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The bicycle theory of India's budget

Preview 2023

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Economics - India

- We expect the government to champion continued fiscal consolidation, despite challenges, in the 1 February budget
- The fiscal deficit is likely to fall from a budgeted 6.4% in FY23 to 5.8% in FY24; but market borrowings could remain elevated
- A negative fiscal impulse will likely help contain inflation and external deficits, aiding macro stability in uncertain times

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'It never gets easier; you just go faster'

\- Greg LeMond, pro road-racing cyclist

The government's promised fiscal consolidation path will require a herculean effort over the next few years. Think of it like a long-distance cyclist that needs to keep pedalling hard to reach the finish line; if it were to suddenly stop, it risks falling over. The stakes aren't quite the same, but a lower fiscal deficit is key for India's macro stability, especially in an uncertain global environment.

But there are a few challenges in the way of fiscal consolidation in FY24. **One**, nominal GDP growth is expected to fall, making tax revenue growth and fiscal consolidation harder to achieve. **Two**, the formalization-led tax bounty could fade if the informal sector revives. **Three**, 2023 is a pre-election year, and these years are generally associated with low privatization receipts and expenditure pressures. **Four**, capex spend is now 1.1% of GDP higher than the pre-pandemic period. Lowering the fiscal deficit without cutting capex will require extra effort. **The good news** is that the government is making an effort to consolidate. Steps like the recently restructured food subsidy scheme, and innovations like the Single Nodal Agency dashboard (which cuts down the interest bill on funds transferred to states), will likely help lower the deficit.

Despite challenges, we expect the fiscal deficit to fall in line with the glide path, to 5.8% of GDP in FY24 from a budgeted 6.4% in FY23. The current expenditure bill could fall by 1% of GDP, led by lower fertilizer, food and other expenditure, more than offsetting lower tax revenues.

There are several other dimensions on which the markets will likely rate the budget – transparent and credible fiscal math (i.e., lower nominal GDP growth and tax buoyancy), an improved tax regime (more direct tax reforms, lower import tariffs), continued capex thrust (at least unchanged as a percentage-of-GDP), support to states (more interest-free loans for capex), and addressing liquidity and bond market concerns.

Despite the fall in the fiscal deficit, **gross market borrowing** by the central government will likely rise to around INR15.9trn, led by a large repayments bill. Tighter liquidity could lead to OMO purchases by the RBI later in the year. A lower fiscal deficit means a negative impulse on **growth**, which could help contain **inflation and the current account deficit**. There are all the reasons for the government to keep pedalling … hard.

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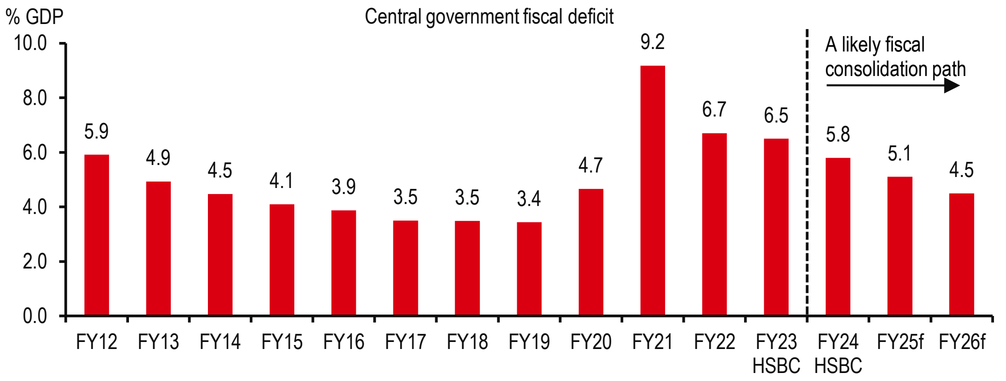
Table 1: India's fiscal math

	FY22 GOI	FY23 BE	FY23 HSBC	FY24 HSBC	FY22 GOI	FY23 BE	FY23 HSBC	FY24 HSBC
	INR bn	INR bn	INR bn	INR bn	% GDP	% GDP	% GDP	% GDP
Gross tax revenue	27083	27578	31598	33104	11.4%	10.7%	11.6%	11.1%
Net tax receipts	18204	19348	20855	21849	7.7%	7.5%	7.7%	7.3%
A. Total Receipts	22076	22837	24124	25679	9.3%	8.9%	8.9%	8.6%
Current Expenditure	32014	31947	34387	34802	13.5%	12.4%	12.6%	11.7%
Capital expenditure	5928	7502	7502	8231	2.5%	2.9%	2.8%	2.8%
B. Total Expenditure	37942	39449	41890	43033	16.0%	15.3%	15.4%	14.4%
Fiscal deficit	15865	16612	17765	17354	6.7%	6.4%	6.5%	5.8%

Fiscal Financing (INR billion)	FY22 GOI	FY23 BE	FY23 HSBC	FY24 HSBC
Gross market borrowing	11274	14950	14950	15920
% of GDP	*4.8%*	*5.8%*	*5.5%*	*5.3%*
Net market borrowing	8631	11186	11186	11974
% of GDP	*3.6%*	*4.3%*	*4.1%*	*4.0%*
Nominal GDP growth (% y-o-y)	19.5	9.0	15.0	9.5

Note: The difference between the gross and net market borrowing in FY24 is the repayments bill minus the GST compensation bonds maturing (INR781bn), plus the special oil and fertilizer bonds maturing (INR450bn), minus some bond switches. If bond switches are higher or if the special bonds maturing are rolled over, the difference between gross and net market borrowing will be lower.
Source: Budget documents, HSBC estimates. Note: BE = Budget estimates

Chart 1: India's fiscal path



Source: CEIC, HSBC estimates

Disclosure appendix

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