

Budget FY2026-27 – A Review

Highlights:

- ✓ *Nominal GDP growth of 10.0 percent assumed for Budget estimates, while a lower revenue growth of 9 per cent is considered.*
- ✓ *Gross borrowings are higher than expectations at ₹17.2 trillion and also marginally higher than the gross fiscal deficit owing to the ~₹5.5 lakh crore worth of redemptions in FY2026-27*
- ✓ *Continuing on the path of fiscal consolidation by reducing the gross fiscal deficit to 4.3 per cent in FY2026-27 from 4.4 per cent in FY2025-26.*
- ✓ *The debt-to-GDP ratio is expected to be achieved for FY2026-27 is 55.6 per cent as compared to 56.1 per cent in the previous financial year.*

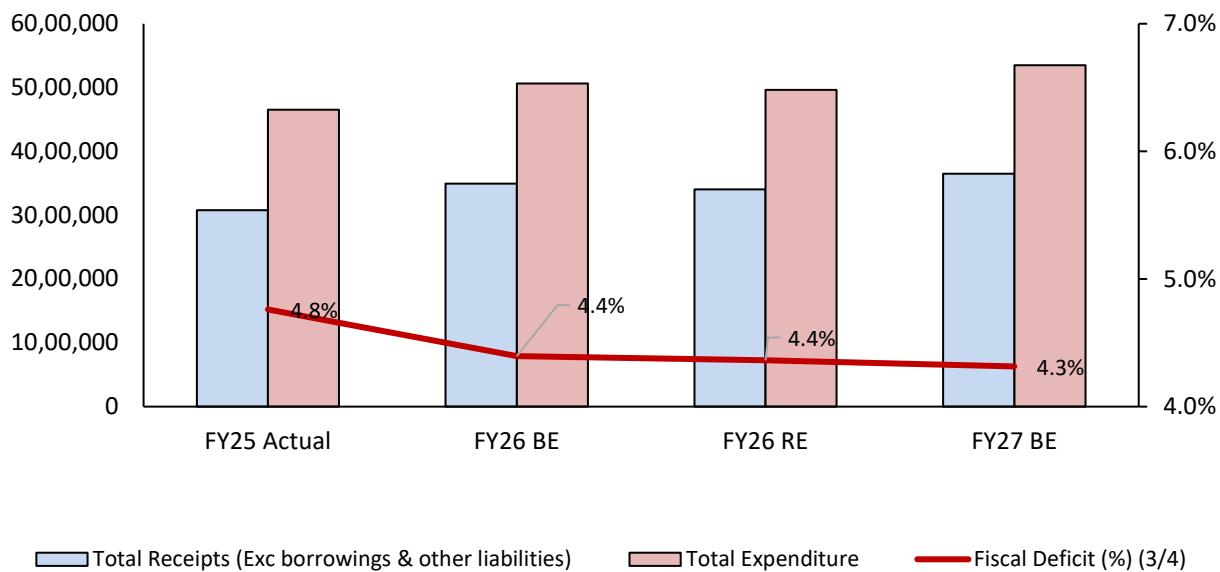
Aditya Vyas
aditya@stcipd.com
 022-66202245

Budget FY2026-27: A Long Run View

The Union Budget for FY2026-27 has introduced many reforms which will shape the economy for the next run to the Viksit Bharat 2047 goal post. The fiscal arithmetic remains conservative with the continued efforts of the central government to assiduously pursue fiscal consolidation. The positive indications of stability and continuity are also accompanied by restrictive increases in the securities transactions tax (STT) which might dampen sentiment in the equity market. Progressive long-run reforms and a capex push along with balanced fiscal parameters are the three pillars of the budget FY2026-27.

Nominal GDP growth @ 10 per cent: Indian economy has so far faced internal as well as external headwinds with resilience and headline growth continues to be robust at 7.4 per cent as per the First Advance Estimates (FAE). Headline inflation is expected to remain moderate at 2.1 per cent for FY2025-26. While growth has been resilient on the back of public spending and a pick-up in household consumption-though not as high as expected. The growth of private investment on a sustained basis remains under doubt even though it is showing signs of revival with a 7.8 per cent average for FY2025-26 as per the first advance estimates. Given that the growth in FY2026-27 is assumed to moderate on the back of a high base in FY2025-26, the government has estimated its budget on the basis of 10 per cent growth.

The Capex push continues: In alignment with the theme of fiscal consolidation the fiscal deficit for FY2025-26 is estimated to be achieved as is at 4.4 per cent, while for the FY2026-27 it will be lower at 4.3 per cent. Owing to the heft of redemptions at ~5.5 lakh crore, the gross borrowings for FY2026-27 are higher than expected at ₹ 17.2 lakh crore with an additional ₹ 1.3 lakh crore in short term T-bill borrowings. Not only has the government continued on this path but also continued the capex push that was a major shift since FY2024-25, with the capex spending now increased to ₹12.2 lakh crore, an increase of 12 per cent over the previous year's revised estimates.

Chart 1: Fiscal Snapshot (₹ in crore and %)

Source: *Union Budget Documents, STCI PD Research*

Following the Shift of the Fiscal Anchor: The economic survey of FY2022-23 spoke about the relationship between debt sustainability and growth. It expounded the one-sided causation, stating that while growth leads to debt sustainability, debt sustainability does not lead necessarily to growth. The shift in fiscal rules i.e. the shift from the GFD/GDP ratio to the more comprehensive Debt/GDP ratio is not expected to materially change the large borrowings that have been the norm since the COVID-19 years FY2020-21. With growth in nominal GDP at 10-10.1 per cent estimated every year the fiscal deficit has come off from a peak of 9.1 per cent to achieving the FRBM target in FY2025-26 at 4.4 per cent. Fiscal consolidation has indeed taken place, and not only that but the quality of spending has also improved with capital expenditure finding a 3 per cent share in GDP as opposed to an earlier 1-1.5 per cent. As per the new rules, and the glide path provided by the budget documents, the Debt-to-GDP ratio needs to be reduced by 0.5-1 per cent every year to achieve the 50 +/- 1 per cent target by 2030.

As is the case with fiscal deficit, the Debt-to-GDP ratio is not impervious to the changes in the GDP deflator and overall level of nominal GDP and has similar implications as in the previous regime of the GFD/GDP era. In fiscal years of high inflation, it is possible for the governments to incur higher debt as a proportion of GDP. However, since the Debt-to-GDP ratio is a stock variable the issue of debt sustainability crops up to deter governments, at least in theory, to issue debt more than the economy can pay for. The case for emerging markets to foster debt sustainability is strong though policy makers are often caught in the dilemma of countercyclical policy measures where the rules have to be different as was witnessed during COVID-19.

Table 1: Government Receipts (in ₹ Lakh Crore)				
	Actual	BE	RE	BE
	FY2024-25	FY2025-26	FY2025-26	FY2026-27
Revenue Receipts	30.37	34.20	33.42	35.33
Tax Revenue (Net)	25.00	28.37	26.74	28.67
Non-Tax Revenue	5.37	5.83	6.68	6.66
Capital Receipts	16.16	16.45	16.23	18.14
Recovery of loans	0.25	0.29	0.30	0.38
Other Receipts	0.17	0.47	0.34	0.80
Borrowings and Other Liabilities	15.74	15.69	15.58	16.96
Total Receipts	46.53	50.65	49.65	53.47

Source: Union Budget Documents, STCI PD Research

Continued Conservatism in Revenue Estimates: The government has estimated a revenue growth of ~9 per cent as compared to a growth 11 per cent in the previous budget. While direct taxes are expected to grow more, especially income tax collections are expected to grow at a rate of 12 per cent in FY2026-27, overall tax revenue is expected to grow at a moderate pace of 7 per cent. Non-Tax revenue is expected to witness some de-growth or remain more or less unchanged as compared to the previous year's revised estimates at ₹ 6.68 lakh crore. The increase in the non-tax revenues in the revised estimates is due to the hefty dividend paid by RBI worth ₹ 2.7 lakh crore in FY2025-26, that created buffers for the government and enabled the government to achieve the fiscal deficit target of 4.4 per cent for FY2025-26.

The Taxation Trends: This also continues the phenomenon of the income taxes surpassing the corporate taxes even this year with the corporate tax collections estimated at ₹12.31 lakh crore while the income tax collections far stronger at ₹14.66 lakh crore. The GST collections are naturally estimated lower owing to the effects considered of the simplification of the tax structure in FY2025-26.

The States' Share: The 16th Finance commission has recommended a vertical devolution of 41 per cent maintain the devolutions of the previous finance commission and this year the states share in the central tax pool is estimated to be ₹15.26 lakh crore which is approximately 34 per cent of the gross tax revenue collections. The central government will provide the states with ₹ 1.4 lakh crore worth of Finance Commission Grants in FY2026-27.

Table 2: Tax Break - Up (In ₹Lakh Crore)

	FY2024-25(Actuals)	FY2025-26(BE)	FY2025-26(RE)	FY2026-27(BE)
Gross Tax Revenue	37.96	42.70	40.78	44.04
Corporation Tax	9.87	10.82	11.09	12.31
Taxes on Income	12.35	14.38	13.12	14.66
Customs	2.33	2.40	2.58	2.71
Union Excise Duties	3.00	3.17	3.37	3.89
Goods and Services Tax	10.27	11.78	10.46	10.19
Taxes on Union Territories	0.10	0.10	0.10	0.10
Less - Transfers to Funds	0.09	0.10	0.10	0.11
Less - State's share	12.87	14.22	13.93	15.26
Less state's share adjustment	-	-	-	-
Centre's Net Tax Revenue	25.00	28.37	26.75	28.67

Source: Union Budget Documents

Expenditure Side-Focus on quality of expenditure: The government has continued the positive trend of improving the quality of expenditure with capex growing at 11.5 per cent, and the total capital expenditure at ₹12.2 lakh crore excluding the grants-in-aid for creation of capital assets at ₹ 4.92 lakh crore. Summing up the total capital spending in FY2026-27 will be ₹ 17.14 lakh crore, 22 percent higher than the previous financial year. In comparison revenue expenditure has grown only by 7 percent as compared to the previous financial year from ₹38.69 lakh crore to ₹ 41.25 lakh crore, 34 per cent of it comprising of the interest payments at ₹14 lakh crore. While defence expenses were expected to increase post the recent war that the country faced, the budget estimates indicate no significant growth in defence spending in this budget with the growth rate at a 7.7 per cent in FY2026-27.

Adjustments in subsidy payouts had to be made in FY2025-26, especially in the case of fertilizer subsidy with increase demand in the agricultural segment due to an extended monsoon and increased moisture for the rabi harvest also playing a role in augmenting the demand for fertilizers, which has lead the FY2025-26 revised estimates of fertilizer subsidy higher at ₹ 1.86 lakh crore as compared to the original budget estimates of ₹ 1.68 lakh crore. While food subsidy also saw a similar upward adjustment from ₹2.03 lakh crore in the original estimates to ₹2.28 lakh crore in the revised estimates.

Table 3: Expenditure Break Up (₹ Lakh Crore)				
	Actuals	BE	RE	BE
	FY2024-25	FY2025-26	FY2025-26	FY2026-27
Revenue Expenditure	36.00	39.44	38.69	41.25
Capital Expenditure	10.52	11.21	10.96	12.22
Total Expenditure	46.53	50.65	49.65	53.47
Key Expenditure				
Interest payments	11.16	12.76	12.74	14.04
Defence	4.51	4.92	5.68	5.95
Pension	2.74	2.77	2.87	2.96
Food Subsidy	2.00	2.03	2.28	2.28
Fertilizer Subsidy	1.71	1.68	1.86	1.71
Education	1.11	1.29	1.22	1.39
Transport	5.60	5.49	5.48	5.99
<i>Source: Union Budget Documents</i>				

Sources of Financing Fiscal Deficit: The gross borrowings are slightly higher than market expectations as among the various sources of financing the fiscal deficit, the securities issued against small savings have been estimated to be only marginally higher at ₹3.87 lakh crore, even as market expectations were above ₹ 4 lakh crore. In addition to this, the other receipts indicate an estimated outflow of ₹ 0.46 lakh crore resulting in the central government to borrow a ₹ 1.3 lakh crore in short term i.e. treasury bills to fund the gap. Net market borrowings are financing ~69 per cent of the fiscal deficit.

Table 4: Sources of Financing the Fiscal Deficit (In ₹ Lakh Crore)					
		Actuals	BE	RE	BE
		FY2024-25	FY2025-26	FY2025-26	FY2026-27
	Debt Receipts				
1	Market Borrowings (net)*	10.75	11.54	10.40	11.73
	Dated (net)	10.75	11.54	10.40	11.73
	T-Bills (net)	-1.60	0.00	0.00	1.30
2	Securities Against Small Savings	4.30	3.43	3.72	3.87
3	State Provident Funds	0.04	0.05	0.04	0.04
4	Other receipts	1.79	0.41	0.76	-0.46
5	External Debt	0.47	0.23	0.20	0.15

6	Draw down of cash balance	0.01	0.02	0.46	0.33
7	Fiscal Deficit (Sum of 1 to 6)	15.74	15.69	15.58	16.96
<i>Note: *Market borrowings are not adjusted for buyback of securities during RE FY2025-26; Source: Union Budget Documents</i>					

Market Borrowings: Gross market borrowings are estimated to be ₹ 17.2 lakh crore with a total redemption estimated for FY2026-27 estimated to be ₹ 5.47 lakh crore including the redemption of the 5-year bond issued for financing the GST compensation cess shortfall. The markets had expected this to be funded by non-debt sources similar to the process adopted by the central government in FY2025-26. Since that has not been the case the redemptions and hence the gross borrowings have been steeper than expected. While the government has announced switches of ₹2.5 lakh crore in the budget there are buybacks estimated in this year's budget. This will create a wider demand-supply gap in bond markets and lead to pressure on bond yields.

Table 5: Market Borrowings (in ₹ Lakh Crore)				
	FY25 (Actual)	FY26(BE)	FY26(RE)	FY27(BE)
Gross Market Borrowings (1+2+3-4)	14.01	14.82	14.61	17.20
1. Net Market Borrowings	11.63	11.54	11.33	11.73
2. Redemption*	2.38	3.28	3.28	5.47
3. Switches	0.03	0	0.05	0

*Redemption includes buyback; Source: Union Budget Documents

Outlook: FY2025-26 saw an awkward bond market trend which has kept bond yields on the higher side, partly due to the policy choices by the central government such as the GST rate rationalisation of reducing the tax slabs from 4 to 2, resulting in slowing down of tax revenue, at the same time intended to push consumption in the economy. The rationalisation was overdue and the income tax relief for individuals earning up to ₹ 12 lakh were steps to boost consumption. The total loss to the exchequer was estimated at around ₹ 1.5 lakh crore for FY2025-26.

At the going rate of tax inflows and the record high RBI dividend that was paid out to the central government, this should not have disturbed the bond markets, and as has been seen in the budget documents, the government has been able to achieve the stated target of 4.4 per cent in FY2025-26. The fiscal policy moves were announced partly as a reaction to boost domestic consumption in the face of the 50 per cent US tariffs imposed on India in April 2025. Union Budget FY2026-27 keeps the continuity and stability factor in focus though the higher gross borrowing would likely lead to a negative movement in the bond markets and we expect the 10 year to trade within 6.70-6.85 per cent in the near term.

STCI Primary Dealer Ltd.
CIN: U67110MH2006PLC165306

A/B1- 801, A Wing, 8th floor, Marathon Innova, Marathon Next Gen Compound,
Off. Ganpatrao Kadam Marg, Lower Parel (w), Mumbai 400013.

Dealing Room: (022) 66202217-20 • Settlements: (022)66202262-64, Fax (022) 66202288
Delhi Office: (011) 47676557-58 • Kolkata Office: (033) 40611435-36• Bengaluru Office: (080) 42183166/1021

Please mail your feedback to stcipd@stcipd.com

- Website: <http://www.stcipd.com>
- Twitter: <https://twitter.com/stcipd>
- LinkedIn: <https://www.linkedin.com/company/stci-primary-dealer-ltd/>

THIS COMMUNICATION IS FOR INTENDED USERS ONLY. IT IS BASED UPON THE INFORMATION GENERALLY AVAILABLE TO PUBLIC AND CONSIDERED RELIABLE. THIS REPORT DOES NOT CONSTITUTE AN INVITATION OR OFFER TO SUBSCRIBE FOR OR PURCHASE OR SALE OF ANY SECURITY AND NEITHER THIS DOCUMENT NOR ANYTHING CONTAINED HEREIN SHALL FORM THE BASIS OF ANY CONTRACT OR COMMITMENT WHATSOEVER WITH STCI PRIMARY DEALER LTD.