2 February 2024

India's no-compromise budget

Fiscal discipline meets capex thrust

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Economics - Emerging Markets

- The central government announced lower-than-expected fiscal deficit estimates for FY24 and FY25
- The fiscal math looks realistic; the 'adjusted' fiscal impulse is likely to be neutral, despite consolidation, led by strong capex

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The government delivered on the need of the day, which was to responsibly bring down the fiscal deficit at a time when state fiscal deficits are rising, such that, over time, India leaves enough resources to fund private sector capex. It announced a 5.8% of GDP fiscal deficit estimate for FY24 (lower than the budgeted 5.9%) and 5.1% for FY25. As a result, gross market borrowing will be markedly lower in FY25, also helped by the use of GST compensation funds to make some repayments.

The fiscal math seems realistic – higher taxes and lower current expenditure in FY25 funding higher capex and the 0.7% of GDP fiscal consolidation. The key assumptions – on nominal GDP growth, tax buoyancy, and dividends – seem credible, too.

The capex thrust rose (from 3.2% of GDP to 3.4% of GDP), but the strategy seems to be different, with a fraction of the funds allocated for any sector that may want more as the year progresses. Given the implementation advantage of the states, capex loans to them were maintained at INR1.3trn, and capex transfers under centrally sponsored schemes increased. Capex was also preferred over current expenditure with plans to lower the food and fertiliser subsidy bill and 'other' current expenses in FY25. In fact, the rural thrust was softer despite it being a pre-election year.

Even though fiscal consolidation should impart a negative fiscal impulse, when adjusted for better quality of spend, we find that the fiscal impulse in FY25 is neutral. This also means the budget won't add to inflation, giving room to RBI to ease later in the year. And this is precisely the winning stroke of this budget, lowering the fiscal deficit, without imparting a negative impulse on growth.

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Table 1: India's fiscal math

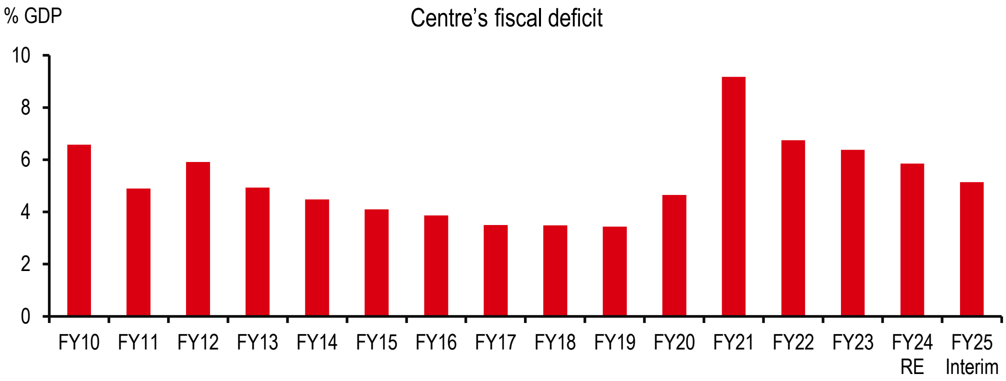
	FY23 INRbn	FY24 RE INRbn	FY25 Interim INR n	FY23 % GDP	FY24 RE % GDP	FY25 Interim % GDP
Gross tax revenue	**30497**	**34327**	**38261**	**11.2%**	**11.6%**	**11.7%**
Direct tax	16591	19450	21988	6.1%	6.6%	6.7%
Corporate	8258	9227	10428	3.0%	3.1%	3.2%
Income	8333	10223	11560	3.1%	3.4%	3.5%
Indirect tax	13906	14877	16273	5.1%	5.0%	5.0%
GST	8491	9566	10677	3.1%	3.2%	3.3%
Customs	2134	2187	2313	0.8%	0.7%	0.7%
Excise	3190	3036	3188	1.2%	1.0%	1.0%
Net tax receipts	**20978**	**23239**	**26016**	**7.7%**	**7.8%**	**7.9%**
Non-tax revenue receipts	2854	3758	3997	1.0%	1.3%	1.2%
Capital receipts	722	560	790	0.3%	0.2%	0.2%
Privatization receipts	460	300	500	0.2%	0.1%	0.2%
A. Total Receipts	**24554**	**27557**	**30803**	**9.0%**	**9.3%**	**9.4%**
Current Expenditure	34531	35402	36547	12.7%	11.9%	11.2%
Interest expenses	9285	10554	11904	3.4%	3.6%	3.6%
Subsidies	4461	4405	4097	1.6%	1.5%	1.3%
Other current expenditure	20785	20443	20545	7.6%	6.9%	6.3%
Capital expenditure	7400	9502	11111	2.7%	3.2%	3.4%
B. Total Expenditure	**41932**	**44905**	**47658**	**15.4%**	**15.1%**	**14.5%**
Fiscal deficit	**17378**	**17348**	**16855**	**6.4%**	**5.8%**	**5.1%**

Fiscal Financing (INRbn)	**FY23**	**FY24 RE**	**FY25 Interim**
Gross market borrowing	14210	15430	14130
% of GDP	*5.2%*	*5.2%*	*4.3%*
Net market borrowing	11058	11805	11752
% of GDP	*4.1%*	*4.0%*	*3.6%*
Nominal GDP growth (% y-o-y)	**16.1**	**8.9**	**10.5**

Fiscal impulse (% GDP)	**FY23**	**FY24 RE**	**FY25 Interim**
Centre's fiscal deficit	6.4	5.8	5.1
Add: Disinvestment	0.2	0.1	0.2
Centre's fiscal deficit adjusted for disinvestment	**6.5**	**6.0**	**5.3**
Fiscal impulse	-0.3	-0.6	-0.7
'Adjusted' fiscal impulse (incorporating improved spend quality)	**0.5**	**0.3**	**0.0**

Source: Budget documents, HSBC. RE: Revised estimates. Net market borrowing = Gross market borrowing – Repayments

Chart 1: Budgeted fiscal consolidation path



Source: Budget documents, HSBC. RE: Revised estimates

The government delivered on the need of the day, which was to responsibly bring down the fiscal deficit at a time when state fiscal deficits are rising, such that, over time, India leaves enough resources to fund private sector capex.

And most impressively, it did so without compromising on the capex thrust. However, several details on sectoral allocations still need to be fleshed out. Let's explain.

Walking the fiscal consolidation line

The government announced the following fiscal deficit path (see table 1 and chart 1) -

- A fiscal deficit of 5.8% of GDP for FY24, lower than the budget estimate of 5.9% of GDP.
- A lower-than-expected fiscal deficit target of 5.1% of GDP for FY25 (HSBC: 5.3% of GDP), marking a 0.7% of GDP fiscal consolidation

Despite FY24 being a pre-election year, and despite nominal GDP growth for the year coming in lower-than-budgeted (10.5% y-o-y vs 8.9%), the government ended the year with a lower-than-budgeted fiscal deficit.

It also surprised with a lower-than-expected fiscal deficit estimate for FY25, thereby sticking closely with its fiscal consolidation roadmap of taking the fiscal deficit to below **4.5% by FY26**.

In fact, the task for the next year (FY26) now appears a tad easier as the government will now need to lower the deficit by 0.6% of GDP (versus our expectation of 0.8% of GDP).

A sharp fall in borrowing …

The government announced a lower-than-expected **gross market borrowing** of INR14.1tr in FY25 (versus INR15.4tr in FY24).

With negative growth in gross market borrowing during a period of positively growing nominal GDP (-8.4% vs +10.5% y-o-y), the overall borrowing calendar seems broadly manageable.

This was not led as much by lower **net market borrowings**, which only fell a shade (from INR11.80tr to INR11.75tr). This means that a larger proportion of the fiscal deficit is now funded by net market borrowing (70% in FY25 versus 68% in FY24). And in some sense, it acts as a buffer – in case the fiscal deficit comes in higher than budgeted, it may not immediately mean more net borrowings.

Rather, the more meaningful fall in gross borrowings came from the use of GST cess funds for lowering the **repayments bill**. INR781bn in FY24 and INR1236bn in FY25 were used to fund part of the repayment bill.

The role of small savings in funding the fiscal deficit has risen over the last two years (funding 23% of fiscal deficit in FY23 versus 28% budgeted in FY25), as new small savings products have been launched.

… buttressed by credible fiscal math …

A lower-than-budgeted fiscal deficit in **FY24** was made possible by higher-than-expected tax revenues and dividends from the RBI and PSEs. Indeed, tax revenues grew 12.6% y-o-y in FY24, throwing up a tax buoyancy number of 1.4. Higher revenues were more than able to offset the rise in current expenditure. Capital expenditure was strong, but lower-than-budgeted.

For **FY25**, the government has budgeted a 0.1% of GDP rise in revenues, led by higher taxes.

On the expenditure front, it aims to lower the food and fertilizer subsidy bill, possibly on the assumption of lower prices, as meaningful reforms take time. The government also wants to lower 'other' current expenditure by a total of 0.8% of GDP.

On the other hand, it aims to raise capex by 0.2% of GDP (details on this later), marking an overall cut in expenditure of 0.6% of GDP.

With higher revenue and lower expenditure, it aims to lower the fiscal deficit by 0.7% of GDP.

… and broadly realistic numbers

Nominal GDP growth assumptions for both FY24 (8.9% y-o-y) and FY25 (10.5% y-o-y) are in line with our expectations and look reasonable.

The tax revenue and expenditure growth numbers for the final quarter of FY24 are realistic[1].

The government has assumed a **tax buoyancy** of 1.1 in FY25, lower than 1.4 in FY24. Given the benefits of an improved tax information network spills over into multiple years, these numbers seem realistic, and in fact appear a shade conservative on the direct tax front.

We think **spectrum sales** assumptions are a bit rich (INR1.2tr in FY25), but in a post-election world, they could be offset by higher-than-budgeted **disinvestment receipts**, which have been budgeted conservatively at INR0.5tr.

Dividends from the RBI and other PSEs have been budgeted at similar levels to FY25, as last year. Here, too, there could be some upside surprise given our analysis of RBI earnings.

On the expenditure front, lowering **current expenditure** may be hard, but possible in a post-election year. After all, 'other' current expenditure remains 0.5% of GDP, higher than pre-pandemic levels. And the central government's steps to increase compliance of state spending on central schemes could help lower this bill.

All told, we think the fiscal deficit targets for FY24 and FY25 are achievable.

Noteworthy themes

1. Capex thrust, but different from before. On the back of a 28% y-o-y increase in FY24, capex is expected to rise again by 17% in FY25. One may quibble that the growth rate has slowed, but it remains higher-than-nominal GDP growth, rising from 3.2% of GDP in FY24 to 3.4% in FY25.

Having said that, the capex thrust this year will likely be a bit different:

One, PSE capex is likely to be lower in FY25 (see chart 2). **Two**, outlays to roads and railways have risen in INR terms, but are a shade softer in % of GDP terms (see chart 3). **Three**, enhanced capital support to oil marketing companies (higher by 0.1% of GDP) may not necessarily be to increase capacity (i.e. genuine capex).

But on the other hand, **four**, capex transfers to states for centrally sponsored schemes is likely to increase (see chart 2 again). **Five**, INR704bn (0.2% of GDP) of funds have been earmarked for new schemes under the Department of Economic Affairs. These will be allocated to sectors that run out of their capex provision for the year and want more (e.g. railways).

1 Tax revenues rising 7.6% in 4Q versus 14.4% in the first three quarters of FY24; expenditure rising 4.8% in 4Q versus 8.4% in the first three quarters of FY24

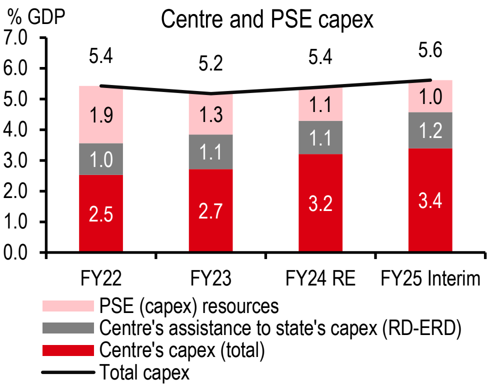
2. Capex preferred over current spending. The **quality of spend** continued to improve, with a lower current expenditure-to-capex ratio (see chart 4). Despite it being a pre-election year, the **rural thrust** softened (see chart 5).

3. Help to states. Given the implementation capability advantage, the central government has been gradually raising capex funds to states, in the form of (1) interest free bonds for state capex, maintained at INR1.3tr in FY25, but to now include an earmarked INR750bn to support the states' milestone-linked reforms, and (2) higher capex funds as a part of centrally sponsored schemes. The states also got much higher tax revenues in FY24 as the shareable tax pot rose faster than the non-shareable pot.

4. Innovation fund. An INR1tr research and innovation fund, providing long-term financing and refinancing facility has been announced. Details will follow later.

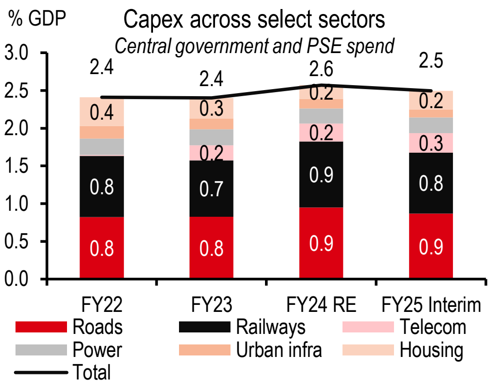
5. Housing plans. The government outlined plans to build 20m rural houses over the next five years and launch a scheme for 'deserving' section of the middle-class to buy or build own houses. This is likely to keep construction activity robust.

Chart 2: Overall capex to rise in FY25



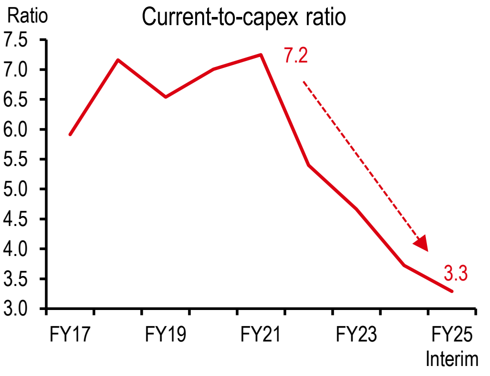
Source: Budget documents, HSBC. RE: Revised estimates

Chart 3: Outlays to some key sectors are a shade softer in % of GDP terms



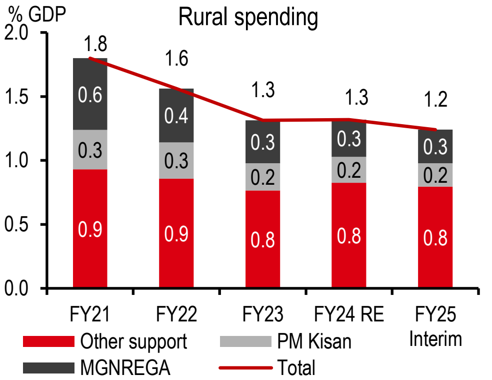
Source: Budget documents, HSBC. RE: Revised estimates

Chart 4: The quality of spend continued to improve



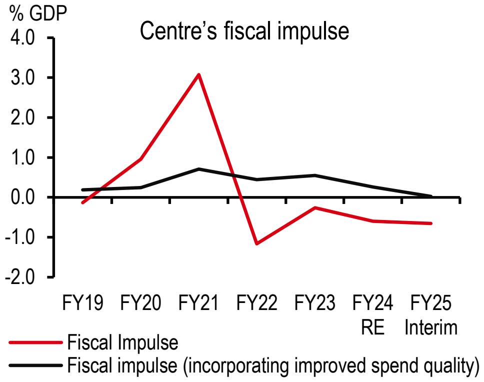
Source: Budget documents, HSBC. RE: Revised estimates

Chart 5: Despite it being a pre-election year, the rural thrust softened



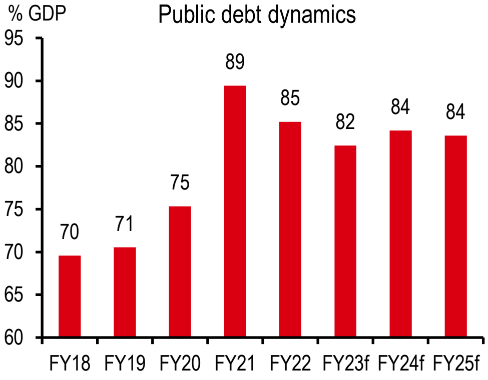
Source: Budget documents, HSBC. RE: Revised estimates

Chart 6: When adjusted for better quality of spend, the fiscal impulse is neutral



Source: Budget documents, HSBC. RE: Revised estimates

Chart 7: Fiscal consolidation will be critical to lower debt



Source: CEIC, RBI, HSBC

6. Import tariffs unchanged. The government had been raising import tariffs on a variety of goods over the last several years. We think higher import tariffs stoke inflation, and hurt growth in a world of value-added exports. In today's budget, it paused on this practice. In fact a few days before the budget, import tariffs were slashed on some goods.

The macro-economic impact

Neutral impact on growth. Even though a fiscal consolidation of 0.7% of GDP should impart a negative fiscal impulse, when adjusted for better quality of spend (more capex, see chart 4), we find that the fiscal impulse to be neutral (neither positive, not negative, see table 1 and chart 6).

And this is precisely the winning stroke of this budget, lowering the fiscal deficit without imparting a negative impulse on growth.

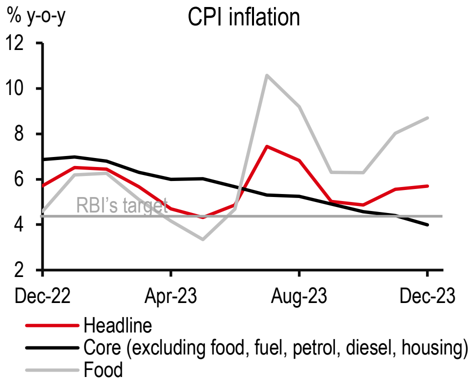
Elevated public debt. India's public debt rose in FY24 as nominal GDP growth slowed. Sticking to the fiscal consolidation path and chalking out targets beyond FY26 would be critical to lowering debt (see chart 7).

Falling inflation. With a non-negative and non-positive fiscal impulse, we expect no impact on inflation led by fiscal policy. Separately, both food and core inflation have been falling recently (see charts 8 and 9). We believe inflation could average 4.5% for the next three quarters (January to September 2024).

Next up: RBI meeting on 8 February. As the 'adjusted' fiscal impulse turns neutral in FY25, and disinflation continues, we believe the RBI will turn less hawkish as the year progresses.

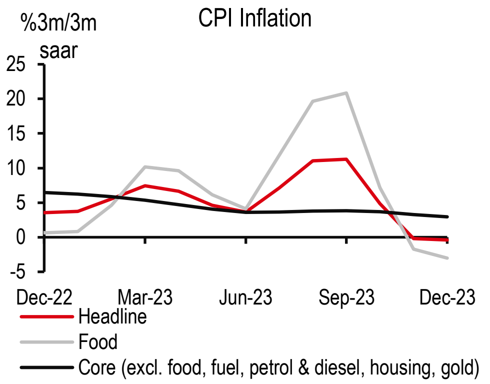
We expect the RBI to ease liquidity over the next few months, using larger quantum of VRRs. This is likely to be followed by a change in stance to neutral, and repo rate cuts of 50bp, starting in June (specifically 25bp in June and 25bp in August), taking the repo rate to 6%.

Chart 8: Core inflation has been coming off for some time now…



Source: CEIC, HSBC

Chart 9: … and food price inflation has eased in sequential terms



Source: CEIC, HSBC

Key forecasts

Table 2: India's key forecasts

	Unit	FY23f (Apr'22-Mar'23)	FY24f (Apr'23-Mar'24)	FY25f (Apr'24-Mar'25)
Real gross domestic product (GDP)	%y-o-y	7.2	6.9	6.0
Consumer price index (CPI)	%y-o-y	6.7	5.3	4.6
Central government fiscal balance	% GDP	-6.4	-5.8	-5.1
State government fiscal balance	% GDP	-2.8	-2.9	-2.9
Repo rate	%, end-period	6.50	6.50	6.00

Source: RBI, CEIC, HSBC estimates

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