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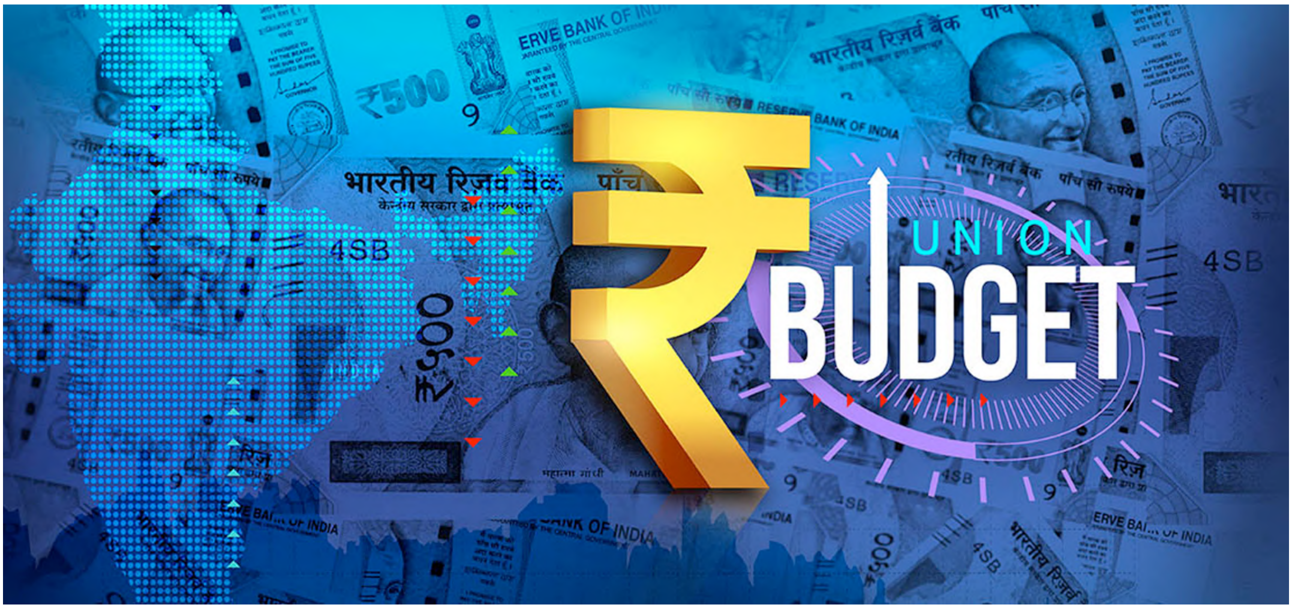
UNION BUDGET 2025-26 EXPECTATIONS: FOCUSING GROWTH WITH STABILITY

29 January 2025

The Union Budget FY26 is a few days away from now, and market is filled with expectations. It has been anticipated that the budget may peg the nominal growth of India’s GDP at 10.4%, higher than 9.7% projected for FY25, which should be aligned with the fiscal deficit target below 4.5%.

Given the global uncertainty posed after Donal Trump has become the 47th president of the United States (US) once again, India among the emerging economies (EM) is in the process of adopting a carefully designed policy path, fighting with a continuous declining rupee and volatile inflation. The policy path ideally should be well-balanced with the objective of maximising growth and employment going forward.



India’s real GDP has been estimated to grow by 6.4% in FY 2024-25 as compared to the growth rate of 8.2% in Provisional Estimate (PE) of GDP for FY 2023-24. Nominal GDP has witnessed a growth rate of 9.7% in FY 2024-25 over the growth rate of 9.6% in FY 2023-24.

The slowdown in the current GDP is largely due to the deceleration in the manufacturing sector at 2.2% during the second quarter (though the first advanced estimate has pegged the overall growth at 5.3%), whereas the agriculture shows promising trend at 3.5% during the same quarter.

It is interesting to note that, whereas the real GVA growth rate for secondary and tertiary sector has been pegged lower at 6.5% and 7.2% respectively, the growth for agriculture sector has been pegged higher at 3.6%.

A larger expectation from the forthcoming budget is to put more purchasing power in the hand of the common people by tweaking in the personal income tax rates as well as by rationalising the Goods and Services (GST) tax structure. According to media reports and central bank data, households' borrowings has increased by 56% towards ₹120 trillion by March 2024, which remains at around 43% of GDP during June'24. Adjusting for per capita income (PCY), it remains much higher compared to some emerging market (EM) economies.

Persistent high inflation has weighed heavily on households' disposable income, especially of urban Indians, whereas the private urban consumption expenditure has taken a heavy toll. Interestingly, personal income tax collections including the securities transaction tax (STT) has crossed ₹10.45 lakh crore in FY24 helping to sustain central government finances, whereas the collection from the corporate taxes falls short at ₹9.11 lakh crore. Hence, some expectations on this front are- rationalisation of income tax slabs (e.g. maximum 30% should start for income above ₹15 lakh, increase in standard deduction from the current ₹75,000 in the new tax regime, increasing tax base further etc.).

Further, if the new tax regime would be gradually made a default tax regime, then appropriate tax slabs should be selected carefully and possibly floating a discussion paper in public domain taking opinions from common people/stakeholders. This is essential for providing relief for middle-income class taxpayers as well as to create bigger market by providing tax incentives to them.

Experts' opinions and some studies have indicated that increasing the basic exemption limit and reducing the number of tax slabs can make the system more competitive along with enhancing tax base.

Private capex is yet to show visible signs of pick-up. The growth in general government capital expenditure (public capex) is also subdued. The GOI is expected to exceed its fiscal consolidation target, ending the year at 4.8% of GDP compared to 4.9% budgeted for the current fiscal, due to the lower capex amid election year.

India is expected to target a fiscal deficit of 4.4-4.6% of GDP for FY26. The anticipated gross tax revenue seems to be aligned with the target; the budget is likely to target a gross tax revenue growth of 10.5%-11% over the revised estimates (RE) of FY25. A positive is that GST and customs duties collections (indirect taxes) have surpassed the Budget Estimate (BE). The custom duty collections are facilitated during Apr~Nov'24 due to higher gold and petroleum imports.

The Goods and Services Tax (GST) collections have gone up by 9.3 per cent so far in the current fiscal 2024-25 to Rs 14.56 lakh crore. In the April-November period of last year, the tax mop-up was Rs 13.32 lakh crore. On the central government borrowing plan, out of Gross Market Borrowing (GMB) of ₹14.01 lakh crore budgeted for FY 2024-25, ₹6.61 lakh crore (47.2%) is planned to be borrowed in H2 through issuance of dated securities, including ₹20,000 crore of Sovereign Green Bonds (SGrBs). After the RBI's liquidity management measures announced on 27 January 2025, the yield on the 10-year G-Sec dropped to the 6.7% mark, going forward the yield is anticipated to be range-bound.

The manufacturing sector in gross value added (GVA) shows disappointing growth that dragged down the growth. Demand concerns in Urban areas that were flagged by most FMCG companies in the Sept'24 quarter are getting worse. This is the time to boost urban consumption, while maintaining the sustained growth momentum for the agricultural sector. This can be done by addressing concerns for MSMEs, MGNREGS and related schemes, measures aimed at raising agricultural production and productivity, etc.

Given the forthcoming probable further 'trump tariff' and repercussion effect between US-China tensions, Budget should review the existing inverted duty structure and to improve further to avoid distortions among the intermediate inputs. Further, this is the high time to rethink about not only 'China plus one' but also 'US plus one' strategy to engage further with other countries including EM countries. There is need to carry on policies such as safeguard duties on the import of certain steel items. However, instead of retaliatory tariff, a careful trading engagement with other countries, even on bilateral basis could more effective.

The FY26 Union Budget is also likely to focus on the National Infrastructure Pipeline (NIP) to incentivise greater private sector participation, addressing funding bottlenecks in critical sectors like-highways, water supply systems, railways, renewable energy etc; as well as channelise investible funds towards sustainable infrastructure etc. Innovative and appealing financing mechanisms like surety bonds can be explored as they are fruitful both from the perspectives of project completion and financial security.

More importantly, a transparent policy with smooth communications and faster project execution are essential to fructify the 'ease of doing business' in an effective manner that would enable more foreign participation with continuous flow of the foreign direct investment (FDI).