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Attracting Development Funds

Thrust of my argument and the resultant forecast in my pre-budget analysis was that Indian government with lots of thought and deliberation is building a virtuous spiral for attracting development funds, huge amounts of which are necessary to sustain a GDP growth of 7-8%. These could come from FDI, FII and Domestic savings. Budget validated that totally by including the following factors:

- Providing tax incentives for savings and most importantly these savings can be in a variety of instruments including equity mutual funds. While it gives a boost to savings, it will also facilitate moving a greater proportion of domestic savings into equities.
- Taking forward of pension reforms, mainly defined contribution scheme. These reforms are also market driven with a strong regulation and again a catalyst for driving long-term savings into capital markets.
- Widening of asset classes like announcement of gold based mutual fund schemes
- Training institutes for capital market intermediaries
- Deepening of corporate bond market and introduction of securitisation
- Derivative trades not being treated as speculative trades, therefore better taxation treatment. OTC derivatives being given proper legal recognition
- Mumbai being developed as regional financial hub
- Specific FDI proposals expected for various industries
- Banking sector reforms announced

Deployment of Funds

For Indian growth to be sustainable over a long period of time, it has to be equitable.

Accordingly, areas that have been specially targeted are:

- Infrastructure
- Agriculture, irrigation, diversification of crops
- Rural development
- Education
- Health
- Sectors with maximum job generation potential
- Textiles
- Exports
- Continuing support for IT, BPO, Housing & Construction

Taxation

- VAT to be implemented
- Major positive changes in personal taxation
- Reduction of corporate taxation
- Custom duties being reduced with an objective to bring these down to ASEAN levels
- NRE interest income tax exemption to continue

Overall verdict

A very good budget that is growth orientated, keeping reforms on track and attempting to benefit all sections of population. Essentially an excellent blueprint for nation building and development in an equitable manner. 3 Is of Infrastructure, Inclusive Growth (growth benefiting everybody) and Industrial Development have effectively been addressed. However, 4th I of Implementation has to be observed closely. It will be important to see whether money is reaching where intended. Various schemes have to be monitored against benchmarks. Additionally, fiscal deficit reduction has to be on course. Moreover, it will be interesting to see whether the government is able to do something about FDI limits in various industries, given the opposition of Left parties.

Initial stock market response

Sensex jumped up nicely from 6570 to 6714. Mid cap index moved from 2739 to 2767.

Action Step

Same as in my pre budget note, except that now that my forecast has been validated, so the view is even more emphatic:

With a 2-year horizon for the invested funds, probability of significant gain is very high with very little downside. My recommendation will be to stay invested and actually add more funds to the portfolio.

As always, we will continue to monitor and analyze important factors impacting the markets including corporate earnings growth and various risk factors.