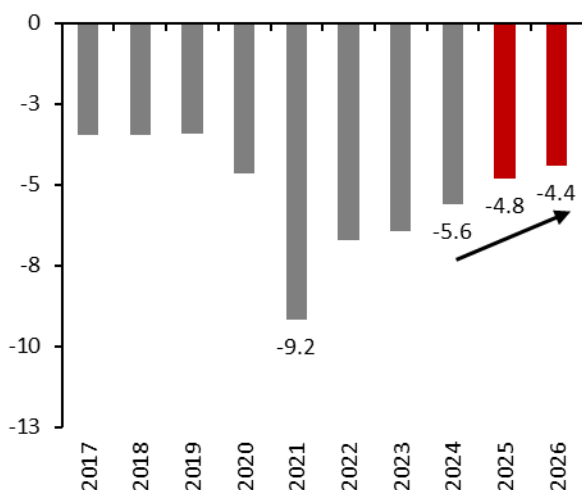


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Centre's fiscal deficit as % of GDP



Source: MOF, CEIC, DBS

- The Budget targets FY26 deficit at -4.4% of GDP, half from Covid highs.
- We find the fiscal consolidation roadmap credible.
- A forward-looking roadmap was outlined, to align deficit targets and debt levels.
- The budget has wide ranging measures to boost consumption, investment, and trade.
- Income tax relief to boost disposable incomes.
- Capital expenditure target is realistic; a reduction in revenue expenditure/GDP, helps consolidation.
- Gross borrowing was higher than consensus on account of higher redemptions.
- Implications for markets: We expect the borrowing program to be neutral for the bond markets.
- Focus will be on the RBI MPC rate review next; we expect a rate cut.

In essence

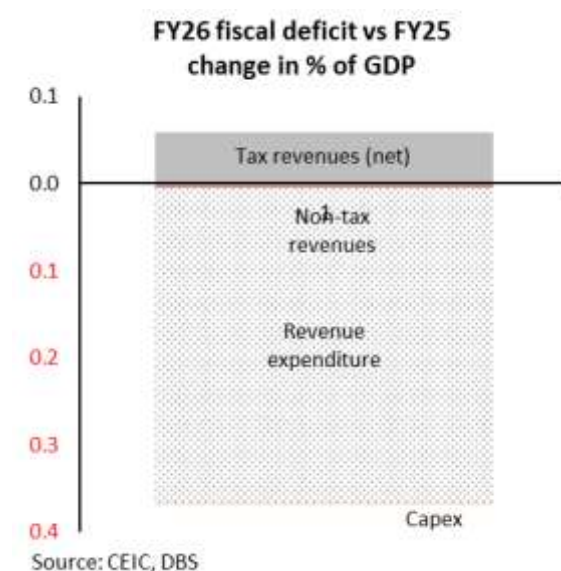
The Budget delivered on a dual mandate, supporting producers via improving the ease of doing business and lowering regulatory impediments, while consumers received tax relief along with measures to boost employment in the medium-term. Amongst the key focus areas were agriculture, MSMEs, clean tech industries, labour intensive segments (like toys, footwear), power, shipping, amongst others. In all, the Budget sought to steady the growth ship, by focusing on key engines i.e., consumption, capital investments, and external trade. Despite these wide-ranging priorities, there was an uncompromising focus on fiscal consolidation.

The Budget faces a few trade-offs, as slowing growth is at odds with faster fiscal consolidation. Encouragingly, lower revenue deficit (see table) will allow for consolidation without compromising on expenditure. Along our expectations, a forward-looking roadmap was also outlined, which sought to align the deficit targets with the debt levels by FY30. As we had highlighted in [India: Is it time to expand the fiscal target framework?](#), there are several moving parts in plans to lower debt levels.

Fiscal math

Consolidation and medium-term glide path.

The central government (GOI) remained committed to consolidating finances, with the deficit targets narrowing to -4.8% of GDP in FY25 and -4.4% of GDP (compared to indicative pegged -4.9% and -4.5% earlier). In addition to the near-term focus, a medium-term follow through was demonstrated by aligning deficit and debt levels. Under the FRBM arrangement, the GOI plans to keep fiscal deficit in each year (from FY 2026-27 till FY 2030-31) such that the Central Government debt is on declining path to attain a debt to GDP level of about 50±1 per cent by 31st March 2031 (the last year of the 16th Finance Commission cycle). We had discussed this likelihood in our [2025 Outlook](#).



FY25 Revised and FY26 Budget Fiscal math

	INR bn						as % of GDP			
	FY24 A	Feb'24 BE	Jul'24 Final RE	Feb'25 RE	FY26 BE (DBSf)	FY26 BE	FY24 A	FY25 RE	FY26 BE (DBSf)	FY26 BE
Revenue receipts	27290	31292	31292	30880	33300	34204	9.2	9.5	9.3	9.6
Tax revenue (net)	23273	25835	25835	25570	28300	28374	7.9	7.9	7.9	7.9
Non-tax revenue	4018	5457	5457	5310	5000	5830	1.4	1.6	1.4	1.6
Non-debt capital rec	597	780	780	590	400	760	0.2	0.2	0.1	0.2
Total expenditure	44434	48205	48205	47165	49800	50654	15.0	14.6	14.0	14.2
Revenue expenditure	34942	37094	37094	36981	38800	39443	11.8	11.4	10.9	11.0
Capital expenditure	9492	11111	11111	10184	11000	11211	3.2	3.1	3.1	3.1
Fiscal deficit	16547	16133	16133	15695.4	16100	15690				
% of GDP	-5.6	-4.9	-4.9	-4.8	-4.5	-4.4				
Nominal GDP	14.5	10.5	10.5	9.7	10.0	10.1				

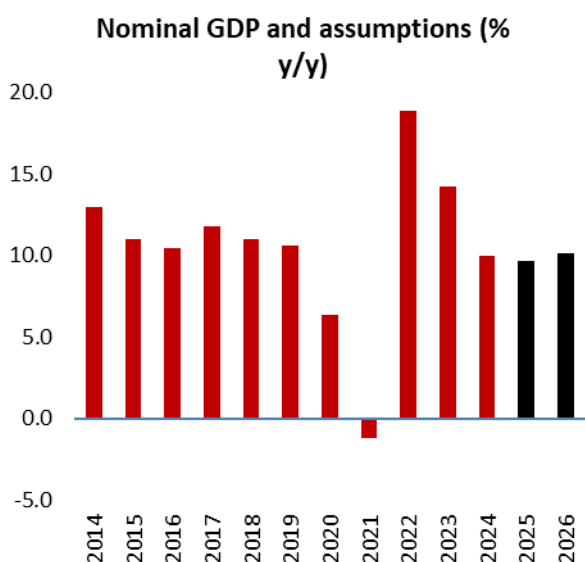
Source: Budget documents, DBS; * = based on revised nominal GDP of 9.7%

Key Ratios

Components (INR trn)	FY25 RE	FY26 BE
Fiscal deficit	15.69	15.69
% of GDP	-4.8	-4.4
Revenue deficit	6.10	5.23
% of GDP	-1.9	-1.5
Effective Revenue Deficit	3.10	0.97
% of GDP	-1.0	-0.3
Primary deficit	4.32	2.93
% of GDP	-1.3	-0.8
Central government debt (% of GDP)	57.1	56.1

Source: Budget documents, DBS

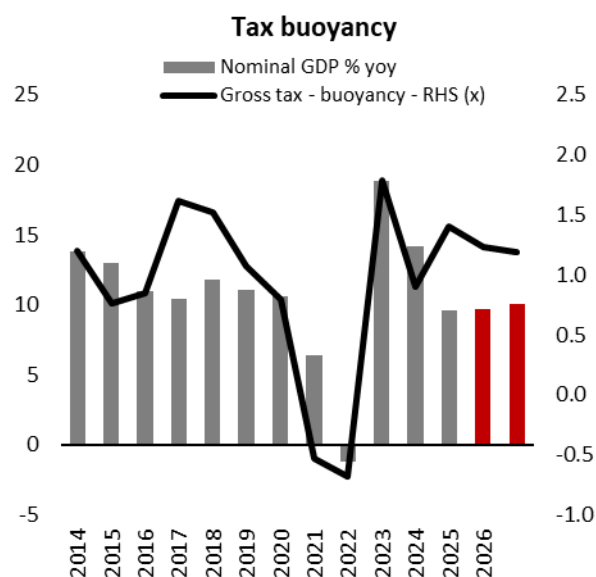
Realistic underlying assumptions. Nominal GDP growth is pegged at 10.1% yoy in FY26 (DBSf 10%), up a revised 9.7% in FY25. This marks a broad return to pre-Covid levels.



Source: CEIC, DBS

Revenues to stay firm. For direct taxes, revised estimates for FY25 point to income tax receipts growing by a faster pace than corporate collections, evident in the Apr-Dec24 run-rate. The FY26 gross tax to GDP is expected to be 12% from 11.9% this year, which is at achievable levels, as it is built on personal income tax growth (+20.3% this year), which continues to outpace nominal GDP growth. Gross tax

buoyancy is moderate at 1.2x in FY26, steady from this year (see chart).



Income tax relief. As a consumption boost, the tax exemption limit was raised to INR 1.2mn under the new tax regime. Tax rates of 20% will be applicable for income between INR 1.6mn and INR 2.0mn and 25% will be applicable for income between INR 2.0mn and INR 2.4mn. For income above INR 2.4mn, 30% tax is applicable. The GOI estimated that the total tax measures could result in INR 1trn (0.28% of GDP) in direct taxes and INR 26bn (0.01%) in indirect taxes in foregone revenues. This is likely behind the modest 14% increase expected in income tax collections next year vs 20% jump this year.

Total income tax returns rose to a record high in 2024, with returns filed till July 2024 at 72.8mn. Of these about 52.7mn filed in the new tax regime according to the official press release, compared to 20mn in the Old Tax Regime, which suggests over 70% have opted for the new regime. More are likely to migrate after the recent Budget tax relief.

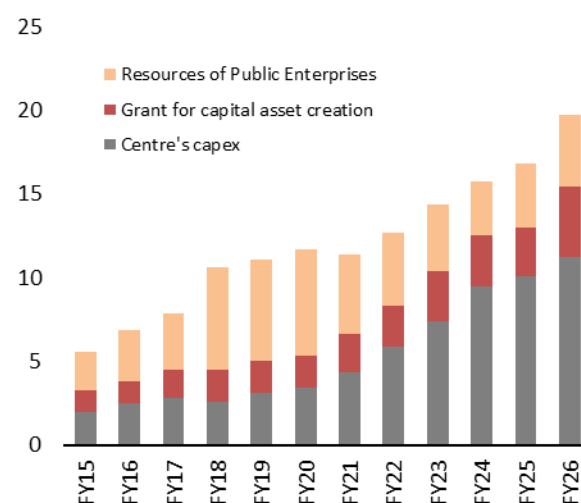
Non-tax revenues to be a potential windfall.

Non-tax revenues have been kept near steady at 1.6% of GDP, with dividends & profits expected to jump to INR 3.2trn. One of the potential windfalls here is a large transfer from the RBI dividends to the government's coffers in FY26, in a repeat of FY25 (INR 2.1trn), on the back of interest earned on securities as well earnings on FX transactions. On the latter, gross dollar selling has been sharply higher this year to defend the currency, which combined with a shift to historical cost accounting in the last few years, helping to boost earnings on foreign exchange transactions. Overall, the central bank's balance sheet is likely to expand due to broad liquidity support.

Spending – some hits & misses. For FY25, capital expenditure stands revised to INR 10.18trn vs budgeted INR 11.1trn. While there has been a late-year burst in disbursements in Dec-24, spending will need to grow by a significant 21% (vs FY25 RE figure) in the remaining three months of the year, which will be an uphill task. Similar prognosis will impact revenue expenditure, as well, suggesting overall expenditure could be lower than RE estimates.

Capex target moderates to realistic levels. For FY26, capex growth stands at a moderate but realistic ~10% yoy at INR 11.2trn versus a 25% CAGR in the past five years. Capacity constraints and slower disbursements have been impediments in the way of faster capex spending. With the GOI and Economic survey making a case for the private sector to also kickstart their investment cycle, we expect the capex allocations to stabilise at 3.0-3.2% of GDP over the next few years.

Considering cumulative capital expenditure, along with grant for capital asset creation and resources of PSUs, there is a sharp increase from FY24 and FY25, with the two segments outside of centre's capex rising notably in FY26.

Centre's Capital expenditure - INR trn

Source: Budget documents, DBS

Revex lends a hand with consolidation. Much of the planned consolidation in FY26 is on the back of lower revenue expenditure (11.4% of GDP to 11% in FY26). While subsidy allocations are due to witness a small fall, interest payments and servicing of debt is likely to rise (see appendix for main table). In line with the Budget's employment push, allocations towards labour, employment, and skill development are due to increase from 185bn in FY25 to INR 325bn in FY26 (BE). Reduced requirement towards capital infusion in BSNL and cut in transfers to the Guarantee Redemption Fund are also expected to help restrain FY26 spending.

Subsidies

Components	INR trn		% of GDP	
	FY25 RE	FY26 BE	FY25 RE	FY26 BE
Food Subsidy	1.97	2.03	0.6	0.6
Fertiliser	1.71	1.68	0.5	0.5
Petroleum	0.15	0.12	0.0	0.0
Interest subsidies	0.28	0.28	0.1	0.1
Others	0.16	0.15	0.1	0.0
Total Major Subsidies	4.27	4.26	1.3	1.2

Source: Budget documents, DBS

Focus areas

The entire list of measures is here in the [Budget speech](#).

- **Key priority groups.** Gareeb (poor), Yuva (youth, Annadata (farmers) and Naari (women) referred to as GYAN segments, were in the forefront of social assistance and development programs. This multi-faceted approach is likely to encompass changes towards the agricultural/ rural sector, boost manufacturing and furthering Make in India, supporting MSMEs, enabling employment-led development and securing energy supplies amongst others. Much support was also extended to the state of Bihar which is poll bound towards the end of the year.
- **Emphasis on ease of doing business.** Efforts are being complemented by a high-level committee for regulatory reforms. Concurrently, an investment friendliness index of states will be introduced. MSMEs also received support, by way of a revision in classification criteria, better access to credit through an enhanced credit guarantee cover as well as credit Cards for micro enterprises, amongst others.
- **Income tax changes** (covered earlier in the note). Net income tax bill will be tabled in mid-February.
- **Expand manufacturing activity and boost exports.** A National Manufacturing Mission covering MSMEs will be curated to support firms via policy support, execution roadmaps, and governance. Clean tech manufacturing is also in focus, aimed at domestic value addition and build an ecosystem for solar PV cells, EV batteries,

motors, amongst others. Custom tariff rates have been rationalized, including steps such as removal of seven tariff rates, and not levy more than one cess or surcharge to these rates. Asset monetisation scheme was launched worth INR10trn for 2025-30. The Production Linked Incentive (PLI) scheme received an increase, with sectors like IT hardware, pharmaceuticals, and ACC batteries witnessing significant increases in their budgets.

- **Skill development and employment.** A need to push labour intensive sectors like toys and footwear will be undertaken. As an offshoot of an emphasis on rural development, tourism and MSMEs, hiring is expected to increase.

Borrowings likely to be non-disruptive.

Gross borrowings were a bit higher than market expectations at INR 14.8trn, but closer to our estimate. This reflects the rise in redemptions at INR 3.3trn, net of which borrowings stand at INR 11.5trn. Of note, redemptions are higher in FY26 on account of Covid-19 pandemic led borrowings that are due for repayment in 2025. As a pre-emptive measure, the government has executed buybacks and switches in FY25 to address part of these loans, to ease pressure on the bond markets and prevent a large concentration of repayments in FY26. These repurchases are intended to lower the centre's liabilities and strengthen the fiscal position.

Financing of the fiscal deficit (INR trn)

	FY24	INR trn FY25 RE	FY26 BE
Market borrowings (net)	11.8	10.7	11.5
Market borrowings (gross)	15.4	14.0	14.8

Source: Budget documents, DBS

North block delivers, Mint Street (RBI) is next

The Reserve Bank of India monetary policy committee (RBI MPC) is scheduled will announce its rate decision on February 7.

Slew of liquidity measures introduced last month is expected to narrow the shortfall, improving policy transmission as the February rate review approaches. Providing liquidity is important, as is easing the price of that liquidity. Amidst decelerating inflation, a brief respite from a one-way dollar rally, signs of soft domestic demand, and ongoing fiscal consolidation, onus is on the monetary policy to assume a growth supportive tone.

New members of the MPC – three external members joined in Oct24, new Governor assumed office in Dec24 and Deputy Governor in Jan25 – have openly conveyed little on their policy bias, though recent actions suggest that the path is being paved for monetary easing. We expect a 25bp cut at the February meeting, marking a start to a shallow rate cut cycle.

Revenues breakdown

	INR bn			% yoy		% of GDP	
	FY24	FY25 RE	FY26 BE	FY25 RE	FY26 BE	FY25 RE	FY26 BE
Gross Tax Revenue	34655	38535	42702	11.2	10.8	11.9	12.0
Corporation Tax	9111	9800	10820	7.6	10.4	3.0	3.0
Taxes on Income	10448	12570	14380	20.3	14.4	3.9	4.0
Customs	2331	2350	2400	0.8	2.1	0.7	0.7
Union Excise Duties	3054	3050	3170	-0.1	3.9	0.9	0.9
GST	9572	10619	11780	10.9	10.9	3.3	3.3
Others	39	50	50				
Taxes of UTs	92	95	101				
Less - NCCD transfers	-88	-96	-104				
Less State's share	-11294	-12741	-14224				
Less States's share adj for prior		-128					
Net tax revenue	23273	25570	28374				
States share %	32.6	33.4	33.3				
				% yoy		% of GDP	
Interest receipts	383	340	477				
Dividends & Profits	1709	2893	3250				
Other non-tax revenue	1896	2046	2069				
Receipts of UTs	30	31	34				
Non-tax revenues	4018	5310	5830	32.2	9.8	1.6	1.6
Total Revenue receipts	27291	30880	34204				
Non-debt receipts	598	590	760				
Recovery of loans	266	260	290				
Others	331	330	470				
Debt receipts	16546	15695	15689				
Capital receipts	17144	16285	16449	-5.0	1.0	5.0	4.6

Source: Budget documents, DBS

Expenditure: Major variations between FY25 RE and FY26 BE

Heads (INRbn)	FY25	FY26	FY25	FY26
	RE	BE	RE	BE
	INR bn		% of GDP	
Interest payments	11379	12763	3.5	3.6
Grants in aid to states	441	1438	0.1	0.4
Defence	4567	4917	1.4	1.4
Capital outlay on eco servs	98	424	0.0	0.1
Loans & adv to states	1394	1706	0.4	0.5
Loans for resh	1	200	0.0	0.1
Labour, empt	185	325	0.1	0.1
Sec - eco servs	67	172	0.0	0.0
Cap outlay on comm	720	338	0.2	0.1
Misc general services	140	0	0.0	0.0
Other expend	28172	28370	8.7	7.9
Total	47165	50653	14.6	14.2

Source: Budget documents, press reports, DBS

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