

INDIA – UNION BUDGET UPDATE

In India, the presentation of the Union Budget is an annual event that is looked forward to by people from all strata of society ranging from corporate leaders to housewives, from students to street vendors. The Budget enumerates the new fiscal policy, setting goals and targets, to be followed during the current financial year. Much was expected by many after the euphoria surrounding the results of the Central Government Elections in May, giving the ruling party a near majority in the Parliament. Most analysts and economists had expected announcements that would signal a push towards greater financial reform, economic liberalization and improved governance.

Against the backdrop of continued global economy weakness on one hand and the opportunity to set the stage for continued stabilization and growth prospects for India, the 2009-10 Union Budget was presented by the Finance Minister (FM) on July 6, 2009. Overall, the FM chose to play it safe and announced a more middle-of-the-road Budget, which somewhat dampened the optimism. The Budget maintained an expansionary fiscal stance and focuses on a slew of spending measures aimed at the rural masses and the economically disadvantaged classes. This, despite the burgeoning fiscal deficit and shortfall in advance tax collections. As a result, the fiscal deficit is expected to increase from 6.2% of GDP in 2008-09 to 6.8% in 2009-10 (approx.\$90 bn). The focus was the common man and hence agriculture and infrastructure related initiatives got the impetus with a view to boost domestic consumption and long term growth. The tax rates were not increased except for the Minimum Alternative Tax (MAT). In fact, keeping the long term view, the overall tax regime was lowered. However, the capital markets did not get the expected aggressive targets for disinvestment of public sector stakes, elimination of the Securities Transaction Tax, deregulation of restricted sectors, or more/better ways to attract foreign capital. Thus, some of the structural impediments to growth remain.

Key Features of Budget 2009-2010

CHALLENGES

- to lead economy to high GDP growth rate of 9 per cent per annum at the earliest
- to deepen and broaden the agenda for inclusive development
- to improve delivery mechanisms of the government.

OVERVIEW OF THE ECONOMY

- Growth rate of Gross Domestic Product dipped from an average of over 9 per cent in the previous three fiscal years to 6.7 per cent during 2008-09.
- Whole sale price index rose to nearly 13 per cent in August, 2008 and had an equally sharp fall to zero per cent in March, 2009.
- The structure of India's economy changed over the last ten years with contribution of the services sector to GDP at well over 50 per cent and share of merchandise trade doubling to 38.9 per cent of GDP in 2008-09.
- Recognising economic recovery and growth as co-operative effort of the Central and State Governments, meeting with Finance Ministers of States held as part of preparation of the Budget. This is intended to become an annual feature.

Budget Highlights:

- Real GDP growth assumed at 6.5% in 2009-10
- Fiscal deficit projected at 6.8% of GDP
- Revenue Deficit projected at 4.8% of GDP
- Total expenditure increased by 36% to \$208 billion over 2008-09
- Indian Infrastructure Finance Company Ltd (IIFCL) to refinance 60% of commercial bank loans for Public Private Partnership (PPP) projects in critical sectors over the next 15-18 months (Annual capital investment on infrastructure in India is around 4% of GDP, much less than 10% in some other Asian countries)
- Allocation to National Highway Authority of India (NHAI) for the national highway development program increased by 23% over 2008-09
- Income Tax exemption limit raised; Fringe Benefit tax and 10% surcharge on personal income tax scrapped; no change in corporate tax
- Funds, subsidies, incentives for housing, amenities for urban poor, farmers, rural masses and agriculture sector
- Target for agriculture credit flow set at \$ 67 billion
- Tax holiday on petroleum sector extended to natural gas. Blueprint to be developed for long distance gas pipelines leading to a National Gas Grid to facilitate transportation of gas across the length and breadth of the country.
- Allocation under Accelerated Power Development and Reform Programme (APDRP) increased by 160 per cent to \$429 million
- Plan Budget increased for Health and Education (with emphasis on Technology Institutes)
- Various measures for restoring Export growth
- Defense spending up 34% (recent WSJ article features the story re: India's plan to spend between \$50-55 billion on military equipment over the next 5 years with some planned purchases of up to \$10 billion)
- Unique Identification Authority of India (UIDAI), headed by Nandan Nilekani, former co-Chairman of Infosys Technologies, to set up online database for Indian residents, improving governance in the delivery of social sector schemes

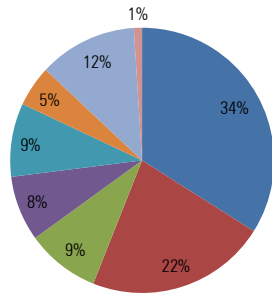
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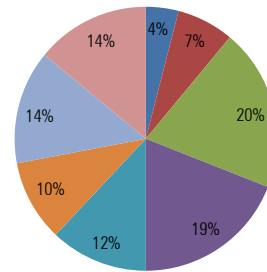
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Where the Rupee comes from



- Borrowings and Other Liabilities
- Corporation Tax
- Income-Tax
- Customs
- Union Excise Duties
- Service tax and other taxes
- Non-Tax revenues
- Non-Debt capital receipts

Where the Rupee Goes



- Non-plan assistance to state and UT Governments
- State and UT plan Insurance
- Central Plan
- Interest payment
- Defence
- Subsidies
- Other non-plan expenditure
- States' share of taxes and duties

Analysis:

The FM did not use the stage to articulate in clear terms his vision of economic reforms and the continued liberalization process. Yet, in the current environment, the FM has focused on restoring higher growth as his key challenge. In addition, his second and third challenges would be to foster inclusive growth and to improve the delivery of government services. To some, this was a politics-driven strategy, where the major policy changes will come later, piecemeal via individual ministries, rather than attracting political debate over massive one-time all encompassing policy change announcements.

India, like other countries, has witnessed an economic slowdown due to the crisis in advanced economies leading to domestic and global slowdown. Despite this slowdown, investments have been buoyant, outpacing GDP growth rate, which reflects resilience of Indian enterprise in the face of global uncertainty. India has a strong banking sector which is both financially sound and well capitalized. Agriculture and rural demand continue to be a strong point for India. Massive structural reforms in these sectors under the new government, if materialized, will provide an upward thrust to the Indian economy. About 69% of India's population is still rural and 60% of the population still engages itself in agriculture based activities, although the GDP composition breakdown is – 17% from agriculture sector, 57% from service sector and the balance from manufacturing sector.

Although, the markets reacted very negatively with a near 6% drop following the Budget speech, currently, the markets have recovered and as of July 15, have overtaken the July 6 lows. Historically speaking, valuations seem reasonable, particularly keeping in mind the long term economic growth prospects. Despite the global economic weakness, India's GDP grew at 6.7% in 2008-09. Government is aiming for a 9% annual growth rate within the next 12-18 months. To conclude, this Budget has taken a call that the economy is still at a stage where it needs fiscal support. Additional expenditure in critical sectors such as infrastructure and agriculture could play a role in boosting the economy. At the same time, tax measures have largely been framed to provide incentives to further investments in critical sectors.