BUDGETING FOR GROWTH

EXPERT VIEW

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India's growth outlook has turned less rosy of late, raising expectations around policy support from the Central government, with the Union budget just around the corner.

The First Advance Estimates (FAE) for FY25 released by the National Statistical Office (NSO) pegged GDP expansion at 6.4% for the fiscal. To be fair, this will exceed the growth of most large economies in the world. However, it is substantially lower than the 8.2% logged in FY24, and also a shade below the range of 6.5-7.0% that the Economic Survey had projected. Further, the outlook for FY26 appears increasingly clouded with sizeable risks stemming from global developments.

Given this context, the upcoming budget for FY26 assumes accentuated importance. While expectations will be high for the government to ensure some growth support to the economy, it will be equally critical to demonstrate continued fiscal consolidation.

One of the fiscal and growth nuances of FY25, a year of Parliamentary elections, has been the slowdown in government capital spending during the election quarter. We foresee a large miss to the tune of ₹1.4 trillion, relative to the capex target of ₹11.1 trillion, which had seemed quite ambitious at the get-go. Further, the lower growth impulse is contributing to a smaller-than-budgeted nominal GDP for the fiscal. On balance, we project the Centre to end up with a fiscal deficit of 4.8% of GDP in FY25 vis-à-vis the target of 4.9%.

From this base, the government could factor in an additional fiscal consolidation of 25-30 bps to 4.5% of GDP in FY26, an absolute amount of ₹16 trillion. It may not be prudent in a growth sense to restrict the fiscal deficit below 4.5% of GDP, as was mentioned in the medium-term path of the July 2024 budget. The fiscal space could be channelised to support economic activity in FY26 via raising the capital outlay.

Assuming a nominal GDP growth of ~10% for FY26, mildly higher than the NSO's estimate of 9.7% for FY25, and a tax buoyancy of ~1.1, we estimate gross tax revenue to rise by 10.5% in FY26.

However, we have pencilled in a modest decline in non-tax revenue in the fiscal, amid expectations that interest rate cuts in the major economies would weigh on the RBI's foreign earnings and, consequently, its dividend payout as compared with the record ₹2.1 trillion seen in FY25.

Our estimates suggest that the Centre will be able to raise its total expenditure by ~7% to ₹50.5 trillion in FY26. Within this, we believe the government should set aside ₹11 trillion for capex in FY2026, which works out to a healthy 3% of GDP, only a whisker below the 3.1% of GDP recorded in FY24 (as per the provisional estimates). While the absolute figure is similar to the budgeted level of ₹11.1 trillion for FY25, it is ~12.5% higher than the level of ₹9.7 trillion projected for the ongoing fiscal.

The aforesaid baselines suggest a net issuance of government securities (G-sec) of ~₹11.4 trillion, marginally lower than the ₹11.6 trillion estimated for FY25. However, after adding redemptions, the gross market issuances are pegged to rise to ₹15.1 trillion in FY26 from ₹14 trillion in FY25.

Should the government pencil in higher capex to support growth and reconcile to a larger fiscal deficit? Our estimates indicate that the Centre could incur additional capex of around ₹35,000 crore for every 10 bps of higher fiscal deficit. In our view, it may be more prudent to start the year with a fiscal deficit of around 4.5% of GDP. If capex kicks off promptly in Q1, and the target of ₹11 trillion appears likely to be achieved, the government could consider enhancing the allocation through an early supplementary, instead of starting the year with a higher borrowing figure.

> FY26 outlook is increasingly uncertain, with sizeable risks from global developments

Aside from capex, the government has several levers that it could use to prop up the economy, notwithstanding the fiscal constraints. For instance, operationalizing the measures to support credit flow to the MSME sector and the employment-linked incentive (ELI) schemes that were announced in the FY2025 budget would also support economic growth.

Additionally, modest tax relief to personal income taxpayers in form of raising tax slabs, or higher deductions, could provide some relief to urban households.

The combination of some relief on the income tax front, lower inflation particularly for food items, and a dip in EMIs on account of the hoped-for rate cuts would rejuvenate urban consumption in FY26, which has been quite uneven in the ongoing fiscal.

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