CIO Memo

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India: interim budget targets strong fiscal improvement

Key takeaways

- The Indian finance minister today presented a 'Vote-on-Account' or interim budget, customary in an election year.
- No changes, therefore, were made to the tax regime, but the government's borrowing programme was reduced for the upcoming financial year, with the forecast FY24-25 fiscal deficit being reduced from -5.8% to -5.1%.
- With further fiscal consolidation planned (to a deficit below -4.5% in FY25-26), the macroeconomic picture appears positive, with short-term rates possibly heading down.

1. What happened?

The interim budget was presented in parliament by the Union finance minister, Nirmala Sitharaman, in lieu of a full budget, as is normal Indian pre-election practice. After highlighting many of the government's recent achievements, his speech focused on 'GYAN' – an acronym for the four focus groups of Garib (poor), Yuva (youth), Annadaata (farmer) and Naari (women). Many of the initiatives directed at these groups were elucidated.

Continuing with the government's focus on public capex, the budget increased its allocation by 11% to INR11.1tn in FY24-25 (starting April 1), with major allocations again for developing rail and road infrastructure, and for the defence sector. A INR1tn allocation was set aside for funding innovation, providing low- or no interest loans for 50 years. Divestment targets for disposing of government stakes in listed companies have been reduced to INR500bn.

Other announcements included schemes on housing, health and tourism. To improve logistical issues and costs, three major railway corridors for the energy, mineral and cement industries have been proposed.

Nominal GDP is forecast to grow by 10.5% in FY24-25 and will provide a major tailwind for fiscal consolidation. On this growth assumption, GDP will total INR328tn (USD3.95tn at current exchange rates) in the year ending March 2025. The fiscal deficit estimate for the current financial year (i.e. FY23-24) was revised downwards from the -5.9% estimate last year to -5.8%. The deficit is projected to fall to -5.1% in FY24-25 before reaching -4.5% in FY25-26. Contributors to this marked improvement in the government's finances are expected to come largely from the revenue side.

Tax revenues are budgeted to increase to INR26tn in FY24-25 from INR23.5tn, an increase of 11.9%, led by both corporate and personal income taxes (but with no changes in the regime).

Estimated gross market borrowing by the government has been unexpectedly reduced from INR15.43tn to INR14.13tn in FY24-25, with net borrowing broadly stable at INR11.75tn.

2. How did markets react?

A budget focused on strong fiscal consolidation unsurprisingly gave support to fixed income markets. Yields on the benchmark 10-year government paper fell by 9 bps to 7.06%, while the 5-year and 3-year tenures showed a 4 bps fall. The INR was flattish and closed at 82.98 vs the USD.

Equity markets had no major triggers from the budget announcements and remained rangebound - the Nifty 50 closed down by -0.13%, The financial sector benchmark Bank Nifty Index went up by 0.4%, with banks expected to benefit from fiscal consolidation.

3. What does it mean for investors?

The interim budget, although as expected not including any big announcements, remained committed to the path of strong fiscal consolidation. Through avoiding any populist measures or handouts, in a pre-election budget, it provides a clear indicator of the government's policy intent. Building on various reforms, process improvements and efficiencies, government finances are now reaping the benefits of policy continuity.

With nominal GDP officially projected to grow at 10.5%, and tax revenues growth forecast at a modest 11%, the tax/growth multiplier is predicted be much lower than seen in the past two years. Divestment revenue targets are similar to the last fiscal year, but previous targets have been consistently missed.

As noted, government capex received an allocation that is 11% higher, equivalent in value to 3.4% of GDP – probably the highest ratio any Indian government has allocated towards developing infrastructure.

The official forecast that gross market borrowing will be lower than in the current FY23-24 is a major surprise and may have implications for the yield curve over the next few months. With India's inclusion in global bond indices due from mid 2024, over USD20bn is expected to flow into government securities. This would constitute about 12% of the total issuance and might crowd out local buyers. While liquidity is tight in the banking system currently, lack of additional investment avenues for banks to park their statutory reserves could result in short term money market rates easing. This might cause a bull-steepening of the yield curve over the course of the next fiscal year.

Though today's budget pronouncements have little to offer to equity investors, the changing dynamics of the Indian yield curve are conducive for fixed income investors to start building on duration, as money market rates are expected to head lower in the second half of 2024.

Glossary

The Bank rate is the rate at which RBI lends money to banks without any security.

The Bank NIFTY includes the biggest-capitalised and most liquid Indian banking stocks.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

The Indian rupee (INR) is the currency of India.

The NIFTY 50 Index is a benchmark Indian equity index representing the weighted average of 50 stocks over 12 sectors.

The Reserve Bank of India (RBI) is India's central bank and regulatory body under the jurisdiction of the Government of India.

USD is the currency code for the U.S. Dollar.

Historical Performance

Performance	31.1.2019 - 31.1.2020	31.1.2020 - 31.1.2021	31.1.2021 - 31.1.2022	31.1.2022 - 31.1.2023	31.1.2023 - 31.1.2024
NIFTY50	10.4%	14.0%	27.2%	1.9%	23.0%
Bank NIFTY	13.0%	-0.9%	24.2%	7.1%	13.1%
India 10Y Government Bond Return	10.4%	10.3%	0.5%	2.0%	8.5%
India 5Y Government Bond Return	10.8%	11.8%	3.9%	2.4%	8.3%
India 3Y Government Bond Return	9.6%	9.9%	4.5%	2.7%	7.7%
INRUSD	-0.8%	-1.8%	-2.2%	-8.8%	-1.6%

Source: LSEG Datastream, Deutsche Bank AG. Data as of February 1, 2024.

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