Union Budget FY25 – Fiscal consolidation on track; added emphasis on job creation

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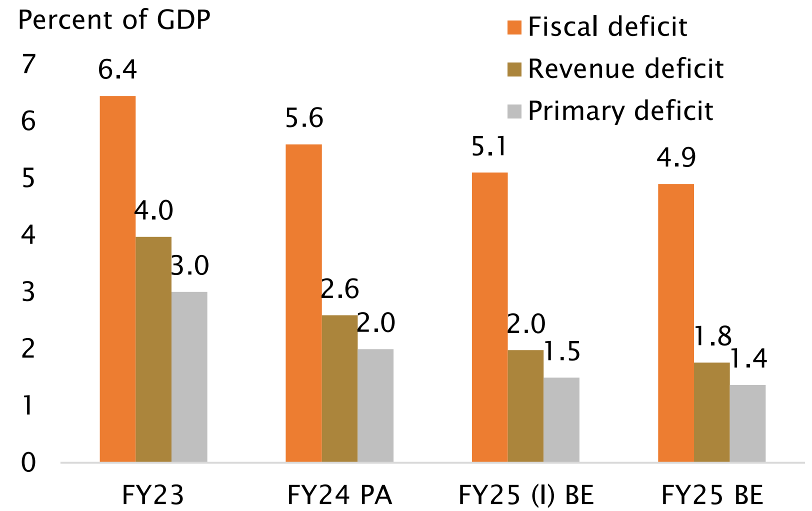
Key takeaways

- The Final Budget for FY25 furthered the government's fiscal consolidation goal by trimming the deficit target to 4.9% of GDP from 5.1% announced in the Interim Budget. This was aided by higher-than-expected dividend receipts from the central bank and other public sector enterprises, and paves the way for the goal of 4.5% fiscal deficit in FY26, though the Budget indicated that the government will be more focused on lowering debt to GDP thereafter. Compared to the Interim Budget, the Final Budget penciled in higher estimates for both revenue and capital receipts. On the expenditure side, revenue spending was raised but capex was kept unchanged.
- The Budget chalked nine priority areas that mostly signaled policy continuity but with particular emphasis on employment generation. The government announced five schemes, three of which were put together as employment-linked incentive (ELI) scheme, akin to the production-linked incentive scheme (PLI) that was introduced in 2020 to support domestic manufacturing. In addition to supporting employers and new employees, two of the five schemes could raise disposable income, with positive spillovers for consumption.
- There was a tinge of coalition politics at play, with some of the projects announced for the states of Bihar and Andhra Pradesh, where regional ruling parties are a part of the alliance party at the Centre.
- Among the nine priorities outlined in the Budget, there was also mention of next generation reforms aimed at enhancing productivity across factors of production.
- The government's focus on rural spending and PLI scheme remained intact, with higher allocations for FY25.
- The Budget also earmarked more support for rural and urban housing under PM Awas Yojana. This bodes well for the capex cycle in the real estate and construction sectors that has been recovering.
- The provision of a credit guarantee scheme for MSMEs in the manufacturing sector for purchase of machinery and equipment without collateral could also support fixed asset capital creation and further broad-based recovery in the capex cycle.
- Both gross and net borrowing are expected to be lower than what was accounted for in the Interim Budget.

Fiscal deficit trimmed to 4.9% for FY25BE; consolidation on track

- The Union Budget for FY25 stuck to the ongoing fiscal consolidation path by lowering fiscal deficit estimate to 4.9% from 5.1% announced in the Interim Budget. This was largely enabled by the non-tax revenue component, which was buoyed by dividend receipts from the central bank and other public sector enterprises.
- Compared to the Interim Budget, net tax revenue is estimated to be lower due to higher devolution earmarked for States. Under non-debt capital receipts, the disinvestment target was unchanged. The Budget did not tinker with capital expenditure, but there was an increase in revenue expenditure estimate.
- The government is resolute in its commitment to lower fiscal deficit below 4.5% in FY26. From FY27, the government will target fiscal deficit in a way that keeps central government debt on a declining path. Provisional data for FY24 shows debt at 58.2% of GDP, and the budget estimate for FY25 is at 56.8%. As per the latest IMF forecasts, India's general government gross debt (Centre + States) was at 82.7% of GDP in 2023 and is expected to moderate to 77.5% by 2029.

Fiscal consolidation on track



Estimates for both receipts and expenditure pegged higher than the Interim Budget; capital expenditure kept unchanged

	Rs. bn					%YY				% of GDP			
	FY23	FY24 PA	FY25 (I) BE	FY25 BE	FY25(I)BE vs BE	FY23/ FY22	FY24PA/ FY23	FY25(I)BE/ FY24PA	FY25BE/ FY24PA	FY23	FY24PA	FY25(I) BE	FY25BE
Total receipts	24554	27889	30803	32072	1269	11.1	13.6	10.4	15.0	9.1	9.4	9.3	9.7
Revenue receipts	23832	27284	30013	31292	1279	9.8	14.5	10.0	14.7	8.8	9.2	9.1	9.5
Net tax revenue	20978	23265	26016	25835	-181	16.2	10.9	11.8	11.0	7.8	7.9	7.9	7.8
Non-tax revenue	2854	4019	3997	5457	1460	-21.8	40.8	-0.5	35.8	1.1	1.4	1.2	1.7
Non-debt capital receipts	722	605	790	780	-10	83.4	-16.3	30.7	29.0	0.3	0.2	0.2	0.2
Total expenditure	41932	44425	47658	48205	547	10.5	5.9	7.3	8.5	15.6	15.0	14.4	14.6
Revenue expenditure	34531	34940	36547	37094	547	7.9	1.2	4.6	6.2	12.8	11.8	11.1	11.3
Capital expenditure	7400	9485	11111	11111	0	24.8	28.2	17.1	17.1	2.7	3.2	3.4	3.4

Net tax revenue lower than IB due to higher devolution for States

- Revenue receipts estimates for FY25 were raised higher from the Interim Budget (IB). Revenue receipts are expected to increase 14.7%YY, marginally higher than 14.5% growth in FY24 (provisional accounts).
- The increase in estimate for revenue receipts compared to the Interim Budget is due to improvement in the non-tax component (1.7% of GDP vs 1.2% in Interim Budget) that was buoyed by dividends from the central bank and other public sector enterprises. Lower estimate for net tax revenue is due to an increase in devolution to States, which more than offset the increase in gross tax revenues. In addition to devolution of taxes, scheme-related transfers to States are expected to increase in FY25, while finance commission grants are slated to moderate.
- The estimates for both direct and indirect taxes were raised from the Interim Budget. Within direct taxes, estimates were lowered for corporate tax but increased for income tax. Within indirect taxes, collections were estimated to be lower in case of GST but expected to be higher for customs and excise duties.
- Within non-tax revenues, interest receipts estimate was increased compared to the Interim Budget, though it was unchanged when compared to the provisional accounts for FY24.

Net tax revenue lower than Interim Budget estimate due to higher devolution earmarked for States

	Rs. bn					%YY				% of GDP			
	FY23	FY24 PA	FY25 (I) BE	FY25 BE	FY25(I)BE vs BE	FY23/ FY22	FY24PA/ FY23	FY25(I)BE/ FY24PA	FY25BE/ FY24PA	FY23	FY24PA	FY25(I) BE	FY25BE
Revenue receipts	23832	27284	30013	31292	1279	9.8	14.5	10.0	14.7	8.8	9.2	9.1	9.5
Gross tax revenue	30542	34648	38308	38402	94	12.7	13.4	10.6	10.8	11.3	11.7	11.6	11.7
Direct taxes	16678	19639	22083	22164	82	17.8	17.8	12.4	12.9	6.2	6.6	6.7	6.7
Corporation tax	8258	9111	10428	10200	-228	16.0	10.3	14.5	12.0	3.1	3.1	3.2	3.1
Income tax (incl. other tax)	8420	10109	11654	11964	310	19.6	20.1	15.3	18.3	3.1	3.4	3.5	3.6
Indirect taxes	13857	14959	16225	16237	12	7.1	8.0	8.5	8.5	5.1	5.1	4.9	4.9
Goods and services tax	8491	9570	10677	10619	-58	21.6	12.7	11.6	11.0	3.2	3.2	3.2	3.2
Customs duty	2134	2331	2313	2377	64	6.8	9.2	-0.8	2.0	0.8	0.8	0.7	0.7
Excise duty	3227	3053	3235	3240	5	-18.2	-5.4	5.9	6.1	1.2	1.0	1.0	1.0
Services tax	4	4	1	1	0	-57.4	-1.6	-76.4	-76.4	0.0	0.0	0.0	0.0
States' share	9484	11295	12198	12472	274	5.6	19.1	8.0	10.4	3.5	3.8	3.7	3.8
Net tax revenue	20978	23265	26016	25835	-181	16.2	10.9	11.8	11.0	7.8	7.9	7.9	7.8
Non-tax revenue	2854	4019	3997	5457	1460	-21.8	40.8	-0.5	35.8	1.1	1.4	1.2	1.7
Interest receipts	279	383	331	382	51	27.3	37.5	-13.6	-0.2	0.1	0.1	0.1	0.1
Dividends and profits	999	1704	1500	2891	1391	-37.8	70.6	-12.0	69.6	0.4	0.6	0.5	0.9

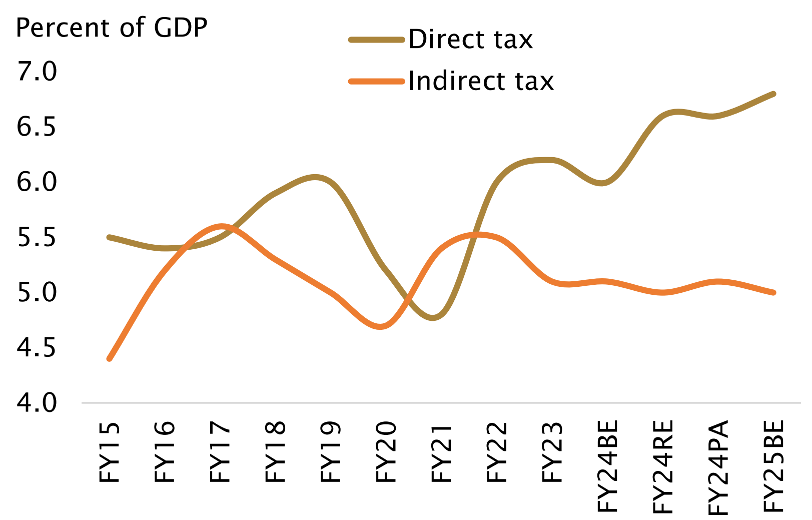
Direct tax collections to remain firm; disinvestment target unchanged

- The strength in gross tax revenues in recent years is being largely driven by direct tax collections. Direct tax collections to GDP continues to remain in an upward trajectory.

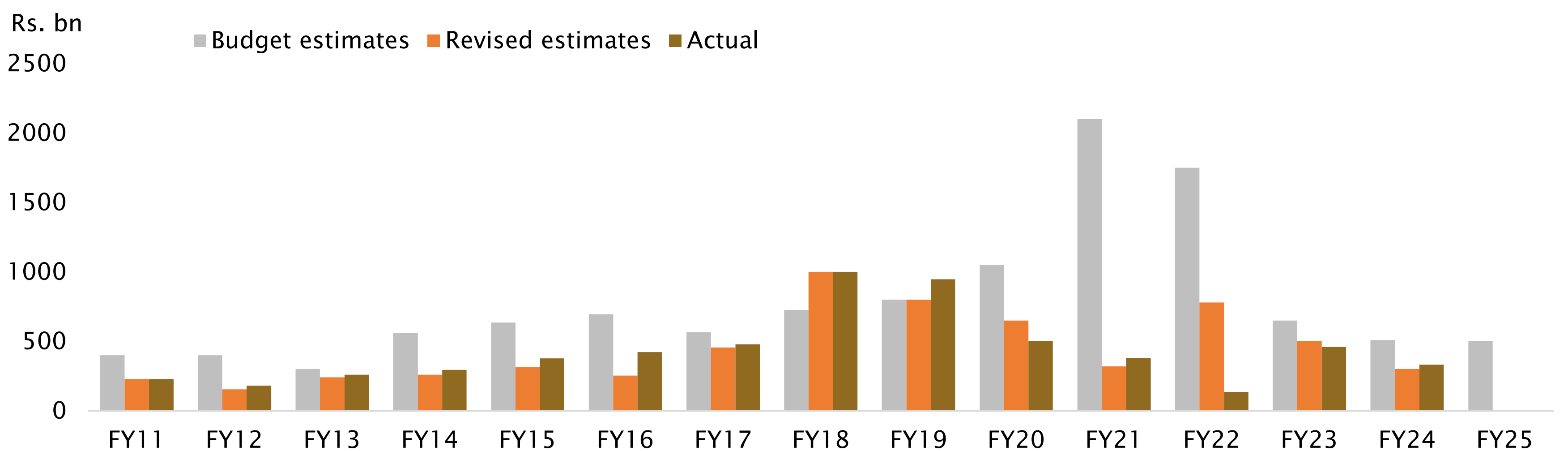
- Under non-debt capital receipts, the disinvestment target for FY25 was left unchanged from the Interim Budget at Rs.500bn. The estimate is in line with the budget estimate for FY24, which was revised lower to Rs.300bn and met by the central government, as per the provisional accounts.

- In the post-Budget press conference, the Finance Minister reiterated the government's intent of a holistic, calibrated disinvestment policy for value maximization rather than just sale of assets.

Direct tax collections continue to grow strongly



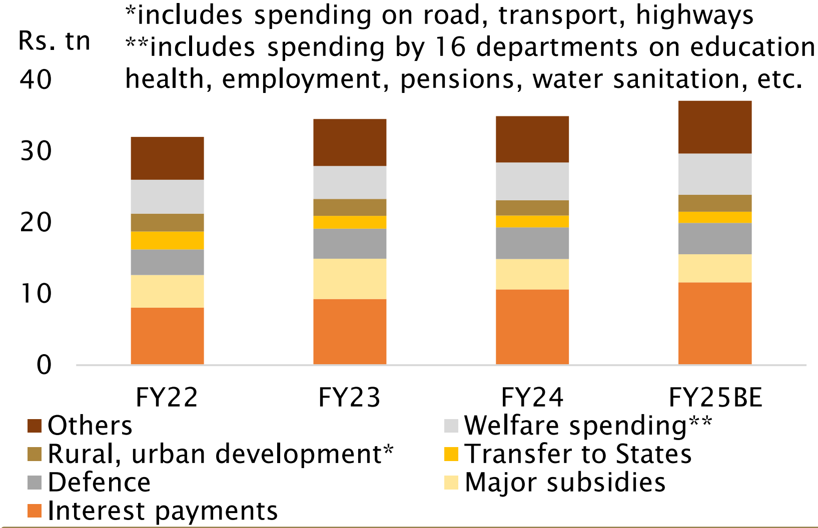
Disinvestment target for FY25 left unchanged from Interim Budget at Rs.500bn



Revenue spending raised from IB; emphasis on job creation, skilling

- The Final Budget for FY25 raised estimate for revenue expenditure by Rs.547bn from the Interim Budget. However, interest payments towards i). internal debt, and ii) small savings, PF, etc. are expected to be lower. The estimate for prepayment premium for reduction of debt was revised higher. Among key areas where expenditure was increased include – labor and employment, agriculture and rural spending, energy security, and infrastructure.
- One of the major features of the Budget was the announcement of five initiatives to facilitate employment and skilling, three of which were put together as employment-linked incentive scheme. The government intends to spend Rs.2 lakh crore over a five-year period that is expected to benefit 4.1 crore youth. The schemes entail a mix of EPFO-related support to employers and new employees, and also cash incentives. The Budget has set aside Rs.120bn for FY25 under the Ministries of labor and corporate affairs for these schemes.
- Despite lower spending earmarked compared to the Interim Budget, the largest part of revenue expenditure in FY25 will continue to be towards interest payments, which is also higher than the provisional data for FY24. While subsidies and defence will also remain major expenditure items, spending is slated to decline year-on-year in FY25.
- Welfare spending, arrived at by summing revenue expenditure by 16 ministries, is expected to be higher, with largest increases in case of agriculture and farmers' welfare, and labour and employment.

Revenue expenditure – key components



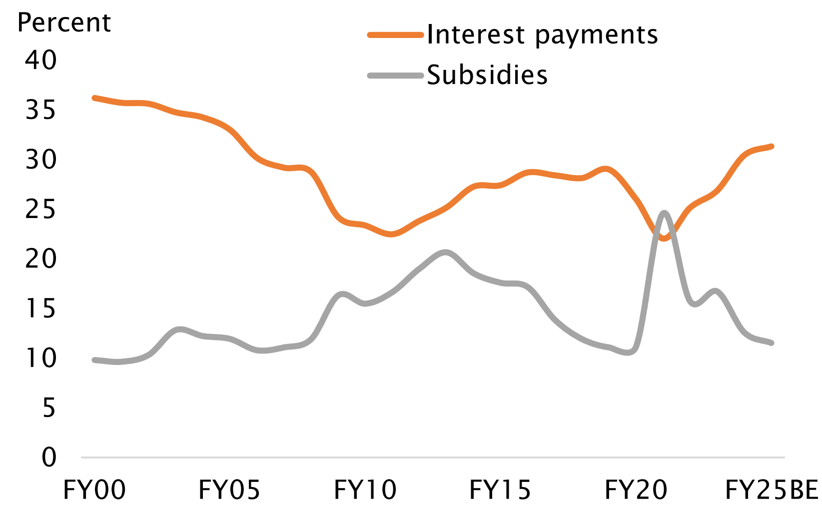
Change in revenue expenditure

Interim vs Final Budget FY25	Rs. bn
Interest payments	-275
Transfers to States	160
Ministry of labour, employment	100
Police (Ministry of home affairs)	93
Ministry of new, renewable energy	63
Ministry of housing, urban affairs	51
Transfers to Jammu and Kashmir	50
Department of agriculture, farmers welfare	50
Department of economic affairs	46
Pensions	25
Ministry of corporate affairs	20
Others	165
Total	547

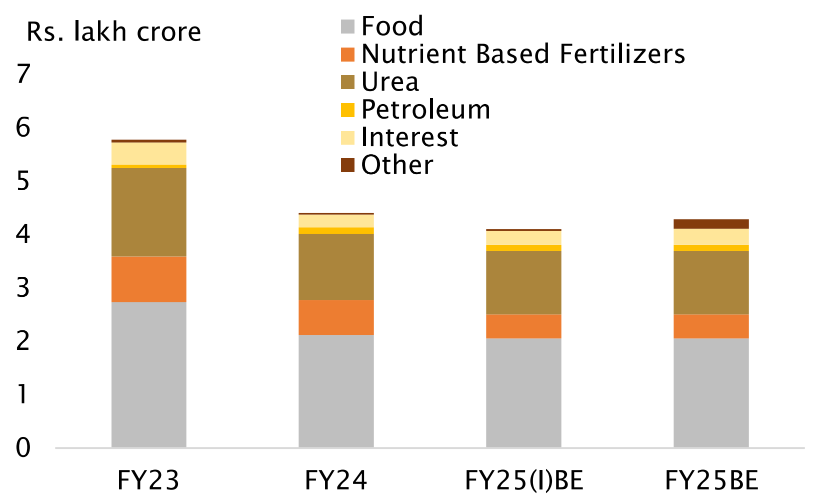
Lower subsidies, higher interest payments earmarked for FY25

- The largest portion of revenue expenditure goes towards interest payments, followed by subsidies and defence. Together, the three account for around half of revenue spending. Post-pandemic, while subsidies have been moderating, interest payments have been on the rise, accounting for 25% of in FY22, which is expected to increase to 31% in FY25BE. This is higher than the pre-pandemic average (FY10-19) of 26%, and inching closer to levels last seen prior to the GFC.
- The share of subsidies in revenue expenditure peaked at around 25% in FY21 and has been declining thereafter. In FY25, it is expected to be at 12%, with lower spending allocated across major subsidy items of food, fertilizer and petroleum (which includes LPG). However, other subsidy items that constitute a relatively lower share, including interest subsidy, are expected to be higher.
- Higher interest subsidies have been allocated for Credit Linked Subsidy Scheme (CLSS) across income groups and Modified Interest Subvention Scheme. The latter provides short-term credit to farmers at subsidized rates, while CLSS provides interest subsidy on housing loans and falls under Pradhan Mantri Awas Yojana (PMAY).
- Under other subsidies, the government allocated Rs.100bn for a price stablisation fund to contain volatility in agri-horticulture items. The Budget also envisaged development of large scale clusters for vegetable production closer to consumption centres, and setting up supply chains.

Share in revenue expenditure



Subsidies



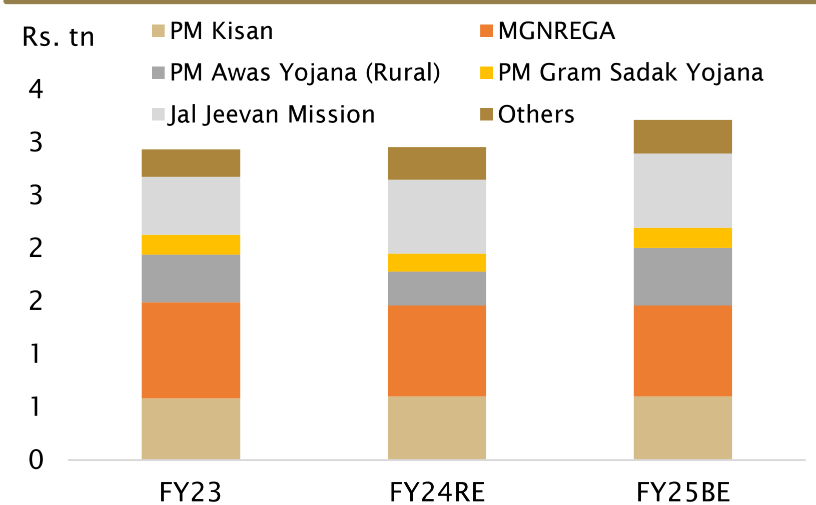
Focus on rural spending, PLI remained intact

- In addition to the introduction of employment-linked incentive (ELI) schemes in the Final Budget for FY25, the government continued to focus on PLI, first introduced in March 2020 for three sectors – large scale electronics, pharmaceutical, and medical devices. Since then, the ambit of the scheme has grown to include other sectors. For FY25, the largest increase in allocation was for the auto and components industry, with overall PLI allocation up 77% year-on-year.
- The government's spending on some of the major rural schemes is slated to increase in FY25 by around 9%YY. The largest allocations continue to be for MGNREGA and Jal Jeevan or National Rural Drinking Water Mission, but spending on these is expected to remain unchanged compared to FY24RE. Higher spending has been allotted under PM Awas Yojana (PMAY-Rural) and PM Gram Sadak Yojana. Under the PMAY scheme, the government plans to support construction of three crore additional houses in rural and urban areas, which includes housing needs of one crore urban poor and middle-class families. Under PMGSY scheme, phase IV will be launched to provide all-weather connectivity to 25,000 rural habitations.
- The Budget noted next generation reforms as one of its priorities, with the development of a policy framework in the pipeline. The Budget touched upon some of the measures around key factors of production, including land and labour.

PLI allocation increased by 77% from FY24RE

(Rs. crore)	FY24RE	FY25BE	Change
Electronics and IT	4560	6200	1640
Large Scale Electronics Mfg.	4489	6125	1636
IT hardware	70	75	5
Auto	484	3500	3016
Pharma	1696	2143	447
Food processing	1150	1444	294
White goods (ACs and LED Lights)	65	298	233
Battery storage	12	250	238
Specialty steel	2	246	243
Drone and components	33	57	24
Textiles	5	45	40
Total	8007	14183	6176

Allocation for rural schemes remains strong for FY25



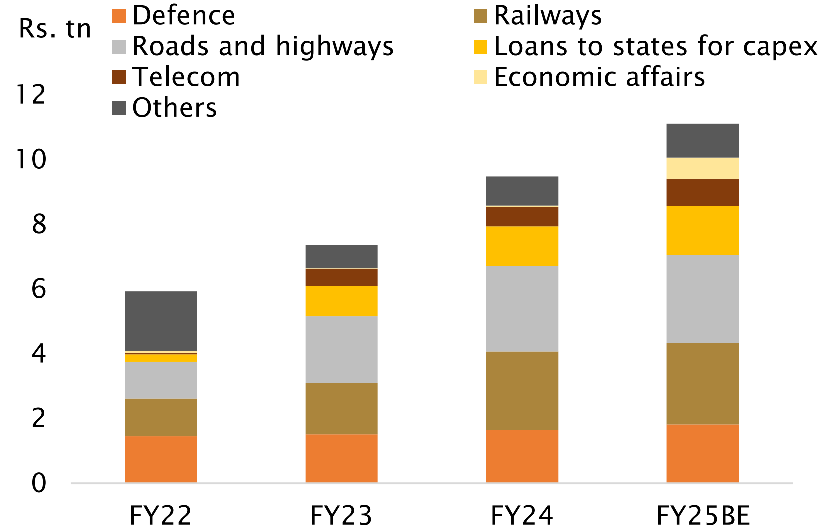
Capital expenditure kept unchanged from the Interim Budget

- In the Final Budget for FY25, capital expenditure was kept unchanged from the Interim Budget at Rs.11.1tn. Despite the moderation in year-on-year growth compared to FY24, capex is slated to remain strong at 3.4% of GDP, and higher when grant-in-aid for capital assets is accounted for. The largest allocations remained towards defence, railways, and roads and highways, with the three accounting for 70% of capex in FY23 and FY24. For FY25, the government has parked a portion of funds under the Department of Economic Affairs to support infrastructure projects whenever required, so that the capex allotted to the three sectors amounted to 64% of spending in FY25.

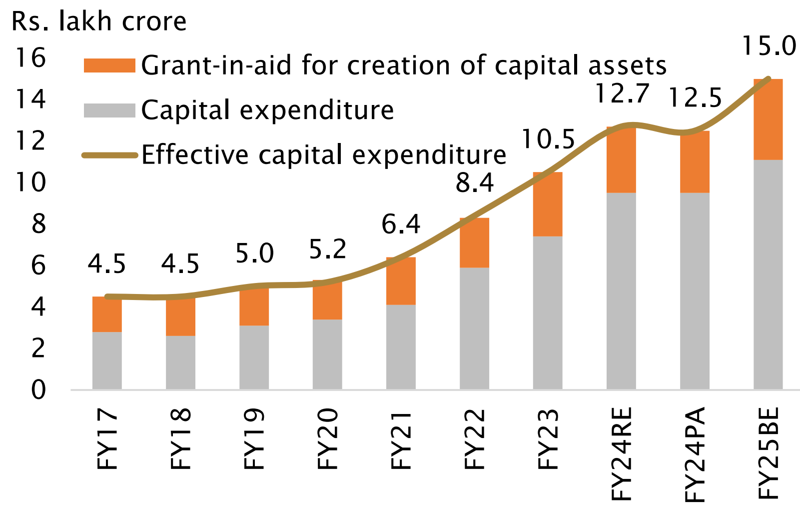
- Loans to states for capital expenditure has been pegged at Rs.1.5tn, up from Rs.1.3tn in FY24BE.

- Among the various schemes announced for supporting the MSME sector, the Budget also provided for a credit guarantee scheme for MSMEs in the manufacturing sector that will facilitate term loans for purchase of machinery and equipment without collateral or third-party guarantee. This could spur fixed asset capital creation and support a broad-based recovery in the capex cycle.

Capital expenditure – key components



Capex expected to remain strong in FY25



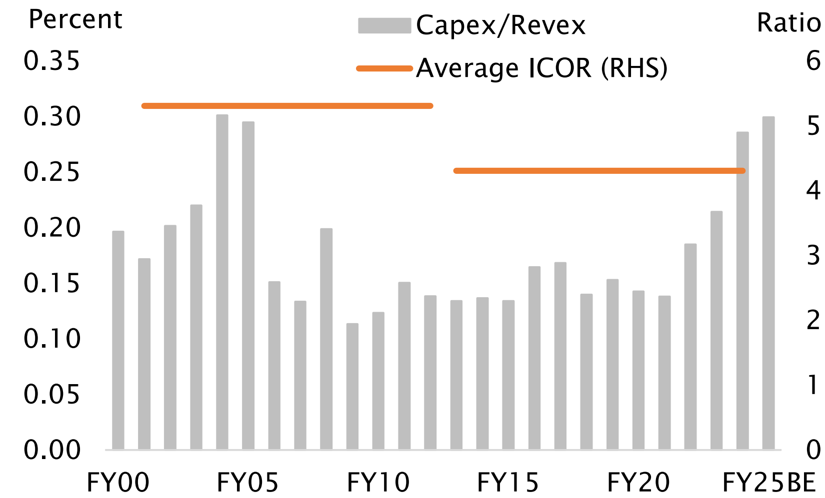
Improvement in capital efficiency bodes well for economic growth

- Amid the government's continued thrust on capital expenditure, the quality of spending, measured by the ratio of capital to revenue expenditure, has been improving and is currently around the peak seen in FY04 and FY05.

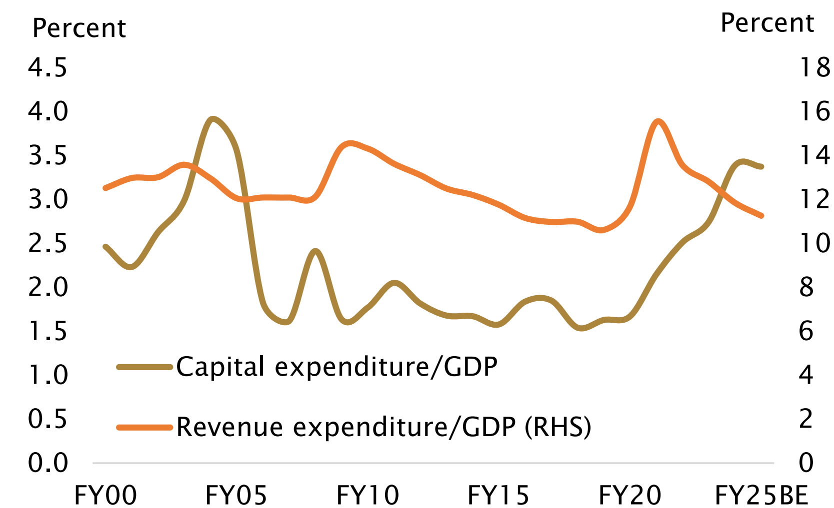
- The capex to GDP ratio, while increasing from 1.5% in FY19 to 3.4% in FY25BE, remains lower than the peak of around 4% in FY04. However, in recent years, there has been an increase in capital efficiency. The incremental capital output ratio (ICOR), which measures the additional unit of capital or investment needed to produce an additional unit of output, has, on average, declined by one percentage point between FY01-12 and FY13-24. This implies that even if the government maintains or moderates capital expenditure going forward, the existing capex/GDP could support higher growth due to capital efficiency gains.

- The capex cycle in the economy has already turned in the real estate and construction sector, with the share in gross fixed capital investment growing to 59% in FY23 from 53% in FY19. In the Final Budget for FY25, higher allocations under the PMAY scheme for affordable housing in rural and urban areas could further push investment in this sector. Additional support to infrastructure-related schemes is expected to sustain the momentum in capex spending in FY25.

Improvement in capital efficiency as measured by ICOR



Capex to GDP remains high, revex continues to ease

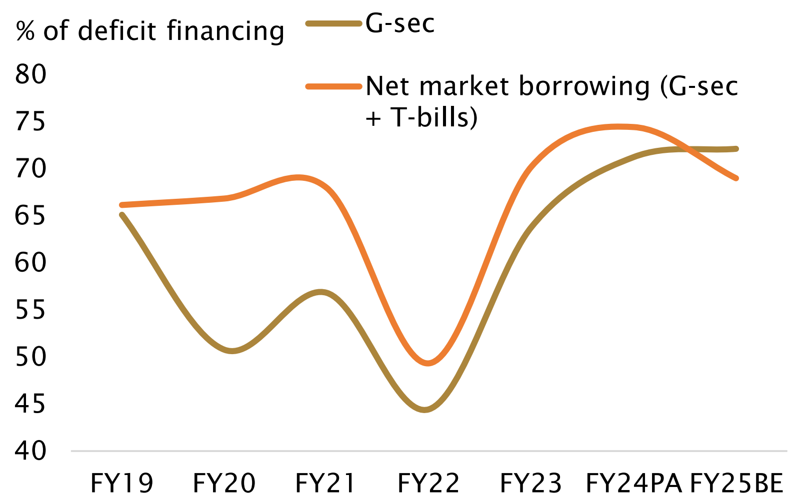


Gross and net market borrowings to be lower in FY25

- Compared to the Interim Budget, the reduction in government's net market borrowing was primarily driven by the t-bill and small savings components. While small savings are expected to be lower due to changes in preferences for financial investments, the government has consciously chosen to reduce borrowing at the short-end of the curve. Cash surplus due to subdued spending in an election year also enabled prudent fiscal management. Also, external debt estimate was left unchanged from the Interim Budget at Rs.160bn.

- Net market borrowing is expected to finance 69% of fiscal deficit in FY25BE, lower than 74% in FY24. However, G-sec borrowing is slated to rise slightly to 72% of deficit from 71% in FY24.

- Market loans amounting to Rs. 3.6tn are scheduled for repayment in FY25, of which the government has already bought back securities worth Rs.302.5bn. It also expects to recover Rs. 1.2tn from GST compensation fund, and the remaining Rs.2.1tn from market loans. Gross borrowing is expected to be Rs. 14.0tn, lower by Rs.120bn compared to the Interim Budget.



Rs.bn	FY23	FY24RE	FY25(I)BE	FY25BE
Scheduled repayments	3764	4406	3614	3614*
minus recovery from GST comp. fund		781	1236	1236
Market borrowing for repayment	3127	3625	2378	2076
plus net market borrowing	11083	11805	11752	11632
Gross market borrowing	14210	15430	14130	14010*

* Includes securities of Rs. 302.5bn bought back by the Government

Rs.bn	FY23	FY24BE	FY24RE	FY25(I)BE	FY25BE
Gross Market Borrowings	14210	15430	15430	14130	14010
Net market borrowing	12178	12309	11818	12252	11132
G-sec	11058	11809	11805	11752	11632
T-bill/Short term	1120	500	13	500	-500
Securities against small savings	3959	4713	4713	4662	4201
State provident funds	51	200	52	52	50
Other receipts	835	543	783	-306	-813
External debt	371	221	248	160	160
Draw Down of Cash Balance	-16	-118	-267	35	1404
Fiscal deficit	17378	17868	17348	16855	16133

Taxation related changes

- The Final Budget for FY25 tinkered with personal income tax slabs under the new regime, while also retaining the old regime. The standard deduction for salaried employees has been raised to Rs.75,000 from Rs.50,000. The Finance Minister also announced a comprehensive review of the Income Tax Act to be completed in six months, which would be by the next Budget.
- The corporate tax rate on foreign companies was reduced to 35% from 40%.
- Security Transactions Tax on futures and options of securities was increased to 0.02% and 0.1%, respectively from 0.0125% and 0.0625%, respectively.
- Short-term capital gains tax (less than one year) was raised to 20% from 15%, while long term capital gains tax was raised to 12.5% from 10%.
- The indexation benefit on real estate was removed, though the capital gains tax rate was also cut from 20% to 12.5%.

Pre-Budget		Post Budget	
Income slab (Rs)	Tax rate (%)	Income slab (Rs)	Tax rate (%)
Upto 3 lakhs	-	Upto 3 lakhs	-
3-6 lakhs	5	3-7 lakhs	5
6-9 lakhs	10	7-10 lakhs	10
9-12 lakhs	15	10-12 lakhs	15
12-15 lakhs	20	12-15 lakhs	20
Above 15 lakhs	30	Above 15 lakhs	30

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