24 July 2024

India's focussed budget

Economics
India

Stable in math, changes in tax

- The central government stuck firmly to the fiscal consolidation path while focussing on job creation
- Changes were made on the tax front including higher incidence for equity investors…
- … and relief for middle-income taxpayers

The fiscal deficit at 4.9% of GDP in FY25 (versus 5.6% in FY24) was in line with our expectation. It split the revenue bounty (of 0.4% of GDP) from the higher RBI dividend equally across higher current expenditure and fiscal consolidation. A modestly lower market borrowing estimate (versus what was announced in the February interim budget) followed.

In terms of spending details, current expenditure was raised by 0.2% of GDP compared to the interim budget, with transfers to states, schemes for job creation, and a bigger food price stabilisation fund for controlling food inflation.

But the capex thrust continued to dominate. Capex outlays were kept high at INR11.1trn (17.1% y-o-y), and the number rises up to INR18.7trn (17.2% y-o-y) once transfers to states for capex and PSE capex are included. There were several changes below the surface. A larger proportion of capex outlays will be given out as interest free loans to states, some of them conditional on getting reforms done. And outlays were raised at a faster clip for housing, power, and telecom, broadening out from just roads and rails.

The focus was sharper than before on job creation (with an umbrella programme worth INR2trn over five years being announced), specifically looking at skilling and loans to small firms. Plans to build industrial parks and simplify FDI norms will also be worked on, in an effort to attract manufacturing. On the other hand, several import tariff tweaks were made. We believe low rates and stability will help more in increasing investment.

It was taxation where most changes were concentrated. A higher incidence of tax on equity market investors was announced (a higher short- and long-term capital gains tax and STT tax on options), in view of the sharp run-up in markets recently. Alongside this, there was a lower incidence on personal income tax for the middle-income segment (e.g., higher standard deduction).

Even though fiscal consolidation should impart a negative fiscal impulse, when adjusted for better quality spend and the higher RBI dividend, the fiscal impulse is marginally positive. And that was the winning stroke – the art of lowering the deficit, but not growth.

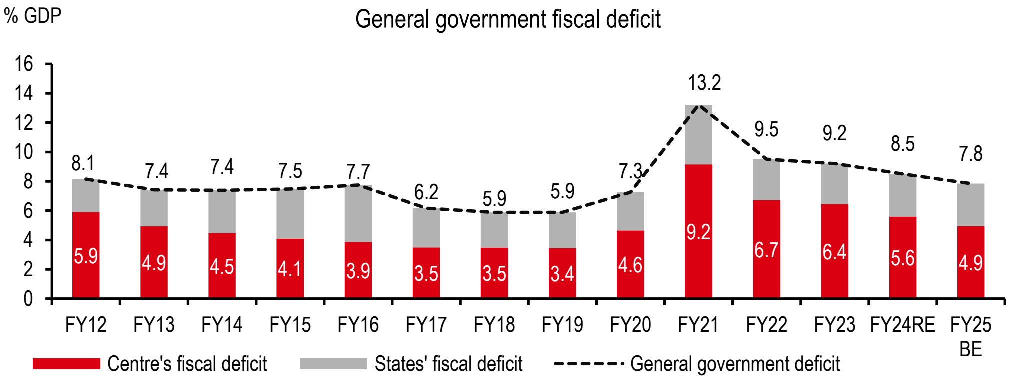
HSBC

Exhibit 1: India's fiscal math

	FY24 PA/RE	FY25 interim	FY25 BE	FY24 PA/ RE	FY25 interim	FY25 BE
	INRbn	INRbn	INRbn	% GDP	% GDP	% GDP
Gross tax revenue	**34516**	**38261**	**38352**	**11.7%**	**11.7%**	**11.8%**
Direct tax	19558	21988	22070	6.6%	6.7%	6.8%
Corporate	9111	10428	10200	3.1%	3.2%	3.1%
Income	10447	11560	11870	3.5%	3.5%	3.6%
Indirect tax	14959	16273	16282	5.1%	5.0%	5.0%
GST	9570	10677	10619	3.2%	3.3%	3.3%
Customs	2331	2313	2377	0.8%	0.7%	0.7%
Excise	3053	3188	3190	1.0%	1.0%	1.0%
Net tax receipts	**23265**	**26016**	**25835**	**7.9%**	**7.9%**	**7.9%**
Non-tax revenue receipts	4019	3997	5457	1.4%	1.2%	1.7%
Capital receipts	605	790	780	0.2%	0.2%	0.2%
Disinvestment and asset monetisation	331	500	500	0.1%	0.2%	0.2%
A. Total receipts	**27889**	**30803**	**32072**	**9.4%**	**9.4%**	**9.8%**
Current expenditure	34940	36547	37094	11.8%	11.2%	11.4%
Interest expenses	10639	11904	11629	3.6%	3.6%	3.6%
Subsidies	4405	4097	4284	1.5%	1.3%	1.3%
Other current expenditure	19896	20545	21180	6.7%	6.3%	6.5%
Capital expenditure	9485	11111	11111	3.2%	3.4%	3.4%
B. Total expenditure	**44425**	**47658**	**48205**	**15.0%**	**14.5%**	**14.8%**
Fiscal deficit	**16537**	**16855**	**16133**	**5.6%**	**5.1%**	**4.9%**

Source: Budget documents, HSBC. Note: PA: Provisional Actuals, RE: Revised estimates, BE: Budget estimates.
Net market borrowing = Gross market borrowing – Repayments

Exhibit 2: India general government fiscal deficit



Source: Budget documents, HSBC. Note: PA: Provisional Actuals, RE: Revised estimates, BE: Budget estimates.

Exhibit 3: Central government borrowing plan

	Particulars	FY24 RE	FY24 PA	FY25 interim	FY25 BE
1	**Gross market borrowings**	**15430**		**14130**	**14010**
2	Repayments	3625		2378	2378
3	***Net borrowing (1-2)***	***11805***	***11778***	***11752***	***11632***
4	Short-term borrowings	13	532	500	-500
5	Post Office Life Insurance Fund (POLIF)	0	0	0	0
6	Small savings	4713	4514	4662	4201
7	State provident funds	52	51	52	50
8	External debt	248	551	160	160
9	Others	783	833	-306	-813
10	Cash drawn down	-267	-1722	35	1404
	Fiscal deficit (3+4+5+6+7+8+9+10)	***17348***	***16537***	***16855***	***16133***

Source: Budget documents, HSBC. Note: PA: Provisional Actuals, RE: Revised estimates, BE: Budget estimates.

The government sprung no major surprise on the fiscal math in today's final budget for FY25 (recall the pre-election interim budget was announced back in February). The fiscal deficit at 4.9% of GDP was in line with our expectation, splitting the revenue bounty (of 0.4% of GDP) from the higher RBI dividend equally across fiscal consolidation and higher current expenditure.

The focus was sharper than before in areas of job creation, specifically skilling and loans to small firms.

All changes, instead, were focused on the tax front, particularly a higher tax incidence on equity market investors, and a lower incidence on personal income tax for the middle-income segment.

Sticking firmly to fiscal consolidation

The government announced the following fiscal deficit path (see exhibits 1 and 2):

- **A fiscal deficit target of 4.9% of GDP for FY25**, in line with our expectation but lower than the 5% that Bloomberg forecasters, on average, had expected. This marks a 0.7% of GDP fiscal consolidation from FY24 levels.
- **A revised fiscal deficit of 5.6% of GDP for FY24**, lower than the interim budget estimate of 5.8% of GDP.

In addition, it reiterated its intention to lower the deficit further to **below 4.5% in FY26**. And because of the outperformance in FY24 and FY25, the consolidation required in FY26 will not be as large (0.4% in FY26 versus 0.7% in FY25).

Lower borrowing

The government announced **lower net** (INR11.6trn versus INR11.8trn) **and gross** (INR14trn versus INR14.1trn) **market borrowing** estimates compared to the interim budget, led by the lower fiscal deficit estimate (see exhibit 3).

At these levels, net market borrowing is likely to fall 1.2% y-o-y, at a time when nominal GDP is meant to grow 10.5% y-o-y. This, to us, means that the supply-demand dynamic will be favourable.

The reason **why the fall in market borrowing was not 1-for-1 with the fall in fiscal deficit** is because some of the other sources of funding the deficit were lowered, namely T-bill issuance, funds from small saving schemes, and 'other' resources of the government.

Credible fiscal math

Compared to the interim budget for FY25 announced back in February this year, **revenues** are budgeted to be 0.4% of GDP higher, coming from the larger-than-expected RBI dividend.

Tax growth is expected to be a shade lower (11.1% y-o-y versus 11.5% in the interim budget), but that is because the base is now higher (FY24 tax growth came in higher at 13% versus an expected 12.4%).

Disinvestment receipts have been kept conservative at INR500bn and even renamed as miscellaneous capital receipts to include revenues from both disinvestment and asset monetization.

On the **expenditure** front, **capital expenditure has been kept unchanged** compared to the interim budget (at INR11.1trn, a 17.1% y-o-y increase). The current expenditure budget has been increased (by 0.2% of GDP, or INR550bn, in line with our expectation).

A breakdown suggests that much of the **increase in current expenditure has gone into** (1) skilling and job creation schemes (more on this later), and (2) INR360bn more in transfers to states, not least the coalition partner states[1], in areas like highways, power sector, flood relief, medical colleges, and tourism (though some are actually transfers for asset creation and should be treated as capex; we make this adjustment later), and (3) higher subsidy by allocating INR100bn towards the food price stabilisation fund.

Overall, revenues are budgeted to rise by 0.4% of GDP compared to the interim budget, equally split between higher current expenditure (by 0.2% of GDP) and fiscal consolidation (of 0.2% of GDP).

Broadly realistic numbers

Nominal GDP growth for FY25 at 10.5% y-o-y is in line with our expectations and looks reasonable.

The government has assumed **a tax buoyancy of 1.1** in FY25, lower than 1.4 in FY24. Given that the benefits of an improved tax information network spills over into multiple years, this number seems realistic – and perhaps a shade conservative on the direct tax front.

Dividends from the **RBI and other PSEs** have been budgeted at a high INR2.9trn. Here, the RBI dividend number is actual and has already transferred to the government, making this target achievable.

On the expenditure front, the **current expenditure** from back in February felt low, and the 0.2%, or INR550bn, increase now puts 'other' current expenditure in line with pre-pandemic levels.

The capex estimate remains unchanged, understandably, given the estimate back in February was fairly large.

All told, we think **the fiscal deficit target for FY25 is achievable**.

Taxman on alert

Tax changes were in focus, especially in view of the sharp run-up in equity markets, which has recently been pointed out as an area of concern by the government, the RBI, and the markets regulator.

The **capital gains tax** has been revised up for both the short term (to 20%) and the long term (to 12.5%) for certain assets. The exemption limit of capital gains on certain financial assets was raised (to INR125,000/year) along with a change in the tenor of long-term assets (one year for listed financial assets and two years for unlisted financial assets and all non-financial assets). Furthermore, the rate of **STT on sale of an option** in securities was raised, a step to curb frenetic activity in that space.

On the other hand, the angel tax for all classes of investors was abolished.

On the personal tax front, the **standard deduction for salaried employees** was increased (to INR75,000 from INR50,000). Likewise, the deduction on family pension for pensioners was enhanced (to INR25,000 from INR15,000), bringing relief to about 40m salaried individuals and pensioners. The tax rate structure under the new tax regime was also revised, helping a salaried employee save up to INR17,500 in income tax.

---

[1] Special financial support of INR150bn, through multilateral development agencies to Andhra Pradesh in the current financial year, financial support of INR 115bn to Bihar for irrigation and flood mitigation projects.

The net tax revenue forgone by the central government as a result of the many changes in direct and indirect taxes will be cINR70bn annually.

Noteworthy themes

Jobs and skilling. The government has allocated INR2trn to facilitate employment, skilling, and other opportunities for 41m youth over a period of five years. In detail, first time formal workers will receive a cash transfer of one month's salary (of up to INR15,000 in three tranches). Incentives on EPFO contribution to employees (in terms of reimbursement of up to INR3,000 per month for two years) and employers were announced. This could benefit 0.2m youth. Upgrading skilling programmes, more internships, and a high focus on apprenticeships were also highlighted.

Capex thrust dominates. Despite growing spending commitments in areas such as jobs and skilling, budgeted growth in capex remains almost three times more rapid than the current expenditure (17.1% y-o-y versus 6.2%). This focus on capex, which began back in FY20, is improving India's quality of spend (see exhibit 4).

Capex thrust, but different than before. Having said that, the breakdown in capex is changing.

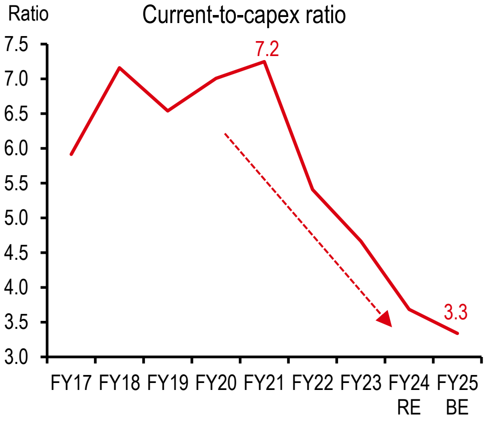
- **First**, it is worth noting that overall capex is much more than **INR11.1trn** (17.1% y-o-y, **3.4% of GDP**). Once we add current transfers to states for asset creation, it is INR15trn (18% y-o-y, **4.6% of GDP**). And when we also add the capex that central PSUs intend to spend from their own borrowing, it rises further to **INR18.7trn** (17.2% y-o-y, **5.7% of GDP**; see exhibit 5).
- **Second**, from within the capex budget, INR1.5trn will be used for to provide long-term interest free **loans to states**. About half of the loans will be conditional on getting **state reforms** done. If this takes off, it could be an important way to get long-pending reforms (like reforming DISCOMs) done.
- **Third**, in terms of sector split, the allocation to **housing** has risen most rapidly (the government plans to build 30m houses across rural and urban India), followed by telecom and power. This means that **capex is broadening out** from just being focussed on roads and rails (see exhibit 6).

Small firms. Bank credit to small firms was in focus, with the limit to the small firms' loan scheme (known as Mudra loans) raised from INR1m to INR2m.

Industrial parks and simpler FDI norms. The government aims to set up 12 industrial parks under its corridor development programme. Separately, it aims to set up 'plug and play' investment parks in 100 cities.

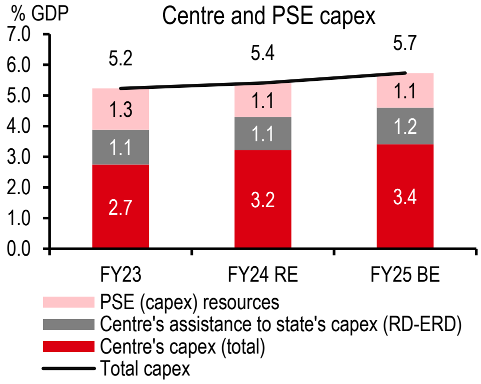
Plans to simplify FDI norms and cut the corporate tax rate on foreign companies to 35% (from 40%) will also likely be supportive for attracting investment over time.

Exhibit 4: Improving quality of spend



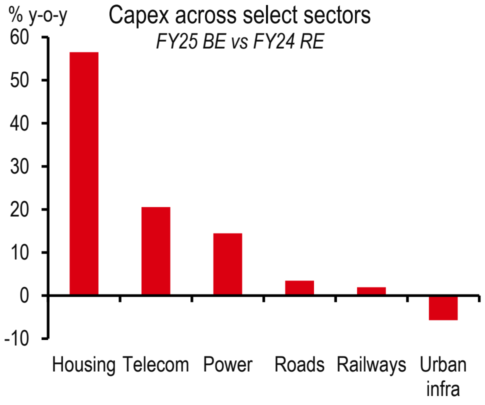
Source: Budget documents, HSBC.
Note: RE: Revised estimates, BE: Budget estimates

Exhibit 5: Overall capex to rise in FY25



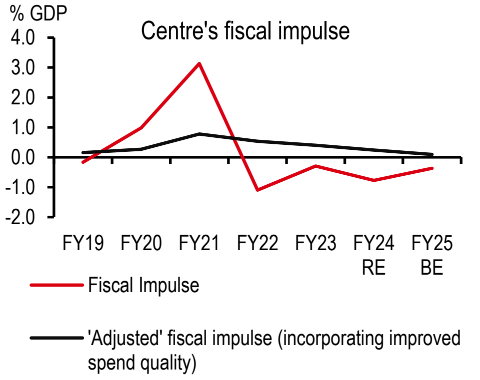
Source: Budget documents, HSBC.
Note: RE: Revised estimates, BE: Budget estimates

Exhibit 6: Capex is broadening out to housing and power



Source: Budget documents, HSBC.
Note: RE: Revised estimates, BE: Budget estimates

Exhibit 7: The adjusted fiscal impulse is marginally positive



Source: Budget documents, HSBC.
Note: RE: Revised estimates, BE: Budget estimates

Import tariffs. Import tariffs were lowered for many items (gold, silver, platinum, lithium, copper, and cobalt), which we think is good for domestic manufacturing. But tariffs were also raised for a few items (like ammonium nitrate, flex banners, and select telecom equipment). We believe low and stable tariffs are at the heart of India gaining prominence in export markets.

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), asset sales, and much of the higher RBI dividend coming in as a transfer from abroad (rather than on the back of domestic financial repression), we find that the fiscal impulse is marginally positive (see exhibit 7).

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

Disclosure appendix

Important disclosures

Additional disclosures

1 This report is dated as at 24 July 2024.

2 All market data included in this report are dated as at close 22 July 2024, unless a different date and/or a specific time of day is indicated in the report.

3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking, Principal Trading, and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

4 You are not permitted to use, for reference, any data in this document for the purpose of (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments, (ii) determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument, and/or (iii) measuring the performance of a financial instrument or of an investment fund.

Disclaimer

[1240489]