Union Budget FY 13 – First Take

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The Union Government presented a budget in line with market expectations and in our view is largely neutral for equities.

What we like?

It meets the minimum requirement of fiscal consolidation. The government proposed reducing the central fiscal deficit from 5.9% in FY12 to 5.1% in FY13. The deficit reduction was backed by specific measures at raising taxes primarily an increase in the excise duty and service tax rate from 10% to 12%, and broad-basing the service tax via a negative list.

The government announced a number of measures for capital markets including tax incentives for small investors in equity savings schemes, reducing taxes on securities transactions, allowing qualified foreign investors in the domestic bond market, and easier norms for listing of corporate bond offerings in exchanges.

The budget is also positive for investments in infrastructure. More infrastructure sectors have been added as eligible for viability gap funding from the government. However, to change our view from neutral to overweight Infra sector would require a hike in diesel and petrol prices in the near term.

What has been missed out?

The budget does not resolve problems relating to subsidies. We see room for the subsidy bill to overshoot.

What we see as a potential threat?

Rising oil prices.

Economics: Slightly better than before on account of some steps towards fiscal consolidation. Higher crude prices, problem of current account deficit and high interest rates remain.

Sentiment: Justifies investments in equities - Since domestic investors are massively underweight equities and more so in case of mid/small cap category, it is a powerful positive for long term investing in equities. Rajiv Gandhi Equity Scheme will be a long term trigger.

Valuations: Not worried on valuation front unlike the case in 2007 / 08. Valuations at 10 year historical average post recent rally. Still find these attractive across large and mid-cap space.

Triggers: What can be seen as a biggest positive in near term for becoming positive on equities from a neutral stance? An increase in diesel and petrol prices by Rs. 4 / litre each.

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Current stance: Neutral weight on equities.

Sectoral view: We like Pharma sector for defense, Exports & Telecom sectors due to recent underperformance. We are underweight on Capital goods due to poor near term outlook. The increase in services tax and excise will be negative to some extent on consumption sector. The outlook on infra is slightly more positive. On Auto, we are again slightly positive now since no special diesel tax has been introduced. We prefer export oriented sectors including IT/software over banking.

Triggers for increasing allocation to equities: Brent Crude prices falling below US$ 110 per barrel and increase in diesel and petrol prices. Our earlier triggers of fiscal consolidation and increase in excise duty and services tax have been met.

Likely direction of market: Range bound with volatility. Global events to be watched.
From a global perspective though, LTRO 2 (Long-Term Refinancing Operations) has attracted investors' attention towards global risk assets, and India among emerging markets could be a big beneficiary of this global risk trade.

With respect to fixed income investments we continue to believe that the one to three year space offers attractive risk adjusted returns and investors can benefit by investing in the short-term and mid-term space.

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