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EXPERT VIEW

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# CAPEX TARGET SHOULD BE SET AT 3.1% OF GDP

India's recent growth outcomes have been shaped to a significant extent by the Government of India's (GoI) capital expenditure. The post-pandemic recovery in real GDP growth was supported by large expansions in the GoI's capex, to the tune of ~30% per annum during FY21-24. As a proportion of GDP, such capital spending had nearly doubled to 3.2% in FY24 from 1.7% in FY20, although a part of this is admittedly on account of off-budget capex that has now come on budget.

Likewise, the recent slowdown in GDP growth, to 6.0% in H1 FY25 from 8.2% in FY24, has been partly driven by a slump in the GoI's capital expenditure, which has witnessed a double-digit decline during this period, owing to the general elections in Q1 and the excess rainfall during the monsoon. Consequently, the GoI capex-to-GDP ratio fell to 2.7% during this period, i.e. H1 FY25.

Given this context, ramping up the GoI's capex would play an important role in supporting growth outcomes in the near term, particularly when considerable global uncertainties abound and could pose downside risks to GDP expansion in FY26.

With a contraction in the GoI's capex during April-November 2024, the FY25 target of ₹11.1 trillion appears set to be missed by a considerable margin of around ₹1.4 trillion. Our assessment suggests that there is space for the GoI's capex target to be set at ₹11 trillion for FY26, similar to the budget estimate for FY25, which would entail a reasonably healthy expansion of ~12-13% in the coming fiscal. Moreover, this would imply a capex-to-GDP ratio of ~3.1% in FY26, marginally higher than the 3.0% expected in FY25, which is quite commendable.

A target of ₹. 11 trillion would enable a robust growth in the expenditure on roads and railways in FY26. This, along with the healthy pipeline of projects, would augment the execution of national highways in the next fiscal, which is expected to decline to ~10,000-10,500km (27-29 km/day) in FY25 from 12,349km in FY24. Additionally, this would enable the railway ministry to continue with upgrading track infrastructure and rolling stock, including passenger and goods wagons, and also focus on safety-related enhancements along with station modernization.

Additionally, we expect the government to allocate funding to operationalize the announcements pertaining to the MSME sector, that were made in the FY25 budget, including a credit guarantee scheme to facilitate loans for the purchase of machinery and equipment without collateral or third-party guarantee. This would ensure credit flow to the MSMEs, thereby boosting private capex, exports and job creation.

**GDP growth slowed to 6.0% in H1 FY25 from 8.2% in FY24, partly driven by a slump in capex**

Additionally, the government's focus on facilitating access to affordable housing is also expected to support continued construction activity. A hike in the revenue expenditure of ₹84,700 crore that was budgeted for the PM Awas Yojana (PMAY) – rural and urban – in FY25, would augment the demand for construction inputs such as cement and steel, thereby providing some boost to core sector output.

On the power front, the government had launched the PM Surya Ghar Muft Bijli Yojana (PMSGMBY) in the FY25 budget, with the aim of increasing the adoption of solar rooftop capacity. It had budgeted ₹6,250 crore for the same for the ongoing fiscal. Owing to the strong demand for rooftop installations from the residential segment, the expenditure on this scheme is expected to witness a robust increase in FY26. While the allocation for this scheme is not accounted for under the GoI's capex, it would provide an impetus to household capex.

What about spending of the state governments? The allocation for the 50-year interest free capex loan to the states has been ramped up multifold to ₹1.5 trillion in FY25 from the modest ₹11,800 crore in FY21, the first year of its introduction. However, its utilisation has been tepid this year, at ₹60,100 crore up to November 2024. In our view, the outlay for this scheme could be kept unchanged at ₹1.5 trillion in FY26, similar to the budget estimate for FY25. However, we expect a relatively larger proportion of this amount to be made 'untied' relative to that in FY25, given the subdued offtake in this amount so far. This would augment the states' capacity to spend on sectors such as water supply and sanitation, roads and bridges, irrigation, energy and health, based on their individual priorities.

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