panorama

February 2025

Key Insights:

Budget prioritises consumption revival while maintaining commitment to fiscal consolidation

- Controlled revenue expenditure to help bring down the fiscal deficit to 4.4% of GDP in FY26
- Centre aims to bring down the debt-to-GDP ratio to 50%±1% by FY31
- Budget delivers a Rs 1 tn boost to consumption through income tax reductions, benefiting 15–20 mn taxpayers
- Capital expenditure, including PSU and revenue grant-funded capex, is set to grow 16% YoY in FY26
- Allocation for Production Linked Incentives doubles in Budget FY26, led by the pharma, auto, and electronics

RBI cuts repo rate by 25 bps in February 2025 on weaker growth and benign inflation outlook

- The RBI forecasts CPI inflation at 4.2% YoY and GDP growth at 6.7% YoY for FY26
- Vegetable prices, the primary driver of inflation, have corrected significantly in line with the seasonal trends
- RBI has announced multiple measures to improve liquidity, such as OMO purchases, FX swaps, etc.
- Durable liquidity to improve significantly after the RBI dividend transfer; RBI FX intervention remains a key risk
- India's yield curve is expected to steepen further with an additional 50–75 bps of rate cuts anticipated

Economic conditions are turning conducive for a consumption rebound

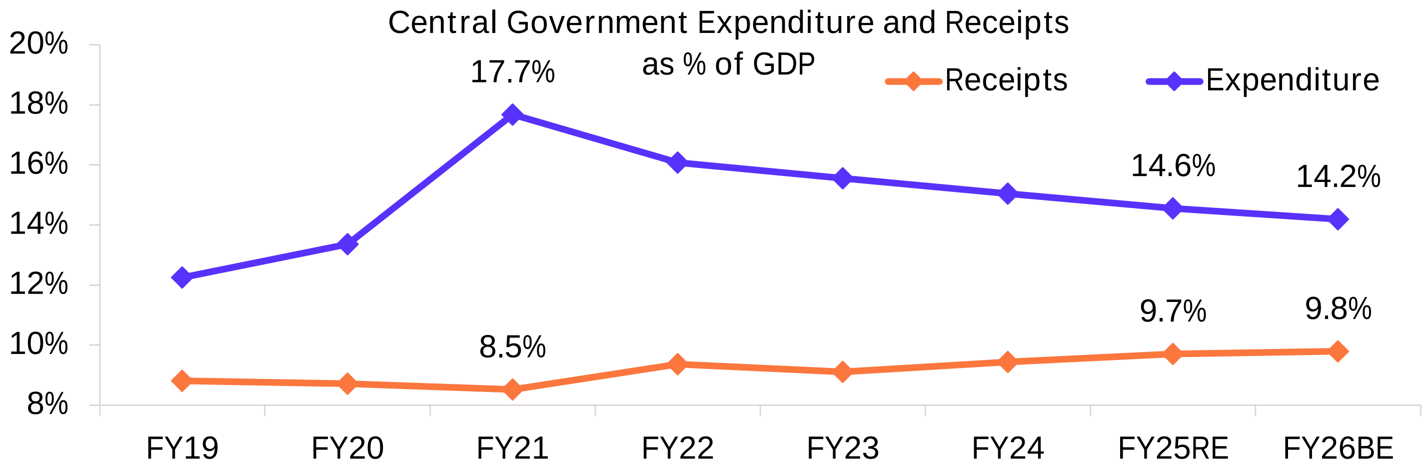
- Easing food inflation, interest rate cuts, and income tax reductions are expected to support consumption
- However, the reverse wealth effect from the equity market correction could dampen demand
- This could have a pronounced impact due to increased investor participation in small, mid, and thematic funds

Budget & RBI Monetary Policy

Controlled revenue expenditure to help bring down the fiscal deficit in FY26

asset 360 ONE

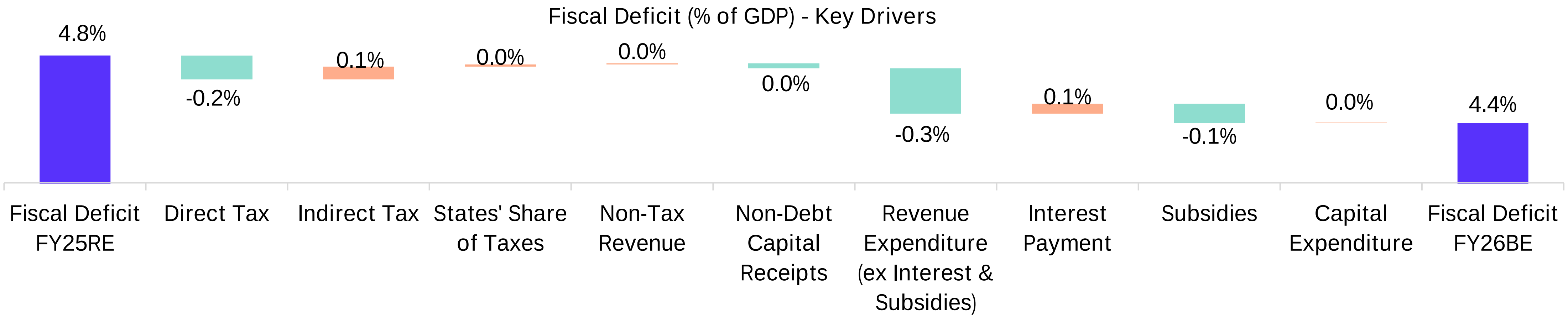
Direct tax receipts as a % of GDP are projected to rise despite the income tax reductions



The Budget FY26 aims to reduce total expenditure to 14.2% of GDP from 14.6% in the previous budget, primarily driven by lower revenue expenditure

Budgeted capital expenditure for FY26 remains flat at 3.1% of the GDP

Direct tax estimates appear optimistic, as collections are expected to increase by 0.2% of GDP despite the income tax cuts

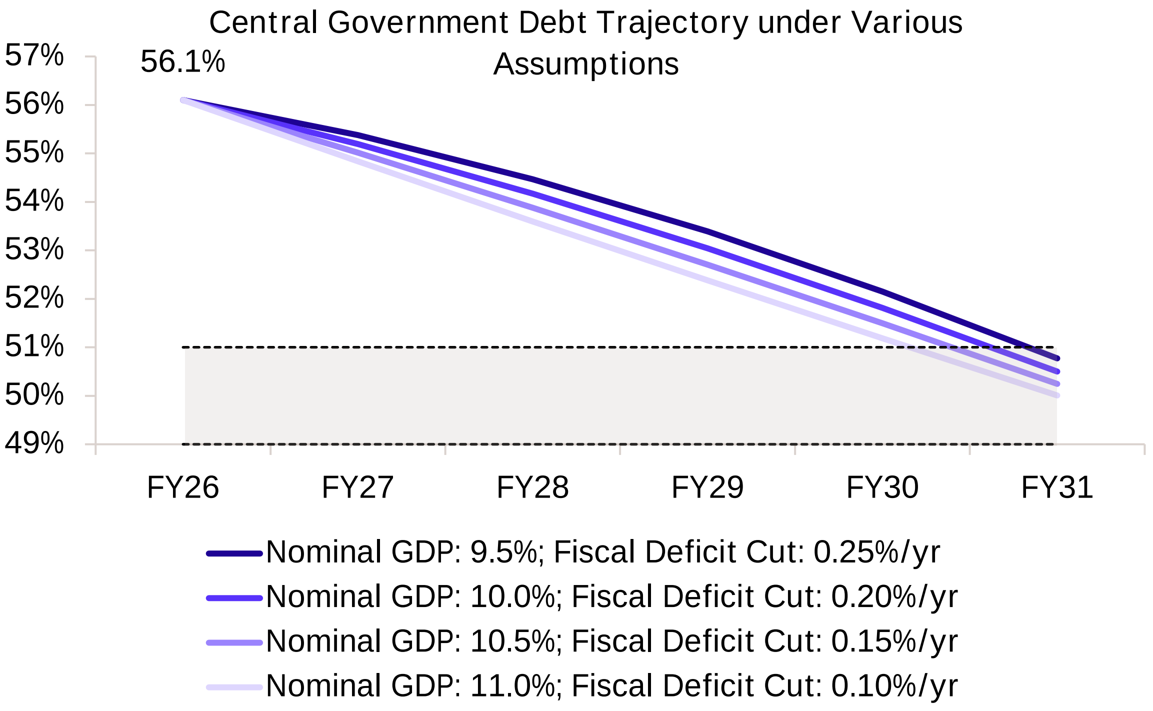


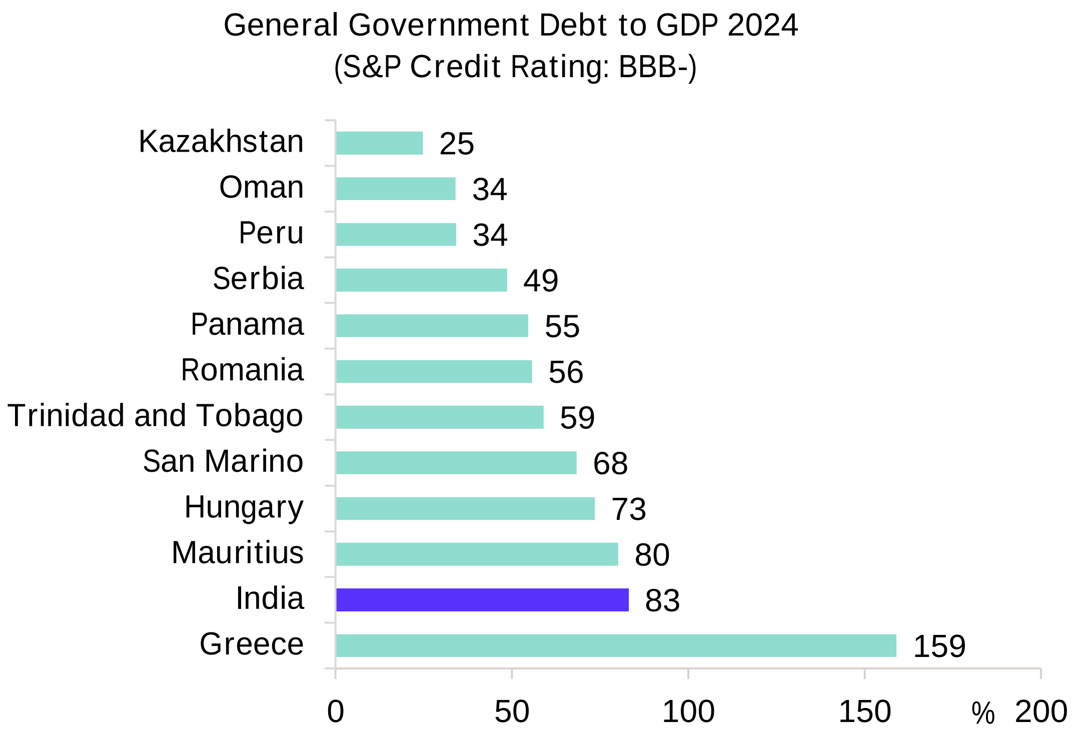
Source: Budget Documents, 360 ONE Asset Research

Note: RE – Revised Estimates, BE – Budget Estimates

Centre aims to bring down the debt-to-GDP ratio to 50%±1% by FY31

India's general government debt-to-GDP ratio is currently at the upper end of its BBB- rated peers





Assuming a reasonable nominal GDP growth of 10%, the required fiscal deficit reduction would be 0.2% per year to achieve the debt-to-GDP target of 50%±1% by FY31

Hence, the pace of fiscal consolidation is expected to slow down compared to the 80 bps consolidation in FY25 and 40 bps in FY26

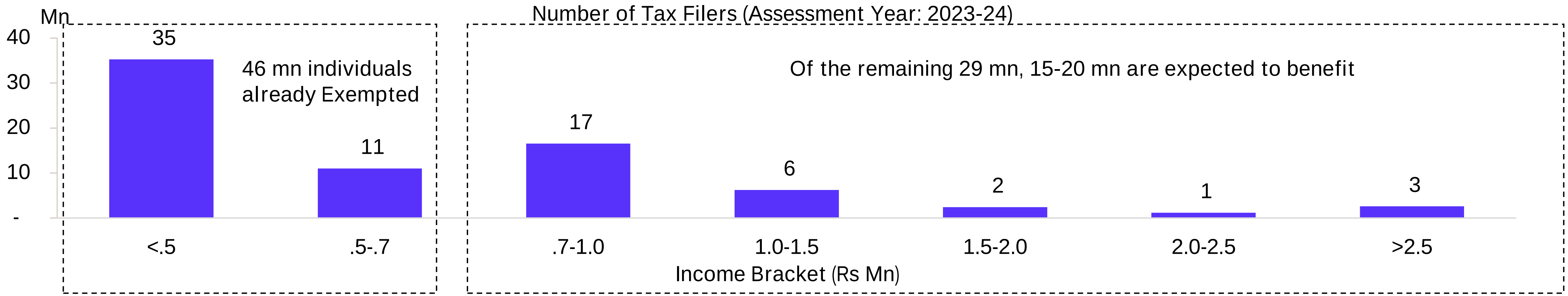
Despite a credible glide path for reducing central government debt to GDP, rating agencies may not upgrade India's sovereign ratings in the near term

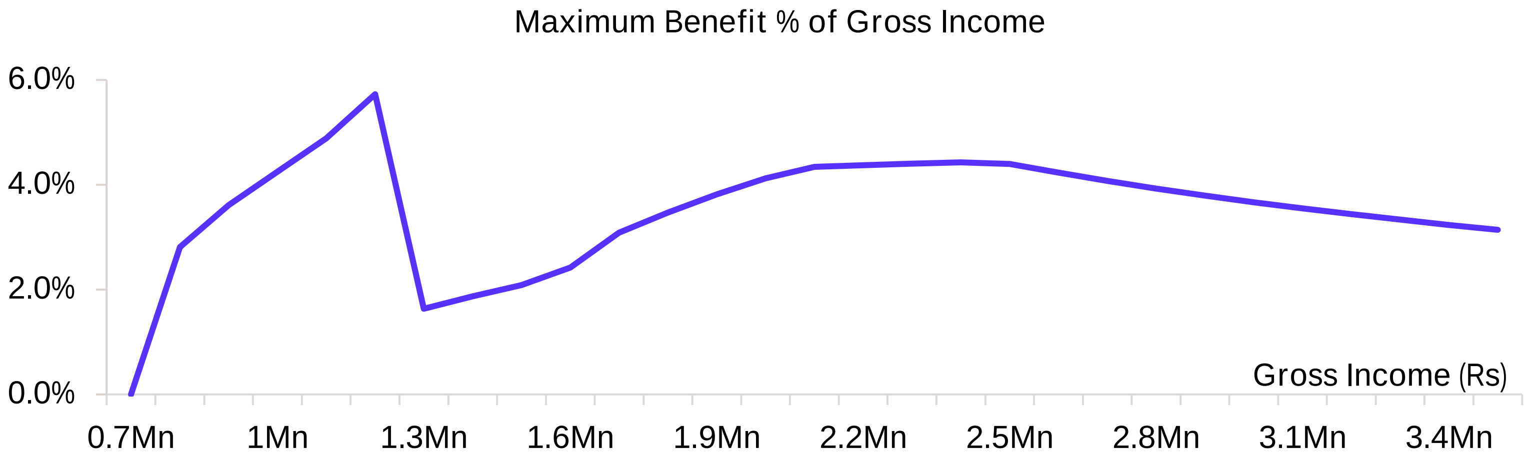
India's general government debt-to-GDP ratio remains at the upper end of its BBB- rated peers and will stay elevated without fiscal consolidation at the state level

Source: Budget Documents, IMF, 360 ONE Asset Research

Budget delivers a Rs. 1 tn boost to consumption by reducing income tax

Urban consumers are likely to gain the most, potentially boosting discretionary consumption





As per back-of-the-envelope calculations, out of 75 mn taxpayers, 46 mn were already exempt under the New Tax Regime

Following the announced changes, 15–20 million taxpayers from the remaining 29 million are expected to benefit, while the rest may continue under the Old Tax Regime

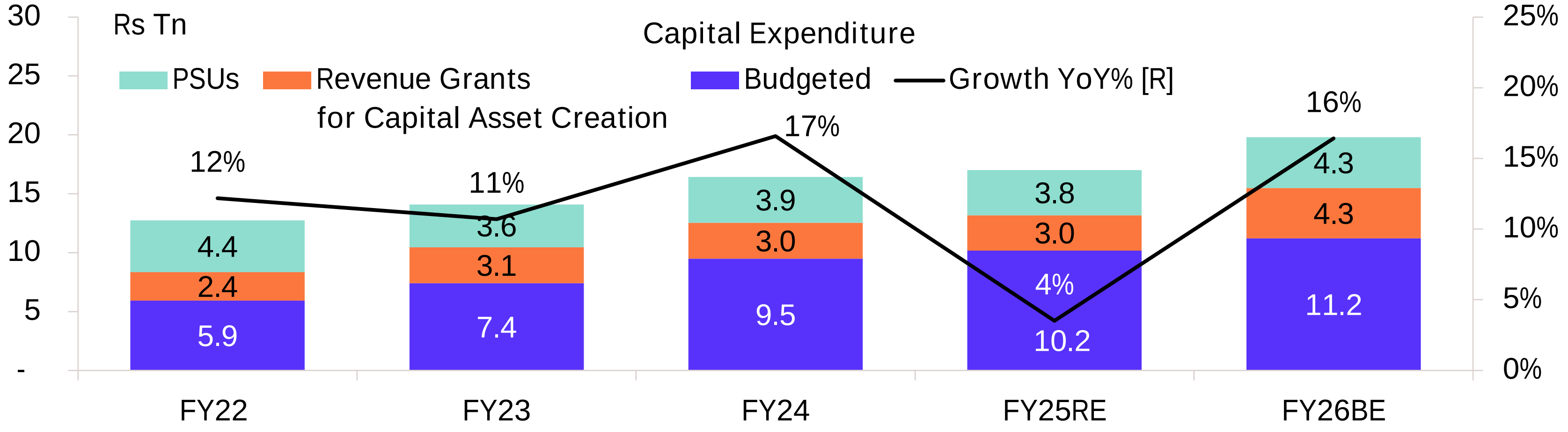
Taxpayers with a gross total income of Rs 0.7-1.2 mn are likely to witness a 3-6% increase in disposable income

Source: Income Tax Department, Budget Documents, 360 ONE Asset Research

Note: Linear interpolation has been applied to determine the number of taxpayers across various tax brackets

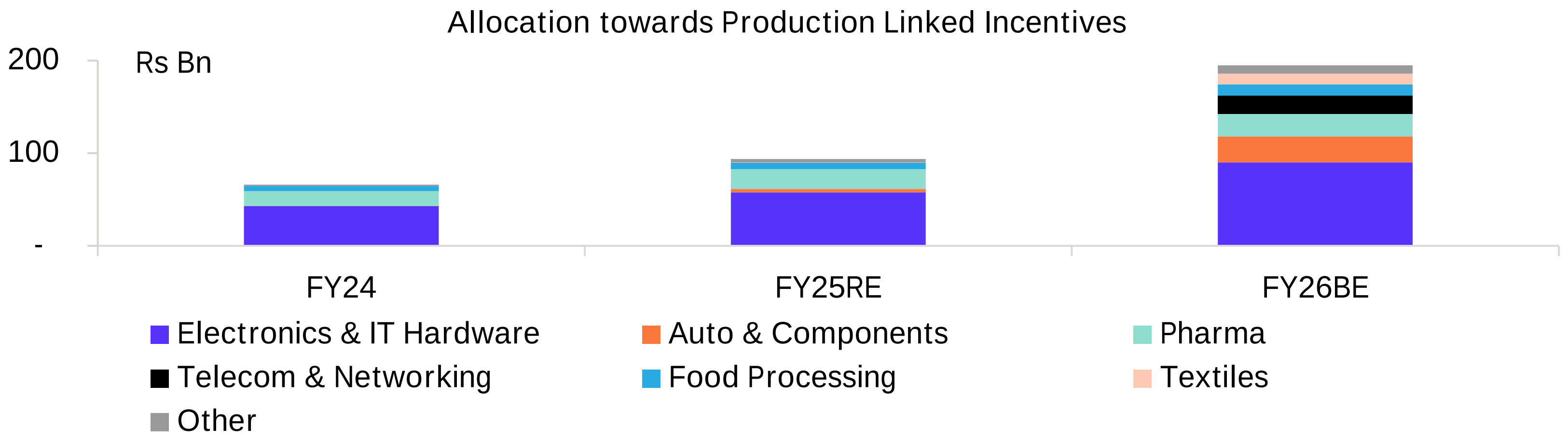
Total capital expenditure to grow by a healthy 16% YoY in FY26

Allocation for Production Linked Incentives doubles in Budget FY26, led by the electronics, auto, and pharma sectors



The total capital expenditure, including budgeted capex, revenue grants for capital asset creation, and capex by public sector undertakings, is targeted to grow at a healthy rate of 16% YoY

However, total capital expenditure in FY25 is projected to report a muted growth of 4% YoY



Allocation for Production Linked Incentives doubled to Rs. 195 bn in FY26 from Rs. 93 bn in FY25

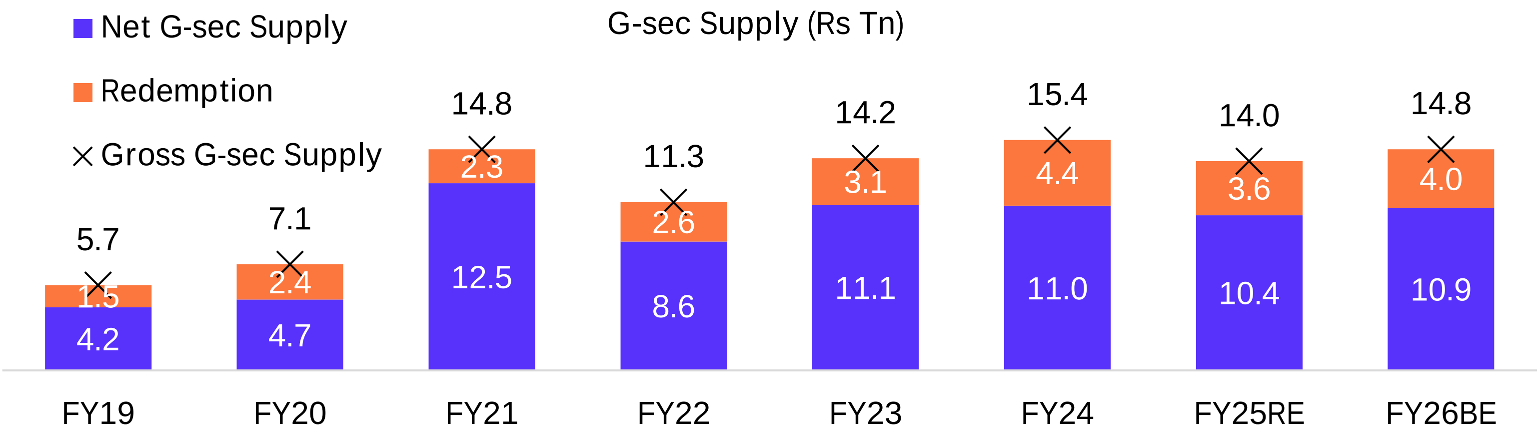
Electronics accounts for the largest allocation, followed by 'Auto & Components' and Pharma

Source: Budget Documents, CMIE, 360 ONE Asset Research

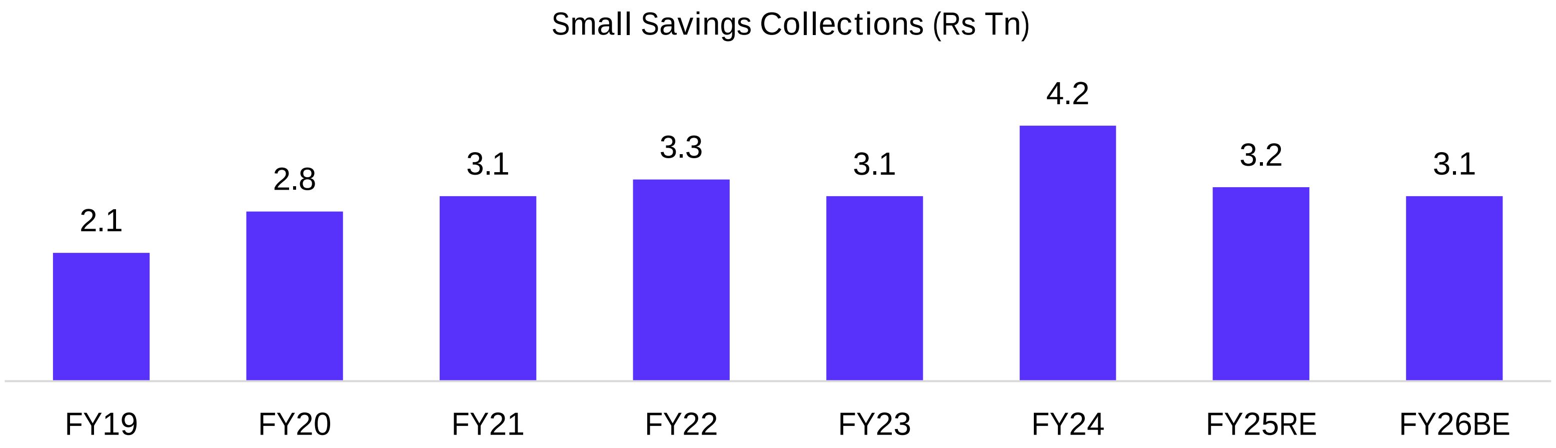
Note: RE – Revised Estimates, BE – Budget Estimates

Gross and net G-sec supply are budgeted to be slightly higher in FY26

Small savings tax collections are budgeted to decline in FY26 but may exceed the target



Although both gross and net borrowings are projected to increase in FY26, they are unlikely to exert upward pressure on yields, as the RBI is also absorbing supply through Open Market Operations (OMOs)



Small savings collections are budgeted to decline to Rs 3.05 tn in FY26 from Rs 3.20 tn in FY25

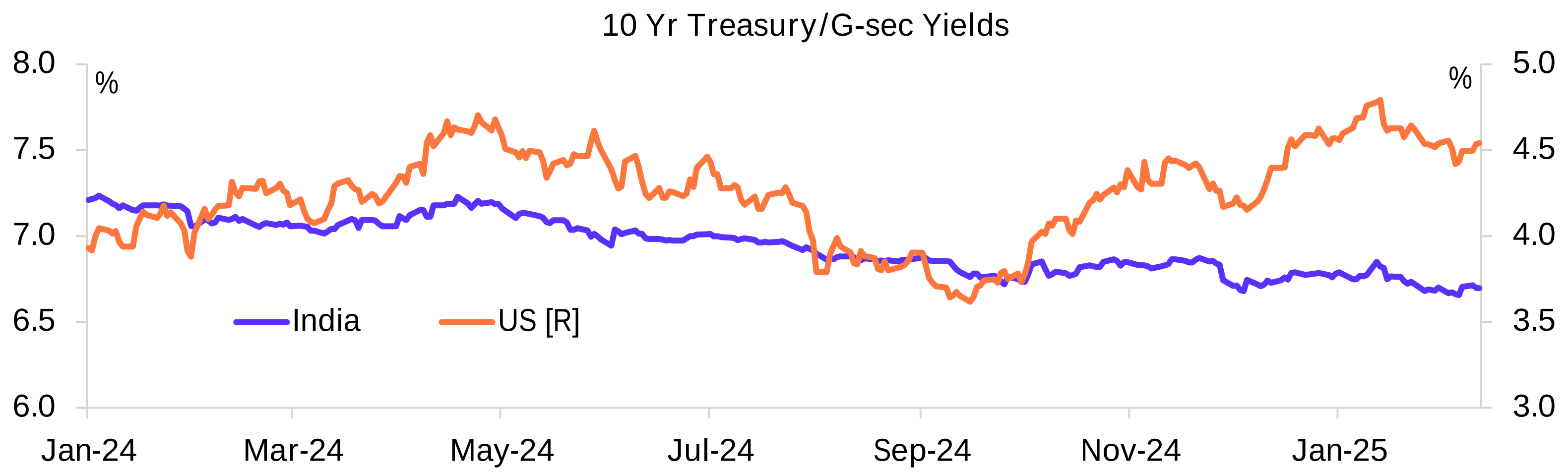
However, actual collections may be higher, as small savings rates adjust slowly in a rate-cut cycle and may offer attractive returns compared to market rates

Source: Budget Documents, 360 ONE Asset Research

Note. RE – Revised Estimates, BE – Budget Estimates. G-sec supply numbers have been adjusted for borrowings for providing back-to-back loans to States and UTs for GST compensation cess shortfall in FY21-22 and repayment from GST compensation fund

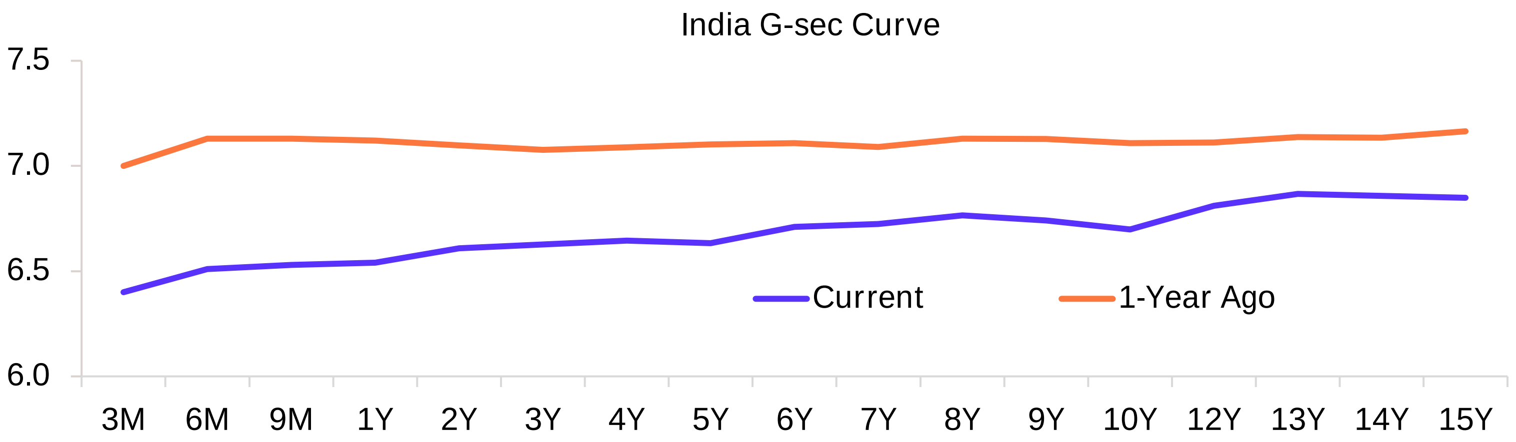
India’s yields have remained insulated from the volatility in US yields

The yield curve has steepened as markets price in RBI rate cuts, with further steepening expected



India's 10-year G-sec yield continues to remain stable despite a sharp increase in global yields

The government's commitment to fiscal consolidation and expected RBI monetary easing prevented domestic yields from hardening



India’s yield curve has steepened over the past year as markets factor in RBI rate cuts

Further steepening is expected, with an additional 50–75 bps of rate cuts anticipated beyond the 25-bps reduction in February 2025

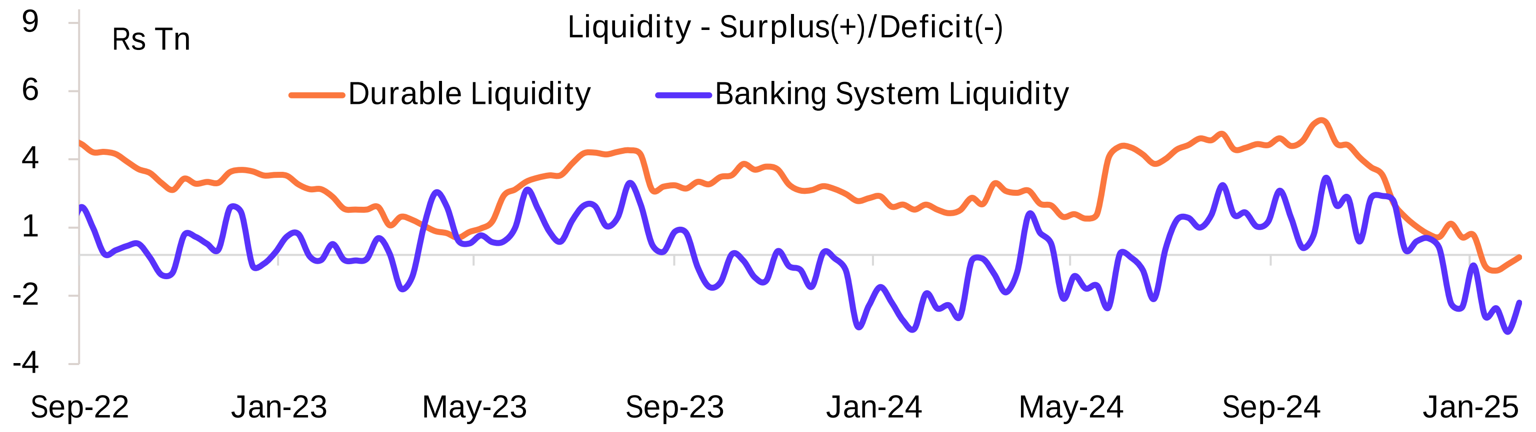
From a one-year perspective, the 3-year to 7-year segment looks attractive from a risk-reward standpoint compared to long-duration bonds

Source: Bloomberg, 360 ONE Asset Research

Note: Current India G-sec Curve as of 12th February 2025

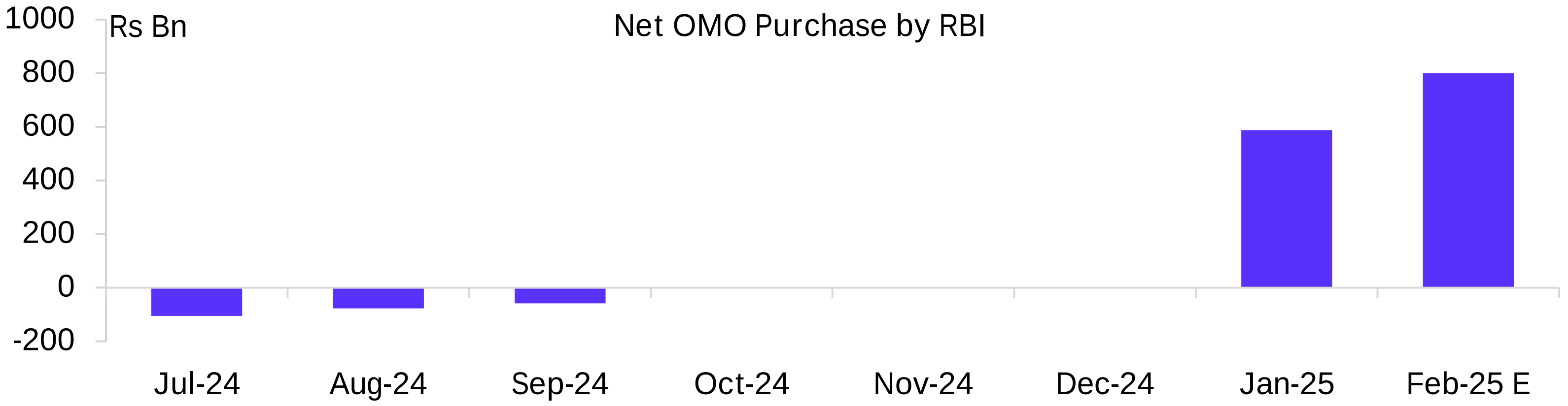
Durable liquidity has turned into a deficit due to the RBI's FX interventions

RBI has announced multiple measures to improve domestic liquidity, such as OMO purchases, FX swaps, etc.



Liquidity conditions have tightened considerably because of RBI's FX interventions to support the INR

However, RBI has announced multiple measures to improve domestic liquidity, including but not limited to conducting Open Market Operations (OMO) involving the purchase of government securities



RBI's OMO purchase auctions have helped yields stabilise

We expect RBI to maintain liquidity conditions close to neutral

Hence, RBI could conduct more OMOs if required to replenish durable liquidity

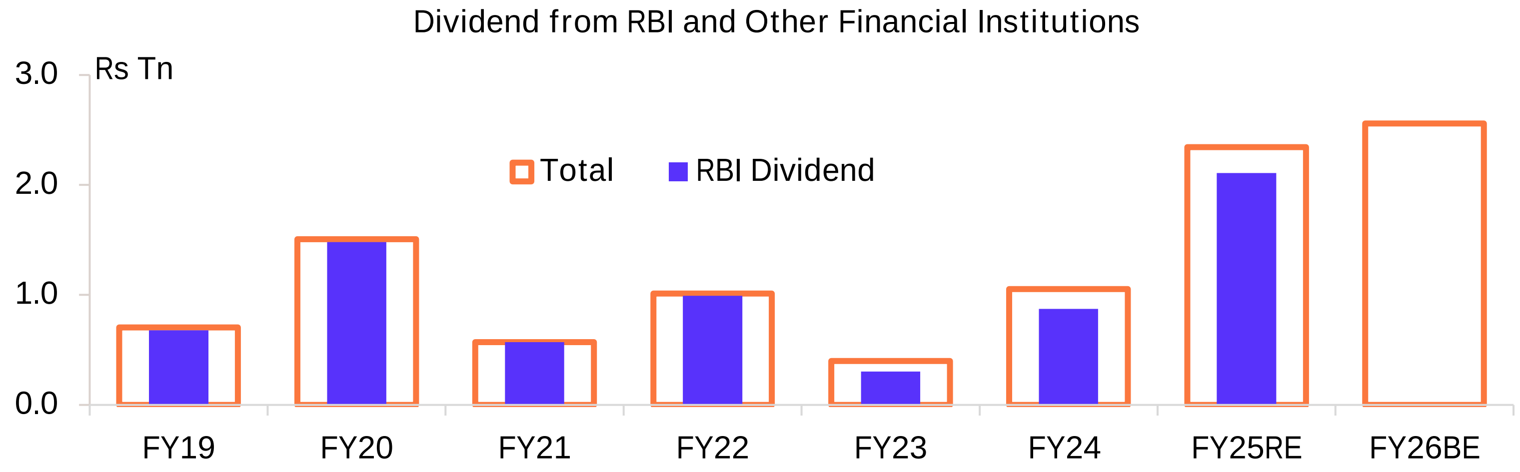
However, repo auctions will be used to manage temporary fluctuations in banking system liquidity caused by changes in government balances with the RBI

Source: CMIE, 360 ONE Asset Research

Note: E – Expected; Durable Liquidity = Banking System Liquidity + Government Balances with RBI + Excess CRR maintained

Liquidity to improve significantly in May after the RBI dividend transfer

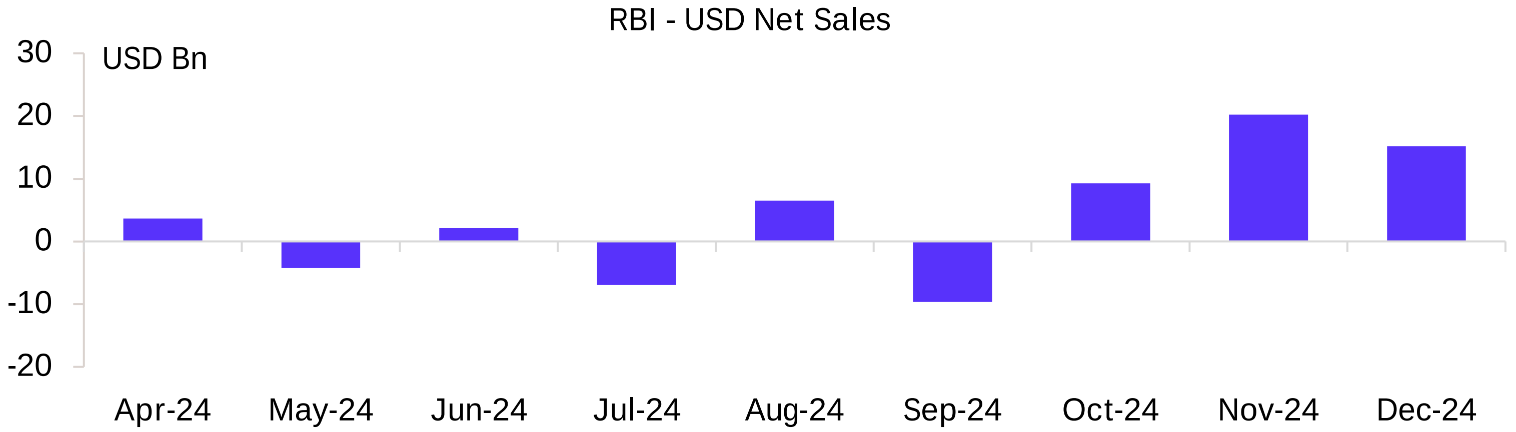
However, persistent RBI FX intervention poses a risk to the liquidity outlook



RBI is expected to transfer a bumper dividend of ~Rs 2.1-2.4 tn, likely in May 2025, as suggested by the FY26 budget estimates under 'Dividend from RBI and Other Financial Institutions'

The transfer is likely to boost durable liquidity

However, banking system liquidity will improve gradually as the government spends

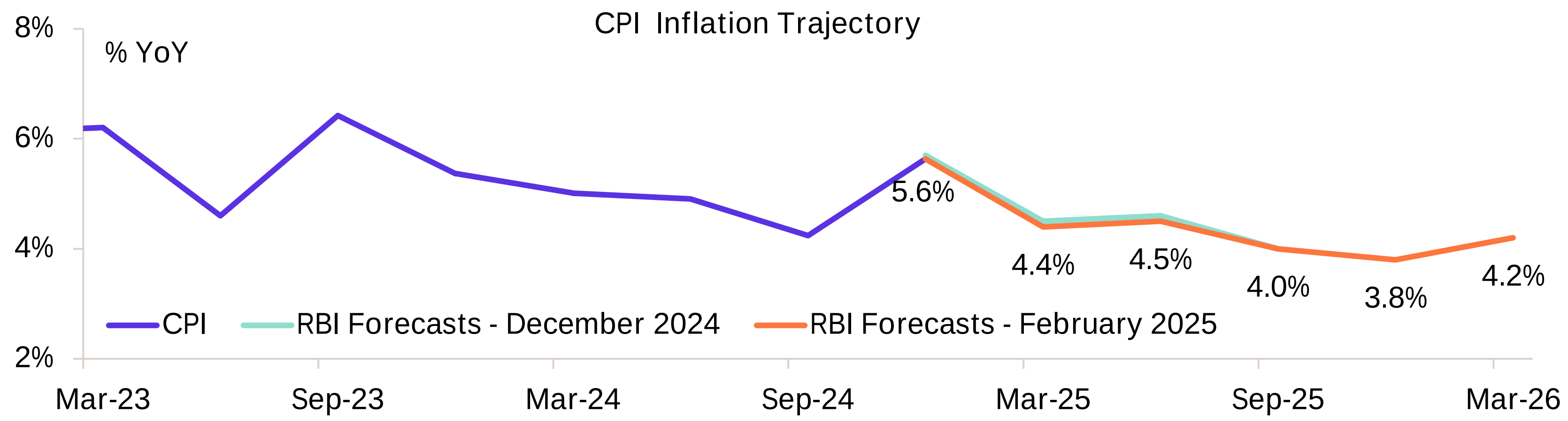


However, sustained RBI FX sell interventions could deplete domestic liquidity, necessitating RBI support through OMOs, FX buy-sell swaps, and other measures

Source: Budget Documents, RBI, 360 ONE Asset Research

RBI cuts repo rate on weaker growth and a benign inflation outlook

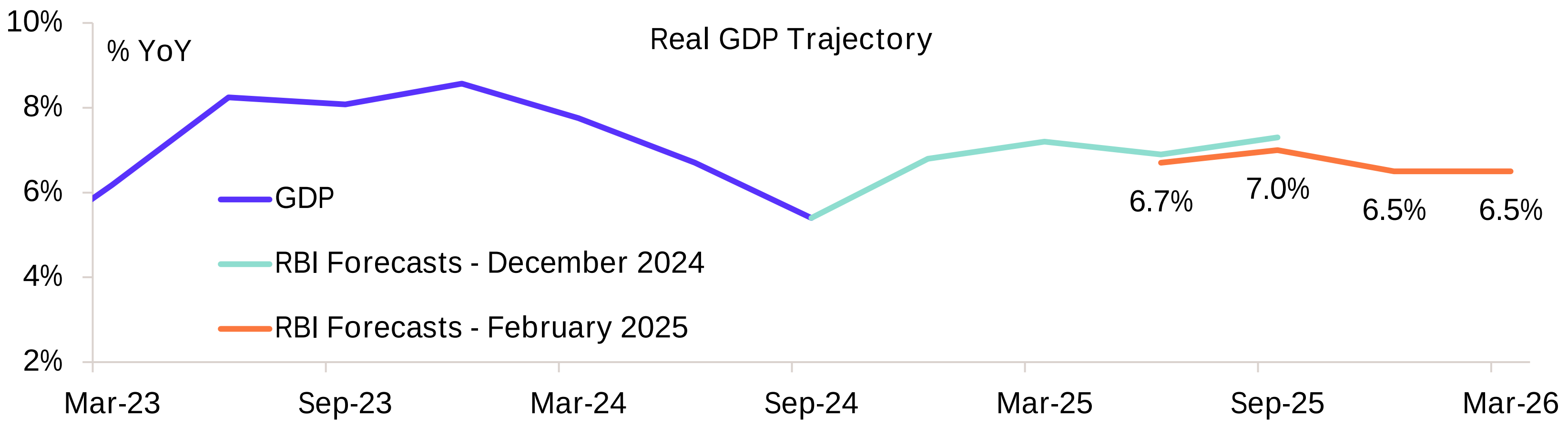
RBI MPC notes that while growth is expected to recover from the Sep'24 low, it remains well below last year's level



The RBI projects CPI inflation for FY26 at 4.2% YoY

Inflation is expected to moderate, supported by a favourable food outlook

Core inflation (which excludes food and fuel) is expected to rise but remain moderate



The RBI projects FY26 GDP growth at 6.7% YoY

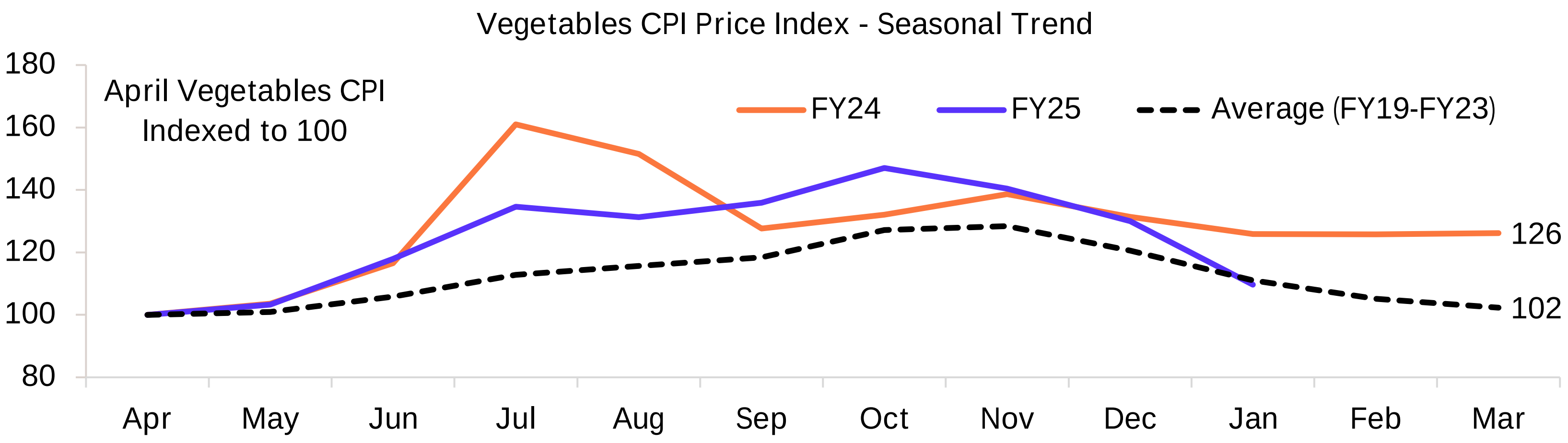
During the policy announcement conference, the Governor emphasised the flexibility of the Inflation Targeting Framework in responding to evolving growth-inflation dynamics

We interpret this statement as an indication that the RBI is willing to tolerate slightly higher inflation as long as it remains within the target band (4±2%) to support growth

Source: RBI, 360 ONE Asset Research

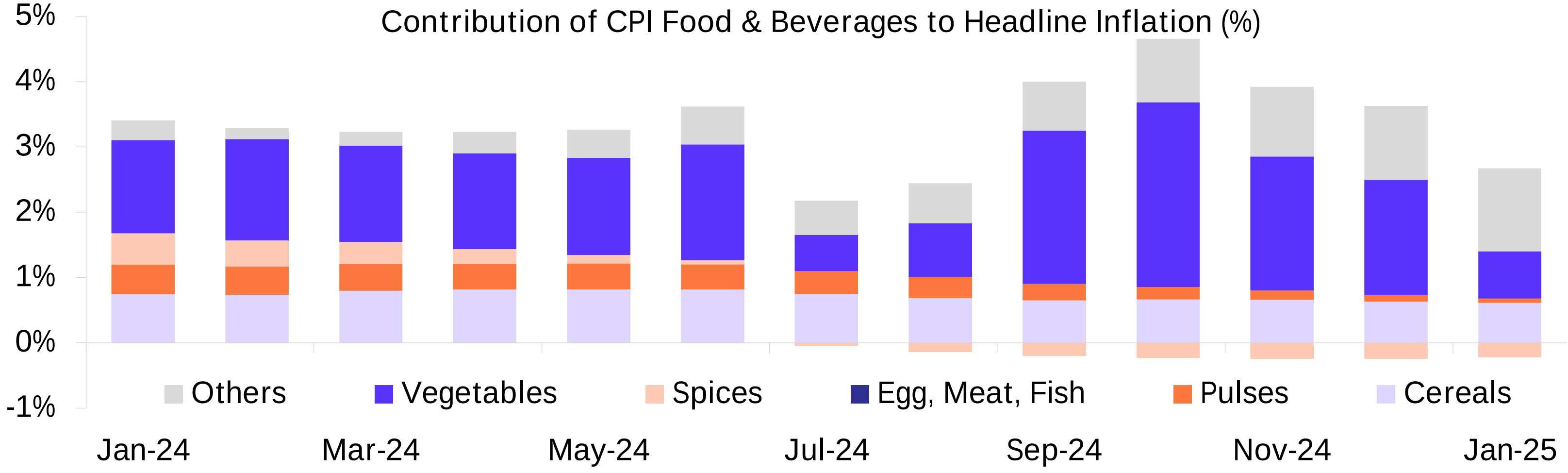
Vegetable prices, the primary driver of inflation, have corrected significantly

Headline CPI falls to 4.31% YoY in January 2025 on account of a steep decline in contribution from vegetables



Vegetable prices have declined significantly since their peak in October 2024

They could fall further in line with seasonal trends



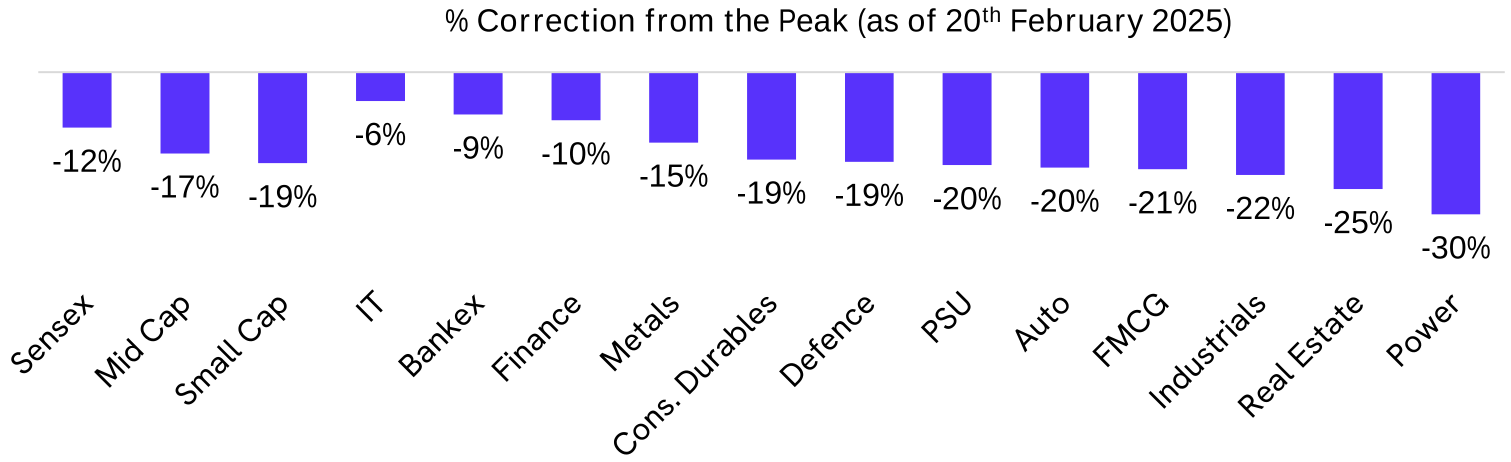
Vegetable prices have been the primary driver of headline inflation over the past year

However, their contribution has been declining since the peak in October 2024 as prices correct

Source: MOSPI, 360 ONE Asset Research

Will consumption revive with easing inflation, rate cuts, and income tax cuts?

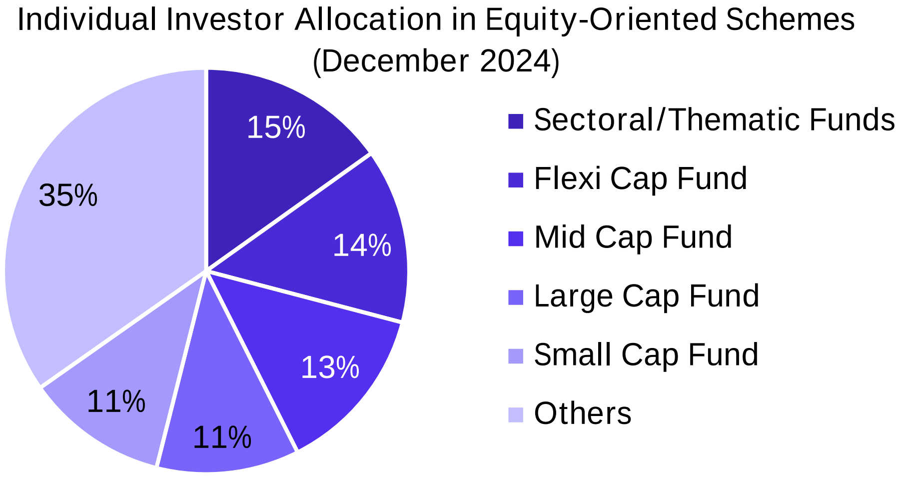
Economic conditions are becoming favourable for a consumption rebound, but the wealth effect could be a drag

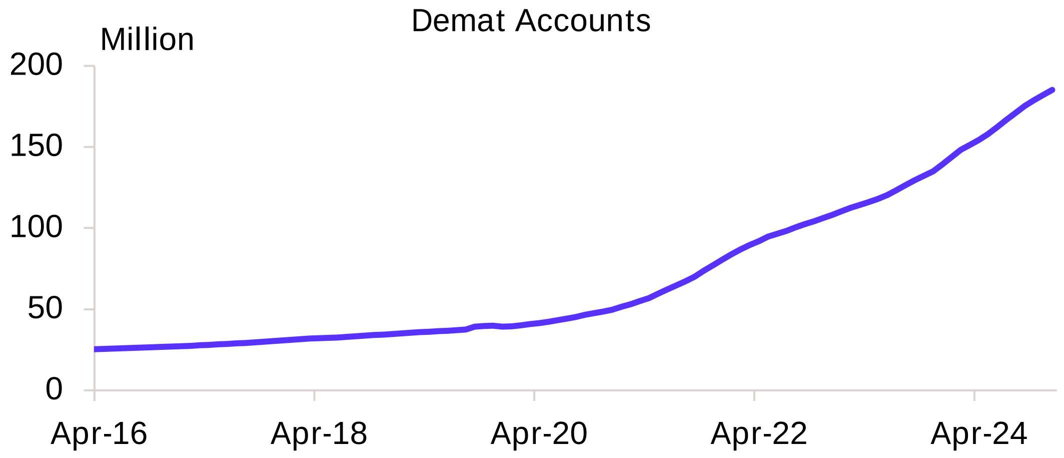


Equity markets have retreated from their peak, which could trigger a reverse wealth effect, dampening demand and consumption as investors perceive a decline in their wealth

A significant portion of investors' mutual fund allocation is in mid-, small-, and thematic funds, which have underperformed compared to the benchmark

With investor participation having increased considerably post-pandemic, the current correction may have a more pronounced impact than previous ones





Source: CMIE, 360 ONE Asset Research

Note: The peak refers to the highest level of benchmark indices on 26th September 2024

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