Economics

DBS Flash

India's Budget to align with strategic objectives

Economics/Growth/Inflation

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- *Positive strides in India's fiscal health were attested by a rating upgrade last year.*
- *We expect the FY26 fiscal deficit target to be met.*
- *A shortfall in revenues will be compensated for by spending rationalisation.*
- *The debt-to-GDP ratio will be the primary anchor for the FY27 Budget, aligned to deficit goals.*
- *We don't expect any direct tax changes; gross revenues buoyancy is expected to stay ~1x.*
- *Capex budget is likely to stay above 3% of GDP, with a focus on implementation.*
- *Gross borrowing is poised to rise to a fresh high, factoring in redemptions and potential switches.*
- *We expect Budget measures to align with the economy's strategic ambitions, including on manufacturing and social welfare.*
- *A busy state election calendar lies ahead.*

India's fiscal health has strengthened post-pandemic, with the central government's deficit halving in this timeframe. A testament to this confidence, S&P upgraded India's outlook and sovereign rating after nearly 18 years in 2025. We expect this trend to continue, albeit the pace of aggressive consolidation is likely to moderate.

FY26 run rate necessitates expenditure rationalisation

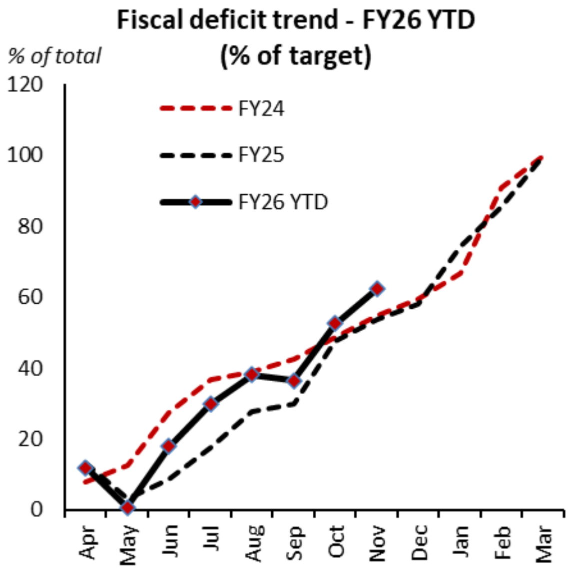
We don't expect a compromise in meeting the FY26 fiscal deficit target, with a shortfall in tax collections likely to be compensated by a recalibration in spending outlays.

Firstly, the impact of the prevailing sub-9% nominal GDP vs. the budgeted 10.1% for FY26 on the fiscal math will be minimal. The First advance GDP growth estimate at 7.4% was near street expectations, capturing data up to Nov25-early Dec25, lending upside bias to the second reading/actual release, as in the past.

Nominal GDP pace is a crucial input for budgetary ratios. The GDP deflator has been estimated at 0.5% vs. 3.1% last year, the lowest in nearly five decades. Although FY26 nominal GDP growth of 8% is weaker than the budgeted 10.1%, the nominal FY25 value fared better than estimated. FY25 nominal GDP rose to INR 330trn vs budgeted INR324trn, raising the comparative base for FY26 and thereby making 8% growth adequate to meet the FY26 deficit ratio. In effect, the stronger-than-expected nominal GDP base in FY25 reduces the risk that

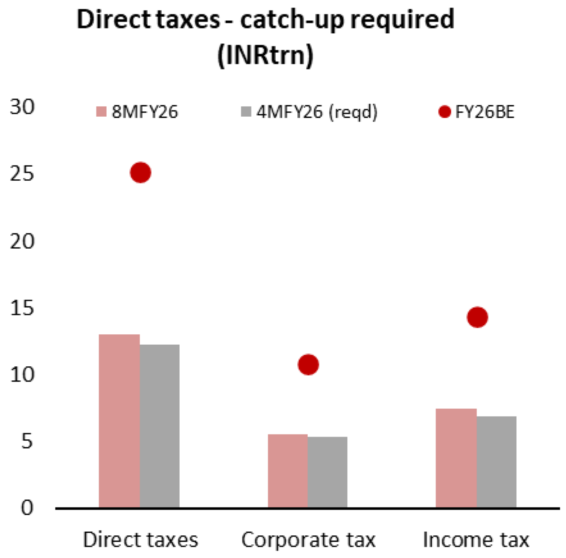
FY26 deficit targets will be missed solely because of slower nominal growth.

Secondly, the Apr-Nov25 (8MFY26) deficit was wider than the corresponding period last year. The 8MFY26 deficit reached 62.3% of the annual target, compared to 52.5% at the same time in FY25. Total receipts stood at INR19trn (55.7% in 8MFY26 vs 59% last year), while expenditure was at INR29.2trn (57.8% vs 56.9%). This is also reflected in the broader run-rate of the primary deficit (fiscal deficit minus interest payments). The 8MFY26 primary gap stood at 78.9% of the full-year target vs. 41.8% at the same time in FY25. Much of this was due to frontloading of capex spending, while revenues lagged.

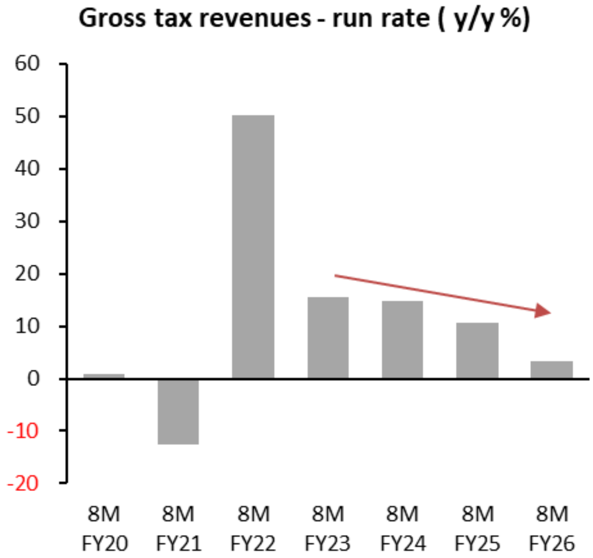


Source: CEIC, CGA, DBS

Next, net tax receipts are on course to miss budgeted estimates due to the GST rate rationalisation measures, direct tax relief, and lower tax buoyancy on the back of weaker nominal growth (see chart). The miss is evident under direct taxes - corporate as well as income tax, which need to rise 11.7% yoy and 43% respectively in the remaining four months to meet the annual budgeted targets. We also note that consecutive tax relief measures have pressured gross tax revenue growth.



Source: CGA, CEIC, DBS



Source: CEIC, CGA, DBS

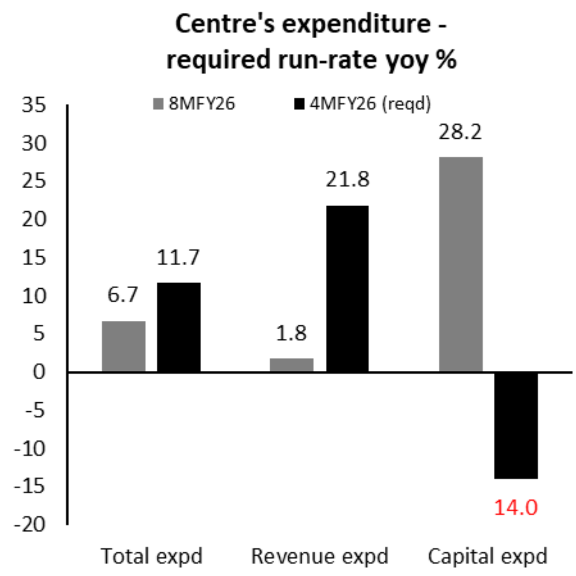
While seasonally, there will be some catch-up in direct collections late in the quarter/year, there is likely to be an undershoot on an annual basis, especially in personal income taxes due to cuts announced in last year's budget, while corporate collections might meet the FY26BE. We expect a revenue shortfall of about INR 1.1 to INR 1.2trn (0.2-0.3% of GDP).

Other tax heads, for instance, customs duty contracted in 1H, with excise duties likely to be the only outlier, as collections received a hand from the increase in petrol duties earlier in the year. Notably, the sub-head **dividends & profits** has been strong (104% of target by 8MFY26) due to the central bank's dividends, which divestments lag with only a tenth of the full-year budget met by 1HFY26. Higher dividends from the central bank, as well as public sector firms and oil companies, will be a key tailwind offsetting slower tax takeaways.

Fourth, expenditure compression will also be a crucial part of the balancing math. Spending is up 6.7% yoy in 8MFY26, much due to an increase in revenue allocations, particularly towards subsidies, while capital spending is running above the budgeted pace.

Revenue expenditure, which makes up four-fifths of the total outlay, has remained in the slow lane (see chart), registering 1.8% growth in 8MFY26. Capex disbursements in FY26 have been relatively faster to make up for lost time in FY25 (due to elections). Capital spending rose a sharp 28% yoy in 8MFY26 (compared to the budgeted 10%). This took capex to 58% of the full-year budget in 8MFY26 vs. 48% at the same time last year. We also note that the rise in capex also entailed an increase in loans to advances to the states and other entities, as well as to departments like FCI for past dues, beyond pure allocations towards infra.

For the remaining four months of FY26, we expect revenue opex to pick up momentum but stay below the targeted pace, while capital spending slows down due to the strong YTD catch-up. We expect a small undershoot in capital spending (-0.1% of GDP) and slower revenue expenditure to pick up some of the slack of below-budgeted revenues.



Source: CEIC, CGA, DBS

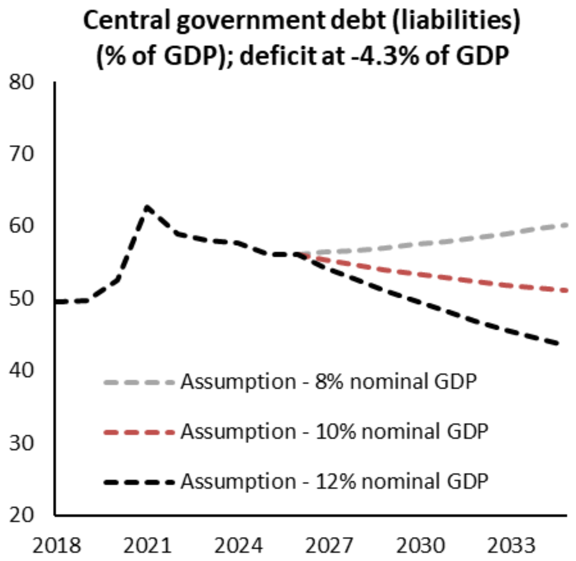
Revenue underperformance at the half-year mark (~0.1-0.2% of GDP shortfall) increases the likelihood that a recalibration in spending outlays will be necessary to keep within the centre's deficit goalposts. In light of the recent sovereign rating upgrade, fiscal health, especially general government (centre and states) fiscal consolidation and moderation in public debt levels, **we don't expect any compromise in meeting the FY26 fiscal deficit targets.**

FY27 targets to align debt with deficit levels

Key factors for the FY27 Budget will include:

i. **Debt to GDP ratio will be the primary anchor**, i.e., aiming to lower the Centre's debt to 50% of GDP by FY31 from ~56.1% in FY26, aligned with the deficit targets. This compares with the previous practice of setting a specific deficit target.

ii. **At this juncture, the nuances of the debt targeting framework are unclear, particularly if the new fiscal rule broadens the goalposts to include the primary balance.** We expect a slower pace of consolidation here on, implying that fiscal policy will not be as contractionary as before. The central government debt target is likely to be maintained at ~55% of GDP, staying on course with the fiscal sustainability path. The FY27 fiscal deficit might be lowered to -4.3% of GDP from the projected -4.4% in FY26. Down the line, we are mindful that swings in the nominal GDP growth and interest rate changes narrow the extent of correction in the fiscal deficit but not materially impact the debt levels (see chart below for scenarios).

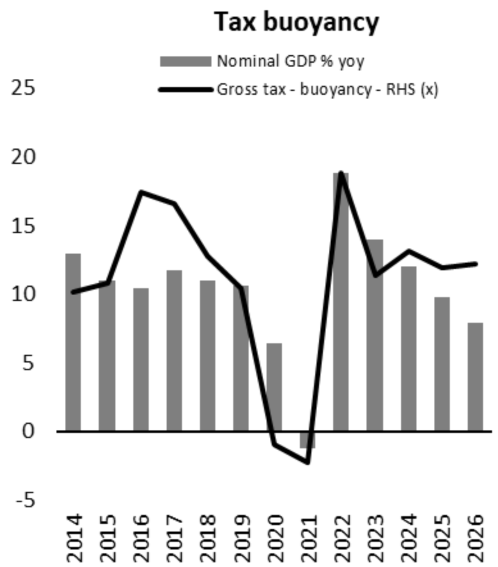


Source: RBI, CEIC, DBS

iii. For our base case, **nominal GDP growth** is assumed at 10% yoy, compared to a revised ~8.0-8.3% in FY26 (see table for details).

iv. **We don't expect any surprise tax announcements** in the Budget presentation. Direct and indirect tax reductions are already in the math, given the income tax relief in the FY26 Budget, GST rate rationalisation in Sep25, an excise duty hike on cigarettes, as well as a GST increase on tobacco products, and a cess on pan masala announced in Jan26 and effective from Feb 1.

v. Given the improvement in the nominal GDP, tax buoyancy is also set to improve. While gross tax revenue might slip from the budgeted 12% of GDP in FY26, FY27 is likely to improve to 11.4-11.5% of GDP. Non-tax revenues should draw strength from dividends from the central bank and state-owned companies. The divestment target is likely to be small at ~INR300-400bn.



Source: CEIC, DBS

vi. **Centre's capex budget in FY27** to stay around 3.0-3.1% of GDP, up ~7-8% yoy from FY26, with an emphasis on identifying shovel-ready and greenfield projects. This spending head will also include concessionary support for states for their capex commitments. In our recent India 2025-2040 macroeconomic report, we outlined our base case for the centre's capex spend to expand to INR 15trn over the next decade and a half, assuming a conservative CAGR of 11% (matching 2000-2019 run-rate), also considering absorption limitations. States' capex allocation (capital outlay) also grew sharply, up 13% CAGR between 2019 and 2025. We expect that momentum to continue in the decade ahead, putting the cumulative centre and states capex at INR 22-23trn.

vii. We expect a small moderation in revenue expenditure, with the proportion likely to moderate from 10.8% of GDP (FY26 RE) to 10.7% of GDP in FY27 BE. Pay commission doesn't need to be reflected in the math as the report has until Apr27 (FY28) to be tabled, although we will be watchful for any potential frontloading in the expenses; this will require the centre to put aside an estimated INR 2.0-2.5trn through to FY28.

viii. While outside the remit of the budget, **state finances will be an important watch factor**. States had estimated a fiscal deficit of -3.2% of GDP for FY26, slightly above the -3% of GDP recommended by the 15th Finance Commission. Revenues typically comprise a mix of own revenue and transfers from the centre, with states budgeting nearly half of their earnings from own tax revenues. The run-rate for 1HFY26 points to a stronger pick up in capital receipts. i.e., borrowings, while growth in revenue receipts was flat. Besides slower pick-up from stamp duty-related receipts, the cessation of compensation cess under GST, and the initial impact of GST rationalisation, these factors might also impact earnings in the coming quarter.

Meanwhile, the centre frontloaded tax devolution transfers in 1HFY26 to boost states' revenue position. Separately, loans disbursed under the capex-related funding plan rose from INR 120bn in FY21 to INR 1.5trn in FY26. Expenditure is increasingly skewed towards revex spending, especially in poll-bound states where populist spending has increased the proportion of non-developmental spending.

On a related note, the country is heading into a busy period for state elections in 1H26, with Tamil Nadu, West Bengal, Puducherry, Kerala, and Assam heading to the polls in May-June 2026.

ix. **The size of borrowings** will be an important consideration for the bond markets. Given our underlying math and deficit target, we expect FY27 net borrowings to rise to INR 12trn (vs ~INR 11.4trn in FY26), which amounts to ~73%

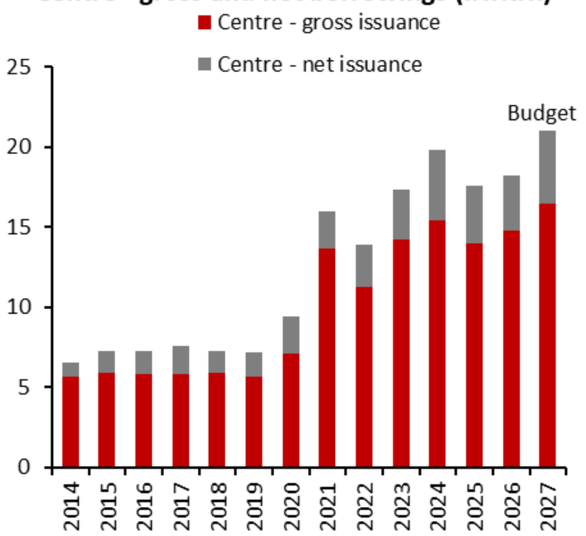
FY26 Revised and FY27 Budget Fiscal math - DBS forecasts

	INR bn					*as % of GDP*		
	FY24 A	*FY25 A*	*FY26 BE*	*FY26 RE (DBSf)*	*FY27 BE (DBSf)**	*FY25*	*FY26 RE (DBSf)*	*FY27 BE (DBSf)**
Revenue receipts	27290	30365	34204	33500	36800	9.2	9.4	9.3
Tax revenue (net)	23273	24990	28374	27400	30800	7.6	7.7	7.8
Non-tax revenue	4018	5375	5830	6100	6000	1.6	1.7	1.5
Non-debt capital rec	597	418	760	400	400	0.1	0.1	0.1
Total expenditure	44434	46555	50654	49500	54000	14.1	13.8	13.7
Revenue expenditure	34942	36035	39443	38500	42100	10.9	10.8	10.7
Capital expenditure	9492	10520	11211	11000	11900	3.2	3.1	3.0
Fiscal deficit	16547	15772	15690	15600	16800			
% of GDP	*-5.5*	*-4.8*	*-4.4*	*-4.4*	*-4.3*			
Nominal GDP	*12.0*	*9.8*	*8.0*	*8.3*	*10.0*			

*Source: Budget documents, DBS; *based on nominal GDP of 10%*

of the deficit next year (see second chart). Assuming redemptions at around INR 4.5trn (factoring in potential switches), gross borrowings are likely to rise to a fresh high of INR 16.5trn. The gross scale might be notionally lower if the authorities opt for more switches to push out part of FY27 maturities for longer-out tenors, though this needs to be balanced with the prevailing tepid demand for duration papers. The FY28 maturities stand at INR6trn, which might be lowered through switches in the coming year (see chart).

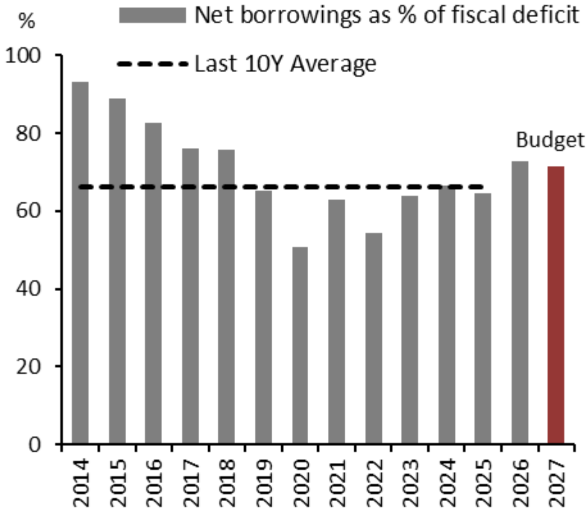
Centre - gross and net borrowings (INRtrn)



Source: CEIC, RBI, DBS

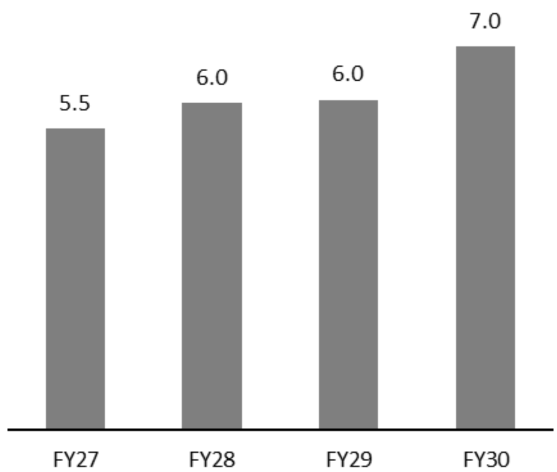
Issuance of T-bills is likely to increase, along with a smaller scale for the small savings scheme, in line with collections this year. **With bond yields hardening over the past six months, robust demand will also be** important. Besides an active central bank, other institutional buyers face hurdles. For instance, tepid replacement demand from banks, incremental interest from pension funds, has leaned towards equities, and insurance companies are constrained by regulatory issues. Adding to this that the centre has rationalised the share of long-term paper in its issuance mix (still higher than past trends), but states are yet to follow suit. In the near-term, the central bank is expected to conduct more open market operations and swaps to infuse liquidity and anchor borrowing costs. Signs of fiscal consolidation also bodes well for bond market sentiments, with offshore interest to be steadier as and when the rupee stabilises.

Centre: Net borrowings vs deficit



Source: CEIC, RBI, DBS

Outstanding GSecs until FY30 (INRtrn)



Source: RBI, DBS

Budget agenda – align with strategic objectives

Tracking the government's move to expedite reforms and oil domestic engines in the past year, we expect the FY27 Union Budget to back strategic priorities and expand the role of 'new economy' sectors. Admittedly, affirmative action will continue outside the budget schedule as well.

First is to continue with higher capex outlays towards infrastructure into railways, roads and highway, defence and transfers to states (these make up ~80% of effective capex), just as private investments, on aggregate, remain uneven and face global uncertainty. A strong supply-side response will be important to attract fresh investments and improve the ease of doing business. As a testament, India's score as well as ranking on the World Bank's Logistics Performance Index – which considers customs, infrastructure, logistics competence and timeliness, amongst other factors – improved post pandemic, compared to the prior five years. On practical grounds, the scope and breadth of the existing PRAGATI platform (Pro-Active Governance and Timely Implementation) can be expanded to strengthen ownership of ministries and states, while PM reviews are reserved for strategic projects[1].

In our recent India 2025-2040 macroeconomic report, we outlined our base case for the centre's capex spend to expand to INR 15trn over the next decade and a half, assuming a conservative CAGR of 11% (matching the 2000-2019 run-rate), also considering absorption limitations. States' capex allocation (capital outlay) also grew sharply, up 13% CAGR between 2019 and 2025. We expect that momentum to continue in the decade ahead, putting the cumulative centre and states capex at INR 22-23trn.

Second, prioritise strategic sectors, including defence, semiconductors, electronics, renewable energy, artificial intelligence/ robotics, etc. Budget allocations towards the defence sector have targeted modernisation and the expansion of indigenous manufacturing capacity, with indications of a double-digit increase in the FY27 Budget. An uncertain geopolitical environment also increases the urgency of boosting domestic procurement and strengthening the security apparatus. Development of new core technologies will also require a skilled workforce, which can benefit from industry and cross-country collaborations. For instance, the auto sector can get a hand with budgetary support for EV vehicles and procurement/progress on rare-earth policies.

The aggregate share of manufacturing as % of GDP has yet to improve materially, even as certain segments have expanded their market share. **In addition to stimulus, the strategy will also focus on improving competitiveness**.

The 2026 Asia Manufacturing Index by Dezan Shira & Associates, which measures the relative competitiveness of major economies across eight key pillars and 43 sub-parameters, ranked India at the sixth position amongst its Asian peers, steady from 2025. China tops the list, followed by Malaysia and Vietnam, while Bangladesh was last. To further boost competitiveness, the centre might explore rationalising custom duties and reworking

[1] Report

import procedures for intermediate components. Maintaining adequate capital outlay for R&D will help move up the sectoral value chain, besides offering long-term tax incentives, expansion of PLI-like programs, credit/ capital supply, and infrastructure zones. For instance, industry leaders have also sought improvements in domestic testing infrastructure, especially for engineering goods and manufacturing output. States have undertaken reforms to attract investments, building strong ecosystems in textiles, aerospace, electronics, autos, and footwear, etc., which highlight the benefits of clustering and scale in production activities.

A case in point was the recent rollout of the India Semiconductor Mission 2.0 (ISM 2.0), which proposed doubling the financial outlay to INR 1.8trn vs. INR760bn in 2021. This edition will prioritise chip design (domestically produced processors), capital equipment for manufacturing, access to specialised gases, etc, and also expand the reach of MSMEs in this space.

After China, India is the only market that provides a combination of a well-sized consumption market and large-scale production, garnering sufficient interest from the investment community for the diversification play. As an imperative, a clear matrix framework for selected product and geography-specific clusters (akin to Assam, Odisha, etc.) will also be helpful in channelising executive and administrative efforts to materially improve the economy's export share as well as defend against diversification attempts by peer countries.

Next, ironing out governance issues will be prioritised via a focus on deregulation and decriminalisation to identify and eliminate redundant or outdated compliance obligations in key sectors, via a bottom-up approach. While the formation of the official Deregulation Commission announced in last year's budget appears to still be waiting in the wings, other high-level committees have sought to address these issues, including involving states to address concurrent subjects like land and labour. We'll await further details on the proposed commission, which would ideally have representation from all key stakeholders especially from the private sector and regulators.

Lastly, ground-up support for the domestic priority sectors is bound to continue - four key priority groups, Gareeb (poor), Yuva (youth), Annadata (farmers) and Naari (women) – referred to as GYAN segments, are likely to be in the forefront of social assistance and development programs. For instance, the farm sector might receive a significant expansion of the food processing schemes, including the Pradhan Mantri Formalisation of Micro Food Processing Enterprises (PMFME) Scheme and the Pradhan Mantri Kisan Sampada Yojana (PMKSY), which are set to lapse at the end of FY26[2]. The MNREGA also underwent a facelift recently, with a change to provisions, mechanisms, and funding arrangements, besides being renamed. Separately, an overarching push towards strengthening human capital will be a prerogative, marked by initiatives in industry-specific training, upskilling, better healthcare, and improved access to education.

[2] Report

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