



▶ Union Budget 2008-09

- A perspective

FRANKLIN TEMPLETON INVESTMENTS

FEBRUARY 29, 2008

▶ Salient Points

- ▶ GDP growth rate estimate for 2007-08 at 8.7% with the manufacturing and services sectors expected to grow at 9.4% and 10.7%
- ▶ Gross domestic savings & the rate of gross capital formation increased to 34.8% & 33.8% of GDP, while per capita income rose by 7.2%
- ▶ Special focus on the agriculture sector along with health care and.
- ▶ Revenue & fiscal deficits for FY 08 targeted at 1% and 2.5%, respectively (compared to 1.4% and 3.1%).
- ▶ Taxation :
 - Rationalization of excise & customs duties to benefit common man and help in combating inflation.
 - New services brought under Service tax including ULIPs.
 - Threshold limit for income tax exemption increased to Rs.1.5 lakhs. The 30% tax rate would now apply for incomes above Rs. 5 lakhs as against Rs. 2.5 lakhs previously. This has helped in increasing the disposable income of upto Rs.35,020 per annum.
 - Short term capital gains tax increased to 15% from 10%.
- ▶ Central Sales Tax (CST) to be reduced to 2% from 3% from April 07 and a road map for Goods & Services Tax (GST) by 2010 to be prepared.
- ▶ PAN made compulsory for all financial transactions.

The Union Budget largely maintained policy direction with the focus on agriculture and education sectors. Despite the moderation witnessed in interest-rate sensitive sectors, economic growth projections remain strong and higher tax revenues are pushing up tax-to-GDP ratio and lowering deficit projections. However, the headline expenditure numbers do not reflect off-balance sheet items such as oil bonds & fertilizer subsidies and the waiver of loans to small/marginal farmers.

While the move towards GST regime was announced last year, no roadmap is in place. But a target date of 2010 looks reasonable. The worldwide experience has been that such a regime would broaden the tax base and also makes revenues less sensitive to economic cycles. This would also help the government in meeting its increased spending needs and its Fiscal Responsibility and Budget Management (FRBM) targets for the next year. While the focus on infrastructure continues, there hasn't been any clearly articulated policy framework to improve urban and rural infrastructure, which is critical to sustain the current economic growth rates.

The various measures including waiver of farm loans need to be viewed from the 'inclusive growth' perspective and the problems being faced by small farmers. Overall, fiscal measures such as cut in indirect taxes and tax exemptions along with focus on the rural segment are aimed at boosting consumption. While these are popular measures, the lower deficit projections give comfort on the fiscal front. But with economic growth moderating, the possibility of meeting revenue targets needs to be evaluated and more clarity is likely to emerge once the impact of the Sixth Pay Commission recommendations is evaluated.

► Equity markets

The markets have started 2008 on a weak note due to a combination of global uncertainty and unwinding of speculative positions by domestic investors. US sub prime issue had wider ramifications in terms of global impact with leading global financial institutions announcing write-downs and credit markets witnessing tight liquidity. Against this backdrop, the increase in short term capital gains tax to 15% had an impact on investor sentiment and there was also disappointment amidst a segment of the market due to absence of tax cuts. We believe the increase in short term gains tax could discourage frequent churning and possibly lead to long term investments. Indices have fallen due to selling in certain stocks on account of MSCI rebalancing and also due to the budget.

Movement on 29.2.2008

Index	Change (%)
BSE Sensex	-1.38%
S&P CNX Nifty	-1.17%
S&P CNX 500	-0.99%
BSE Mid Cap	-0.41%
BSE Small Cap	-0.41%
BSE IT Index	-2.65%
BSE FMCG	0.91%
BSE Capital Goods	-2.89%
BSE BANKEX	0.40%
BSE AUTO	1.19%

Excise duty cuts and other measures are seen as positive for sectors such as auto and healthcare. The waiver of farm loans could be seen as positive for the banking sector as these loans could have been part of the NPAs and the government is likely to share the burden with the banks. The proposal to reduce CENVAT is aimed at giving a boost to the manufacturing sector and allowing the parent company to set off dividends from subsidiaries against its dividend distribution will prevent double taxation due to DDT. The focus also appears to be on inflation control and capital flows are likely to be monitored more closely given the global uncertainty.

The current consolidation in the Indian markets has come about after 4 straight years of a strong rally and was along expected lines. The medium term direction will be driven by emerging cues about the extent of slowdown in developed economies and the consequent impact on risk premiums.

► Debt Markets

The Union budget was largely positive for the debt markets with the fiscal deficit projections and market borrowings lower than expectations. However, concerns remain on the funding of farm loans waiver and the increased outlay for various sectors. Sustained fiscal prudence could also lead to lower than budgeted borrowings in FY 07, which would help the debt markets. The yields on key securities have moved down from yesterday's levels.

	28-2-2008	29-2-2008
1 Year Gilt	7.55	7.53
5 Year Gilt	7.57	7.54
10 Year Gilt	7.69	7.62
30 Year Gilt	8.00	7.97
5 Year Corporate Bonds (AAA)	9.33	9.28

Increased spending plans along with reduced market borrowings could improve systemic liquidity and are seen as a positive for the debt markets. The efforts to boost consumption through excise duty cuts, increased tax exemptions and measures to boost agriculture, could be seen as pump priming. The proposals to expand debt markets are positive and include –

- Launching of exchange-traded currency and interest rate futures
- Development of a transparent credit derivatives market
- Enabling investors to trade the embedded equity option in a convertible bond separately
- Market-based system for classifying financial instruments based on risks and complexity.

Liquidity conditions impacted by lower-than-expected government spending in recent times, could remain tight due to advance tax flows. With global interest rates declining in recent months on the back of monetary easing by leading central banks across globe, we expect interest rates in India to remain steady with a downward bias. The global scenario along with moderating growth and strong fiscal health provide a benign environment for the debt markets in FY 09. The outlook for long bonds remains positive over a 9-12 month period and inflation along with liquidity are likely to drive market direction over medium term. At this juncture, we believe investors should look at FMPs with double indexation benefits, short term income funds and long bond funds (with appropriate risk profile).

The information contained in this commentary is not a complete presentation of every material fact regarding any industry, security or the fund and is neither an offer for units nor an invitation to invest. This communication is meant for use by the recipient and not for circulation/reproduction without prior approval. The views expressed by the portfolio managers are based on current market conditions and information available to them and do not constitute investment advice.

Risk Factors: All investments in mutual funds and securities are subject to market risks and the NAVs of the schemes may go up or down depending upon the factors and forces affecting the securities market. The past performance of the mutual funds managed by the Franklin Templeton Group and its affiliates is not necessarily indicative of future performance of the schemes. Please refer to the Offer Document before investing. **Statutory Details:** Franklin Templeton Mutual Fund in India has been set up as a trust by Templeton International Inc. (liability restricted to the seed corpus of Rs.1 lac) with Franklin Templeton Trustee Services Pvt. Ltd. as the trustee (Trustee under the Indian Trusts Act 1882) and with Franklin Templeton Asset Management (India) Pvt. Ltd. as the Investment Manager.



FRANKLIN TEMPLETON®
INVESTMENTS

www.franklintempletonindia.com