain high in 2008-09

- Production of key fertilisers declined during the first 8 months of 2007-08, primarily due to the scarcity of raw materials. Hence, in order to support the healthy demand, imports increased.
- Changes in the concession scheme for phosphatic fertilisers (instituted in September 2007) enabled players in this segment to realise higher profitability. However, players in the urea segment witnessed a drop in profits in the first half of 2007-08 over the previous year. This was due to high production costs on account of naphtha usage since the availability of natural gas was low.
- The Union Budget 2007-08 provided Rs 305 billion towards fertiliser subsidy. In addition, the government decided to issue bonds of Rs. 75 billion during the year. However, the subsidy bill for 2007-08 is estimated to be around Rs 500 billion, leaving a wide gap between the actual and budgeted amounts.
- Going forward, given the healthy growth in demand, we expect imports to increase, as the domestic supply will remain sluggish. In the medium term, demand for urea is expected to grow by 4-5 per cent while that of phosphatic fertilisers is likely to increase by 5-6 per cent. However, availability of key raw materials such as phosphoric acid and sulphur could remain a concern in 2008-09. Natural gas availability, though, is expected to improve marginally from mid 2008-09, after the RIL KG pipeline is commissioned.
- As imports are expected to rise and international prices likely to remain firm, the subsidy bill for 2008-09 is expected to be Rs 500-600 billion, excluding arrears for 2007-08. However, the government has budgeted for only Rs. 310 billion as fertilizer subsidy for 2008-09.

Fertilisers: Tariffs, prices and landed costs

	Tariffs (per cent)				Prices (Jan 2008)		Landed costs (Rs/tonne)	
	Customs[1]		Excise[1]		Domestic	International	Pre-	Post-
	2007-08	2008-09	2007-08	2008-09	(Rs/tonne)	($/tonne)	budget	budget
Urea	5.2	5.2	-	-	4,830 [2]	410	18,157	18,157
DAP	5.0	5.0	-	-	9,350 [2]	765	34,365	34,365
MOP	5.2	5.2	-	-	4,455 [2]	330	15,286	15,286
Ammonia	5.2	5.2	-	-	14,339	580	24,491	24,491
Phosphoric acid	7.7	5.2	-	-	NT	566	24,496	23,910
Sulphur	5.2	2.1	-	-	23,676	620	26,180	25,410
Rock phosphate	5.2	5.2	-	-	NT	205	9,501	9,501
Naphtha	0.0	0.0	16.5	14.4	37,020	813	33,036	33,036
Fuel oil / LSHS (non-feed use)	10.3	10.3	16.5	14.4	21,715	457	20,616	20,616
LNG[3]	5.2	5.2	-	-	-	-	6,332	6,332

DAP: Di-ammonium phosphate; LNG: Liquified natural gas; LSHS: Low sulphur heavy stock;
MOP: Muriate of potash; NT: Not traded
- indicates not applicable
Notes:
[1] Includes education cess except for DAP
[2] Farmgate price from March 12, 2003
[3] Price per thousand scm
Source: CRISIL Research

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Fertilisers

Neutral Impact despite custom duty cut

Company	Impact	Impact factors
Chambal Fertilisers & Chemicals Ltd	↔	**B**
Coromandel Fertilisers Ltd	↔	**A,B**
Gujarat Narmada Valley Fertilizers Company Ltd	↔	**A,B**
Gujarat State Fertilisers Company Ltd	↔	**B**
Rashtriya Chemicals and Fertilisers Ltd	↔	**A,B**
Tata Chemicals Ltd	↔	**A,B**
Zuari Industries Ltd	↔	**A,B**

Source: CRISIL Research

Impact factors

A. The customs duty on phosphoric acid has been reduced from 7.5 per cent to 5.0 per cent, while on sulphur it has been cut from 5 per cent to 2 per cent. This will not have an impact on margins as product prices are regulated.

B. The budgetary allocation for fertiliser subsidy has been raised marginally from Rs 305 billion in 2007-08 to Rs 310 billion in 2008-09, even as the estimated subsidy bill for 2008-09 is expected to be around Rs 500 billion. Hence, this could result in arrears if the balance subsidy is not provided in time, thereby straining the working capital of fertiliser companies.

Other factors

C. Greater thrust on agricultural credit and irrigation would help increase fertiliser consumption in the long run.

Hotels

Supply to dampen occupancy rates in business destinations, while leisure destinations to perform well

- In the first 9 months of 2007-08, average room demand remained more or less stable, while supply increased by 2 per cent. Hence, occupancy rates slipped marginally from around 72 per cent to 71 per cent.
- Among business destinations, only Kolkata witnessed a growth in room demand. The overall negative demand growth can be attributed to the high average room rates (ARRs) prevailing across cities. All leisure destinations recorded positive growth in demand, with Goa and Agra clocking the highest growth at 8 per cent.
- The overall ARRs of the premium segment increased by 13 per cent from around Rs 6,300 during April-December 2006 to Rs 7,100 during April-December 2007. Consequently, overall revenue per available room (RevPAR) also increased by 12 per cent to reach Rs 5,100 from Rs 4,500.
- The highest increase in ARRs was witnessed in Goa (36 per cent increase from around Rs 5,700 to Rs 7,700), followed by Pune (32 per cent increase from around Rs 6,200 to Rs 8,200).
- Tourist arrivals increased by around 11 per cent, from 2.7 million in April-November 2006 to 2.9 million in April-November 2007.
- CRISIL Research expects average room demand to increase by around 11 per cent in 2008-09. However, room availability is likely to grow by around 15 per cent, which would dampen the occupancy rates, leading to higher competition and a decline in ARRs in cities such as Hyderabad, Chennai and Bangalore. Also, the good prospects of leisure destinations would contribute to the demand growth.
- Average ARRs are expected to increase by around 5 per cent from around Rs 10,100 in 2007-08 to around Rs 10,600 in 2008-09. The rise will be propelled by leisure destinations such as Goa and Jaipur and business destinations such as Mumbai, Delhi and Kolkata. The occupancy rates, however, are expected to decline, resulting in a smaller increase in RevPARs during 2008-09.

No impact on premium segment hotels

Company	Impact	Impact factors
Indian Hotels	↔	-
EIH	↔	-
Hotel Leelaventure Ltd	↔	-

Source: CRISIL Research

Impact factors

A. A 5-year tax holiday has been announced for two-, three- and four-star hotels that are established in specified districts that have UNESCO-declared 'World Heritage Sites' (there are 27 such sites in India). The above-mentioned hotels should be constructed and begin functioning between April 1, 2008 and March 31, 2013. Since the incentive is specific to two-, three- and four-star hotels, there would be no impact on premium segment hotels.

Household Appliances

Household appliances sector to grow by double-digit in 2008-09

- Sales of major appliances are expected to grow by 9-11 per cent in value terms to Rs 209 billion in 2007-08.
- Growth in urban demand and the free distribution of CTVs by the Tamil Nadu government aided volume growth. But declining CTV prices resulted in lower value growth.
- Apart from volume growth, the continued shift towards higher value segments and marginal increase in prices will support value growth.

Product category	2007-08 over 2006-07 Volume growth%	Growth drivers
Air-conditioners	19-21	Changing lifestyles, rising personal disposable incomes and increasing demand from the commercial segment.
Refrigerators	10-12	Growing urban consumption and growth in frost-free due to upgradation.
Colour televisions	13-15	Free distribution of 14" CTVs by the Tamil Nadu government.
Washing machines	14-16	Increasing penetration from low base and rising disposable incomes.

E: Expected growth

Source: CRISIL Research

Household appliances: Tariffs

(per cent)	Customs		Excise		Abatement rate	
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
B/W TVs	10.3 *	10.3 *	16.5	14.4	-	-
Colour TVs (CRT,LCD)	10.3 *	10.3 *	16.5	14.4	35	35
Refrigerators	10.3 *	10.3 *	16.5	14.4	40	40
Room ACs	10.3 *	10.3 *	16.5	14.4	30	30
Washing machines	10.3 *	10.3 *	16.5	14.4	40	40
CPT and glass parts	10.3	10.3	16.5	14.4	-	-
Compressors, Thermostat and Tubes	7.7	7.7	16.5	14.4	-	-
Steel, Polymers	5.2	5.2	16.5	14.4	-	-

* Protection to domestic industry is higher due to 4% SCVD

CRT: Cathode ray tube, LCD: Liquid crystal display, CPT: Colour picture

Source: CRISIL Research

Household Appliances

Income tax slab changes to induce demand

Company	Impact	Impact factors
Samtel	↑	A
LG	↑	A , B
Samsung	↑	A , B
Whirlpool of India Ltd	↑	A , B
MIRC Electronics Ltd	↑	A , B

Source: CRISIL Research

Impact factors

A. The alteration in income tax slabs will lead to a significant reduction in tax liability for the salaried-class (especially for income up to Rs 5 lakh), inducing higher demand for household appliances.

B. Reduction of basic excise duty from 16 per cent to 14 per cent is unlikely to benefit the household appliances industry, as a significant part of the production of major manufacturers comes from excise-free zones. The resultant reduction in CVD will have negligible effect on the industry, as it faces a limited import threat. This is due to unique product specifications (such as size) and competitiveness of the domestic industry in terms of cost, brand perception and distribution network.

C. Reduction of excise duty on CPT and other components will have very marginal positive impact on margins of OEMs, as we expect them to retain the benefit.

Housing

Rise in residential prices, coupled with increasing interest rates, leads to sluggish demand

- CRISIL Research estimates an average annual addition of 3.09 million units in urban areas, taking the housing stock to over 150 million units by 2012.
- Although increasing migration and urbanisation are fuelling the rise in the number of urban households, increasing real estate prices are driving ticket sizes higher. CRISIL Research study shows that residential real estate prices in most major cities in India have grown over 200 per cent in the last 2-3 years, which is much higher than the increase in incomes, thus leading to sluggish demand. However, supply still lags demand in many large cities, which has become the key reason for the continuing offtake.
- Increase in interest rates by the RBI has further made housing finance more expensive, leading to the postponement of home purchases by households.

No major impact on organised and urban segments

Company	Impact	Impact factors
Akruti City Ltd	↔	-
DLF Universal Ltd	↔	-
Mahindra Gesco Developers Ltd	↔	-
Sobha Developers Ltd	↔	-
Unitech Ltd	↔	-

Source: CRISIL Research

Impact factors

A. The subsidy under the Indira Awas Yojna for construction of housing units for people living below the poverty line in rural areas has been enhanced. Although a beneficiary will require own funds to complete the house, the subsidy per unit has been enhanced for new houses sanctioned after April 1, 2008 from Rs 25,000 to Rs 35,000 in plain areas and from Rs 27,500 to Rs 38,500 in hilly/difficult areas. This will provide relief from the higher cost of construction. The subsidy for upgradation of houses will be increased from Rs 12,500 per unit to Rs 15,000. As this proposal is aimed at rural households, it will not impact the organised housing sector, which is presently focused on urban India.

Information Technology

Moderate growth ahead

- The Indian IT industry primarily consists of three segments: IT services, ITeS (commonly referred to as BPO/KPO services) and the hardware industry. According to CRISIL Research, IT services revenues are expected to account for $22.8 billion in 2007-08, a y-o-y growth rate of 27 per cent. External factors such as the rising rupee, wage inflation and impending US slowdown have put some pressure on the profitability of Indian players and consequently, some slackening in the industry growth rates. Players have gradually moved to offer value-added services like System Integration (SI) and Infrastructure Management Services (IMS). CRISIL Research expects SI and IMS to grow at approximately twice the pace of traditional Custom Application and Development services and the overall IT services industry to grow at a CAGR of 20 per cent during 2008-11.
- As with the IT services industry, the ITeS industry has seen a gradual shift from low-end services such as customer care and transaction to knowledge-driven, domain specific services such as legal process outsourcing and data analytics. The Indian ITeS industry is expected to grow by an annual rate of 24 per cent in 2007-08 and reach $10 billion. CRISIL Research believes ITeS export revenues to grow at a CAGR of 21 per cent during 2008-11.
- The above-mentioned external issues have affected the competitiveness of the Indian industry, putting brakes on the galloping growth rates. Accordingly, the IT players have resorted to measures like diversifying their geographical mix, increasing billing rates and improving utilisation levels of employees. A shift to value-added services should also provide means to mitigate the impact of the above-mentioned issues affecting the industry.
- Revenues of the hardware industry grew from $6.5 billion in 2005-06 to $8.0 billion in 2006-07. They were primarily driven by personal computers (PC) and notebooks, which form a major chunk of the hardware industry revenues and clocked an impressive 28.7 per cent year-on-year (y-o-y). With domestic PC penetration levels still low at 35 units per 1,000, increasing penetration levels and persistent downward trend in prices, are expected to drive volumes in the future. Factors like increasing adoption of IT, growth in banking, financial services and insurance (BFSI), and higher IT spending by the government are expected to boost domestic hardware revenues.

IT: Hardware & Software tariffs

(per cent)	Customs		Excise	
	2007-08	2008-09	2007-08	2008-09
Application and system software	0.0	0.0	8.2	8.2
Packaged software	0.0	0.0	8.2	12.2
Computer accessories (excluding PPCBs)	0.0	0.0	16.5	16.5
Computers and peripherals	0.0	0.0	12.4	12.4
Monitor, keyboard, mouse	0.0	0.0	16.5	16.5
Printer	0.0	0.0	16.5	16.5
FDD, HDD, CD-ROM drive and other storage drives	0.0	0.0	0.0	0.0
Ink cartridges with print head assembly	0.0	0.0	16.5	16.5
Integrated circuits and micro assemblies	0.0	0.0	16.5	16.5
Microprocessors	0.0	0.0	0.0	0.0
Routers and other networking equipment	0.0	0.0	16.5	16.5
Other units of automatic data processing machines	0.0	0.0	8.2	8.2
Storage devices	0.0	0.0	16.5	16.5
Computer parts other than ink cartridges, PPCBs, Motherboards	0.0	0.0	16.5	16.5
Digital video disc drive CDs & CD writers	0.0	0.0	16.5	16.5
Speakers	15.3	15.3	16.5	16.5
Printed circuits (PPCBs)	0.0	0.0	16.5	16.5
Key switches for keyboards	0.0	0.0	16.5	16.5
Others, including modems, routers, ISDN terminals, etc	0.0	0.0	16.5	16.5

FDD: Floppy disk drive; HDD: Hard disk drive; CD-ROM: Compact disk-read only memory

Source: CRISIL Research

Impact on the industry will be marginally negative

Company	Impact	Impact factors
Infosys Technologies Ltd	↓	C,D
TCS	↓	C,D
HCL Technologies	↓	C,D
First Source	↔	
Zenith Computers	↑	B

Source: CRISIL Research

Impact factors

A. Excise duty on packaged software has increased from 8 per cent to 12 per cent. The ability of packaged software players to pass on the cost to its consumers remains a concern and accordingly, will impact its profitability. The excise duty hike will also have a negative impact on curbing piracy in the packaged software segment. However, its impact on Indian players will be marginal because of their limited presence in this segment.

B. The Indian hardware industry is predominantly import driven. Consequently, the exemption of excise duty on manufacturing of printers and monitors in Uttarakhand and Himachal Pradesh is expected to induce domestic hardware manufacturers to set up plants in this region.

C. Customised software has been included in the service tax net. Players may have to manage internal cost so as to negate a higher billing to the customer. This is expected to negatively impact the domestic software and Tier I IT players who predominantly provide these services. However, the impact on players is small as revenues from providing customized software to domestic clients is a small part of the total revenues.

D. Indian IT industry is thriving because of its ability to provide quality manpower at a cost advantage, vis-à-vis other global offshore destinations, in huge numbers. Consistent growth over the past decade coupled with wage inflation has put pressure on the availability of qualified supply pool. The Government is focussed on building the talent pool in the country by contributing Rs 1,000 crores as equity out of a proposed Rs 15,000 crores corpus. This is expected to benefit the IT sector, as it is a major recipient of the vast knowledge resources of the country.

Media and Entertainment

Growth in advertising spends to propel industry

- CRISIL Research expects total revenues of the media and entertainment industry to increase from an estimated Rs 500 billion in 2007 to Rs 1,019 billion by 2012, registering a CAGR of 15.4 per cent over the 5-year period. This growth in revenues will be driven by continued buoyancy in advertising spends, increase in the penetration of media platforms, ubiquitous availability of content and access devices, and expanding international markets for Indian content.
- In 2007, subscription revenues dominated total revenue, accounting for 62 per cent, whereas advertising revenue accounted for 38 per cent. Over the next 5 years, annual subscription and advertising revenues are forecast to grow at 14.3 per cent and 17.0 per cent, respectively.
- Among the larger industry segments, revenues of the television industry are expected to grow at 15.8 per cent (CAGR) from an estimated Rs 227 billion in 2007 to Rs 471 billion by 2012. With the advent of addressable distribution platforms such as direct-to-home, conditional access system, and Internet protocol television, the average revenue earned per cable subscriber is expected to increase. Continuing growth in television advertising spends, reach of cable television and the number of channels are also expected to contribute to the industry's revenues.
- Revenues of newspaper publishers and the film industry are projected to register a CAGR of 10.2 per cent and 16.4 per cent, respectively, touching Rs 205 billion and Rs 217 billion by 2012. Indian newspaper publishers, unlike their global counterparts, are still to feel the impact of the proliferation of the Internet. This can be attributed to the low Internet penetration in India and the predominance of vernacular newspapers in the readership mix. In the films segment, the growth in the number of multiplex screens and the increasing implementation of digital technology in cinemas are viewed as positives.

Media and entertainment: Tariffs

(per cent)	Customs		Excise	
	2007-08	2008-09	2007-08	2008-09
Digital cinema equipment	7.7	7.7	16.5	16.5
Broadcast equipment	10.3	10.3	16.5	16.5
Set-top boxes	0.0	0.0	16.5	16.5
Infra red modules	7.5	0.0	16.5	16.5

Source: CRISIL Research

CRISIL RESEARCH

Media and Entertainment

Budget neutral for media and entertainment sector

Company	Impact	Impact factors
Adlabs Films Ltd	↔	-
Balaji Telefilms Ltd	↔	-
Entertainment Network (India) Ltd	↔	-
HT Media Ltd	↔	-
Mukta Arts Ltd	↔	-
New Delhi Television Ltd	↔	-
PVR Ltd	↔	-
Pyramid Saimira Theatre Ltd	↔	-
Saregama India Ltd	↔	-
Sun TV Ltd	↔	-
Zee Entertainment Enterprises Ltd	↔	-

Source: CRISIL Research

Impact factors

A. The customs duty on certain parts of the set-top boxes such as switched mode power supply (SMPS) power board and infra red (IR) module has been reduced from 7.5 per cent to nil. This reduction rationalises the differential between importing raw materials for set-top box manufacturing and importing the finished set-top box, which attracts zero customs duty. This move is expected to boost the domestic manufacturing of set-top boxes.

Non-ferrous Metals

Profitability of aluminium players to remain stable, while that of copper and zinc players to decline

Aluminium

- During April 2007-January 2008, average international as well as domestic prices of aluminium declined by around 3 per cent y-o-y. Rise in inventory levels, sub prime crises in the US, followed by the global meltdown in the commodities market caused the decline in prices.
- Global aluminium prices are likely to remain firm at current levels ($2,450-2,650 per tonne) due to balanced demand-supply scenario.
- Higher availability in the global alumina market may exert downward pressure on alumina prices; however, aluminium prices are unlikely to decline, as the global aluminium market remains balanced.
- Average domestic prices will follow international prices and remain firm during 2008-09. The profitability of domestic players is expected to remain stable on account of firm prices.
- Domestic demand is likely to grow by 9-10 per cent during 2008-09, driven by improved activity in the power, construction and packaging sectors. Domestic availability of the metal is expected to increase at a faster pace than demand due to commissioning of capacities. However, the domestic market is likely to remain balanced, as the surplus would be exported.

Copper

- During April 2007-January 2008, average international copper prices were higher by around 4 per cent, while domestic prices were lower by around 2 per cent over the corresponding period last year. Speculative interest in the international market propelled the increase in prices, which had dropped on account of the global meltdown in the commodities market. Global prices witnessed a sharp increase in January 2008, while domestic prices are catching up in February 2008.
- With the commissioning of new capacities, metal supply in the global market is expected to outpace demand. Consequently, prices are likely to soften from the current levels, though the fall will be restricted. However, given the high speculative interest in the commodity, prices will remain volatile.
- As Indian producers (excluding Hindustan Copper) are custom smelters, they receive Tc/Rc margins. Concentrate markets are expected to experience a shortfall in 2008, causing Tc/Rc margins to come under pressure in the near term.

Zinc

- Rising inventory levels, followed by expectations of a surplus in 2007, caused global zinc prices to decline by around 15 per cent y-o-y during April 2007-January 2008.
- Global supply is likely to outpace demand in 2008, which is expected to result in declining prices. However, the drop in prices from current levels will be limited.
- Domestic demand for zinc is likely to increase by around 9 per cent in 2008-09, driven by growth in the galvanising sector. Domestic supply will also increase due to capacity addition by Hindustan Zinc. This is likely to bring down imports.

Lead

- During April 2007-January 2008, average international lead prices increased by around 110 per cent y-o-y, while domestic lead prices increased by around 64 per cent y-o-y.
- Rising demand for acid/lead batteries, following higher demand from the automobiles segment, will result in higher lead consumption.
- Average global prices are likely to remain firm in 2008, as supply shortages continue to plague the global industry.

Non-ferrous metals: Tariffs, prices and landed costs

	Tariff (per cent)				Prices (January 2008)		Landed cost (Rs/tonne)	
	Customs		Excise		Domestic	International	Pre-budget	Post-budget
	2007-08	2008-09	2007-08	2008-09	(Rs/tonne)	($/tonne)		
Aluminium ingots	5.2	5.2	16.5	14.4	120,250	2,445	125,894	123,690
Aluminium products	5.2	5.2	16.5	14.4	-	-	-	-
Aluminium scrap	5.2	0.0	16.5	14.4	-	-	-	-
Non-coking coal	5.2	5.2			-	-	-	-
Caustic soda	10.3	10.3	16.5	14.4	-	-	-	-
Calcined petroleum coke	5.2	5.2	16.5	14.4	-	-	-	-
Copper	5.2	5.2	16.5	14.4	369,750	7,061	357,448	351,188
Copper scrap	5.2	5.2	16.5	14.4	-	-	-	-
Copper ore and concentrates	2.1	2.1	16.5	14.4	-	-	-	-
Lead	5.2	5.2	16.5	14.4	117,500	2,607	134,033	131,685
Lead ore and concentrates	2.1	2.1	16.5	14.4	-	-	-	-
Zinc	5.2	5.2	16.5	14.4	126,000	2,340	120,619	118,507
Zinc ore and concentrates	2.1	2.1	16.5	14.4	-	-	-	-

Notes
1) Domestic prices are average Mumbai market prices for January 2008.
2) International prices are average LME cash prices for January 2008.
Source: CRISIL Research

Non-ferrous Metals

Neutral impact on NFM sector

Company	Impact	Impact factors
Hindalco Industries Ltd	↔	A,B
Hindustan Copper Ltd	↔	B
Hindustan Zinc Ltd	↔	B
National Aluminium Company Ltd	↔	A,B
Sterlite Industries (India) Ltd	↔	A,B

Source: CRISIL Research

Impact factors

A. Customs duty on aluminium scrap has been reduced from 5 per cent to zero. This is unlikely to have any significant impact on the industry, given the low share of recycled aluminium in the domestic aluminium sector.

B. The cut in the CENVAT rate on all goods, from 16 per cent to 14 per cent, will result in a decline of around Rs 2,000 per tonne in aluminium and zinc prices, and Rs 5,000-6000 per tonne in copper prices, notwithstanding the future trend in international prices. However, the reduction will not have a significant impact on the sectors, as these items are sold to industrial buyers. The excise duty on these items is MODVAT'able, and hence, the industrial buyer's cost remains unchanged.

Profitability of industries constrained by higher marketing losses in 2007-08

- Average crude oil (Dated Brent) prices moved up by over 11 per cent in 2007 over the previous year to average $72.7 per barrel as compared with $65.3 per barrel in 2006. This rise in prices over the last year is mainly reflective of the continuing weakness experienced by the US dollar against other world currencies, primarily the euro.
- Tighter global product markets are expected to improve average GRMs for Indian refining entities in 2007-08 to $6.5-7.0 per barrel when compared with the previous year of $4.7 per barrel, as their entire production, except auto (petrol and diesel) and cooking fuels [(liquefied petroleum gas (LPG) and kerosene], is priced on import parity basis. Auto and cooking fuels are priced on trade parity basis (import parity and export parity in the ratio of 80:20) and export parity basis, respectively.
- Although the appreciating rupee vis-à-vis the US dollar has lowered the impact of the rising international auto and cooking fuel prices on the retail sale of these products in domestic markets by oil marketing companies (OMCs), they continue to slide deeper into the red on this front in 2007-08. In 2007-08, blended auto fuel margins are expected to be in the negative Rs 3.5-4.0 per litre as compared with a negative of Rs 1.97 per litre of 2006-07. Similarly, the total under-recovery on LPG and kerosene is expected to be Rs 159-161 per cylinder and Rs 13-14 per litre, respectively, in 2007-08 as against Rs 136.34 per cylinder and Rs 15.29 per litre, respectively, in 2006-07. Thus, the total under-recovery on the retail sale of these fuels is expected to worsen in 2007-08 to Rs 490-500 billion as compared with Rs 341 billion in 2006-07.
- However, this will be offset by the loss-sharing mechanism followed by the government in the current year (2007-08) as in the previous year (2006-07). This is in the form of upstream assistance given by companies, such as Oil and Natural Gas Corp (ONGC), GAIL (India) Ltd and Oil India Ltd (OIL), and oil bonds issued by the government in lieu of the losses suffered by OMCs on retail sales of auto and cooking fuels. This, coupled with higher refining profits, has improved operating profits of the refining and marketing industry for the 9 months ended of 2007-08 to around Rs 166 billion as compared with the corresponding period of the previous year when it was around Rs 103 billion.
- Domestic consumption of petroleum products continued to grow at a healthy rate of 5.5 per cent during April-December 2007 as compared with the previous year, backed by higher growth in petrol, LPG and diesel.
- Differential pricing is followed for pricing domestic natural gas in the country, wherein a large proportion of the gas is allocated to sectors, such as power, fertilisers, transportation, and consumers, consuming less than 0.05 mmscmd of gas on a controlled preferential basis. However, unlike retail auto and cooking fuels, the government seems to be moving towards a market-determined pricing mechanism for natural gas, as it has recently approved a market-evolved price for the gas from Reliance Industries Ltd's (RIL) Krishna-Godavari (KG) Dhirubhai (D) - 6 block. As against this, the price of imported natural gas, liquefied natural gas (LNG), averaged $11-12/mmbtu (cif) between April 2007 and January 2008.
- CRISIL Research believes the exchange rate will remain a critical element in determining the average crude oil price in 2008 in dollar term. Assuming no further depreciation in the dollar-euro exchange rate from the levels of $1.46 per euro and an easing market for crude, its price is forecast to be $74-76 per barrel in 2008 as compared with $72.7 per barrel in 2007. We also expect GRMs to decline from its 2007-08 levels to average $5.0-5.5 per barrel in 2008-09 on the back of easing product markets. With the government still actively involved in the pricing of retail auto and cooking fuels, the marketing business of OMCs is expected to remain strained even in 2008-09. However, since the government is also likely to continue with its financial assistance scheme, the overall profitability of the sector may not suffer.

Oil and Gas

Oil and gas: Tariffs, prices and landed costs

	Tariffs (per cent)				Prices (Jan 2008)		Landed costs (Rs/tonne)	
	Customs		Excise		Domestic	International	Pre-Budget	Post-Budget
	2007-08	2008-09	2007-08	2008-09	(Rs/tonne)	($/tonne)		
Motor spirit (MS)	7.7	7.7	6.2 + Addl Rs 13/ltr	Rs 14.35/ltr	28,764.1	822.2	35,272.8	35,272.8
Aviation turbine fuel (ATF)	10.3	10.3	8.2	8.2	31,820.0	821.6	36,833.8	36,833.8
Naphtha	5.2	5.2	16.5	14.4	37,020.0	812.7	34,737.7	34,737.7
Superior kerosene oil (SKO)								
- Industrial use	10.3	10.3	16.5	14.4	40,002.6	819.6	36,744.0	36,744.0
- Domestic use	0.0	0.0	0.0	0.0	10,239.0	819.6	33,312.7	33,312.7
High-speed diesel (HSD)	7.7	7.7	6.2 + Addl Rs 3.25/ltr	Rs 4.6/ltr	26,151.1	781.1	33,527.8	33,527.8
Fuel oil	10.3	10.3	16.5	14.4	23,256.9	456.7	20,671.9	20,671.9
Liquefied petroleum gas (LPG)								
- Industrial use	5.2	5.2	8.2	8.2	31,190.0	818.6	34,985.9	34,986.0
- Domestic use	0.0	0.0	0.0	0.0	16,304.0	818.6	33,272.4	33,272.0
Bitumen	10.3	10.3	16.5	14.4	n.a.	749.8	-	-
Crude oil[1]	5.2	5.2	0.0	0.0	n.a.	654.3	28,049.0	28,049.0
Natural gas[2]								
- Priority sector	5.2	5.2	0.0	0.0	3,200.0	-	-	-
- Transportation and consumers drawing gas less than 0.05 mmscmd	5.2	5.2	0.0	0.0	3,840.0	-	-	-
- Non-priority sector	5.2	5.2	0.0	0.0	7,421.1	-	-	-
LNG[3]	5.2	5.2	0.0	0.0	-	-	6,331.7	6,331.7
CNG	5.2	5.2	16.5	14.4	-	-	-	-

- indicates Not applicable

n.a.: Not available, -: Not relevant; Addl: Additional excise duty

[1] Cess on crude (in lieu of excise) is Rs 2500/tonne

[2] Price per thousand scm

[3] Prices are for pooled LNG FOB in Rs per thousand scm

Notes

1) International prices are fob Arab Gulf prices.

2) Domestic price of petroleum products are ex-storage point prices.

3) Customs duty on Naphtha used in fertiliser is nil.

4) Priority sectors for natural gas includes power and fertiliser.

5) Natural gas domestic prices represent landfall prices (inclusive of royalty) for each category.

Source: CRISIL Research

CRISIL RESEARCH

Oil and Gas

Withdrawal of duty exemption on naphtha and cheaper project imports to benefit the industry

Company	Impact	Impact factors
Oil and Natural Gas Corpn Ltd	↑	B
GAIL India Ltd	↔	-
Petronet LNG Ltd	↔	-
Chennai Petroleum Corpn Ltd	↑	A, B
Mangalore Refinery & Petrochemicals Ltd	↑	A, B
Indian Oil Corpn Ltd	↑	A, B
Bharat Petroleum Corpn Ltd	↑	A, B
Hindustan Petroleum Corpn Ltd	↑	A, B

Source: CRISIL Research

Impact factors

A. The withdrawal of customs duty exemption on naphtha for the manufacture of polymers and subjecting it to its normal rate of 5 per cent is expected to marginally improve refining profits by Rs 7-8 billion.

B. Reduction of 2.5 per cent in customs duty on project imports is likely to reduce capital costs of players in the oil and gas industry.

Other factors

C. The replacement of ad-valorem portion of the excise duty (6.2 per cent) on unbranded petrol and diesel by an equivalent specific duty of Rs 1.35 per litre would be revenue neutral. However, this is expected to act as a cushion against the cascading effect of any future change in international prices on domestic prices for consumers.

D. Reduction in peak excise duty (by 2 per cent) and CST (by 1 per cent) is expected to be revenue neutral for the sector, as they are likely to be passed on to the final consumer.

Paper

Declining prices to put pressure on margins but increased operating efficiency to mitigate the impact

- The paper industry witnessed an improvement in its operating margins by around 3 per cent, from around 20 per cent in the first 9 months of 2006-07 to around 23 per cent in the corresponding period of 2007-08. This increase was mainly due to improved capacity utilisation levels, declining manufacturing and selling overheads.
- CRISIL Research expects operating margins of companies, in the writing and printing segment, to decline as capacity additions in this segment are expected to be more than the incremental demand in this segment. This would exert downward pressure on prices. This, coupled with increase in input prices, would suppress margins over the next 2-3 years. However, the drop is expected to be virtually compensated by increased efficiency, from modernisation in paper and pulp manufacturing.
- The paper industry is currently on an expansion spree with most players undertaking modernisation and expansion plans. Out of the total capacity additions of 2.5 million tonnes, 1.5 million tonnes would be added in the writing and printing segment and 1.0 million tonnes in industrial segment. With excess capacity flowing in, operating rates in writing and printing segments are expected to fall over the next 2-3 years.
- Margins in the industrial paper segment are expected to remain stable with capacity additions matching incremental demand over the next 2-3 years and a stable demand-supply situation.
- With the paper industry growing at a steady 6.5 per cent over the last few years, CRISIL Research expects the demand for paper to grow by 7.0 per cent over the next 2-3 years. The demand for industrial paper is expected to increase by 7.5 per cent on the back of healthy growth in manufacturing sector and branded products, whereas the demand for writing and printing paper is expected to grow by 7 per cent.
- Margins in the newsprint segment have declined during the first 9 months of 2007-08. Increasing exports from China has resulted in a decline in international and domestic newsprint prices. Though newsprint demand is expected to be in excess of capacity expansions, rising imports will result in stable operating rates and prices over the next 2-3 years.

Paper: Tariffs

(per cent)	Tariff (per cent)				Prices (Feb 2008)		Landed cost (Rs/tonne)	
	Customs		Excise		Domestic	International	Pre-Budget	Post-Budget
	2007-08	2008-09	2007-08	2008-09	(Rs/tonne)	($/tonne)		
Newsprint	5.2	5.2	0.0	0.0	27,000	665	27,669	27,669
Maplitho	10.3	10.3	12.4	8.2	49000 [1]	1,025	50,266	48,423
Duplex board	10.3	10.3	12.4	8.2	30000 [1]	-	-	-
Coated paper	10.3	10.3	12.4	8.2	51000 [1]	1,100	53,944	51,966
Wood pulp (hard)	5.2	5.2	0.0	0.0	NT	796	33,120	33,120
Wood pulp (soft)	5.2	5.2	0.0	0.0	NT	880	36,615	36,615
Waste paper [2] (OCC)	5.2	5.2	0.0	0.0	7,800	275	13,273	13,273

NT: Not traded

[1] Market prices include excise duty and are net of trade discounts

[2] A countervailing duty (CVD) of 16 per cent was levied on wastepaper (except for that used in the printing of educational text books) in the Union Budget 2007-08

Source: CRISIL Research

Neutral impact on the sector

Company	Impact	Impact factors
Andhra Pradesh Paper Mills Ltd	↔	A
Ballarpur Industries Ltd	↔	A
JK Paper Ltd	↔	A
Seshasayee Paper and Boards Ltd	↔	A
Tamil Nadu Newsprint and Papers Ltd	↔	A

Source: CRISIL Research

Impact factors

A. The excise duty on paper, paper board and articles manufactured out of non-conventional raw materials is reduced from 12 per cent to 8 per cent. Further, the excise duty on clearances upto 3,500 MT is reduced from 8 per cent to nil. Excise duty has also been cut from 12 per cent to 8 per cent for most of the varieties of paper. These measures can potentially result in a decline in domestic prices by around Rs 1,500 to Rs 2,000 per tonne, notwithstanding the future trend in international prices. The prices of high-grade varieties such as coated paper, where the pricing in the domestic market closely follows the landed cost of imports, are likely to decline. Other varieties of paper, where the threat of imports is low due to these grades being unique to Indian market, will also decline, with small players in the industry passing on the benefit from the excise cut to their buyers. The decline in prices will not have an adverse impact on margins of the players.

Other factors

B. Higher emphasis on educational sector is likely to boost the demand for the writing and printing paper from this segment. The segment is estimated to account for around 30 per cent of the total writing and printing paper demand.

Petrochemicals

Cracker margins to remain weak in the medium term; polymer demand to be robust

- Global petrochemical product prices rose in 2007. However, margins declined on account of feedstock prices rising further than product prices. In 2007, naphtha prices increased by 19.0 per cent to $693 per tonne while ethylene prices rose marginally (up 0.4 per cent) to $1,142 per tonne. This led to cracker margins falling by 64 per cent from $483 per tonne in 2006 to $173 per tonne in 2007. On the polymers front, hdPE prices rose by just 7 per cent to $1,330 per tonne in 2007, affecting margins of integrated players. Gas-based players using re-gasified LNG were adversely impacted as well due to the 34 per cent rise in pooled LNG prices.
- CRISIL Research forecasts margins in the petrochemicals sector to remain weak over the next 18-24 months. However, any softening of feedstock prices (especially naphtha) is likely to improve cracker margins. Domestic product prices will continue to move in-line with global prices in the medium term.
- Sustained strong demand in polymers is expected in the domestic market. The increased thrust on packaging on account of the growth in organised retail and the booming construction sector is likely to fuel polymer demand. CRISIL Research expects polymer demand to continue to grow by 9-10 per cent in 2007-08. PE, PP and PVC are expected to witness healthy growth.
- The domestic polymer market is characterised by significant overcapacity across all polymers except PVC and ldPE/lldPE where there is a deficit. The entry of new players like IOC and the establishment of Petroleum, Chemicals and Petrochemicals Investment Region (PCPIR) are expected to further push up the surplus in the long run. Moreover, due to the expected capacity additions in the Middle East, which have the advantage of low-cost feedstock, player profitability could be strained in the long run.

Demand for commodity chemicals to grow at 5-8 per cent in 2007-08; margins to improve due to steeper price rise of commodity chemicals over feedstock prices

- Growth in the manufacturing sector is expected to see demand for commodity chemicals grow by 5-8 per cent in 2007-08. The demand for some products, however, will be met through imports.
- The prices of commodity products rose more than feedstock (n-paraffin, benzene, naphtha and propylene) prices due to strong demand.
- Industry margins improved as players were able to increase prices due to strong demand.

CRISIL RESEARCH

Petrochemicals

Petrochemicals: Tariffs, domestic prices and landed costs

	Tariff (per cent)				Prices (Jan 2008)		Landed cost (Rs/tonne)	
	Customs		Excise		Domestic	International	Pre-budget	Post-budget
	2007-08	2008-09	2007-08	2008-09	(Rs/tonne)	($/tonne)		
Polymers								
hdPE (IM)	5.2	5.2	16.5	14.4	77,210 [1]	1,529 [3]	78,186 [1]	76,806 [1]
ldPE	5.2	5.2	16.5	14.4	85,380 [1]	1,689 [3]	86,349 [1]	84,826 [1]
lldPE	5.2	5.2	16.5	14.4	79,066 [1]	1,582 [3]	80,899 [1]	79,471 [1]
PPHP (IM)	5.2	5.2	16.5	14.4	76,908 [1]	1,457 [3]	74,495 [1]	73,181 [1]
PVC	5.2	5.2	16.5	14.4	55,100 [1]	1,025 [3]	52,414 [1]	51,489 [1]
PS (GP)	5.2	5.2	16.5	14.4	78,880 [1]	1,418 [3]	72,510 [1]	71,230 [1]
ABS	5.2	5.2	16.5	14.4	83,000	1,725 [3]	72,846	72,846
SBR (1502)	10.3	10.3	16.5	14.4	90,000 [6]	1,900 [3,6]	84,306	84,306
PBR (1220)	10.3	10.3	16.5	14.4	84,000 [6]	2,150 [3,6]	95,399	95,399
Basic petrochemicals and intermediates								
EDC	2.1	2.1	16.5	14.4	30,000 [1]	403 [3]	22,090 [1]	21,701 [1]
VCM	2.1	2.1	16.5	14.4	n.a.	773 [3]	39,754	39,052
Styrene	2.1	2.1	16.5	14.4	77,000 [1]	1,322 [2]	68,600 [1]	67,388 [1]
Ethylene	5.2	5.2	16.5	14.4	59,500	1,400 [2]	61,233	61,233
Propylene	5.2	5.2	16.5	14.4	56,800	1,211 [2]	53,251	53,251
Butadiene	5.2	5.2	16.5	14.4	66,000	1,739 [2]	75,538	75,538
Benzene	5.2	5.2	16.5	14.4	45,800 [6]	1,006 [2]	45,002	45,002
Toluene	5.2	5.2	16.5	14.4	43,600	932 [2]	41,461	41,461
Naphtha	0.0	5.2	16.5	14.4	37,020	860 [4]	34,901	36,328
Commodity chemicals								
LAB	7.7	7.7	16.5	14.4	78,000 [5]	1,750	75,764	75,764
PAN	7.7	7.7	16.5	14.4	52,000	1,260 [2]	54,550	54,550
Methanol	7.7	7.7	16.5	14.4	20,500	480	20,781	20,781
Phenol	7.7	7.7	16.5	14.4	73,000	1,351 [2]	61,099	61,099
Orthoxylene	5.2	5.2	16.5	14.4	48,000	1,028	43,421	43,421

[1] Market prices (including excise duty/CVD), [2] Fob prices, [3] C&F Far-East Asia, [4] C&F Japan,
[5] Excludes trade discount of Rs 4,000 per tonnne, [6] Prices are of December 2007

LAB: Linear alkyl benzene; PAN : Phthalic anhydride

n.a - not available

Notes

1) Domestic prices and landed cost does not include excise duty/CVD unless mentioned otherwise.

2) Education cess of 3 per cent has been included in the custom duty and excise duty.

3) Custom duty on Naphtha for petrochemical use has been increased from zero to 5 per cent.

4) Anti-dumping duties on PS and SBR have not been included in the landed cost since they vary by country.

5) Additional CVD of 4 per cent has been levied on polymers and basic petrochemicals and intermediates.

Source: CRISIL Research

Petrochemicals

Custom duty on naphtha to affect a few players; overall impact neutral

Company	Impact	Impact factors
Basic petrochemicals and intermediates		
Chemplast Sanmar Ltd	↔	-
DCW Ltd	↔	-
Finolex Industries Ltd	↔	-
Haldia Petrochemicals Ltd	↓	A
Reliance Industries Ltd	↔	A
Supreme Petrochem Ltd	↔	-
Commodity chemicals		
Phillips Carbon Black Ltd	↔	-
Tamil Nadu Petroproducts Ltd	↔	-
IG Petrochemicals	↔	-
Thirumalai Chemicals Ltd	↔	-
Hindustan Organic Chemicals Ltd	↔	-
Schenectady Herdillia Ltd	↔	-

Source: CRISIL Research

Petrochemicals

Impact factors

Petrochemicals - Basic and polymers

A. Customs duties on basic petrochemicals as well as polymers have been kept unchanged. However, the customs duty on naphtha has been increased from zero to 5 per cent. This will have a negative impact on naphtha-based crackers, which constitute 60 per cent of total capacity.

B. Excise duty (CENVAT) has been reduced from 16 per cent to 14 per cent. This is expected to be passed on to the end consumers, and hence, aid demand growth.

C. Central sales tax has been reduced from 3 per cent to 2 per cent. This is expected to be passed on by the players, resulting in a decline in domestic prices.

Commodity chemicals

A1 The decline in excise duties from 16 per cent to 14 per cent is expected to result in lowering of domestic prices. This will compel players to pass on the reduction in duties in line with import price parity. This is likely to translate into a growth in demand.

Pharmaceuticals

Exports to steer overall pharmaceutical industry growth

- Formulation and bulk drug exports, estimated to be around $7 billion in 2006-07, have grown at a compounded rate of 28 per cent over the past 5 years. The domestic formulations market grew at a compounded rate of over 14 per cent during 2004-05 to 2006-07 to reach $6.2 billion in 2006-07.
- Going forward, pharmaceutical exports are slated to occupy a dominant position in the overall gamut of manufacturing opportunities for the Indian pharmaceutical industry.
- Between 2006-07 and 2011-12, formulation exports are expected to grow three times (CAGR of 24 per cent) to reach $9.5 billion in 2011-12, while bulk drugs' exports are likely to grow to $12.7 billion by 2011-12 (CAGR of 28 per cent). This growth will be driven by the increasing number of opportunities arising from regulated markets.
- On the other hand, the domestic formulations market is expected to grow moderately at a CAGR of 13 per cent to reach $11.4 billion by 2011-12. Growth will be driven by chronic and lifestyle segments such as anti-diabetic, CNS, CVS and gastrointestinal ailments. The changing lifestyle in the Indian society is expected to result in a higher incidence of chronic ailments.

Key demand drivers

Exports

- Expected surge in generics exports to regulated markets, driven by drugs worth $80 billion (US) and $53 billion (Europe) (2005 sales) going off-patent between 2007 and 2012. India is emerging as a strong player, which is evident from the number of increasing ANDA approvals, rising market share in new molecules going off-patent, and strong pipeline of ANDA filings comparable to global players.
- Growth in demand for contract manufacturing and research services by providing cost-effective manufacturing (bulk drugs and formulations) and research and development services (includes new drug discovery and bio-equivalence and bio-availability studies) to global players.
- Focus on growth through the inorganic route.

Domestic

- Increasing focus on chronic and lifestyle segments.

Pharmaceuticals: Tariffs

(per cent)	Customs		Excise	
	2007-08	2008-09	2007-08	2008-09
Bulk drugs	7.7	7.7	16.5	16.5
Formulations	10.3	10.3	16.5	8.2

Note:

1. Custom duty on bulk drugs used in manufacturing select life saving drugs have been reduced to 5 per cent from 10 per cent
2. Tax rates are inclusive of education cess

Source: CRISIL Research

Excise duty cut to be marginally positive for the industry

Company	Impact	Impact factors
Aurobindo Pharma Ltd	↑	**B**
Cipla Ltd	↑	**B,D**
Dr Reddy's Laboratories Ltd	↑	**A,B,C**
GlaxoSmithKline Pharmaceuticals	↑	**A,B,D**
Orchid Pharmaceuticals	↑	**B**
Nicholas Piramal India Ltd	↑	**A,B,C**
Pfizer Ltd	↑	**A,B**
Ranbaxy Laboratories Ltd	↑	**A,B,C**

Source: CRISIL Research

Impact factors

A. The reduction in customs duty on select life-saving bulk drugs, from 10 per cent to 5 per cent, will be marginally positive.

B. The cut in excise duty on all pharmaceutical formulation products, from 16 per cent to 8 per cent, will reduce the excise-burden on players. However, most large and mid-sized players are already present in excise-free zones. Hence, the overall impact will be limited to the extent of the presence of their manufacturing facilities outside these zones. Among key players, the Indian arms of MNCs such as Pfizer, GSK, AstraZeneca, Merck, and domestic players like FDC, who incur higher excise duty (as a percentage of domestic sales) will benefit.

C. The weighted deduction of 125 per cent for expenditure related to Research and Development (R&D) outsourcing will encourage the same and will increase the competitiveness of Indian players. This will enhance the potential of clinical R&D outsourcing demand in India.

D. Increase in the outlay for HIV treatment will benefit key players in the anti-HIV space such as Cipla, GlaxoSmithKline and FDC.

Power

Capacity additions in generation: The key focus area

- As of January 2008, the installed power capacity in India stood at 141 GW, the average plant load factor (PLF) was 77.7 per cent and the energy shortage was 9.0 per cent (the peak shortage was 15.2 per cent). Demand for electricity is expected to grow by 6-7 per cent over the medium term. To meet the demand growth, the government has planned a capacity augmentation of around 78.5 GW in the Eleventh Plan (2007-2012).
- CRISIL Research expects total capacity additions during the Eleventh Plan to be around 50,000 MW as against the government's target of 78,577 MW (CRISIL Research estimates capacity additions of 8,104 MW in 2007-08 and around 8,480 MW in 2008-09). A focused approach towards power generation is expected to speed up the process of capacity additions during the Eleventh Plan.
- To aid the implementation of the capacity addition programme in future plan periods, the government had announced the setting up of Ultra Mega Power Projects (UMPP), many of which will be commissioned in the Twelfth Plan. Many private players have also announced huge capacities, aided by captive coal blocks, to be commissioned in the Twelfth plan. Going forward, this, along with the steady reduction in T&D losses, would result in a balanced demand-supply scenario.
- On the transmission side, the current capacity is around 17,000 MW (till December 2007). The government expects to achieve 37,000 MW of inter-regional capacity by the end of the Eleventh Plan. Private participation in transmission is steadily growing with the completion of the Tala project (a JV with Tata Power and Power Grid). Further, the Parbati-Koldam and Western Region strengthening scheme have been awarded to Reliance Energy.
- In the distribution sector, privatisation through the franchisee route is growing, with Maharashtra being the first state to implement it. The Bhiwandi Circle in Mumbai has been given to Torrent Power on a franchisee basis. Nagpur in Maharashtra has also opted for this format by giving three circles to Crompton Greaves. Other states such as Madhya Pradesh and Haryana are also planning to adopt the franchisee route.
- Fuel supply, poor financial health of state electricity boards (being marred by inefficiencies, tariff rationalisation issues and irregular payment of subsidies by state governments, causing a slowdown in SEB investments in capacity additions) and delays in project implementation, due to delays in land availability, environmental clearance and equipment availability, continue to remain the key issues impacting power sector progress.
- In order to tackle these issues, the government has introduced measures such as Accelerated Power Development and Reforms Programme (which monitors the performance of the state and provides incentives for target achievement), reforms in the coal sector through privatisation in mining and e-auctions facilitating a smooth supply of fuel, and setting up of the National Power Project Management Board (NPPMB) to monitor project implementation.

Overall impact neutral for the power sector

Company	Impact	Impact factors
National Thermal Power Corp Ltd	↔	-
Power Grid Corporation of India Ltd	↔	-
Reliance Energy Ltd	↔	-
Tata Power Company Ltd	↔	-
Suzlon Energy	↔	-

Source: CRISIL Research

Impact factors

A. The basic customs duty on power project imports has been reduced from 7.5 per cent to 5 per cent. However, the exemption on additional duty of 4 per cent has been withdrawn for all projects except mega-power projects. Thus, the overall impact of duty changes on power sector project imports is neutral.

B. There has been no change in the APDRP scheme. The budgetary allocation for APDRP programme has been maintained at Rs 8 billion.

C. To address the concern of higher losses at the transmission and distribution level and for the development of the sector, the government has proposed to set up a National Transmission and Distribution Fund.

Roads

Implementation of NHDP continues at snail pace

- National Highway Development Programme (NHDP) encompasses upgradation, rehabilitation and broadening existing national highways to a higher standard. It is being implemented in four phases: I, II, III and V. In December 2007, Cabinet Committee on Economic Affairs (CCEA) approved Phase VII, while phase IV is awaiting the government's approval.
- NHAI has, to date, awarded 56 projects through the BOT - Toll route to private investors for reducing dependence on its own funds and for promoting private sector involvement in the development of projects. Out of these, six are part of GQ, 13 are part of NSEW and 31 projects are under Phase III. Going forward, all the other new phases are expected to be awarded predominantly on BOT- Toll basis.
- Nearly, 33 per cent of total length under NHDP was completed as on December 31, 2007. The progress has been slow, as Golden Quadrilateral, launched in 2000, was 96.5 per cent complete as on December 31, 2007. The focus of implementation has shifted to the NSEW Corridor (Phase II) and Phase III, with total length under implementation improving reasonably for the latter in 2007. Based on the pace of awarding and implementation of Phase I, II, III and V, coupled with our interaction with industry sources, CRISIL Research believes that the ongoing projects under NHDP will largely be completed by 2015.
- As on December 31, 2007, the total cost incurred for NHDP was Rs 515 billion. This expenditure is inclusive of cost spent on stretches under implementation as well. Majority of the funding is from diesel and petrol cess collection. Total cess collection from 2002-03 to 2006-07 has been Rs 392 billion, out of which, national highway's share has been Rs 155 billion. For the phases currently under implementation, the government has estimated expenditure to the tune of Rs 1.6 trillion for the balance length to be awarded.
- The UPA government has identified rural roads as one of the six components of Bharat Nirman (PMGSY). It has set a goal to provide connectivity and an all-weather road to all villages with a population of 1,000 (500 in the case of hilly or tribal areas). Although the government has cleared proposals worth Rs 506 billion for all phases, only Rs 240 billion has been released till date.

Increase in allocation for ongoing road programme; Neutral for the sector

Impact factors

A. The Government has enhanced the allocation for National Highway Development Programme (NHDP), from Rs 109 billion in 2007-08 to Rs 130 billion in 2008-09, an increase of 19 per cent on year-on-year (y-o-y) basis. This portion is in line with the stated requirement of Rs 1.6 trillion for the phases in action of NHDP for the next 5 years, in spite of being higher than the increase of 9 per cent, y-o-y, in 2007-08 (allocation of Rs 99 billion in 2006-07). Consecutively, this would help finance the expected road construction activity.

B. Despite the Union Budget stating that under Bharat Nirman (PMGSY) programme, 17 habitations are connected through all-weather roads each day, only 17 per cent had been achieved until December 2007, as against the target set of 20,071 habitations for 2007-08.

C. Similar to last year's Union Budget, allocations for rural roads is proposed at Rs 40 billion for 2008-09 and would be routed through a separate window created under the Rural Infrastructure Development Fund (RIDF). This will provide the necessary funds for the upgradation and development of rural roads planned under Bharat Nirman.

Steel

Margins to soften over the next 3-4 quarters

- Margins remained stable during the first 9 months of 2007-08 as compared with the corresponding period of the previous year. Increase in raw material prices was compensated by a similar rise in steel prices. Increasing input costs and higher operating rates, which were mainly due to the robust demand, helped prices to move upwards.
- Domestic consumption of finished steel rose by around 11 per cent during April-October 2007 over the corresponding period in the previous year, driven by increased demand from the infrastructure and construction segment.
- In 2008, global demand is expected to rise by around 6 per cent backed by the continuous healthy demand from China, while domestic demand is likely to increase by about 11 per cent. End-user segments such as automobiles, pipes and tubes, and construction will continue to drive domestic demand for steel products.
- Prices of key inputs, coke and iron ore, are expected to increase substantially in 2008. A price agreement signed in January 2008, between CVRD and Japan's Nippon Steel for an increase of 65 per cent in prices of iron ore, is likely to set a benchmark for deciding iron ore prices in 2008.
- Increase in input costs is likely to push global steel prices northwards on the back of higher global operating rates. However, as observed in the past, the rise in domestic prices, which tend to follow the international price trend, could be influenced by the government.

Steel: Tariffs, prices and landed costs

	Tariff (per cent)				Prices (January 2008)		Landed cost (Rs/tonne)	
	Customs		Excise		Domestic	International	Pre-Budget	Post-Budget
	2007-08	2008-09	2007-08	2008-09	(Rs/tonne)	($/tonne)		
GP/GC	5.2	5.2	16.5	14.4	46,000	790	43,040	42,287
CR coils	5.2	5.2	16.5	14.4	38,300	680	37,535	36,878
HR coils	5.2	5.2	16.5	14.4	34,890	620	34,532	33,928
Structurals	5.2	5.2	16.5	14.4	35,000	-	-	-
Bars and rods	5.2	5.2	16.5	14.4	33,250	570	32,027	31,818
Alloy steel	5.2	5.2	16.5	14.4	-	-	-	-
Billets/Slabs [1]	5.2	5.2	16.5	14.4		594	33,228	33,011
Pig iron	5.2	5.2	16.5	14.4	19,500	433	25,171	25,007
HBI/Sponge iron	5.2	5.2	16.5	14.4	17,300	-	-	-
Ferro alloys	5.2	5.2	16.5	14.4	-	-	-	-
Steel melting scrap[1]	5.2	0.0	16.5	14.4	17,200	260	16,514	15,606
Iron ore[2]	2.1	2.1	0.0	0.0	-	-	-	-
Coking coal (< 12% ash content)	0.0	0.0	-		-	-	-	-
Coking coal (> 12% ash content)	0.0	0.0	-		-	-	-	-
Metallurgical coke	5.2	5.2	-		-	-	-	-
Non-coking coal	5.2	5.2	-		-	-	-	-

[1] Domestic prices are average prices for January 2008

[2] Export duty of Rs 300 per tonne was imposed on export of iron ore in Union Budget 2007-08.

Notes

1) International prices are FOB prices.

2) Prices are average prices for January 2008.

Source: CRISIL Research

Neutral impact on the steel sector

Company name	Impact	Impact factors
Essar Steel Ltd	⇔	AB
Ispat Industries Ltd	⇔	AB
JSW Steel Ltd	⇔	AB
Steel Authority of India Ltd	⇔	AB
Tata Steel Ltd	⇔	AB

Source: CRISIL Research

Impact factors

A. The customs duty on steel melting scrap is reduced from 5 per cent to nil. This is unlikely to have any significant impact on the industry, given the low share of imported melting scrap in the raw material mix of the industry.

B. The CENVAT rate has been reduced from 16 per cent to 14 per cent. The same is likely to result in a decline in domestic steel prices by around Rs 500 per tonne, notwithstanding the future trend in international prices. However, the impact of the same on the industry is neutral, as the excise duty on most of the steel sold is MODVAT'able, except where the output is directly used by the retail buyer. Hence, the cost to the industrial buyer remains unchanged. Around 60 per cent of the GP/GC sheets sold in the domestic market are bought by retail buyers for roofing purposes, while some portion of the long steel, primarily bars and rods, is purchased by retail buyers for self-developed housing projects.

Sugar

High inventory levels to keep sugar prices in check

- The fall in sugar prices severely impacted the financial performance of sugar companies during 2006-07 (second half) and 2007-08. Sugar prices (Mumbai M-30) in January 2008, were at Rs 14,920 per tonnne, 22.4 per cent below their peak levels of June 2006. The decline in prices since then has been on account of the imposition of the export ban in June 2006 (removed in January 2007), and bumper production in the 2006-07 sugar season (SS).
- We expect sugar production in the 2007-08 SS to fall by 4.6 per cent to 27 million tonnes on account of lower yields and a late start to the crushing season in the major producing states of Maharashtra and Uttar Pradesh. Production in the 2008-09 SS is forecast to fall further to 21.2 million tonnes mainly on account of a decline in the area under sugarcane. Exports in both the 2007-08 and 2008-09 SSs are forecast to be at 3 million tonnes, given India's freight advantage over other exporting nations and export subsidies by central and state governments.
- Sugar prices are expected to remain at around the current levels in the short term, due to the fact that closing stock at the end of the 2007-08 SS is expected to be equivalent to about 7.5 months of sugar offtake (consumption + exports). In January 2008, global sugar prices have moved up by about 12 per cent from their levels of December 2007, because of lower Indian production and the high oil prices, which make ethanol more profitable for Brazilian sugar companies.
- In October 2007, the government announced a relief package for the sugar industry in which a number of measures were taken, such as making 5 per cent ethanol blending mandatory with immediate effect, mandatory 10 per cent ethanol blending from October 2008 and interest free loans (to the extent of excise duty paid) to make payments towards cane arrears. CRISIL Research believes that the relief package will have only a marginal impact on improving the profitability of sugar mills.
- The biggest issue facing the industry at present is sugarcane pricing, especially in states where the state advised price (SAP) system is prevalent. Sugar companies in Uttar Pradesh have been worst hit as the difference between sugar realisations and sugarcane prices paid by them has narrowed considerably leading them to make losses. Margins of UP-based sugar companies will depend on the outcome of pending court cases relating to sugarcane pricing.

Sugar: Tariffs, prices and landed costs

	Tariff				Prices (Jan 2008)		Landed cost (Rs/tonne)	
	Customs (per cent)		Excise (Rs per tonne)		Domestic (Rs/tonne)	International ($/tonne)	Pre-Budget	Post-Budget
	2007-08	2008-09	2006-07	2008-09				
Domestically produced sugar								
Free Sale	n.a.	n.a.	875.5	978.5	14,920	-	-	-
Levy	n.a.	n.a.	535.6	638.6	13,500	-	-	-
Imported white sugar	61.8	61.8	875.5	978.5	-	338	27,502	27,605
Imported raw sugar	61.8	61.8	875.5	978.5	-	264	22,782	22,885
Imported raw sugar (under ALS)	0.0	0.0	875.5	978.5	-	264	14,415	14,518
Molasses	10.3	10.3	772.5	772.5	-	n.a.	n.a.	n.a.

n.a.: Not applicable

Notes

1) Domestic and International prices are the average for January 2008.

2) ALS - Advance License Scheme. Under this scheme sugar mills are allowed to import raw sugar duty free provided they re-export the same quantity of white sugar.

Source: CRISIL Research

Increase in excise duty to have a marginally negative impact

Company	Impact	Impact factors
Bajaj Hindustan Ltd	↓	**A, B**
Balrampur Chini Mills Ltd	↓	**A, B**
Bannari Amman Sugars Ltd	↓	**A, B**
EID Parry Ltd	↓	**A, B**
Shree Renuka Sugars	↓	**A, B**

Source: CRISIL Research

Impact factors

A. The increase in the excise duty from Rs 875.5 per tonne to Rs 978.5 per tonne, just before the budget is likely to put pressure on margins of sugar companies, as they will be unable to pass on the increase to consumers on account of the oversupply situation prevailing in the market. The cess component of the excise duty on sugar has been hiked from Rs 140 per tonne to Rs 240 per tonne while the basic excise duty on sugar has been left unchanged at Rs 710 per tonne. The proceeds collected from the imposition of the cess will be transferred to the Sugar Development Fund, which will be mainly used for extending loans to mills at subsidised interest rates.

B. The imposition of a commodities transaction tax for transactions in commodities futures is expected to marginally increase the hedging cost of sugar companies.

Telecom

Wireless subscriber base to double over the next 4 years

- With an addition of around 8 million subscribers per month, India's wireless market is one of the fastest growing markets in the world. At the end of January 2008, the wireless subscriber base stood at 242.4 million, making it the third largest wireless market in the world after China and the US, respectively. India's total telecom subscriber base stood at 281.6 million at the end of January 2008, indicating an overall teledensity of 24.63 per cent.
- During the first 10 months of 2007-08, the wireless segment added 77.30 million subscribers, registering an average 7.73 million subscribers per month. CRISIL Research expects the wireless subscriber base to touch 490 million by the end of March 2012. This growth is expected to be driven by opportunities arising from low penetration, rising income levels, falling handset costs and local tariffs. Future growth is expected to come from semi-urban and rural areas, which will offer lower ARPU as compared to existing subscribers, thereby putting pressure on operators' margins.
- The Department of Telecommunications recently allotted LoIs/ licences to 11 companies to provide telecom services. This is expected to further intensify competition, resulting in lower cost of service to subscribers.
- As against wireless subscribers, the fixed wireline subscriber base registered a decline of 1.53 million subscribers. At the end of January 2008, the fixed wireline subscriber base stood at 39.22 million from 40.75 million at the end of March 2007. At the end of September 2007, the wireline Internet subscriber base rose to 9.63 million from 9.27 million in March 2007. The broadband subscriber base stood at 3.24 million at the end of January 2007 from 2.34 million subscribers at the end of March 2007. We expect Internet and broadband subscriber net additions to increase over the next few years due to the aggressive rollout plans undertaken by the players, advent of new delivery mechanisms (wireless broadband) and declining cost of access device.
- CRISIL Research expects investments of Rs 1,100 billion in the wireless segment between 2007-08 and 2011-12. Foreign equipment vendors, due to their technological expertise, ability to undertake turnkey projects and global experience will continue to have an advantage over domestic manufacturers. However, the capability of domestic equipment manufacturers lies in the manufacturing of wireline equipments where the demand is stagnant.

Telecom: Tariffs

(per cent)	Customs[1]		Excise[1]	
	2007-08	2008-09	2007-08	2008-09
Microwave equipment, HDSL systems,	0.0	0.0	16.5	16.5
DWDM equipment	0.0	0.0	16.5	16.5
Wireless Internet data card	0.0	0.0	16.5	0.0
Cellular phones	0.0	1.0	16.5	16.5

1: Telecom products are subjet to Special Additional Duty of 4 per cent.
HDSL: High bit-rate digital subscriber line; DWDM: Dense wavelength division multiplexing
Source: CRISIL Research

Budget neutral for telecom sector

Company	Impact	Impact factors
Himachal Futuristic Communications Ltd	↔	-
ITI Ltd	↔	-
Bharti Televentures Ltd	↔	C
Mahanagar Telephone Nigam Ltd	↔	A,B
Reliance Infocomm Ltd	↔	C
Videsh Sanchar Nigam Ltd	↔	C

Source: CRISIL Research

Impact factors

A. The reduction in customs duty from 10 per cent to 5 per cent on certain convergence products could benefit services like Voice over Internet Protocol (VoIP) services.

B. The reduction in excise duty from 16 per cent to 8 per cent on certain convergence products might benefit services like Voice over Internet Protocol (VoIP) services.

C. The excise duty cut on wireless data card from 16 per cent to zero is marginally positive, as the effective duty would reduce from 21.65 per cent to 4.00 per cent. This will facilitate the increase in penetration of wireless Internet services.

D. With an average handset priced at Rs 2,500, the 1 per cent National Calamity Contingent Duty (NCCD) would have negligible impact; hence, the penetration of cellular services will not be affected.

Textiles

The sharp appreciation in the value of the rupee vis-à-vis the dollar and the euro has affected garments and home textile exports to the US and EU. To protect exporters, the government had raised the duty drawback and DEPB rates by 3 per cent in July 2007. While this has partially offset the loss resulting from the rupee appreciation, the overall impact has been severe pressure on the margins of exporters having large dollar exposures.

The Indian textile industry continues to be characterised by high level of fragmentation across the value chain, and a weak weaving and processing sector. Although the TUFS has encouraged investments, there has been a considerable skew in investment towards spinning. To correct this imbalance, the government announced some modification to the TUF scheme by lowering the interest rate subsidy for spinning from 5 to 4 per cent, while retaining it at 5 per cent for other constituents of the value chain. There is a need for greater investments in the weaving and processing segment to improve India's competitiveness as a key supplier of garments and made-ups in the global market.

Cotton and Cotton yarn

- CRISIL Research expects cotton yarn demand to grow at a CAGR of around 6 per cent in the medium-term, driven by strong demand from the domestic market, which accounts for around 67 per cent of cotton yarn demand. While demand growth continues to be robust, there has been considerable capacity addition in spinning, resulting in an oversupply in the sector.
- Global cotton production in 2007-08 is expected to fall, while India will be the only major cotton producing nation to experience a bumper cotton crop. With global cotton consumption expected to outstrip production, cotton prices are likely to increase. CRISIL Research expects domestic prices to increase by 6-7 per cent, which would exert pressure on the margins of spinners.

Man-made fibres

- CRISIL Research expects polyester demand to increase at a CAGR of 8-10 per cent in the medium term. While operating rates will improve, the industry will continue to be characterised by overcapacity. Demand for man made fibers will be driven by strong growth in blended yarn segment and the increasing use of non-cotton fabric in technical textiles and home textiles.
- In November 2007, the government reduced the customs duty on PSF/PFY from 7.5 per cent to 5.0 per cent and on fibre intermediates from 7.5 per cent to 5.0 per cent. The customs duty cut resulted in domestic polyester prices being closely aligned with international prices. While this reduction did not impact margins, it resulted in reduced profits for MMF players.
- Polyester feedstock prices are expected to soften in the medium term, which would ease the pressure on margins. Rising cotton prices will also provide pricing flexibility to polyester players and help improve margins.

Readymade garments

- Garment exports have been severely affected due to the sharp rupee appreciation against the dollar - the rupee rose by around 12 per cent against the dollar during January-December 2007. However, its appreciation against the euro was not as sharp over the same period. India's market share (in value terms) in the US fell from 4.5 per cent in 2006 to 4.3 per cent in 2007; its share in the EU declined from 3.9 per cent to 3.8 per cent over the same period.
- The highly fragmented nature of the industry has hindered India's attempts to gain a larger share of the global apparel market. Moreover, lack of adequate investments in weaving and processing has affected this sector to a large extent. Going forward, in order to mitigate the currency risk, CRISIL Research believes that Indian garment exporters should move toward high-value products, where competition is limited and realisations are better. The EU market, for instance, offers considerable opportunities for exporting premium products.
- The domestic market continues to be robust and is expected to exhibit strong growth in the medium term. Rising incomes, increasing preference for readymade apparels over tailor-made garments and higher penetration of organised retail would continue to act as growth drivers.

Apparels and fabrics: Tariffs

	Tariff (per cent)			
	Customs		Excise[3]	
	2007-08	2008-09	2007-08	2008-09
Cotton-based apparels[1]	10.30	10.30	4.12	4.12
Non cotton-based apparels[1]	10.30	10.30	8.24	8.24
Cotton Woven fabrics[2,4]	10.00	10.00	4.00	4.00
Non Cotton Woven fabrics[2,4]	10.00	10.00	8.00	8.00
Cotton knitted fabrics[2]	10.30	10.30	4.12	4.12
Non-cotton knitted fabrics[2,4]	10.00	10.00	8.00	8.00

[1] Garments attract additional 4 per cent countervailing duty (CVD)

[2] There is no CVD on fabrics as they do not attract VAT

[3] Excise duty is optional in nature, i.e., the companies can opt for either zero duty or regular excise duty and claim CENVAT credit.

[4] Exempt from educational cess.

Source: CRISIL Research

Cotton and cotton yarn: Tariffs, prices and landed costs

	Tariff (per cent)				Prices (Feb 2008)
	Customs		Excise[2]		Domestic
	2007-08	2008-09	2007-08	2008-09	(Rs/tonne)
Cotton yarn (60s)	10.30	10.30	4.12	4.12	176,000
Cotton[1]	10.30	10.30	0.00	0.00	61,000

[1] Domestic price of MCU-5 variety

[2] Excise duty is optional in nature, i.e., the companies can opt for either zero duty or pay excise duty and claim CENVAT credit.

Source: CRISIL Research

Textiles

Man-made fibre and intermediates: Tariffs, prices and landed costs

	Tariff (per cent)				Prices (Feb 2008)		Landed cost (Rs/tonne)	
	Customs		Excise		Domestic	International[1]	Pre-Budget[2]	Post-Budget
	2007-08	2008-09	2007-08	2008-09	(Rs/tonne)	($/tonne)	(Rs/tonne)	(Rs/tonne)
PSF 1.2d	5.15	5.15	8.24	8.24	66,026	1,477	70,297	70,297
VSF 1.5d	5.15	5.15	8.24	8.24	115,095	n.a	n.a	n.a
POY 126d	5.15	5.15	8.24	8.24	75,275	1,605	77,194	76,407
NFY 20sd	10.30	10.30	8.24	8.24	258,831	n.a	n.a	n.a
VFY 120d	5.15	5.15	8.24	8.24	242,818	n.a	n.a	n.a
PV 30s	10.30	10.30	8.24	8.24	119,333	n.a	n.a	n.a
PTA	5.15	5.15	8.24	8.24	39,832	847	40,330	40,330
MEG	5.15	5.15	12.36	12.36	71,086	1,478	73,031	73,031
Caprolactam	10.30	10.30	12.36	12.36	125,656	2,462	127,616	127,616
ACN	5.15	5.15	8.24	8.24	89,433	1,901	90,474	90,474
RGWP	5.15	5.15	0.00	0.00	n.a	1,238	54,464	54,464
Paraxylene	5.15	5.15	8.24	8.24	n.a	1,133	54,482	54,482

ACN: Acrylonitrile; MEG: Mono-ethylene glycol; VFY: Viscose filament yarn; VSF: Viscose staple fibre
NFY: Nylon filament yarn; PC: Polyester cotton; POY: Partially oriented yarn; PSF: Polyester staple fibre, PTA: Purified terephthalic acid; PV: Polyester viscose; RGWP: Rayon grade wood pulp
n.a.: Not available

[1] FOB prices

[2] Landed costs reflect the impact of Customs duty cut implemented in November 2007 and include 1 per cent NCCD on PFY which has been removed in Union Budget 2008-09

Landed costs also include handling charges of 2 per cent

Source: CRISIL Research

Enhanced budgetary support under TUFS to boost investments

Company	Impact	Impact factors
Alok Industries Ltd	↑	A,B
Arvind Mills Ltd	↑	B
Gokaldas Exports Ltd	↑	B
Indo Rama Synthetics (India) Ltd	↔	A
JBF Industries Ltd	↔	A
RSWM Ltd	↑	B
Vardhaman Textiles Ltd	↑	B
Welspun India Ltd	↑	B
Zodiac Clothing Co. Ltd	↑	B

Source: CRISIL Research

Impact factors

A. Removal of the National Calamity Contingency Duty (NCCD) of 1 per cent on PFY is expected to be passed on by polyester manufacturers. This will lead to a marginal decline in polyester prices, which will benefit texturisers and fabric manufacturers.

B. The TUFS allocation has been enhanced by 20 per cent for 2008-09 to Rs 10.9 billion as against the 70 per cent growth in allocation for 2007-08, indicating a slowdown in the growth of budgetary support. Although the TUFS scheme would continue to provide an incentive for investments, CRISIL Research believes that there is a need for accelerated pace of investments in the weaving and processing segment.

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CRISIL RESEARCH

Capital markets

Capital markets

Debt market

After the several opportunities the RBI's governor got, it was finally the finance minister's chance to balance the growth momentum with the inflationary pressures visible in the economy. The finance minister adopted a neutral stance in his fourth Union Budget without significantly diverting the economy away from the path of growth buoyancy.

With rising inflationary tendencies in the economy driving the RBI's policy of monetary tightening, the average yields on the benchmark 10-year G-sec hardened in the current fiscal compared to the previous one. Capital flows and variation in cash balances of the central government remained the key drivers of liquidity conditions in the economy. However, rising crude oil prices and falling US interest rates also played a part in guiding the liquidity scenario. To control the surge in capital flows in the economy, the RBI re-activated the CRR as a policy instrument after an interval of over 2 years. In the current fiscal, the CRR has been hiked by 150 bps, and currently it stands at 7.5 per cent. The CRR hike pushed the call rates outside the official corridor of repo and reverse repo (6.0-7.75 per cent) to touch 10 per cent, as commercial banks increased their demand for funds to meet the enhanced CRR requirements.

The current fiscal could easily be described as one where easy liquidity prevailed interspersed with transient periods of tightness. This led the RBI to raise the ceiling on the outstanding amount under the MSS on four occasions to Rs 2500 billion. All the other key policy rates, viz, repo and reverse repo were kept unchanged at 7.75 per cent and 6.0 per cent respectively. The existence of suppressed inflation in the economy was cited as one of the major reasons behind RBI's decision on status-quo on these key policy rates. All these events resulted in hardening of the yields across all categories.

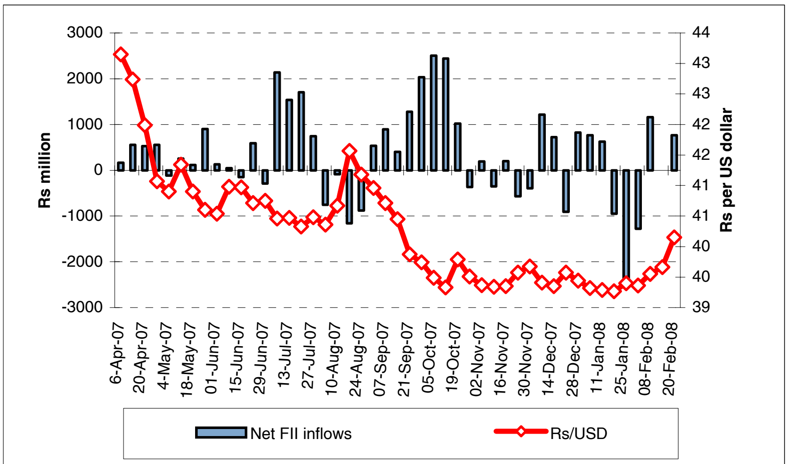
Impact analysis

The budget impact on the debt market could be largely gauged as a positive one. The Finance Minister has stressed on the development of the corporate debt market so that revenue generated from it could be used as an additional income source for various infrastructural projects. Steps would also be taken to create exchange-traded fund for corporate funds. Trading in domestic convertible bonds would be made easier by placing a suitable mechanism in place. Indian bonds yields eased as the FM put a lower deficit figure target for the next year. The yield on the benchmark 10-year G-sec ended the day at 7.60 per cent. The limit on issuance of MSS bonds has been kept unchanged at Rs 2,500 billion. In conclusion, we can say that with the continued emphasis on taming inflation in the economy, the stress in the next fiscal year would be using monetary measures to target inflation growth in the economy. On balance, we expect benchmark 10-year yield to be at 7.5-7.7 per cent by the end of 2008-09.

Currency

The rupee gained significantly during the current fiscal, appreciating by around 10 per cent up to February. Strong investor sentiments, driven by robust economic growth, kept capital inflows strong over the year. There were significant inflows not only because of the FIIs, but also due to the ECBs. Monetary tightening, adopted by incorporating a series of rate hikes, improved the interest rate differential, further aiding the inflow of funds. Most of the appreciation was witnessed in the first quarter, when the Rupee gained from over 43 a dollar to around 40.75 a dollar. From the second quarter onwards, the RBI intervened significantly to curb the rate of appreciation and its volatility and the currency remained range-bound. On the contrary, in recent weeks, the RBI was seen intervening in the market to support the currency and curb the rate of depreciation, as capital outflows began due to profit booking and the expected slowdown/recession in the US economy.

Figure 1: Exchange rate and FII investment and interest rates



Source: RBI, SEBI

Impact analysis

With its focus on increasing expenditure on infrastructure, health and education sector, the budget has on the whole remained pro growth. Fiscal consolidation sends positive signals to the investor community, thereby strengthening the overall sentiment on the economy. These measures should boost capital flows. In contrast, the expected slowdown in the US and the world economy may result in lower capital flows. The Finance Minister announced in the budget that capital flows would be carefully monitored and moderated, if necessary, though temporary restrictive measures. The short term capital gains tax has also been increased from 10 to 15 per cent, which may have a dampening effect on capital flows. Also, having an exchange traded currency futures market means easier access to a market instrument to hedge currency risk, thereby allowing more elbow room to the RBI to manage the exchange rate. In balance, we expect the rupee to trade around 38.5-39.0 against the dollar by the fiscal year end 2008-09.

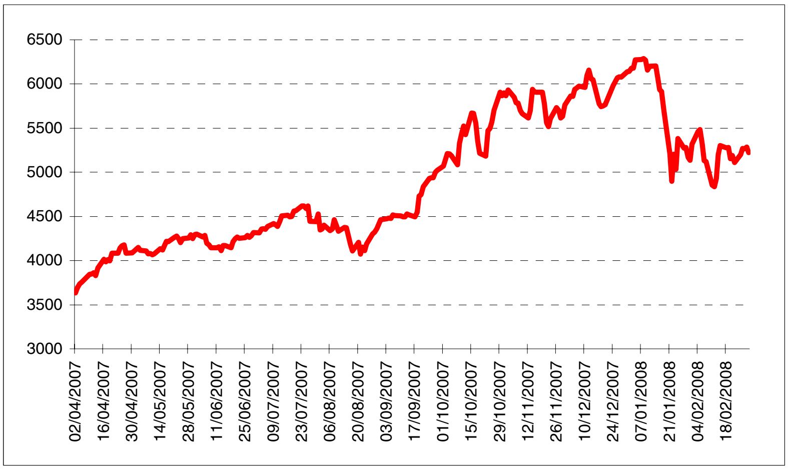
Equity market

While the equity markets were bullish for the most part during the current fiscal year, supported by robust capital inflows and domestic corporate investment, the market remained volatile, especially after mid-October. The BSE Sensex lost over 4,000 points within a month's period starting in the second week of January. The S&P CNX Nifty lost close to 2000 points during the same period. Setting off from the index value of 3473, the S&P CNX Nifty gained over 573 points over the year. The BSE Sensex touched its all time high of 14,652 on February 8, 2007, while the Nifty touched its high of 4224.25 on February 7, 2007.

Impact Analysis

The budget has announced a scheme for agriculture loan waivers to the extent of Rs 60,000 crores. It was also announced that banks would be compensated for their losses. However, the mechanism for the same was not clarified; as a result, banking stocks plunged. Also, a rise in short term capital gains tax, from 10 to 15 per cent, was announced in the budget. These developments were viewed negatively by the market and the BSE Sensex ended down 246 points. The S&P CNX Nifty ended 62 points below the February 28 mark. An increase of 5 per cent in the short term capital gains tax, raising it to 15 per cent, should help reduce the speculative flows in the market. Overall, however, the budget should not have a negative impact on the stock market, unless some sort of capital controls are put in place to significantly moderate foreign capital flows.

Figure 2: S&P CNX Nifty (2007-08)



Source: NSE

Notes

CRISIL's Research and Information business

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