Budget FY25 targets ambitious pace of fiscal consolidation on the back of lower subsidy and robust tax collections; focus on CAPEX remains

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- The interim budget delivered no significant announcement and continued to focus on the fiscal consolidation path while remaining growth supportive.
- For FY24, the fiscal deficit is estimated at 5.8% of GDP, lower than the market consensus of 5.9%. This is attributed to lower capital expenditure and higher non-tax revenue, which has more than offset the shortfall in divestment and higher subsidy expenditure.
- To achieve the medium-term fiscal deficit target of 4.5% by FY26, the government has pegged the fiscal deficit for FY25 at 5.1%, targeting a consolidation of 0.7 pp. This will be facilitated through continued robust growth in tax collection and rationalisation of subsidies.
- Focus on CAPEX remains (even though the pace of growth is estimated to be slower). Capital expenditure growth for FY25 is expected to moderate from 28.4% in FY24 to 16.9% (over FY24 RE).
- Revenue expenditure, on the other hand, is only expected to grow modestly (3.2%), led by higher interest payments, as the subsidy expenditure is expected to normalise due to the decline in fertiliser and fuel subsidies.
- Outlays for development sectors, including education, health, social welfare, and rural development, were increased.
- On the receipt side, the government expects gross tax revenue to grow by 11.5%, lower than the growth of 12.5% in FY24 RE. However, given that nominal GDP growth for FY25 is estimated to be higher than the FY24 estimate, this assumption seems conservative. Further, the divestment target remains largely unchanged from FY24 BE at Rs 50K crores.
- With a lower level of fiscal deficit for FY25, the government's gross borrowing is estimated at Rs 14.13 lakh crore down from Rs 15.43 lakh crore in FY24. This brought cheer to the bond market, and the benchmark 10-year G-sec was down by ~8 bps.
- The lower market borrowings of the government could potentially spur the crowding-in of private investment.

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FY25 budget strikes a balance between supporting economic growth through continued CAPEX and progress on fiscal consolidation

The government presented a vote-on-account budget today, which continued to remain growth-supportive while sticking to its fiscal consolidation path to achieve the target of 4.5% in FY26. Indeed, the government pegged the fiscal deficit target at 5.1% for FY25. Continued fiscal consolidation in FY25 will be enabled by robust growth tax collection and rationalisation of subsidies. Focus on CAPEX remains (even though the pace of growth is assumed to be slower). As largely anticipated, there were no significant announcements in the interim budget as the speech largely focused on the achievements of the existing government along with the government's long-term economic agenda of achieving inclusive growth and development.

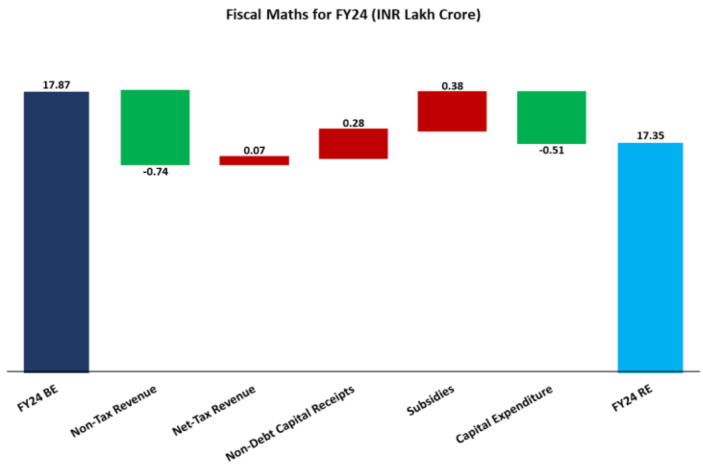
FY24 fiscal deficit is estimated at 5.8% of GDP, lower than the Budgeted Estimate of 5.9%

FY24 fiscal deficit is pegged at 5.8% of GDP, lower than the market consensus of 5.9%. After accounting for weaker than budgeted nominal GDP growth of 8.9% (vs 10.5%), the moderation in the level of fiscal deficit is attributed to lower capital expenditure and higher non-tax revenue which has more than offset the shortfall in divestment and higher subsidy expenditure.

On the receipts side, total non-debt receipts in FY24 are estimated to grow by 12.2%, higher than the budgeted growth of 10.6%. This is mainly attributed to a sharp increase in direct tax collection, particularly income tax. The income tax collection is estimated to grow by 22.7% in FY24, much higher than the budgeted growth of 8.1%. Anecdotal evidence suggests that the increase in income tax in the past few years is attributable to improvement in the taxation system, strengthening administration, and use of technology which has led to transparency around sources of income and increased tax compliance. Corporate tax growth has remained strong and came in line with the BE. Overall direct tax revenue is estimated to be higher than BE to the tune of Rs 1.2 lakh crore. Indirect tax collection is expected to be lower by 1.9% on account of the decline in excise duty and a slowdown in customs duty. The GST collection estimate is in line with the BE. On balance, gross tax revenue is expected to overshoot the BE by Rs 76K crore. Despite higher gross tax collections, net tax revenue was lower owing to the larger devolution of funds to the states. Non-tax revenue was higher on account of higher-than-budgeted dividend transfers from the RBI and PSUs.

The disinvestment target is revised downwards to Rs 30K crores from Rs 51K crores earlier. However, this still seems ambitious as the receipts so far are tracking at Rs 12.5K crores. With most of the projects, including IDBI Bank, Shipping Corp. of India, BEML Ltd, etc., in the various stages of divestment, the receipts are likely to be realised in FY25. On balance, total non-debt receipts are estimated to overshoot the budget estimate by Rs 39K crores.

Fiscal deficit expected to undershoot marginally in FY24



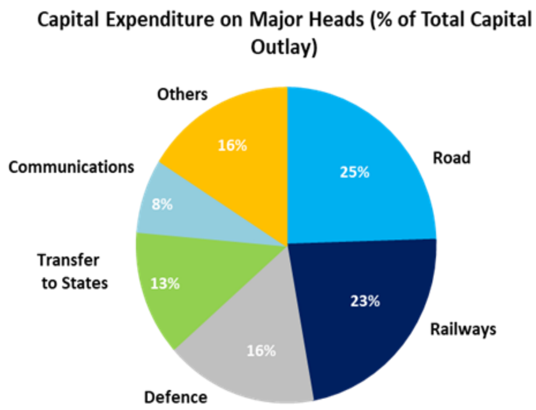
Source: Union Budget Documents.

Meanwhile, the total expenditure of the government is estimated to grow at 7.1%, marginally lower than the budgeted growth of 7.4%, led by lower capital expenditure and lower interest payments. Part of the shortfall in the CAPEX (Rs 51K crore) is being countered by the surge in the subsidy expenditure, led by the rise in input cost pressures for fertilisers and LPG price cuts for the fuel subsidy. Further, the government has revised the allocation for MNREGA subsidy at Rs 86K crore (from Rs 60K earlier), which we expect to be optimistic, given the current expenditure on the scheme is already tracking at Rs 89K crore. Overall, while the government estimates a marginally lower absolute fiscal deficit, we could see some slippage arising on account of higher MNREGA expenditure and lower disinvestment receipts.

Focus on fiscal consolidation continued - FY25 target pegged at 5.1%

In its commitment to achieve the medium-term fiscal deficit target of 4.5% by FY26, the government has pegged the fiscal deficit for FY25 at 5.1% - achieving a consolidation of 0.7 pp. This is slightly more aggressive than our estimate of 5.2%-5.3% of fiscal deficit for FY25. The fiscal space for the same has been created mainly through the rationalisation of subsidies. Even though the focus on CAPEX remains, the pace of growth has been reduced. Accordingly, the capital expenditure is pegged at a historic high of Rs 11.1 lakh crores in FY25, noting an increase of 16.9% over FY24 RE. Despite a slower increase in the capital expenditure, it is expected to reach 3.4% of GDP in FY25, up from its five-year pre-pandemic average of 1.7% of GDP and 3.2% of GDP in FY24, reflecting the government's continued focus on investment-led growth which is expected to crowd in private investment required to support economic growth. Ministry-wise the expenditure shows CAPEX in FY25 is expected to focus on roads which account for 25% of capital expenditure, railways 23%, defence 16%, and transfer to states 13% share and telecom 8% share.

CAPEX growth led by Road and Railways

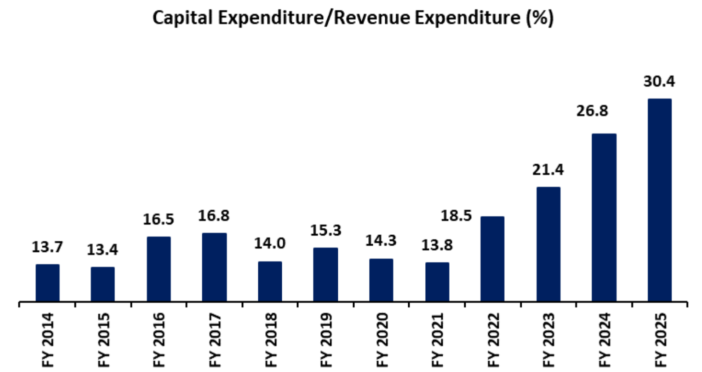


Source: Union Budget Documents; DMI Calculation

To provide further impetus to CAPEX, the central government has extended the interest-free 50-year loans to the state for capital expenditure for FY25 as well with an unchanged outlay of Rs 1.3 lakh crores. In FY24, these loans supported the capital expenditure by the state governments. Indeed, based on data[1] till November, the state government capital spending is tracking 44% above last year's levels. Overall, with the pace of the centre's capital spending expected to moderate in FY25, the private CAPEX will have to pick up to sustain growth momentum in FY25.

The government has continued to focus on improving the quality of expenditure as revenue expenditure is budgeted to grow by merely 3.2% against a higher growth in capital spending (16.9%). The increase in revenue expenditure is led by higher interest payments that are projected to grow by 12.8% amidst the elevated government borrowings in the past two years. Part of the increase in the interest payment is countered by the normalisation of subsidy expenditure – primarily fertiliser subsidy amidst easing commodity prices. Meanwhile, the food and fuel subsidy remained largely flat due to the extension of the free food program and the increase in the coverage of Ujjwala Yojna. Indeed, the subsidy expenditure of the government is estimated to decline by 7.8% in FY25 and is expected to reach 1.2% of GDP from 1.4% in FY24 RE and 1.9% in FY23 and FY22. Additionally, the government also announced increased outlays for development sectors including education, health, social welfare, and rural development.

Capital-revenue expenditure ratio reaches its multi-decadal highs



Source: Union Budget Documents; CMIE

Fiscal Metrics					As % of GDP				%YoY				
INR Lakh Crore	FY 23 A	FY24 BE	FY 24 RE	FY 25 BE	FY23 A	FY24 BE	FY24 RE	FY25 BE	FY23 A	FY24 BE	FY24 RE	FY25 BE over FY24 RE	FY25 BE over FY24 BE
Revenue Receipts	23.83	26.32	27.00	30.01	8.7	8.7	9.1	9.2	9.8	10.5	13.3	11.2	14.0
Net Tax Revenues	20.98	23.31	23.24	26.02	7.7	7.7	7.8	7.9	16.2	11.1	10.8	11.9	11.6
Gross Tax Revenues	30.54	33.61	34.37	38.31	11.2	11.1	11.6	11.7	12.7	10.0	12.5	11.5	14.0
Direct Tax	16.59	18.23	19.45	21.99	6.1	6.0	6.6	6.7	17.8	9.9	17.2	13.1	20.6
Corporate Tax	8.26	9.23	9.23	10.43	3.0	3.1	3.1	3.2	16.0	11.7	11.7	13.0	13.0
Income Tax	8.33	9.01	10.22	11.56	3.1	3.0	3.4	3.5	19.7	8.1	22.7	13.1	28.4
Indirect Tax ex GST	5.33	5.73	5.23	5.50	2.0	1.9	1.8	1.7	-10.5	7.5	-1.9	5.2	-3.9
Customs	2.13	2.33	2.19	2.31	0.8	0.8	0.7	0.7	6.8	9.2	2.5	5.8	-0.8
Union Excise Duty	3.19	3.39	3.04	3.19	1.2	1.1	1.0	1.0	-19.2	6.3	-4.8	5.0	-6.0
Service Tax	0.00	0.01	0.01	0.00	0.0	0.0	0.0	0.0	-57.4	16.0	16.0	-80.0	-80.0
GST	8.49	9.57	9.57	10.68	3.1	3.2	3.2	3.3	21.6	12.7	12.7	11.6	11.6
Taxes of union territory	0.09	0.08	0.08	0.09	0.0	0.0	0.0	0.0	15.8	-3.5	-4.4	13.1	12.1
less states share	9.48	10.21	11.04	12.20	3.5	3.4	3.7	3.7	5.6	7.7	16.5	10.4	19.4
less NCCD transferred	0.08	0.09	0.09	0.09	0.0	0.0	0.0	0.0	30.5	9.7	10.0	7.3	7.5
Non-Tax Revenues	2.85	3.02	3.76	4.00	1.0	1.0	1.3	1.2	-21.8	5.7	31.7	6.4	32.5
Non-Debt Capital Receipts	0.72	0.84	0.56	0.79	0.3	0.3	0.2	0.2	83.4	16.3	-22.4	41.1	-6.0
Disinvestments	0.46	0.51	0.30	0.50	0.2	0.2	0.1	0.2	237.8	10.8	-34.8	66.7	-2.0
Total Receipts	**24.55**	**27.16**	**27.56**	**30.80**	**9.0**	**9.0**	**9.3**	**9.4**	**11.1**	**10.6**	**12.2**	**11.8**	**13.4**
Total Expenditure	**41.93**	**45.03**	**44.90**	**47.66**	**15.4**	**14.9**	**15.1**	**14.5**	**10.5**	**7.4**	**7.1**	**6.1**	**5.8**
Revenue Expenditure	34.53	35.02	35.40	36.55	12.7	11.6	11.9	11.2	7.9	1.4	2.5	3.2	4.4
Interest Payments	9.29	10.80	10.55	11.90	3.4	3.6	3.6	3.6	15.3	16.3	13.7	12.8	10.2
Capital Expenditure	7.40	10.01	9.50	11.11	2.7	3.3	3.2	3.4	24.8	35.3	28.4	16.9	11.0
Fiscal Deficit	**17.38**	**17.87**	**17.35**	**16.85**	**6.4**	**5.9**	**5.8**	**5.1**					

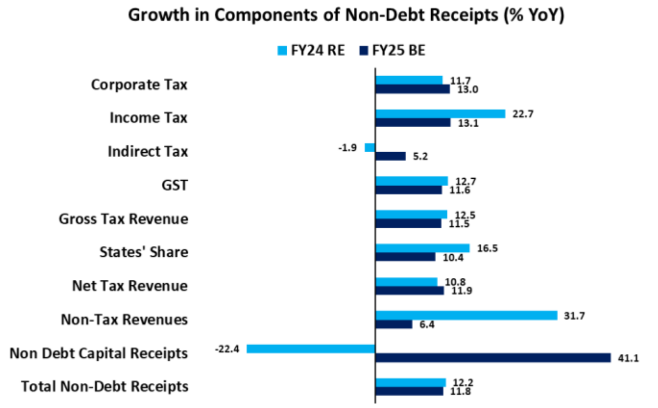
Source: Union Budget Documents; Note: BE - Budget Estimates; RE - Revised Estimates; A - Actuals

[1] Based on data of 24 states

Robust tax collection growth is expected to continue in FY25; assumed growth seems conservative

For FY25, the government is targeting total non-debt receipts growth of 11.8% over FY24 RE. It expects robust growth in tax revenue, particularly direct tax, and GST, to continue in FY25, as growth in indirect taxes ex. GST remains subdued. Overall, the gross tax revenue growth target of 11.5% looks reasonable in the context of a nominal growth assumption of 10.5%. However, given that FY25's assumption of nominal growth is higher than the 8.9% growth expected in FY24, the tax revenue growth assumptions look conservative and carry an upside risk. With lower growth in the states' share in revenue, the net tax revenue growth is expected to jump to 11.9%, compared with 10.8% in FY24. Non-tax revenue in FY25 is projected to grow by 6.4% compared with 31.7% in FY24. The sharp slowdown in growth is owing to an adverse base effect (in FY24 non-tax revenue growth was remarkably high owing to higher-than-expected dividend transfer from the RBI). The divestment target is left largely unchanged from FY24 BE at Rs 50K crores.

Non-debt receipts growth is projected to moderate in FY25



Source: Union Budget Documents, CMIE

Positive surprise on government borrowings

For FY24, a lower-than-budgeted fiscal deficit led to a decline in short-term market borrowings while the dated securities borrowings remained largely unchanged – financing 68% of the total fiscal deficit. For FY25, both the gross and net borrowing are budgeted to decline to Rs 14.13 lakh crore (from Rs 15.43 lakh crore) and Rs 11.75 lakh crore (from Rs 11.8 lakh crore) respectively as the finance minister emphasised the need to reduce government borrowing to not crowd out the private players. Meanwhile, the reliance on small saving schemes is expected to remain high, financing 27.7% of the fiscal deficit up from 27.2% in FY24 RE. With lower-than-expected market borrowings, the market reacted positively as the 10-year benchmark G-sec yield was down by ~8 bps at the end of the session.

Sources of funding the deficit

INR Lakh Crores	FY23 A	FY24 BE	FY24 RE	FY25 BE
Fiscal Deficit (A)	**17.38**	**17.87**	**17.35**	**16.85**
Fiscal Deficit (% of GDP)	**6.4**	**5.9**	**5.8**	**5.1**
Sources of Funding	**FY23 A**	**FY24 BE**	**FY24 RE**	**FY24 BE**
Net Short Term Borrowings + Switches	1.10	0.50	0.01	0.50
External Finance	0.37	0.22	0.25	0.16
Securities Issued Against Small Savings	3.96	4.71	4.71	4.66
State Provident Fund (Net)	0.05	0.20	0.05	0.05
Other Receipts (Net)	0.83	0.54	0.78	-0.31
Drawdown of Cash Balances	-0.02	-0.12	-0.27	0.04
Net G-sec Borrowing (B)	11.08	11.81	11.80	11.75
Total Funding of Deficit	17.38	17.87	17.35	16.85
Redemption + Buy Back (C)*	3.13	3.62	3.63	2.38
Gross Borrowing (B+C)	**14.21**	**15.43**	**15.43**	**14.13**
Net Borrowing as % of Fiscal Deficit	**63.8**	**66.1**	**68.0**	**69.7**

Source: Union budget documents; Note - *redemption is net of recovery from GST compensation fund for FY24 RE and FY25 BE.

The table below summarises some additional announcements made in the FY25 budget speech:

Category	Announcement
PM Awas Yojana (Grameen)	The target of three crore houses is set to be achieved despite COVID challenges. Two crore houses are announced for next five years.
Rooftop Solarisation	One crore households to obtain 300 units free electricity every month through rooftop solarisation.
Ayushman Bharat	Healthcare cover under the scheme to be extended to all ASHA workers, Anganwadi Workers and Helpers.
Matsya Sampada	Five integrated aquaparks will be setup.
Research & Innovation	A corpus of Rs.1 lakh crore to be established with 50-year interest free loan to provide long-term financing or refinancing with long tenors and low or zero interest rates. This will encourage the private sector to scale up research and innovation significantly in sunrise domains.
	A new scheme named 'atmanirbharta' is set to be launched, aiming to strengthen deep-tech technologies for defence purposes.
Railways	Under PM Gati Shakti initiative three major economic railway corridor programs focused on improving logistics efficiency and reducing costs in energy, mineral, and cement corridors, port connectivity corridors, and high-traffic density corridors.
	Forty thousand normal rail bogies are to be converted to Vande Bharat standards.
Green Energy	Viability gap funding will be provided for harnessing offshore wind energy potential for initial capacity of 1 GW.
	Coal gasification and liquefaction capacity of 100 MT to be set up by 2030.
	Phased mandatory blending of compressed biogas (CBG) in compressed natural gas (CNG) for transport and piped natural gas (PNG) for domestic purposes to be mandated.
Tourism Sector	States to receive long-term interest-free loans for development on a matching basis and are encouraged to undertake comprehensive initiatives, including global branding and marketing, for iconic tourist centres.
	Framework for rating of the tourist centres based on quality of facilities and services to be established.
Taxes	No changes in direct or indirect taxes were introduced. However, certain tax benefits to start-ups and investments made by sovereign wealth or pension funds as also tax exemption on certain income of some IFSC units which are due to expire on 31st March 2024, were proposed to be extended by 1 year.
	Proposal to withdraw petty, non-verified, non-reconciled or disputed outstanding direct tax demands up to Rs. 25,000 pertaining to the period up to FY2009-10 and up to Rs. 10,000 for fiscal years FY2010-11 to FY2014-15. This is expected to benefit about a crore taxpayers.
State Reforms	A provision of Rs.75,000 crore rupees as fifty-year interest free loan is proposed to support milestone-linked reforms by the State Governments.

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