India Viewpoint

FY25 Union budget preview: Continued consolidation

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GEM Economics
Asia | India

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Glossary

GDP: Gross domestic product

BE: Budget estimate

RE: Revised estimate

FD: Fiscal deficit

TD: Till Date

Despite poll pressure, fiscal consolidation to continue

Concerns surrounding fiscal slippage in an election year are understandable. However, we expect the Centre to meet their fiscal deficit target of 5.9% of GDP in FY24. For FY25, we see Centre's fiscal deficit to consolidate further to 5.3% of GDP, despite poll pressure. We have previously argued that the current government's intent is to consolidate fiscal deficit through capital expenditure driven growth instead of expenditure compression. We expect this strategy to continue in FY25 union budget as well. Digitization led formalization of the economy is a blessing in disguise aiding tax buoyancy on one side and reducing wasteful expenditure (subsidy leakage) on the other.

See FY24 fiscal deficit at 5.9% of GDP, FY25 at 5.3%

Between Apr-Nov in FY24, India used up 50.7% of the full year budgeted fiscal deficit target. This compares well vs the median 75.9% of total that gets exhausted during Apr-Nov usually. The outperformance was led by higher than median revenue receipts even as total expenditure continued to trace the median run rate. For the remainder of FY24, we see higher than budgeted tax and non-tax revenue to more than offset- the potential shortfall in divestment proceeds, higher than budgeted subsidy bill, modestly higher interest expense and other revenue expenditure. We do see some saving on the loans and advances component of capital expenditure. This should result in a lower than budgeted fiscal deficit in absolute terms, while meeting the target 5.9% of GDP, despite lower than estimated nominal GDP outcome.

In our Year Ahead 2024 we looked at multiple macro variables a year before, during and after national polls and failed to establish any correlation between macro performance and elections. For FY25, we expect Centre's fiscal deficit to consolidate to 5.3% of GDP, tracking the glide path to 4.5% of GDP by FY26. On the receipts side, we estimate revenue receipts at INR30.4trn (up 10.5% yoy vs FY24 BofAe), led by a 10% yoy increase in tax revenue, 14% jump in non-tax revenue and modest increase in divestment proceeds. Resultantly, total receipts in FY25 are estimated at INR31.15trn, up from INR27.83trn in FY24 (BofAe). On the expenditure front, we estimate total expenditure in FY25 to grow by 7.2% yoy, down from an estimated 8.2% yoy in FY24 BofAe (budgeted growth is estimated at 7.5% yoy). As for composition- interest expense burden and subsidy bill, both are estimated to rise further. Revenue expenditure net of interest payments and subsidies is estimated to grow modestly. Robust growth in capex (18.5% yoy, BofAe) is estimated, in line with policy focus showcased so far.

Market borrowings, largely unchanged

Market borrowings have been the main source of funding the fiscal deficit. Over the last 10 years, on an average 65% of fiscal deficit for the Centre has been funded via market borrowings. In FY24, gross and net market borrowings stood at INR 15.4 trn and INR 11.8 trn respectively. For FY25, at 5.3% of GDP, we are tracking a fiscal deficit of INR17.6 trn. We expect 65% of this to be financed by market borrowings. Accordingly, we see market borrowings in FY25 at INR 11.6 trn. Given maturities of INR 3.61 trn in FY25, gross market borrowings are estimated at INR 15.2 trn.

Despite headwinds, FY24 fiscal deficit target on track

Between Apr-Nov in FY24, India used up 50.7% of the full year budgeted fiscal deficit target. This compares well vs the median 75.9% of total that gets exhausted during Apr-Nov usually. The outperformance was led by higher than usual revenue receipts even as total expenditure continued to trace the median run rate. Exhibits 2,3 & 4 show monthly run rate of fiscal deficit, revenue receipts and total expenditure vs median monthly run rate (cumulative) in a fiscal year. As for fiscal deficit, month after month, the actual run rate has been meaningfully lower than the median run rate. This is driven by outperformance of revenue receipts, which in FY24TD are tracking 65.3% of FY24BE vs 53% of full year (usually). Expenditure run rate on the other hand is mostly in line with median. Exhibit 5 shows that Apr-Nov FY24 yoy growth rate for total receipts and tax revenue receipts at 19.2% yoy and 17.2% yoy is sizably higher than the average growth rate seen in these months over the last 10years. The reverse is true for total expenditure, where corresponding figures are 8.6% yoy for FY24 Apr-Nov vs 11% yoy, 10year average. Interestingly, growth in capex at 31% yoy FY24 (Apr-Nov) is sharply higher than the 10-year average seen in this period of 17.5% yoy. Media reports suggest that various ministries have been frontloading their capital expenditure in the run up to general elections in May 2024. These include- Ministry of road, transport & highways, Ministry of Defense & Ministry of railways. In Exhibit 6 we decode components of tax revenue responsible for driving higher than budgeted growth rate. Both corporate and income collection have surpassed their budgeted growth rates meaningfully, more than offsetting the disappointment seen in excise and custom duty revenue collection.

Exhibit 1: Fiscal math: Expect FY24 fiscal deficit to meet the targeted 5.9% of GDP, see it consolidating to 5.3% of GDP in FY25

Robust tax revenue growth, higher non tax revenue and prudent expenditure growth to pave way for consolidation in FY25

in INR crore	FY23 Actuals	FY24 BE	FY24 BE yoy	FY24 (Apr-Nov)	FY24 TD yoy	Imputed yoy growth for Dec-Mar FY24 for BE to be met	Avg Dec-Mar yoy	FY24 BofAe	FY25 BofAe	FY24 yoy BofAe	FY25 yoy BofAe
1.Revenue receipts	2383519	2632281	10.4%	1720120	20.9%	-5.0%	8.50%	2750000	3040000	15.4%	10.5%
Tax revenue	2097368	2330631	11.1%	1435755	17.2%	2.6%	10.30%	2400000	2640000	14.4%	10.0%
Non-tax revenue	286151	301650	5.4%	284365	43.4%	-80.3%	4.90%	350000	400000	22.3%	14.3%
2. Non-Debt Capital receipts	72187	84000	16.4%	25463	-38.6%	90.6%	1.20%	33000	75000	-54.3%	127.3%
2.1 Recovery of loans	26152	23000	-12.1%	16604	27.2%	-51.2%	1.90%	23000	25000	-12.1%	8.7%
2.2 Other receipts	46035	61000	32.5%	8859	-68.8%	196.2%	7.90%	10000	50000	-78.3%	400.0%
3. Total receipts (1+2)	2455706	2716281	10.6%	1745583	19.2%	-2.1%	11.20%	2783000	3115000	13.3%	11.9%
4. Revenue expenditure	3452518	3502724	1.5%	2066522	3.6%	-1.4%	5.30%	3565000	3725000	3.3%	4.5%
of which, interest payments	928424	1079971	16.3%	607963	11.5%	23.2%	3.80%	1080000	1100000	16.3%	1.9%
of which, subsidy	530959	374707	-29.4%	242755.55	-19.4%	-42.6%		420000	425000	-20.9%	1.2%
& residual	1993135	2048046	2.8%	1215803	5.8%	886.4%	7.50%	2065000	2200000	3.6%	6.5%
5. Capital expenditure	736319	1000373	35.9%	585645	31.0%	43.4%	23%	970000	1150000	31.7%	18.6%
of which, loans & advances	115268	163834	42.1%	80886	48.0%	36.8%	-125%	135000	100000	17.1%	-25.9%
6. Total expenditure (4+5)	4188837	4503097	7.5%	2652167	8.6%	6.0%	7.00%	4535000	4875000	8.3%	7.5%
Fiscal deficit	1733131	1786816		906584		16.6%	2.30%	1752000	1760000	1.1%	0.5%
as % of GDP	6.4	5.9						5.9	5.3		

Source: CGA, FinMin

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Going forward, for the remainder of FY24, below are our key observations:

The first advance estimate of FY24 nominal GDP growth by MOSPI (apex statistical agency) came in at 8.9% yoy (vs 10.5% yoy assumed in budget math by Ministry of finance). This arithmetically pushes up fiscal deficit as % of GDP by 10bp. We believe, absolute fiscal deficit for FY24 would turn out to be lower than BE, thus meeting the target 5.9% of GDP.

If we look at actual Apr-Nov FY24 yoy growth rate for each sub-component of fiscal deficit and compare it with the budgeted growth rate, one can extrapolate the Dec-Mar average growth rate needed to achieve the budgeted target.

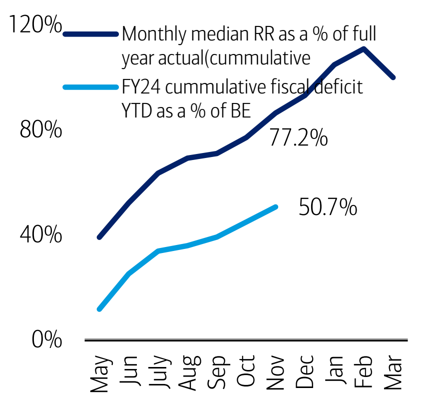
As can be seen in Exhibit 1, in case of revenue receipts the imputed growth rate for Dec-Mar FY24 stands at -5% yoy, on one hand. On the other hand, a 90.6% yoy growth is needed in case of non-debt capital receipts, to achieve the budget estimate. Comparing this with average Dec-Mar growth rate over the past decade, we conclude that:

- Tax revenue is expected to exceed BE by INR693bn, non-tax revenue by INR483bn.
- Divestment proceeds are expected to fall short of BE by INR510bn.
- In sum, total receipts are expected to surpass BE by INR667bn.
- This however would get absorbed to make up for higher-than-expected subsidy bill to the tune of INR330bn and provide for lower than estimated nominal GDP.
- We see a modest increase vs BE numbers in case of interest payments even as 10y bond yields in FY24TD have averaged 15bp lower vs FY23, amidst elevated borrowing.
- Revenue expenditure net of interest payments and subsidy is estimated to overshoot the budgeted number.
- On capex side, we see some saving/shortfall in loans by Centre to state (50year interest free loan), to the tune of INR300bn.

In sum, we see higher than budgeted tax and non-tax revenue to provide for potential shortfall in divestment proceeds, higher than budgeted subsidy bill, modestly higher interest expense and other revenue expenditure. We do see some saving on the loans and advances component of capital expenditure. This should result in a lower than budgeted fiscal deficit in absolute terms, while meeting the target 5.9% of GDP, despite lower than estimated nominal GDP growth rate.

Exhibit 2: Fiscal deficit: monthly run rate vs median

Actual monthly outcome has outperformed median run rate month after month



Source: CGA, CEIC

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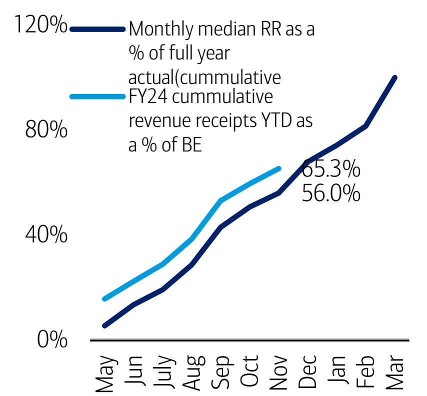
Exhibit 3: Revenue receipts monthly run-rate vs median

Revenue receipts have been consistently higher than usual



Source: CGA, CEIC

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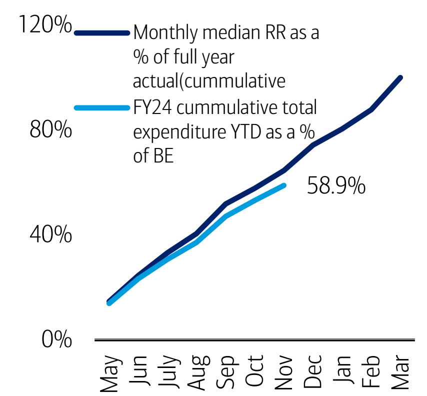
Exhibit 4: Total expenditure: monthly run rate vs median

Expenditure run rate has mostly hugged the median monthly run rate



Source: CGA, CEIC

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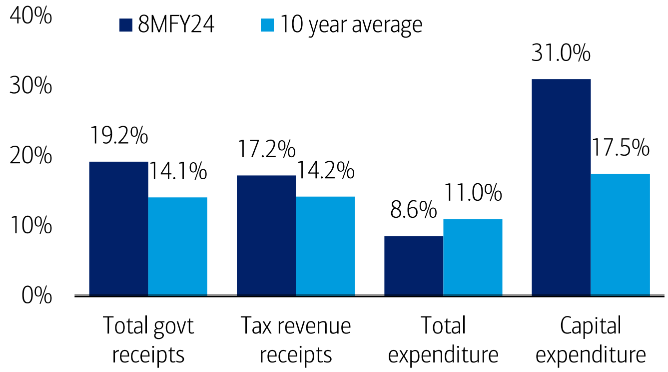
Exhibit 5: Apr-Nov FY24 growth rates have outperformed 10y avg
Both tax and non-tax revenue growth has been reasonably higher than 10yr avg growth rate, capex growth is sizably higher



Source: CGA, CEIC

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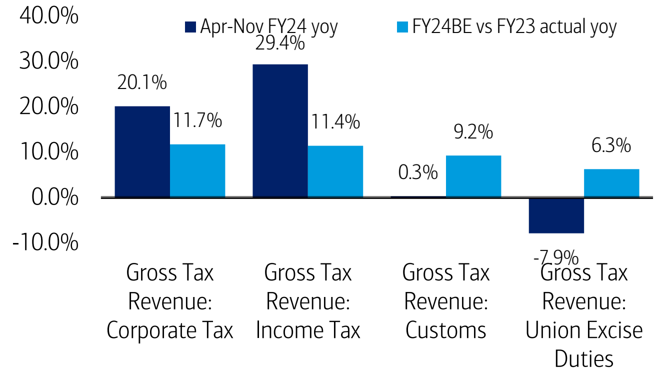
Exhibit 6: Tax revenue growth rate: Apr-Nov FY24 vs F24BE yoy
Direct tax revenue growth has been sharply higher than budgeted, more than offsetting the lower than budgeted outcome for indirect tax growth



Source: CGA, CEIC

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Moving on to FY25 fiscal math: tracking glide path

As general elections in May 2024 draw closer, markets are worried if the interim budget that will be presented on Feb 1st would reel under any such political compulsions. In our Year Ahead 2024 we looked at multiple macro variables a year before, during and after national polls and failed to establish any correlation between macro performance and elections. Atop that, we have previously argued that the current leadership under PM Modi has shown fiscal prudence by focusing on capital expenditure driven growth to consolidate fiscal deficit instead of expenditure compression.
Continuing with that spirit, we expect Centre's fiscal deficit to consolidate to 5.3% of GDP in FY25, tracking the glide path to 4.5% of GDP by FY26.

Our key assumptions are:
A main reason of a lower-than-expected nominal GDP growth, was the sharp WPI deflation seen in FY24 (-1.1% yoy between Apr-Dec). As this reverses, we expect Finance ministry to work with a 10-10.5% yoy nominal GDP growth estimate for FY25. (BofAe real GDP growth in FY25 is 5.8% yoy, CPI inflation is 4.6% yoy).

Exhibit 7 shows strong positive correlation between nominal GDP growth and direct tax revenue growth. Accordingly, we estimate tax revenue to grow by 10% yoy in FY25. In fact, improved tax buoyancy (Exhibit 8) could potentially result in tax revenue growth rate to exceed nominal GDP growth rate. Post pandemic, tax buoyancy has risen steadily to 1.18 vs 1.03 in the decade preceding Covid-19.

Indirect tax collection has been showing encouraging signs too. Monthly run rate of GST collection has risen sharply from INR98k in FY19 to INR1.66trn in FY24 (Apr-Nov, Exhibit 9). One can argue that the share of IGST that now goes to center is tapering (and rightly so, with states getting their due share, Exhibit 10), the continuation of GST compensation cess until FY26 (all the proceeds belong to Centre) offers an alternate revenue source.

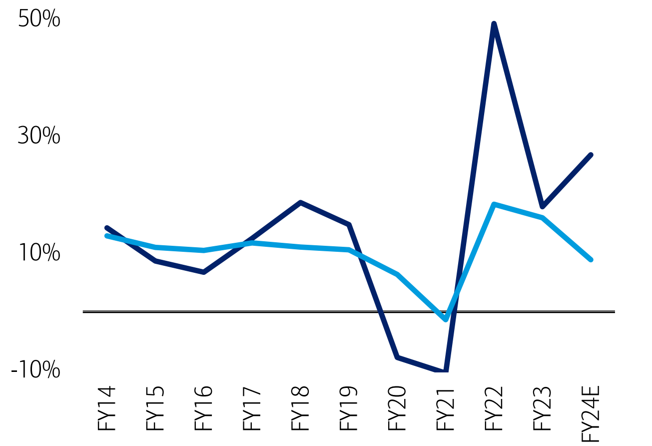
Non-tax revenue, led by dividend and profits is expected to exceed the budget estimate in FY24 given higher than expected dividend transferred by the RBI (Exhibit 11). Media reports suggest that RBI's balance sheet has risen in FY24 and thus the RBI could give an even higher dividend in FY25. Centre's public sector enterprises (CPSEs) are also expected to yield higher dividend amidst improved profitability. Accordingly, we peg non-tax revenue in FY25 at INR 4 trn.

As for divestment, proceeds between Apr-Nov FY24 have disappointed vs estimates. Only in 3 out of last 16 years have actual divestment proceeds surpassed the budgeted number (Exhibit 12). In that context, we assume a modest INR500bn from non-debt capital receipts in FY25. We are mindful of the downside risk this estimate entails.

In sum, on the receipts side, for FY25 we estimate revenue receipts at INR30.4trn (up 10.5% yoy vs FY24 BofAe), led by a 10% yoy increase in tax revenue, 14% jump in non-tax revenue and reasonable increase in divestment proceeds. Resultantly, total receipts in FY25 are estimated at INR31.15trn, up from INR27.83trn in FY24 (BofAe).

Exhibit 7: Direct tax revenue growth & nominal GDP growth yoy

While nominal GDP growth is expected to stay low given WPI deflation, direct tax revenue growth has been high benefitting from improved compliance



Source: CGA, CEIC

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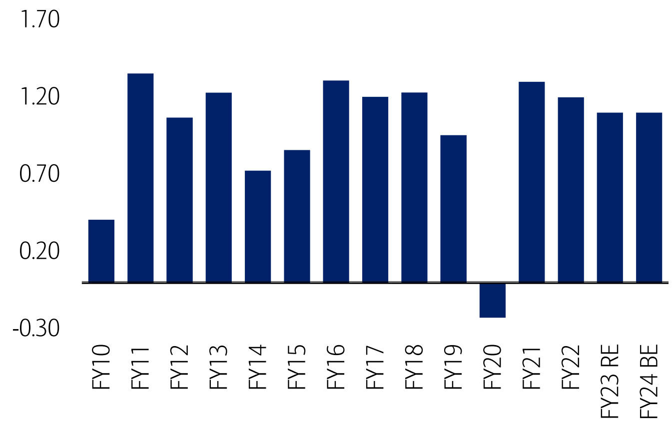
Exhibit 8: Tax buoyancy (Centre + states combined)

Post pandemic tax buoyancy has improved steadily to 1.18 vs 1.03 in the 10 years preceding the pandemic



Source: CGA, CEIC

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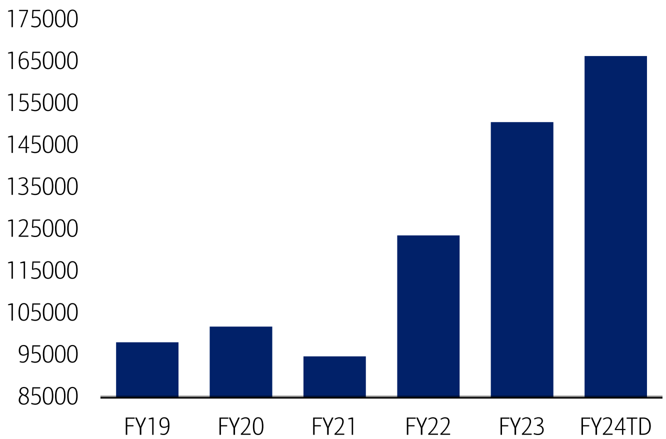
Exhibit 9: GST collection monthly run rate, FY basis

Monthly GST collection run rate has risen sharply from INR98k in FY19 to INR1.66trn in FY24 so far



Source: GST council

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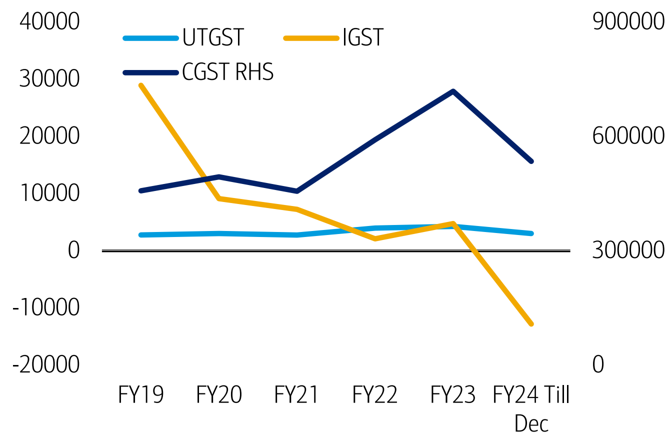
Exhibit 10: Annual GST collected by Centre (in INR cr)

With state GST arrears now close to getting settled, IGST's contribution to Centre's tax revenue is falling



Source: CEIC

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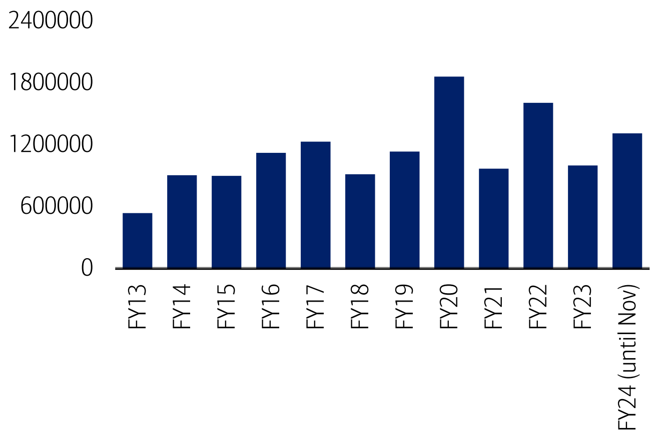
Exhibit 11: Non-tax revenue: Dividend & profits (45% of NTR)

Higher than budgeted dividend & profits from RBI & CPSEs have aided non-tax revenue collection in FY24 so far



Source: CGA, CEIC, In INR mn

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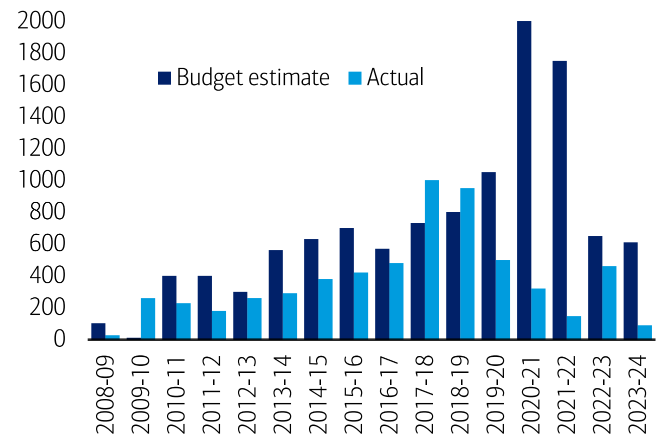
Exhibit 12: Divestment proceeds: BE vs Actual (INR bn)

For the fifth successive year, actual divestment proceeds fell short of budgeted



Source: CGA, CEIC

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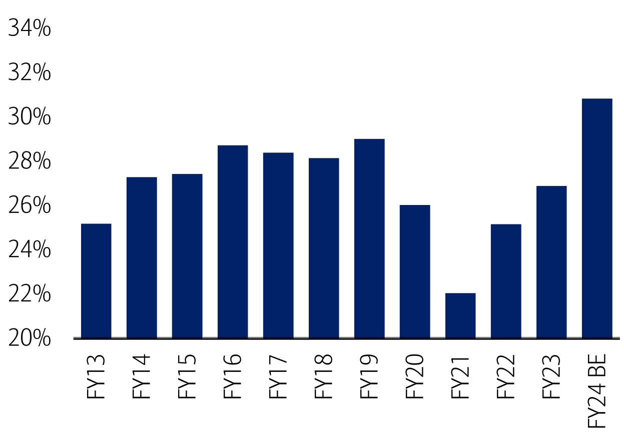
Moving on to the expenditure side:

Of the total expenditure, 85% is revenue (or current) expenditure and 15% is capital expenditure. Within revenue expenditure, interest payment and subsidy bill together account for 41% of total. Amidst elevated borrowing, interest expense has grown sizably over the last few years, accounting for 30.8% of total revenue expenditure in FY24 (Exhibit 13). We don't see any respite in the interest burden in FY25 and estimate it to rise modestly to INR11.1trn.

India's subsidy bill is largely divided into 3 categories food (45%), fuel (15%) and fertilizer (32%). Additional expenditure on account of extending the free food grain program and cooking gas cylinder price cut together amounted to INR330bn in FY24 (Exhibit 14). For FY25 we estimate food subsidy to remain elevated as free food grain program is extended by 5 years. Some saving on the fertilizer subsidy could in part offset the higher food subsidy bill. Accordingly, we estimate subsidy bill to rise further to INR4.25trn in FY25.

Exhibit 13: Interest payment as % of revenue expenditure

Amidst higher borrowing, interest cost burden has risen meaningfully from 25% of total revenue expenditure in FY13 to 31% in FY24



Source: CGA, CEIC

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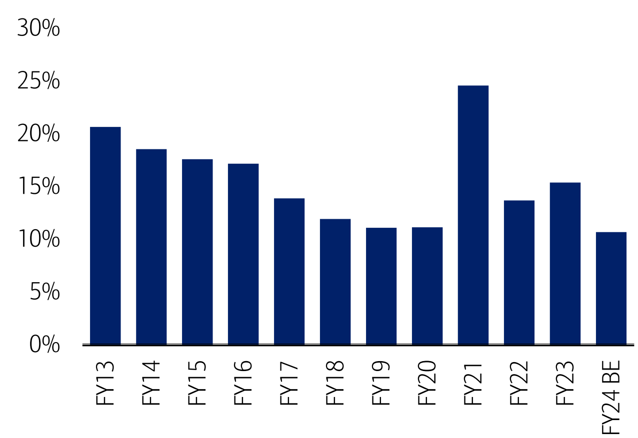
Exhibit 14: Total subsidies as % of revenue expenditure

Overall subsidies share in revenue expenditure has been coming off steadily since the pandemic, now seen at 10.7% of RE, down from 24.6% in FY21



Source: CGA, CEIC

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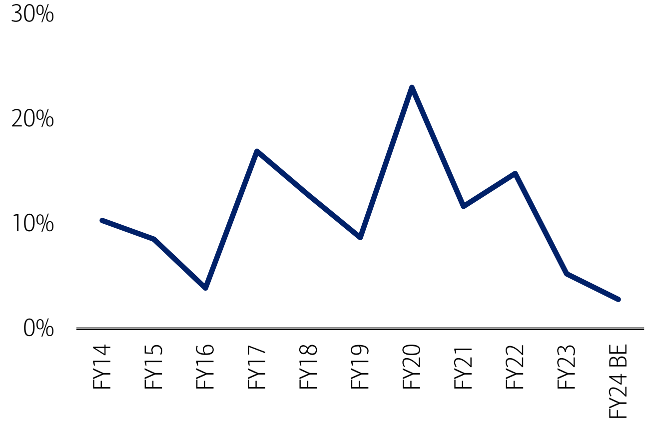
Net of interest payment and subsidies, revenue expenditure is estimated to grow by 6.5% yoy in FY25 vs 3.6% yoy in FY24 (BofAe). Budgeted growth for revenue expenditure net of interest payment and subsidies is even lower at 2.8% yoy (Exhibit 15).

Exhibit 15: Growth of revenue expenditure net of interest payments and subsidies (% yoy)

RENIS growth in FY24 is estimated to slow to 2.8% yoy vs 5.2% yoy in FY23



Source: CGA, CEIC

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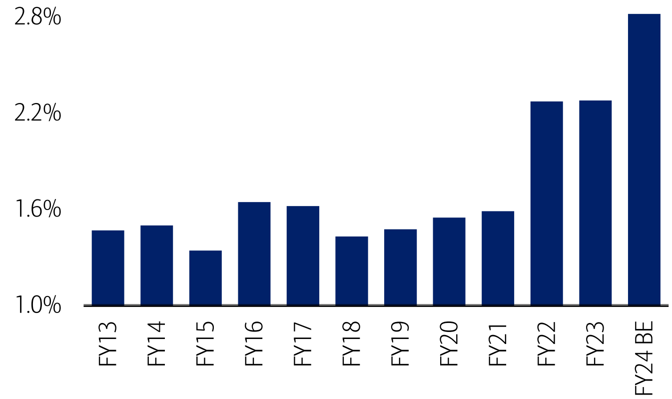
Exhibit 16: Capital outlay as % of GDP

Big ticket infra has been a policy focus, resultantly capital outlay as % of GDP has risen steadily from 1.5% in FY19 to 2.8% in FY24



Source: CGA, CEIC

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One of the striking features of fiscal management under the current leadership has been deployment of resources towards capital expenditure vs non-committed revenue expenditure. Accordingly, capital outlay as % of GDP has risen steadily from 1.6% of GDP in FY21 to 2.8% of GDP in FY24 (Exhibit 16).

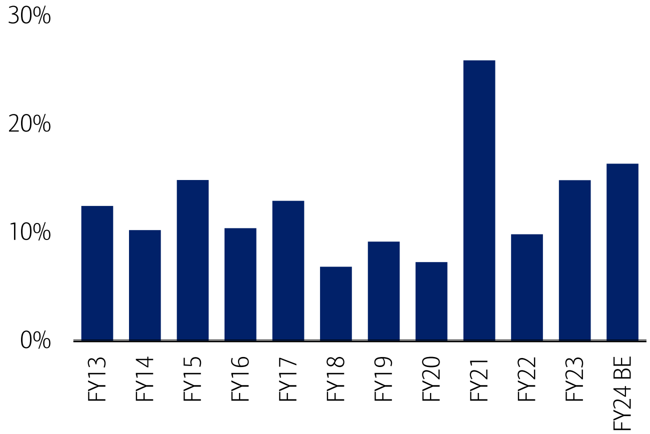
Since the pandemic, Centre's support to states, especially towards augmenting capital spend has been improving. Loans and advances as a share of capex has accordingly moved up from 10.5% during FY13-FY20 to 16.7% between FY21-FY24 (Exhibit 17). Between Apr-Nov FY24, INR81k of the budgeted INR1.63 trn have been disbursed by Centre to states as a 50year interest free loan. We believe this is front loaded and expect FY24 total loans disbursement to stand at INR1.35 trn.

In FY25, we expect the government to focus on capital outlay and contain the loans and advances component at INR 1 trn. Accordingly, we see an 18.5% yoy increase in capex in FY25.

In sum, on the expenditure side, we see total expenditure in FY25 to grow by 7.2% yoy, down from an estimated 8.2% yoy in FY24 BofAe (budgeted estimate is 7.5% yoy). As for composition, interest expense burden and subsidy bill, both are estimated to rise further. Revenue expenditure net of interest payments and subsidies is estimated to grow modestly. We estimate robust growth in capex (18.5% yoy, BofAe) continuing with policy focus exhibited so far.

A quick word on the quality of fiscal deficit: While some may argue that Covid-19 has again derailed India's fiscal consolidation path, we would like to highlight an underlying shift in the quality of fiscal deficit. Policy focus of the current government has been to drive capital expenditure driven growth which in turn aids revenue mobilization and finally facilitates fiscal consolidation as against expenditure compression led fiscal consolidation. Accordingly, ratio of revenue expenditure to capital outlay (RECO), which is a relevant proxy of quality of fiscal deficit has been falling steadily from 7.6 in FY20 to 4.2 in FY24 (Exhibit 18). We expect this moderation to continue in FY25.

Exhibit 17: Loans & advances as % of Capex
Centre has been giving a larger share of capex as loans to states, that has gone up from 7.3% in FY20 to 16.4% in FY24



Source: CGA, CEIC

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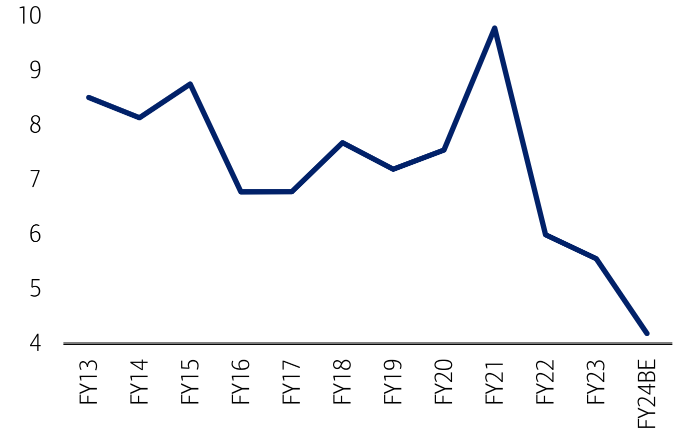
Exhibit 18: Ratio of revenue expenditure to capital outlay (RECO)
RECO has fallen steadily from 9.8 in FY21 to an estimated 4.2 in FY24



Source: CGA, CEIC

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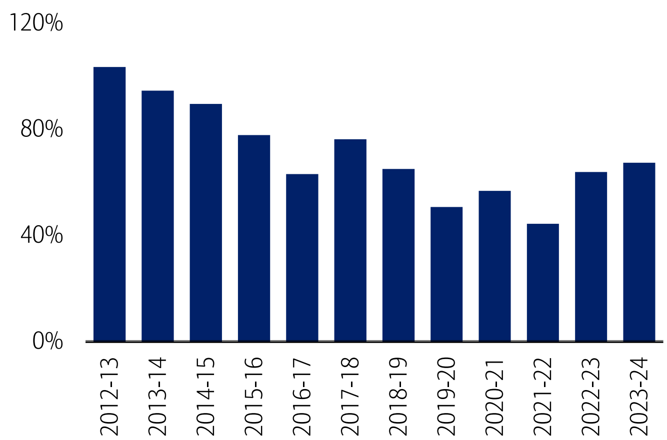
Market borrowings, largely unchanged

Market borrowings have been the main source of financing the fiscal deficit. Over the last 10 years, on an average 65% of fiscal deficit for the Centre has been funded via market borrowings (Exhibit 19). In FY24, gross and net market borrowings stood at INR 15.4 trn and INR 11.8 trn respectively (Exhibit 20). For FY25, at 5.3% of GDP, we are tracking a fiscal deficit of INR17.6 trn. We expect 65% of this to be financed via market borrowings. Accordingly, we see market borrowings in FY25 at INR 11.6 trn. Given maturities of INR 3.61 trn in FY25, we estimate gross market borrowings at INR 15.2 trn.

Exhibit 19: Financing of Centre's fiscal deficit via market borrowing
Over the last 10 years, 65% of fiscal deficit has been funded by market borrowings



Source: RBI, FinMin

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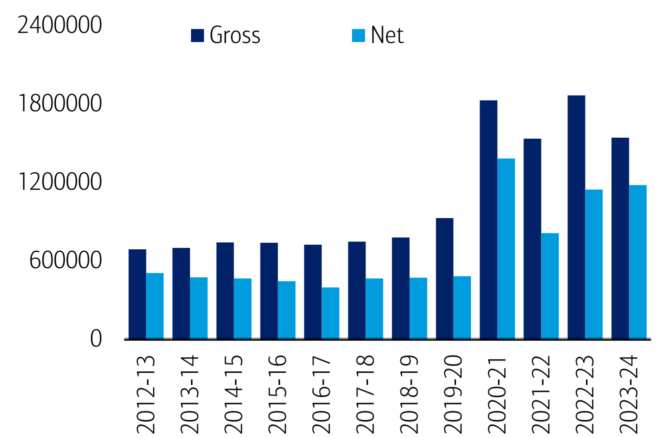
Exhibit 20: Gross vs net market borrowing (in INR crore)
Maturities in FY25 stand at INR3.61trn, roughly same as FY24



Source: RBI, FinMin

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