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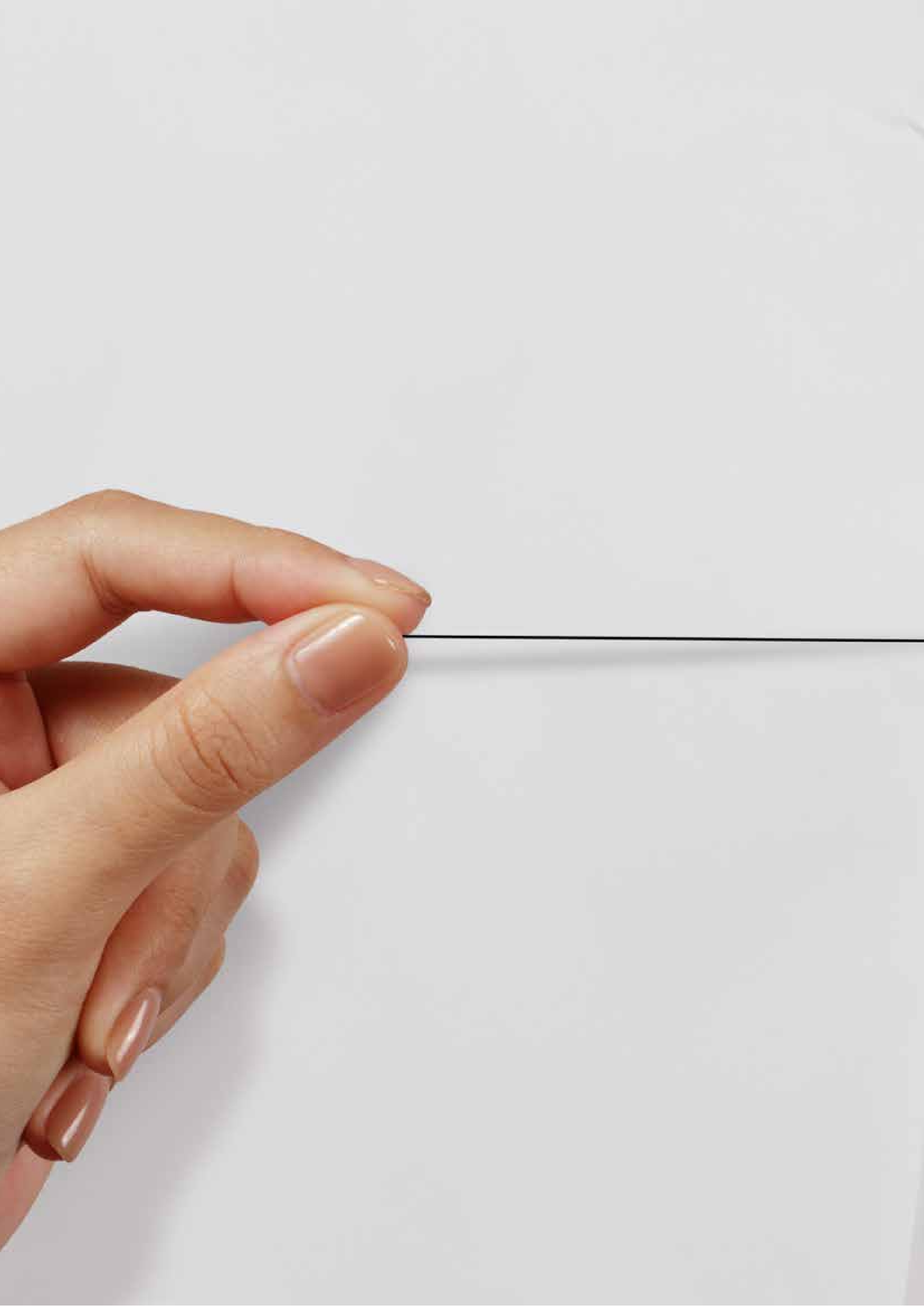
UNION BUDGET:
PREPARING FOR TAKE-OFF!

INDIA BUDGET 2014-15



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Research Team:
Ati Ranjan, Avinash Ganesh Singh & Vikram Ramarajan

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BEGINNING A SLOW AND GRINDING PROCESS

When the Finance Minister Mr. Arun Jaitley assumed office earlier this year, he had his task cut out for him. The country was slowly descending towards the “Hindu rate of growth” (3.5%) over the past two years. Fiscal numbers were amiss, indecisiveness and red tape had affected government operations, supply side bottlenecks were creating stagflation, and business sentiment was in doldrums.

In interviews leading to the budget, Mr. Jaitley indicated that he was cognizant of the country’s economic woes. He had suggested the steps that would be implemented in the short term – fiscal consolidation, investment cycle revival, driving the manufacturing sector, supporting agriculture and restore business sentiment – to rekindle growth. Presenting the first budget of his political career, the Finance Minister stuck to his game plan, delivering a document aimed at bringing the **“acche din”** back.

Fiscal prudence continues to be at the forefront of the government’s economic agenda

To begin with, the fiscal deficit for the year has been pegged at 4.1% of GDP in 2014–15; this would be reduced further to 3% by 2016–17. Despite the steep target and sluggish macroeconomic conditions, the Finance Minister has decided to dig his heels in and work on this admittedly hard task. Though he has not outlined how he would go about achieving these targets, the Finance Minister has stated that tax buoyancy (rather than curbing essential expenditure) would be the way forward. The establishment of the Expenditure Management Commission and the introduction of the Goods and Service Tax could be the first steps. However, this would evidently not be enough and would need to be complemented by efficiency in tax collection and structural reforms (read land and labour laws reform), which are outside the purview of the budget document.

Banking on investments in infrastructure to improve India's 'investability'

Significant infrastructure outlays (road, power, ports and airports) have been planned to revive the investment cycle and unclog infrastructural bottlenecks. The government has earmarked INR 37,887 crore (a little over USD6 bn) for the NHAI and state highways, INR11,600 crore (USD2 bn) to develop outer harbour projects, INR4,200 crore (USD700 mn) for Allahabad-Haldia inland waterways, besides awarding 16 new airport projects this fiscal, and allocating INR1,000 crore (little over USD150 mn) to the solar power sector. This will send a strong signal to both domestic and foreign enterprises that India means business. The scale of these investments is also expected to buoy private sector sentiment and drive investments that have been lagging in recent years. However, the devil is in the details and the timely implementation of these projects would be key if the country is to reap externalities from these projects in the long run.

Enhancing private sector participation has also been an important budget theme. Key announcements include the increase in FDI within the ecommerce, defence and insurance sectors as well as public private partnerships (PPPs) for development of gas pipelines, airports and metro rail (in Ahmedabad and Lucknow). These decisions were complemented by assurances that retrospective tax amendments would be undertaken with caution, and that the economy would not be hostage to indecisiveness and populism.

Not forgetting the farmer

Promoting agriculture was important as it still comprises the backbone of the economy; almost 50% of the population depend on this sector for their livelihood. The government is targeting 4% sector growth through farm loan subsidies, additional funds for farm credit, rebuilding rural infrastructure and creating a growing knowledge base through Kisan Television (which will provide real time information on various farming and agriculture issues). A big planned reform would be the tweaking of the MNREGA scheme, which will be modified to make it more asset-creation oriented.

Reviving manufacturing was a priority for the government as this sector could emerge as a viable way to accelerate economic growth and create jobs. Having missed the bus twice, the budget has laid down some concrete steps that include allocations for industrial corridors to help manufacturing, proposing the establishment of six new textile clusters and allowing manufacturing units to sell their products through retail and e-commerce channels. Allocating up to INR 1000 crore (USD170 mn) for start-ups that dominate manufacturing and are perennially starved of funds would also be a pivotal step.

A vote-of-thanks to the electorate?

Last but not the least, the budget did not forget the "aam aadmi" who voted on its feet and gave an overwhelming majority to the government. As a sign of thanks there were a number of benefits in the form of tax concessions (rise in tax exemption, easier norms for student loans, allocations for low-cost housing and rise in investment limits).

The NDA government has projected this budget has the first step in returning the country to 7–8% growth. Given the short time frame, numerous problems at hand and limited fiscal bandwidth, the Finance Minister unveiled a pragmatic budget which takes into account ground realities and suggests some quick fixes. It would be too early to pronounce judgment on this budget and the government would face its real test in 2015-16, when the honourable Finance Minister rises to present his second budget.

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STEPS NOW, MILESTONES LATER

The Union Finance Minister's cautious tone in addressing economic issues underlines the difficult task ahead of the newly formed NDA government. A slowing economic growth rate, high inflation and an uncomfortable fiscal and current account situation are issues that need to be addressed simultaneously. As such, the FinMin's tone is understandable, given that the NDA government is only 45 days old.

Challenging targets but effort on taking the right steps

While it is early to critically view the government's ambitious target of achieving 7-8% economic growth over the next 3-4 years, we expect the effort, in the immediate term, would be more towards correcting the country's fiscal situation, inflation and improving the overall investment sentiment, both from within and outside the country. The government hopes to bring the fiscal deficit down to 4.1% in FY2015, 3.6% in FY16 and 3.0% in FY17; from 4.5% in FY14. In this regard, the government has decided to create an Expenditure Management Commission to review efficiencies in government expenditure and flag areas of concern.

Getting closer to GST but not without negotiations

That said, the budget reflected the government's preference for revenue growth ahead of expenditure cuts. For this, both the Tax to GDP ratio and other non-tax revenue sources must be explored. The biggest step through the course of the current fiscal year would probably be the implementation of the goods and services tax (GST). Although the budget did not lay down a concrete roadmap and timeline, the finance minister was clear in expressing the government's strong desire to achieve GST. We believe better clarity on GST would emerge only towards the end of the current fiscal year, and could positively impact the fiscal situation for FY16 and FY17. Also, the finance minister ruled out any major retrospective tax changes without considering its impact on the concerned parties and the investment sentiment in general.

The budget focused heavily on increasing investments, domestic as well as international, across various industries and sectors with an aim to improve the output. A significant step towards that was increasing the FDI limit in the defence manufacturing sector. The finance minister has proposed increasing the FDI limit to 49% from the current 26%. However, the management and control would remain with an Indian entity through the FIPB route. This would not only bring down the government's defence purchases in the international market but also open up the sector to opportunities abroad. The other major FDI announcement has come in the insurance sector, where the cap has been raised to 49% from 26%. Again, the management and control would rest with an Indian entity through the FIPB route. We believe penetration of insurance products still remains relatively low in at least the semi-urban and rural areas and this is likely to act as a catalyst.

Among the other initiatives that the budget has laid out, there appears to be a greater thrust towards the infrastructure/capital intensive industries. Provisions and budgetary allocations have been made towards sectors such as shipping, inland navigation, airports, roads and highways. The government plans to set up 16 new ports with a total investment of nearly USD2 bn besides promoting the ship building industry. The government also plans to expand the country's airports network by building airports in tier-2 and tier-3 cities. For the roads and highways sector, the budget has proposed an investment of a little over USD6 bn in the National Highway Authority of India.

Widening the gamut of the banking industry

For capital markets, the budget focused on increasing the penetration of the banking sector in underpenetrated areas, and also increasing the number of bank accounts per household. Additionally, the RBI will create a framework for the granting of licenses to small and differentiated banks. The finance minister appears to have made an attempt to strike a balance between jump-starting the investment cycle in the country, opening up parts of the industry to international participants and create a structured framework to curtain expenses. On the inflation side, excise duty cuts on certain food, food processing and packaging machinery would likely make select goods cheaper, but clearly the Iraqi crisis and the continued Middle East volatility will be far more influential in the near term.

Below is a summary of the key direct and indirect tax changes proposed in the budget:

Direct Tax	Indirect Tax
Exemption limit increased by INR50,000 to INR250,000 for individual taxpayers below the age of 60years and from INR 250,000 to INR300,000 for senior citizens	General customs, excise and services tax rates remained unchanged
No change in tax rate, surcharge and education cess	No specific timelines announced for implementation GST and pending issues to be resolved
Increase in investment limit under Section 80C increased to INR150,000	Increase in free baggage allowance for inbound travelers from INR35,000 to INR45,000. Scheme of Advance Ruling in indirect taxes extended to cover resident private limited companies.

Direct Tax	Indirect Tax
Increase in deduction limit for interest expense in respect of self occupied property from INR150,000 to INR200,000	Excise duty concessions on capital goods, consumer durables and automotive sector extended for 6 months. Certain renewable energy products to be exempted from excise duty. 'Indian Customs Single Window Project' proposed to be implemented
REITs and Investment Trusts to be set up in accordance with SEBI regulations to enjoy tax pass status with an exception in case of capital gains on disposal of assets	
Concessional rate of 15% tax on dividends received by Indian companies from their foreign companied to continue without any sunset date	
Eligible date of long-term foreign borrowings by Indian companies for concessional rate of 5% on interest payments to continue till June 2017 and also extended to all bond types instead of only infrastructure bonds	

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A MIX OF INFRA AND AGRI-PUSH TO THE ECONOMY

The first budget by the recently-elected NDA government underscores its keenness to drive investment and galvanize the agriculture sector. The infrastructure sector, weakened as a consequence of the recent economic slowdown and lack of policy initiatives, has expectedly been one of the focal points of the government's agenda to lead the recovery.

We view the government's agri-push as positive given that a large proportion of the semi-urban and rural population depends on the sector. We believe sustained agriculture reforms are necessary to drive consumption and growth in an economy such as India's. Wages, job creation and improving the overall purchasing power of the rural population are likely to be the key factors driving agriculture reforms.

Regulatory changes

- An institution called 3P India would be set up at a cost of INR500 crore (USD80 mn) to provide support to mainstream PPP projects

Financing/Fiscal measures

- Long term financing for infrastructure projects would be promoted with banks adopting flexible structuring to absorb potential contingencies, while long term funds for the same would be raised with minimum regulatory constraints such as CRR, SLR and Priority Sector Lending (PSL).
- The eligible date of borrowing in foreign currency has been extended by a year to June, 2017; the tax rate on interest payments for all bonds is 5%.
- Infrastructure Investment Trusts (InvITs) would be created for PPPs and other infrastructure projects that would have a tax structure similar to Real Estate Investment Trusts (REITS).
- Pooled Municipal Debt Obligation Facility has been increased from INR5,000 crore (USD830 mn) to INR50,000 crore (USD8.3 bn)

Shipping

- A policy would be formulated to promote growth of Indian controlled tonnage
- 16 new port projects would be awarded
- A sum of INR11,635 crore (USD2 bn) would be allocated for development of the Outer Harbour Project in Tuticorin
- A policy would be formulated to promote the Indian ship-building industry
- SEZs would be developed at Kandla and JNPT port facilities
- 'Jal Marg Vikas', an inland navigation project costing INR4,200 crore (USD700 mn) and covering a distance of 1,620 kms between Allahabad and Haldia would be completed in six years

Airports

- New development scheme would be launched for development of Tier I and Tier II airports
- Electronic Travel Authorization (e-Visa) would be implemented in a phased manner at nine major airports to promote tourism

Roads

- Nearly 8,500 km of national highway would be constructed during the current financial year
- INR37,800 crore (USD6.3 bn) would be allocated to the National Highways Authority of India and State Roads; INR3,000 crore (USD500 mn) of this would be directed to the North East region

Railways

- INR100 crore (USD17 mn) has been allocated for Metro Projects in Lucknow and Ahmedabad; the government is considering metro projects for cities with a two million plus population

Power

- INR100 crore (USD17 mn) has been allocated for initial stages of "Ultra-Modern Super Critical Coal Based Thermal Power Technology", promoting cleaner and efficient use of thermal power
- Measures have been adopted to enhance domestic production of coal through infrastructure development
- INR500 crore (USD80 mn) has been allocated for development of Ultra Mega Solar Power Projects in Rajasthan, Gujarat, Tamil Nadu, and Jammu & Kashmir
- Nearly one lakh solar power-driven agricultural pump sets would be developed at a cost of INR400 crore (USD70 mn)
- 1 MW Solar Parks on the banks of canals would be developed at a cost of INR100 crore (USD17 mn)
- Green Energy Corridor Project implementation would be accelerated

Energy

- Nearly 15,000 km of gas pipelines would be developed in the PPP model to reduce over reliance on a single source of energy
- The government would adopt measures to revive production from coal bed methane reserves and accelerate development in new fields

Mining

- Changes to the MMDR Act 1957 would be introduced to address the current hurdles in the mining sector
- Royalty rates would be revised so that state governments get a larger share of revenue

Agriculture

The agriculture sector on average has posted a growth rate of 4.1% over the Eleventh Five Year Plan (2007–2011) and 1.4% and 4.7% in 2012 and 2013 respectively. With the government showing intent of sustaining a 4% growth rate in agriculture, a second green revolution is now proposed. Focus would shift to technology-driven measures to improve agriculture productivity. Greater emphasis would now be placed on making investments to modernize existing infrastructure as well as set up new facilities to make agriculture more productive and profitable on a global level. To bring about the modernization, the following measures have been proposed:

- Two agriculture research institutes would be established in Assam and Jharkhand at a cost of INR100 crore (USD17 mn)
- A sum of INR100 crore (USD17 mn) would be set aside for an Agri-Tech Infrastructure Fund
- INR200 crore (USD33 mn) would be allocated to establish Agriculture Universities in Andhra Pradesh and Rajasthan and Horticulture Universities in Telangana and Haryana
- A sum of INR100 crore (USD17 mn) would be set aside for a scheme to provide soil health cards, while INR56 crore (USD9 mn) would be set aside for soil testing labs
- National Adaptation Fund will be set up with an initial sum of INR100 crore (USD17 mn) to address concerns pertaining to climate change
- INR100 crore (USD17 mn) would be allocated for Kisan Television, which would provide real time information on various farming and agriculture issues
- INR50 crore (USD8.3 mn) would be allocated for the development of indigenous cattle breeds and INR50 crore (USD8.3 mn) would be allocated for a blue revolution in inland fisheries

Significant investments and reforms have also been made to overhaul the existing agriculture systems and infrastructure. Some of the measures adopted include:

- 'Bhoomi Heen Kisan' scheme, which would see finance provided to 5 lakh landless farmers through NABARD
- A sum of INR 500 crore (USD83 mn) has been set aside to establish a Price Stabilization Fund
- INR5,000 crore (USD 830 mn) has been earmarked to address the need for scientific warehousing
- State governments would be encouraged to develop Farmer's Markets in towns so that produce can be sold directly
- A target of INR8 lakh crore (USD133 bn) has been set for agriculture credit during 2014-15
- Interest Subvention Scheme for Short Term Crop Loans has been extended to 2014–15

- Rural Infrastructure Development Fund (RIDF) corpus has been raised to INR25,000 crore (USD4.2 bn)
- A Long Term Rural Credit Fund would be created in NABARD, having an initial corpus of INR5,000 crore (USD833 mn) to provide refinance support to Cooperative Banks and Regional Rural Banks
- A sum of INR200 crore (USD33 mn) would be utilized to build 2,000 producers organizations under PRODUCE

INR50,000 crore (USD8.3 bn) has been allocated for Short Term Cooperative Rural Credit (STCRC) during 2014-2015.

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SECTORAL IMPACT ASSESSMENT

AUTOMOTIVE

Expectation: It was expected that the budget would outline a new policy/incentive scheme to replace old vehicles (more than 15 years) and increase demand, increase depreciation allowance (with product/ownership cycle becoming shorter) and lay a uniform excise duty structure across passenger vehicles.

Budget Proposals: The current excise duty on automobiles will continue to be in force up to December 2014.

Impact: Besides maintaining the excise duty, the union budget did not announce any measure that would directly impact the automotive sector. However, more savings in the hands of customers, steps to develop infrastructure and allocation for rural credit refinance fund are likely to positively impact demand.

AVIATION

Expectation: The budget was expected to focus on taxes on fuels and custom duty on engines, besides targeting new airport development, in order to boost growth in non-metro air traffic infrastructure amid rising maintenance costs.

Budget Proposals: Allocation for the civil aviation sector has been increased by 11.4%, as the government looks to improve connectivity by building airports in Tier II and III cities. These will be built under the public private partnership (PPP) mode by the Airport Authority of India (AAI), which has been given a grant of INR2,134 crore (USD350 mn). The budget also proposes that e-visas be granted at nine ports in the country; this is likely to boost tourism and civil aviation.

Impact: Construction of airports in smaller cities would open up new routes and increase passenger traffic. However, the industry is likely to continue facing challenges such as high fuel costs, with the commodity being taxed as a finished product rather than raw material. Overall, the budget carries mixed news for the aviation sector.

BANKING

Expectations:

- The budget was expected to increase capital infusion to INR40,000–50,000 crore (USD6.7-8.3 bn) in PSU banks by FY15. Notably, INR11,200 crore (USD1.9 bn) has already been disbursed to PSU banks in the FY15 interim budget. Also, it was expected to introduce a prudent mechanism to reduce vulnerable advances of PSBs (gross NPAs plus standard restructured advances), which were relatively high at 10.6% as on March 31, 2014.
- State-run banks were looking forward to a roadmap for the creation of a holding company.
- It was expected to increase the housing loan interest limit beyond INR 150,000 for tax exemption and promote affordable housing to fuel housing loan growth.

Budget Proposals:

- PSU banks would need INR2.4 lakh crore (USD40 bn) capital infusion by 2018; hence, the government proposed to sell banks' shares to retail investors.
- Banks would be allowed to raise long-term funds with minimum regulations.
- For the faster recovery of bad loans, the government plans to set up 6 debt recovery tribunals.
- The government would examine the proposal to give additional autonomy to banks.
- RBI would create a framework for the licensing of differentiated banks.
- The government proposed additional 3% interest subsidy on farm loans. Furthermore, it proposed to continue interest subvention for farmers.
- Banks would be encouraged to give long-term loans for infrastructure developement.
- Banks would be given SOPs against long-term infrastructure loans.
- The government proposed INR4,000 crore (USD670 mn) for affordable housing via NHB; also, it would allocate INR12,000 crore (USD2 bn) to NHB.
- Tax exemption for self-occupied homes has been raised to INR200,000; also, the 80C limit for individuals has been increased to INR150,000.

Impact:

- Capital infusion, giving further autonomy and faster recovery of bad debt would act positively for the banking sector.
- Promoting affordable housing and increasing exemption limit on home loans (both principal and interest via 80C) would promote home loan growth.
- Promoting banks for infrastructure lending would boost banks' loan growth.
- Increasing interest subsidy on farm loans and interest subvention for farmers would act negatively for PSU banks as it would hit their top and bottom lines.

CONSUMER SECTORS

Expectation: The market expected the finance minister to announce some concessions in the sector.

Budget proposal to boost consumption: The finance minister has tried a balancing act by bringing down the cost of basic and aspirational consumption and at the same time increasing the cost of non-essentials.

- Excise duty cuts on food processing machinery to 6% from 10%
- The excise duty on footwear has been reduced from 12% to 6%
- Duty cuts have been proposed to boost consumer goods such as LCD, LED TVs, PCs, mobile phones
- Personal hygiene items would get cheaper with a cut in the basic customs duty on raw materials used for manufacturing soaps
- Imposition of a 5% excise duty on aerated drinks would increase the price of colas, juices, flavoured water, etc
- The excise cut on food processing machinery would lower prices of processed food products, making them more affordable.

Impact: The array of concessions is expected to increase the overall affordability of products (both FMCG and durable consumer products). Moreover, measures to boost disposable income through direct tax measure would boost demand.

HEALTHCARE

Expectation: The budget was expected to offer tax sops to boost investments and improve infrastructure, in line with the long-term aim to double healthcare spending to 8% in next 5 years, as per a survey by Reuters.

Budget Proposals: The budget proposes to increase the composite cap on foreign direct investment (FDI) to 49% in insurance sector from 26% currently. It also proposes to build 15 model rural health research centres across the country to focus on rural healthcare, besides setting up new drug testing laboratories and expanding the existing 31 state laboratories. The government has allocated INR500 crore (USD83 mn) to add four new AIIMs like institutions, one each in Andhra Pradesh, West Bengal, Maharashtra and Uttar Pradesh. Moreover, 58 government medical colleges have been approved, with a proposal for an additional 12. Initiatives such as Free Drug Service and Free Diagnosis Service have been prioritized. Certain exemptions for technical testing on humans related to newly developed drugs have been withdrawn.

Impact: The budget proposes measures to boost healthcare in India, focusing on the rural population. It also seeks to encourage public sector participation, which would increase competition for private healthcare firms.

INSURANCE

Expectation: The budget was expected to attract higher investments from foreign investors and offer tax sops to fuel long-term growth and expansion of the insurance sector.

Budget Proposals: The budget proposed to increase the composite cap on foreign direct investment (FDI) to 49% from 26% currently. The government will take up the pending Insurance Laws (Amendment) Bill in the Parliament soon. The budget also raised the investment limit under Section 80(C) to INR150,000 from INR100,000.

Impact: The budget has met expectations and reforms are set to boost the sector's growth prospects through capital infusion and higher demand.

METALS & MINING

Expectation: The sector expected measures to resolve issues pertaining to mining regulations and adoption of reforms for raw material security. It was also looking forward to reforms to reduce logistical bottlenecks in the transportation of raw materials to and from mines, and finished products. In addition, metal producers and miners expected tax benefits on capital expenditure would continue.

Budget Proposals: The budget proposes to double the export duty on bauxite to 20% and raise the import duty on flat-rolled stainless steel to 7.5% from 5%. Furthermore, the basic customs duty on metallurgical coke has been increased from zero to 2.5%, in line with the duty on coking coal.

Impact: The focus on infrastructure development is likely to revive demand in the sector. For aluminium manufacturers, hiking the export duty on bauxite would constrain exports, increasing the availability of the raw material. Similarly, raising the import duty on stainless steel is expected to benefit stainless steel manufacturers that are currently facing intense competition from their Chinese, Japanese and Korean counterparts. However, hiking the customs duty on metallurgical coke is a negative for metal manufacturers as this would increase manufacturing costs, denting profits.

POWER SECTOR

Expectation: The power sector is one of the most critical yet the most deprived sector in the country. The expectation was on kick-starting investment across the power value chain, from generation to transmission and distribution, along with reforms for state electricity boards. Announcement on boosting renewable power generation were also expected.

Budget Proposals: The budget was overall positive with multiple measures aimed at boosting power generation and strengthening transmission & distribution. It allocates INR500 crore (USD83 m) to boost rural infrastructure and proposes that adequate quantity of coal be provided to power plants commissioned before March 2015; ultra-modern solar power projects be taken up in Rajasthan, Tamil Nadu and Ladakh with INR500 crore (USD 83 m); allocates INR200 crore (USD33 m) for power reforms in Delhi; extends the 10-year tax holiday on projects (generation, T&D) that start operations by 2017; and earmarks INR100 crore (USD17 mn) for preparatory work of clean thermal energy scheme.

Impact: Power projects across the country have suffered due to non-linkage with coal supplies because of regulatory bottlenecks. Hence, end of the impasse on coal linkage is a much needed relief. The 10 year tax holiday will primarily benefit independent power producers plagued with issues such as fuel supply shortages. The higher allocation to renewable power projects is the need of the hour.

REAL ESTATE

Expectation: The sector was looking to obtain 'infrastructure status' to address poor liquidity, implement pending legislations for policy improvements, establish a regulatory authority, introduce a single window system for all clearances to fast-track the execution process and streamline tax laws for the establishment of real estate investment trusts (REITs). The affordable housing sector expected a reduction in home loan rates and tax benefits to improve buyer sentiment.

Budget Proposals: The budget proposes incentives for the establishment of REITs that will be granted a tax-pass through status to avoid double taxation. It has also allocated INR40 bn for affordable housing through National Housing Bank and increased the housing interest tax deduction limit to INR200,000. Slum development has been made a part of CSR activities—INR70.6 bn has been earmarked to create 100 "smart cities". In addition, the budget proposes a reduction in the size of projects eligible for FDI in real estate under the automatic route (from 50,000 to 20,000 sq m) and minimum investment limit (from USD10mn to USD5mn).

Impact: Incentivizing REITs and granting pass-through status is expected to facilitate the development of of REITs in India, which in turn will support the liquidity requirements of the realty sector. The proposed spending on affordable housing, opening up of FDI for smaller projects, and tax benefits are expected to boost the affordable urban housing market. Budgetary allocation for smart cities and other urban infrastructure projects is expected to spur commercial and housing demand. However, the lack of necessary initiatives on the policy front will continue to be a bottleneck for the industry.

SUGAR

Expectation: There were no significant expectations from the budget as the government had introduced various policy changes a few days before the budget that benefit both sugarcane producers and mill owners. These included increase in import duty on sugar to 40% from 15%; rise in ethanol blending with petrol to 10% from 5%; continuation of sugar export subsidy (INR3,300 per tonne) until September 2014; and additional interest-free loans of up to INR44 billion for sugar mills over and above the INR66 billion interest free loans announced in December 2013 to pay off mounting cane arrears.

A change in the cane pricing method with linkage of cane prices to sugar prices can be a significant sweetener. However, with elections in Maharashtra in the near term, the probability of pricing change is negligible.

Budget Proposals: In line with expectations, no proposals were made for the sugar sector in the Union budget 2014-15.

Impact: While the sector remains buoyant on the pre-budget policy changes, their enforcement would bring about the anticipated turnaround.

TEXTILES

Expectation: The budget was expected to reduce the basic custom duty on PTA, MEG, PSF, POY and textile machinery. Allocation to Technology Up-gradation Fund Scheme (TUFS) was expected to increase. The Scheme for Integrated Textile Parks (SITP) was expected to continue. The excise duty on man-made-fibre (MMF) was expected to be reduced to 8% from 12%.

Budget Proposals: Basic customs duties on specified inputs for manufacture of spandex yarn were reduced from 5% to zero. Basic customs duty on few petrochemicals is proposed to be reduced from 5%/10% to 2.5%/5%. The budget has allocated INR200 crore (USD34 mn) to set up six more textile mega-clusters at Bareily, Lucknow, Surat, Kuttch, Bhagalpur and Mysore and a seventh in Tamil Nadu. An export promotion commission is to be set up. The Indian Custom Single Window Project is to be taken up for facilitating trade and online approval systems for importers and exporters would be set up.

Impact: The reduction in custom duty for some inputs will help lower RM costs to some extent. Setting up of 6 more textile clusters is a positive in terms of creating additional quality manufacturing capacity. The single window project and online approval system would facilitate textile export trade.

TOBACCO

Expectation: The market was expecting a hike in excise duty given that the health minister had proposed a 100% hike on excise duty on cigarette.

Budget Proposal: In line with the expectation, Finance Minister Mr. Arun Jaitley hiked the excise duty on cigarettes between 11% and 72%.

Impact: The hike will put additional volume and margin pressure on cigarette manufacturers. The cigarette industry has already experienced two consecutive years of 20% + hike on excise duty and an additional price hike would impact volumes negatively. Yet, it is believed that players such as ITC (that holds 50% market share in India) would be able to pass on price increases to consumers due to their brand power. Overall, the higher excise duty on cigarettes would result in higher prices of cigarettes, relatively lower demand (compared to earlier years) and higher revenues for the government.

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Contact

Ati Ranjan
Associate Vice President

Aranca,
Floor 2, Wing-B,
Supreme Business Park,
Hiranandani Gardens, Powai,
Mumbai, Maharashtra 400076, India
Board Line: +91 22 3937 9999
Email: ati.ranjan@aranca.com

aranca
Research.Analyze.Communicate

Global Delivery Center

India
Floor 2, Wing-B,
Supreme Business Park,
Hiranandani Gardens, Powai
Mumbai 400 076
T: +91 (22) 3937 9999

Americas

New York
275 Madison Avenue, 6th Floor,
New York, NY 10016
T: +1 212 878 8826

Europe, Middle East & Africa

London
93-95 Gloucester Place
London W1U 6JQ
T: +44 (0) 207 487 8214

www.aranca.com
info@aranca.com