Budget FY2025-26 – A Review

Budget FY2025-26: Reviving Consumption

Highlights:

- ***Gross fiscal deficit is estimated to be at 4.4%, leading to a fiscal consolidation of 0.4 percentage points in FY2025-26***
- ***Capital Expenditure estimated at ₹11.2 Lakh Crore in FY2025-26***
- ***Gross borrowings to be ₹14.8 Lakh Crore for FY2025-26.***
- ***FY2024-25 gross fiscal deficit is now lower by 0.1 percentage point at 4.8%.***
- ***Nominal GDP growth for FY2025-26 is estimated at 10.1% over the previous year.***

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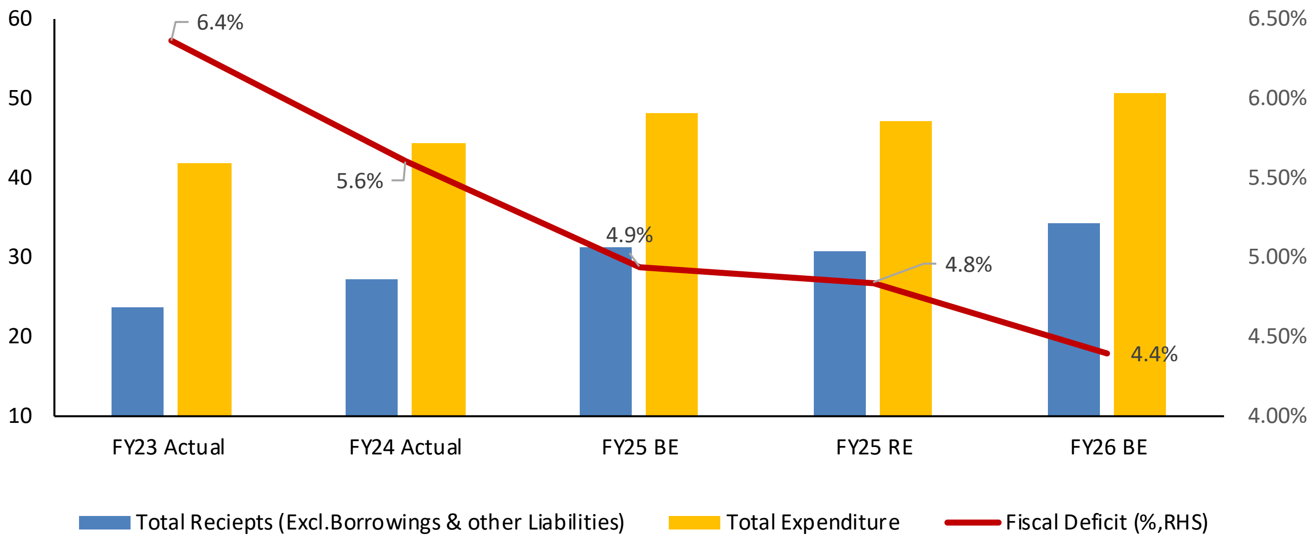
The Union Budget for FY2025-26, conveys a sense of acceptance of the burden of taxation that was at least partially causing a slowdown in the economy's consumption. For the bond markets there is little or no relief as gross market borrowings have been flattish to slightly higher than market estimates. Nothing out of the blue, though nothing that would bolster sentiment either. We expected a gross borrowing of ₹ 14.7 lakh crore, and the budget estimates are only marginally higher. The fiscal deficit too, has been steadily declining from 6.4 per cent in FY2022-23 to below 4.5 per cent in FY2025-26, indicating the Government's unwavering focus on fiscal consolidation. The path that the Center has taken will lead to more degrees of freedom for RBI to initiate monetary policy easing soon. We expect the MPC to cut interest rates by 25 basis points in the coming policy announcement post the Budget.

The important themes running through the budget are reducing the tax burden for the common tax payer to boost consumption and keeping the focus on improving the quality of spending by the Government. In FY2024-25, a significant 3 per cent of GDP ₹11.1 lakh crore was to be deployed in capital expenditure, which has now been reduced to ₹ 10.2 lakh crore in the revised estimates, looking at the pace of capital expenditure in the past year. Though this downward revision has been done, for FY2025-26 there is an estimated ₹ 11.2 lakh crore of capital spending to be done. Though towards the end this estimate might also be revised downwards, it signals the intent of the Government to push growth through the right mix of investment and consumption.

Though delayed in action, the Government has realized that for any private investment to pick up, there has to be a positive story unfolding for consumption, and aggregate demand has to be bolstered. In this light, it is only fitting that the central bank cut policy rates to begin a long process of bringing consumption on track. Easier policy rates and the tax relief should lead to a positive growth push.

Chart 1:Fiscal Snapshot (₹ Lakh Crore, Per Cent)



Source: Union Budget Documents

I. Revenues- Continued realism

The Union Budget for FY2025-26 has conveyed a growth of 11.1 per cent in total receipts (excl. borrowing and other liabilities), slightly higher than the estimated nominal GDP growth of 10.1 per cent reckoned for FY2025-26. The growth in revenue receipts is 10.8 per cent. The two largest revenue earning streams i.e. corporate taxes and personal income taxes are estimated to grow at 10.4 per cent and 14.4 per cent respectively. This estimation can be looked at with some skepticism as the tax exemption limit has been raised from a former ₹7 lakhs to ₹12 lakhs in the new regime and the estimated revenue forgone for the Central Government is estimated to be ₹1 lakh crore. The consumption propensity of different classes differs according to the varied levels of disposable income and hence it would be presumptuous to assume that the boost to consumption will be instantaneous. It would likely be spread out over the coming quarters.

Corporate taxes have been assumed to grow at 10.4 per cent, which also reinforces the argument that for consumption to kick start investment, there will be needed evidence from the economy that consumption has increased from the current 6 per cent to at least 8-10 per cent. This shift has to happen on the average level and the present tax reform is necessary but not sufficient to propel the economy on the high consumption growth path.

Table 1: Government Receipts (in ₹ Lakh Crore)				
	Actual	BE	RE	BE
	FY2023-24	FY2024-25	FY2024-25	FY2025-26
Revenue Receipts	**27.29**	**31.29**	**30.88**	**34.20**
Tax Revenue (Net)	23.27	25.83	25.57	28.37
Non-Tax Revenue	4.02	5.46	5.31	5.83
Capital Receipts	**17.14**	**16.91**	**16.28**	**16.45**
Recovery of loans	0.27	0.28	0.26	0.29
Other Receipts	0.33	0.50	0.33	0.47
Borrowings and Other Liabilities	**16.54**	**16.13**	**15.69**	**15.69**
Total Receipts	**44.43**	**48.20**	**47.16**	**50.65**
Source: Union Budget Documents, STCI PD Research				

The Government has continued with its conservative approach in accounting for revenues both from the tax and non-tax sources. Over the revised estimates of FY2024-25, revenue receipts are estimated to grow at a rate of 10.8 per cent as compared to a higher pace of 13 per cent estimated in the revised figures for FY2024-25.

In the revised estimates for non-tax revenues, a growth rate of 32.2 per cent is accounted for over the actuals of FY2023-24, due to the significant dividend payout worth ₹ 2.11 lakh crore transferred by RBI to the Central Government. The magnitude of the payment might be lesser in the coming financial year and the Government has been realistic with the growth of non-tax revenues estimated to be around 10.8 per cent over previous year's revised estimates.

The annual divestment target for FY2024-25 has been revised downwards to ₹ 0.33 lakh crore from the budgeted estimate of ₹ 0.50 lakh crore as there has been no significant progress in divestment. The Government has accounted for a ₹ 0.47 lakh crore worth of divestment for FY2025-26, which appears slightly on the higher side and is expected to be revised lower at the end of the year. Though this will probably not make any material difference to the fiscal deficit in FY2025-26, as a source of non-tax revenue divestment appears to be less effective.

Table 2: Tax Break - Up (In ₹Lakh Crore)				
	FY2023-24(Actuals)	FY2024-25(BE)	FY2024-25(RE)	FY2025-26(BE)
Gross Tax Revenue	**34.66**	**38.40**	**38.53**	**42.70**
Corporation Tax	**9.11**	**10.20**	**9.80**	**10.82**
Taxes on Income	**10.45**	**11.87**	**12.57**	**14.38**
Wealth Tax	**0.00**	**0.00**	**0.00**	**0.00**
Customs	**2.33**	**2.38**	**2.35**	**2.40**
Union Excise Duties	**3.09**	**3.24**	**3.10**	**3.22**
Service Tax	**0.00**	**0.00**	**0.00**	**0.00**
Goods and Services Tax	**9.57**	**10.62**	**10.62**	**11.78**
Taxes on Union Territories	**0.09**	**0.09**	**0.09**	**0.10**
Less - Transfers to Funds	**0.09**	**0.09**	**0.10**	**0.10**
Less - State's share	**11.29**	**12.47**	**12.74**	**14.22**
Less state's share adjustment	-	-	**0.13**	-
Centre's Net Tax Revenue	**23.27**	**25.83**	**25.57**	**28.37**
Source: Union Budget Documents				

II. Expenditure Side- Keeping the quality of spending intact

The size of expenditure in the budget has undergone change since the previous year as far as the proportion of capex is concerned with capital spending jumping to slightly above 3 per cent of GDP, from the earlier 2.7 per cent in FY2022-23. Revenue expenditure is estimated to grow by ~7 per cent for FY2025-26. The main drivers of revenue expenditure remain the expenditure of the Government on its interest payments which has grown over the pervious year by 12 per cent and in absolute terms amounting to ₹ 12.8 lakh crore, almost 3.6 per cent of GDP. Interest payments are slightly higher than the capital expenditure budgeted and it is in this light that the importance of reducing the outstanding debt as a percentage to GDP assumes importance going ahead.

The other two major drivers of revenue expenditure are the expenditure on defense and pensions, growing at 8 per cent and 1 per cent respectively. As a percentage of GDP, both defense spending and the pension expense for the Government are unchanged at 1.4 per cent and 0.8 per cent respectively.

Table 3: Expenditure Break Up (₹ Lakh Crore)				
	Actuals	**BE**	**RE**	**BE**
	FY2023-24	**FY2024-25**	**FY2024-25**	**FY2025-26**
Revenue Expenditure	34.94	37.09	36.98	39.44
Capital Expenditure	9.49	11.11	10.18	11.21
Total Expenditure	**44.43**	**48.21**	**47.16**	**50.65**
Key Expenditure				
Interest payments	10.64	11.63	11.38	12.76
Defence	4.45	4.55	4.57	4.92
Pension	2.38	2.40	2.75	2.77
Food Subsidy	2.12	2.05	1.97	2.03
Fertilizer Subsidy	1.88	1.64	1.71	1.68
Education	1.23	1.26	1.14	1.29
Transport	5.27	5.44	5.41	5.49
Source: Union Budget Documents				

For FY2025-26 capital spending has been revised slightly downward by 0.3 percentage points, from 3.4 per cent of GDP to 3.1 per cent in FY2025-26. In absolute terms, and looking at the pace of spending which remained sluggish during the year due to the model code of conduct implemented during the general elections in FY2024-25, the Government has estimated the capex spending for FY2025-26 at a growth rate in line with the nominal GDP growth of 10.1 per cent over the revised estimates, which is realistic.

Though the year end estimates might fall short marginally, the pace of capex this year should be better than the previous year as this year is not encumbered by elections and headline growth is in severe need of mending which could partially be corrected by a robust capex, especially in light of the new and uncertain external environment.

III. Sources of Financing Fiscal Deficit

Fiscal deficit for FY2025-26 is estimated to be ₹ 15.7 lakh crore, which is 4.4 per cent of the nominal GDP, and as mentioned above 0.1 percentage point below the target of 4.5 per cent of GDP. This is lower than the ₹ 16.13 lakh crore of the budget estimates for FY2024-25, and flat as compared to the revised estimates of ₹15.7 lakh crore for FY2024-25, in absolute terms. This is also an effect of the nominal GDP growth, as the nominal GDP has grown from ₹324 lakh crore to ₹ 356 lakh crore for FY2025-26, in addition to the higher pace reckoned for revenue receipts at 11 per cent, while expenditure is estimated to grow at 7 per cent for FY2025-26.

Net market borrowings (G-sec+T Bills) is estimated to finance 74 per cent of the fiscal deficit, higher than the previous year's budgeted 69 per cent of fiscal deficit and the recent years where net borrowings would finance within the range of 66-69 per cent of the fiscal deficit. As of now the Government has not factored in any buyback, though it has accounted for a switch of ₹ 2.5 lakh crore for FY2025-26.

Table 4: Sources of Financing the Fiscal Deficit (In ₹ Lakh Crore)

		Actuals	BE	RE	BE
		FY2023-24	**FY2024-25**	**FY2024-25**	**FY2025-26**
	Debt Receipts				
1	Market Borrowings (net)*	12.31	11.13	10.43	11.54
	Dated (net)	11.78	11.63	11.63	11.54
	T-Bills (net)	0.53	-0.50	-1.20	0.00
2	Securities Against Small Savings	4.51	4.20	4.12	3.43
3	State Provident Funds	0.05	0.05	0.05	0.05
4	Other receipts	-0.89	-0.81	0.26	0.41
5	External Debt	0.55	0.16	0.32	0.23
6	Draw down of cash balance	0.01	1.40	0.52	0.02
7	Fiscal Deficit (Sum of 1 to 6)	**16.55**	**16.13**	**15.70**	**15.69**

*Note: *Market borrowings is not adjusted for buyback of securities during RE FY2024-25; Source: Union Budget Documents*

For other major sources of financing the Government has been very conservative and short-term borrowings via T Bills, on a net basis is nil for FY2025-26 as compared to redemptions of ₹ 1.2 lakh crore in the previous year. Moreover, the other large source of financing, i.e. Securities issued against small savings has been declining, since FY2023-24, from 27 per cent of the fiscal deficit to 22 per cent in FY2025-26.

IV. Market Borrowings

Gross market borrowings were slightly higher than market expectations at ₹14.82 lakh crore for FY2025-26, and also higher than ₹14.01 lakh crore borrowed by the Government in the previous year. The gross borrowing is a sum of the net market borrowings and redemptions for FY2025-26. As per the budget estimates, redemptions for FY2025-26 are estimated at ₹3.28 lakh crore. The actual redemption for FY2025-26 is ₹3.95 lakh crore though like the previous year the Government shall fund ₹ 0.67 lakh crore from the GST compensation fund. This is also assuming no buybacks and factoring in a switch of ₹2.5 lakh crore.

Table 5: Market Borrowings (in ₹ Lakh Crore)				
	FY24 (Actual)	**FY25(BE)**	**FY25(RE)**	**FY26(BE)**
Gross Market Borrowings (1+2+3-4)	15.43	14.01	14.00	14.82
1. Net Market Borrowings	11.78	11.63	10.75	11.54
2. Redemption*	4.41	3.61	4.49	3.96
3. Switches	0.03	0	0	0
4. Borrowing for providing back-to-back loan to States and UTs for GST compensation cess shortfall	0.78	1.23	1.23	0.68
**Redemption includes buyback; Source: Union Budget Documents*				

The Government has estimated a WMA of ₹ 5 lakh crore and CMB issuances of ₹0.5 lakh crore for FY2025-26. Assuming the Government plans to front load the borrowing with a 60 per cent weight in H1FY2025-26, the average auction size for dated borrowings could be ₹0.32-0.34 lakh crore.

V. Outlook:

This is the last year of the term of the 15th Finance commission and the Central government has delivered on its promise of maintaining the fiscal deficit below the prescribed 4.5 per cent of GDP. The Central Government will be shifting to a debt-to-GDP target which will afford more flexibility. As per the FY2025-26 budget the Central debt is to be 50 per cent with a tolerance of 1 per cent to be achieved by March 31, 2031. The Central debt will become an anchor of fiscal policy beginning FY2026-27, which means within four years outstanding Central Government debt has to decline by approximately 15-20 per cent. This is a challenging task, given the uncertainties facing the Government on account of the risks emanating from geo-politics and geo-economics, and completely force majeure factors such as climate change.

The consumption boost from the tax relief that was given by way of increasing the exemption limit will take some time to manifest in economic growth, and the respective push of the Government to increase capex and manufacturing activity, specifically technological industries should be beneficial in the medium term. The focus and achievement of the fiscal targets will open up room for the central bank to ease monetary policy and we expect a 25-basis point interest cut in the upcoming MPC meeting outcome on February 7, 2025.

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