

Analysis of Interim Budget 2009-10

February 2009

HIGHLIGHTS

Macroeconomic Backdrop.....	2
Fiscal Performance.....	6
Infrastructure.....	7
Agriculture and Social Sector.....	10

CREDIT ANALYSIS & RESEARCH LTD.

4th Floor, Godrej Coliseum, Somaiya Hospital Road,
Off Eastern Express Highway, Sion (East), Mumbai-400 022.

Tel.: (022) 6754 3456

Visit us at <http://www.careratings.com>

Email: care@careratings.com / careresearch@careratings.com

Macroeconomic Backdrop

Economic Scenario

The Indian economy, after exhibiting strong growth during the past couple of years has been experiencing moderation in its growth momentum in the wake of the global economic slowdown. This was reflected in the Advanced Estimates (AE) of growth in Gross Domestic Product (GDP) at 7.1 per cent for FY09 as against 9 per cent (Quick Estimate) during the previous fiscal. The economy registered impressive growth rates of 7.5 per cent, 9.4 per cent and 9.6 per cent during FY05, FY06 and FY07 respectively.

None of the sectors (except mining and quarrying) managed to remain immune from the lag effects of the tightening monetary policy during FY08 and global and domestic economic slump. Manufacturing sector – having strong economic backward and forward linkages, is expected to witness a tepid growth of 4.1 per cent during FY09 as against 8.2 per cent during the previous fiscal. Industry as a whole, had also witnessed a sharp slowdown, with the Index for Industrial Production (IIP) reporting meager growth of 3.1 per cent during April-December 2008, as compared to 9.2 per cent during the corresponding period a year ago. Significant fall in capital goods production had raised worries about the growth outlook as index for capital goods posted 7.7 per cent growth as against 20.4 per cent during the period under consideration. Despite this, the fiscal and monetary measures to arrest the economic downturn would kick growth in near future. Moreover, efforts by other countries to revive their respective economy would bolster exports demand, further helping the local manufacturing sector which meets nearly 77 per cent of total exports.

The service sector, which has been the prime growth engine over the past years, also is showing signs of slowdown mainly in ‘construction, trade, hotels, transport and communication’ (10.3 per cent in FY09 vs.12.4 percent in FY08) and ‘financing, insurance, real estate and business services’ (11.7 per cent vs. 8.6 per cent). The growth rate of 'community, social and personal services' segment, however is estimated to be 9.3 per cent during FY08 higher than 6.8 per cent during FY09.

Agriculture sector – having share of 17 per cent in the overall GDP, is estimated to grow at 2.6 per cent during FY09 as compared to 4.9 per cent in FY08.

Given the fact that the aggregate demand in the Indian economy is primarily domestically driven, decelerating growth in Private Final Consumption Expenditure (PFCE) and Gross Fixed Capital Formation (GFCF) heightened the worries about the turning point of the current slowdown. Growth in PFCE moderated to 6.76 per cent in FY09 from 8.47 per cent in FY08 while that of GFCF declined to 8.87 per cent from 12.95 per cent. On the other hand, growth in Government Final Consumption Expenditure (GFCE) doubled (16.78 per cent from 7.35 per cent) during the period under consideration.

Current fiscal started with Wholesale Price Index (WPI) inflation at close to 8 per cent, which shot up to near 13 per cent during August, owing to soared international oil and commodities prices. From October onwards, it started declining steadily as a combined result of southward trend in international commodity prices and fuel price cut by the Government of India (GOI) in addition to the few fiscal and monetary steps. As a result, inflation, slumped to one-year low of 4.6 per cent during January 2009. The sharp fall during the span of four months, accompanied by economic slowdown, had raised concerns of possibility of deflation in the Indian economy in near future.

India's external sector was characterised by a steep fall in reserves, widening current account deficit, capital outflows and depreciation of rupee against the US dollar.

India's current account deficit widened to 3.8 per cent of GDP (US\$22.3 billion) from 2.1 per cent of GDP (US\$11 billion) led by trade deficits, partly offset by the uptrend in invisibles. Demand and supply mismatches, caused by heavy Foreign Institutional Investors (FIIs) outflow, resulted in 17.7 per cent depreciation in rupee against the dollar during April-December 2008, having consequent implications on exporters, importers and debt service payments. The foreign exchange reserves, a cushion in case of any economic uncertainty, declined to USD255 billion as on January 9, 2009, from USD314.6 billion in May 2008. The fall can be attributed to the efforts of the Reserve Bank of

India (RBI) to stabilise the domestic currency and the valuation effect following the changes in the exchange rates.

The Central Bank, being responsive to the global financial crisis and recessionary signs, shifted its tightening monetary policy stance to the expansionary one. Till January 2009, it slashed Cash Reserve Ratio (CRR) by 400 bps to 5 per cent, repo rate by 350 bps to 5.5 per cent and reverse repo

rate by 200 bps to 4 per cent and Statutory Liquidity Ratio (SLR) by 100 bps to 24 per cent in order to keep monetary measures supportive to macroeconomic growth and price stability. However, full impact of the easing monetary policy on various monetary aggregates, such as reserve money, money supply (M3), non-food bank credit and aggregate deposits would be reflected with a lag of one year or so.

As a part of the fiscal policy, the GOI introduced two packages to minimise the impact of global economic slump. Measures like reduction in Central Value Added Tax (CENVAT), exemption from basic customs duty on certain goods, robust expenditure on infrastructure, industry and export sector which were the part of packages, are expected to bring the economy on the growth track in future.

To sum up, the economy has been experiencing moderation in its growth momentum, with further downside risks emanating from the ongoing global economic slowdown and deterioration in global financial markets along with the corresponding slowing down in the domestic demand. Both GOI and RBI are engaged to restore the growth momentum. Increase in consumption demand mainly reflecting rise in basic exemption limits and tax slabs, Sixth Pay Commission awards, debt waiver for farmers and stimulus packages would help to revive the growth. Moreover, falling commodity prices in both international and domestic economies would soften inflation and could boost consumption and economic activities.

Select Macroeconomic Indicators

Particulars	Values		Per cent Change	
	April-December		April-December	
	2007-08	2008-09	2007-08	2008-09
GDP (Rs. thousand. crore) (at constant prices)	3,129.7 QE	3,351.6 AE	9.0	7.1
Index of industrial production ¹	258.6	268.7	9.2	3.9
Wholesale price index (Base 199394=100) ²	219.0	230.1	4.8	5.1
Consumer price index (2001=100) ³	134	147	5.5	9.7
Money Supply (M3)(Rs. hundred crore) ⁴	3,892.7	3,892.7	11.7	10.6
Exports at current prices (in US\$ million)*	1,12,737	1,31,990	23.5	17.1
Imports growth (in US\$ million)*	1,71,718	2,25,809	27.8	31.5
Trade Deficit (in US\$ million)*	58,981	-93,819	-	-
Foreign Currency Assets (in US\$ million)	2,66,553	2,46,603	-	-
Current Account Balance (In US\$ million) [@]	-17,034	-22,332	-	-

Source: Interim Budget 2009-10 documents

QE: Quick estimate, AE: Advance estimate P: Provisional

¹ Base:1993-94=100 Period relates to April-November;

² as on January 24 (point to point)

³ End of December (point to point)

⁴ variation during financial year (upto December 19)

* on Customs basis; comparison for current year is on provisional over revised basis.

[@] for 2007-08, the period relates to April-March and for 2008-09, the period relates to April-September.

Fiscal Performance

Indian economy is amongst the fastest growing economy in the world. The domestic investment rate as a proportion of GDP increased from 27.6 per cent in FY04 to 39 per cent in FY08. Gross domestic savings rate also showed substantial improvement from 29.8 per cent in FY04 to 37.7 per cent in FY08. During FY04 to FY08, GDP grew at average of 9 per cent with tax to GDP ratio increasing from 9.2 per cent in FY04 to 12.5 per cent in FY08. Amidst this favorable economic environment, revenue deficit to GDP declined from 3.6 per cent to 1.1 per cent and fiscal deficit to GDP declined from 4.5 per cent in FY04 to 2.7 per cent in FY08, showing considerable improvement and close to the Fiscal Responsibility and Budget Management (FRBM) targets.

However due to the global financial crisis with major financial institutions collapsing, the global economy entered into recessionary phase with major economies getting affected including US, Europe and Japan. India was also affected by the global slowdown and has started showing signs of slowdown. Against this backdrop and to boost demand, the GOI announced a series of stimulus packages.

Revised estimates for 2008-09

The GOI provided tax cuts as a part of sector-specific measures to stimulate a slowing economy during FY09 including reduction in central excise rates. As per the revised estimates, tax cuts and other measures are expected to lead to a shortfall in tax collection by Rs.59766 crore.

The revised estimate for FY09 had also placed the total expenditure at Rs.900,953 crore, showing an increase of Rs.1,50,069 crore as against the budget estimate. The increase in expenditure was on account of increase in plan expenditure by Rs.39,571 crore and Rs.110,498 crore on the non-plan side.

On account of increased expenditure and shortfall in tax collections, the revised revenue deficit is placed at 4.4 per cent as against 1 per cent in the budget estimate for FY09. Similarly revised fiscal deficit is estimated at 6 per cent of GDP as against 2.5 per cent in the Budget estimate.

Budget estimates for 2009-10

The Indian economy is expected to register 7 per cent GDP growth in FY09 but with the recessionary trend expected to continue in FY10, it is also estimated to show a declining trend in the next few years. To negate the effect and boost the demand, the GOI in its interim budget announced to relax FRBM targets and induct counter-cyclical measures to counter the global economic slowdown.

The interim budget estimates total expenditure for FY10 at Rs.953,231 crore. This includes Rs.285,145 crore for plan expenditure and Rs.668,883 crore for non-plan expenditure. In the interim budget, the GOI has focused on increasing expenditure on social sector, rural development sectors, export-oriented sectors and infrastructure projects to boost demand. Considering the increased expenditure to bolster demand during the slowdown, the target for FY10 for revenue deficit to GDP is put at 4 per cent and fiscal deficit to GDP at 5.5 per cent.

With general election to be held in May 2009, the GOI also announced populist measures. However, the decreasing tax collections and the increasing fiscal deficit (on account of stimulus packages announced) limited the GOI's capacity to announce elaborate populist measures. The GOI through its interim budget has been trying to maintain a balance between maintaining fiscal balances as well as providing stimulus to boost the economy.

Infrastructure

Background:

Despite the rapid growth in the economy in recent years, India continues to suffer from evident infrastructural constraints such as huge resource gap, lack of resource mobilisation, ineffective regulatory framework, poor quality of services, deteriorating asset quality etc.

These constraints have not only affected the urbanisation process in India but have also resulted in lagging rural development. Infrastructure is expected to contribute significantly to the total GDP, establishing a two-way cause-effect relationship. A growth in infrastructure would lead to a robust

GDP growth and this in turn would support the growing infrastructure. Hence, enhancing the productivity of infrastructural projects becomes essential for the country.

Some recent measures taken:

The current financial turmoil and the consequent economic slowdown led the GOI to introduce some pro-active fiscal and monetary measures. Some of these fiscal measures were taken in the direction of the infrastructure sector:

- Measures to increase private investments in infrastructure through Public Private Partnership (PPP) in sectors of telecommunication, power generations and airports. 54 such Central sector infrastructure projects with a total cost of Rs.67,700 crore have been given the final approval by the PPP appraisal committee, while 23 such projects worth Rs.27,900 crore were approved for viability gap funding in 2008-09.
- A further assurance of financial feasibility to these projects in the current economic downturn was provided through refinance to the banks providing long-term credit to these projects. Additionally, India Infrastructure Finance Company Ltd. (IIFCL) will refinance 60 per cent of the commercial bank loans extended towards PPP projects in critical sectors over a period of eighteen months.
- As per the fiscal stimulus package worth Rs.37,000 crore announced on December 7, 2008, the GOI, in order to expedite the infrastructural projects authorised IIFCL to raise up to Rs.10,000 crore from the market by March 2009. Additionally, it provided easier financing through tax breaks on fund raising by IIFCL. Also, an additional sum of Rs.30,000 crore can be raised by IIFCL if required.

Proposals made during Interim Budget:

The plan-expenditure for 2008-09 which was placed at Rs.2,43,386 crore has been revised to Rs.2,82,957 crore, of which an increase of Rs.15,397 crore was on account of the Central assistance to State and Urban Development plans, mainly for rural development, telecommunications, externally-aided projects, accelerated irrigation benefit programmes and roads & bridges.

- Investments in Urban Infrastructure has been spearheaded by investments under central government sponsored Jawaharlal Nehru National Urban Renewal Mission (JNNURM). This includes investments in basic infrastructure and services, to the tune of Rs.17,219 crore annually and a total corpus of Rs.1, 20,536 crore, spreading across 63 cities. The interim budget proposed an allocation of Rs.11,842 crore for the year 2009-10 which is considerably higher than the previous budget allocation of Rs.6,866 crore.
- RIDF- XV (Rural Infrastructure Development Fund) which is one of the main instruments to channelise bank funds for financing rural infrastructure has been proposed an allocation of Rs.14,000 crore in 2009-10 as against the same amount in the previous budget allocation, ensuring continued fund availability. Along with this, a separate window for rural roads under RIDF, with a corpus of Rs.4,000 crore has been set up.
- Bharat Nirman which is a time-bound (2005-09) plan for rural infrastructure by the GOI in partnership with State government and Panchayati Raj institutions has been allocated a sum of Rs.40,900 crore, as against Rs.31,280 crore as per the previous budget allocation. The programme focuses on six main sectors namely; rural roads, telephone, irrigation, drinking water supply, housing and electrification.

Analysis of the interim budget:

- A continued emphasis on Infrastructure is evident from proposed allocations in both rural and urban infrastructure projects. The funding towards existing projects like Bharat Nirman,

JNNURM has been maintained and further strengthened with the provision of RIDF XV. There have been renewed efforts towards fresh infrastructure projects with prompt investments via Fiscal Packages proposed earlier.

- In order to bridge the existing infrastructural gap to sustain the economic growth, an investment in infrastructure sector of more than 9 per cent of the GDP by 2014 is proposed.

Agriculture and Social Sector

Key Highlights:

- To strengthen the short-term co-operative credit structure, the GOI is implementing a revival package in 25 states involving a financial assistance of around Rs.13,500 crore.
- The GOI will continue to provide interest subvention in FY10 so that short-term crop loans upto Rs.3,00,000 are obtained at 7 per cent per annum.
- An allocation of Rs.30,100 crore for National Rural Employment Guarantee Scheme (NREGS) for FY10.
- Rs.21,100 crore spend on flagship education programmes including Sarva Shiksha Abhiyan and Mid-Day meals scheme. The same amount was allotted last year for these schemes.
- Allocation on other flagship social sector programmes to the order of Rs.27,375 crore in FY10. This is about 2 per cent higher than the allocation made in FY09 for these schemes.

Analysis:

Favorable weather conditions, increased disbursement of credit, policy incentives via rising minimum support prices, improved capital formation and increased spending on rural development programmes have led to a robust growth in the agriculture segment in recent years. In the last four years, the agricultural growth has been around 3.7 per cent on an annualised basis. Food grains production which grew at 0.2 per cent Compounded Annual Growth Rate (CAGR) between FY01 and FY05 has shown a growth of about 5 per cent CAGR in the succeeding four years.

In this backdrop, the prevailing recessionary environment presents its own set of challenges. From the GOI side, moderating revenues on the back of slower growth along with proactive fiscal incentives like tax cuts would have to be matched by sustaining expenditure needed on flagship social sector programmes. The impact of these pressures has already been felt and in FY10, expenditure on all key flagship programmes have either remained stagnant or increased marginally over the previous years outlay. These various pulls and pressures set their own constraints to greater agriculture spending.

Two fundamental pillars of the GOI's policy towards agriculture in recent years have been the administered pricing system and strengthening the supply of credit to the sector. The administered pricing system has mainly operated through the minimum support price mechanism for foodgrains on the demand side and a subsidised pricing regime for vital inputs like fertilisers. In FY09 (RE), about 51 per cent of the total non-plan expenditure is estimated to accrue from agriculture and food-related subsidies (including fertilisers). The outlay for FY10 budgets a continuance of this trend. Agriculture would be impacted not only by the falling demand but also by a temporary rise in labour costs till the productivity benefits of rural wage employment schemes are evident. In this context, a high subsidy regime if not targeted properly would put a significant cost on the revenue side of the budget without the corresponding impact on farm sector returns. Alternative measures like a national mission on extension, increased research endeavours and further tapping the irrigation potential would also need to be sustained.

Credit growth to the agriculture has been robust in the past five years. Credit disbursement increased from Rs.87,000 crore in FY04 to Rs.2,50,000 crore in FY08. The agriculture debt waiver and relief scheme was implemented by June 30, 2008 and so far has amounted to Rs.65,000 crore. The risk premium on lending to sectors like agriculture increases significantly during recession. In this context, the budget's focus on revitalising the co-operative segment, continuing with the process of Regional Rural Bank recapitalisation and interest subvention is welcome. However the key to provide sustainable farm credit across cycles would be to institutionally and systemically strengthen

the dedicated rural lending institutions like co-operatives and Regional Rural Banks (RRBs). This continues to remain a challenge to the GOI.

Overall, the Interim Budget continues the policy focus on agriculture and social sectors. The expenditure on rural infrastructure and employment wage schemes would however contribute to strengthen the structural basis for the trend growth. The importance of the same indicates the continuance of this focus in the post-election budget irrespective of the party in power. The slowing economy already appears to be putting pressure on the GOI in sustaining its expenditure on these sectors. Dealing with the continuing effects of the recession would be the key challenge to the new government post-elections.

Concluding observations

The slowing economy in the backdrop of a global recession has resulted in a temporary break in the fiscal consolidation process as mandated by the FRBM Act. The Interim Budget carries forward the strong focus on infrastructure investment emphasised in the earlier fiscal stimulus packages as a means to revive the economy. The implementation of the sixth pay commission and continued allocation to rural wage employment schemes should significantly boost consumption and hence contribute in improving the aggregate demand situation. Continued fiscal pressure would continue to be felt well into the next year and could pose significant challenges for the new government, post elections.

Disclaimer

This Newsletter is published by Credit Analysis & Research Ltd. (CARE) and is for private circulation only. Nothing contained in this Newsletter shall constitute or be deemed to constitute an offer to sell/purchase any security or as an invitation or solicitation to do so for any securities of any entity. CARE has taken due care and caution in preparing this Newsletter. Information has been obtained by CARE from sources it considers reliable. CARE does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions for the results obtained from the use of such information. CARE especially states that it has no financial liability whatsoever to any user on account of the use of information provided in this Newsletter.