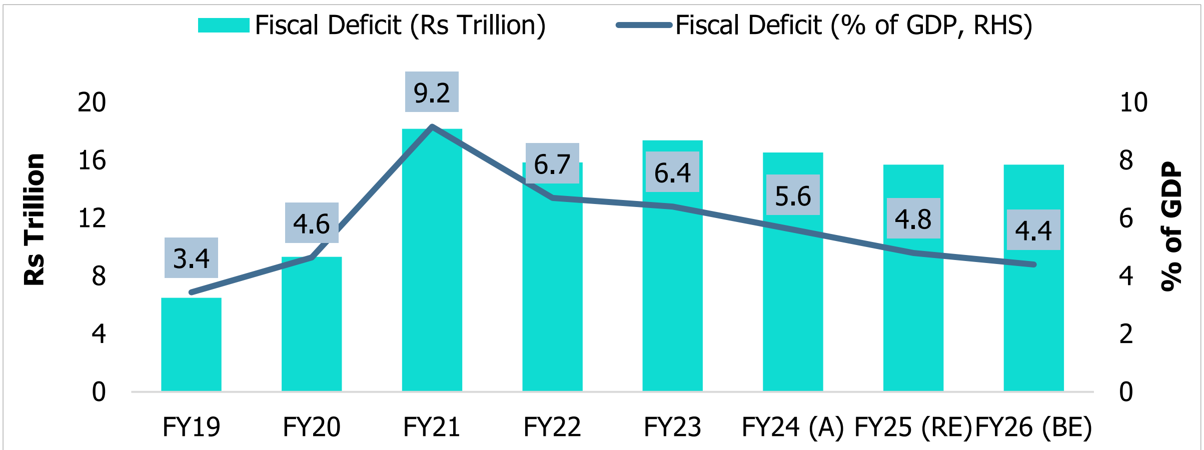
Focus on Fiscal Consolidation and Growth in Recent Union Budget Underpins India's Credit Profile

The FY26 Union Budget of the Republic of India (India), announced on February 1, 2025, reinforces credibility in India's fiscal consolidation roadmap. Moreover, it does so while judiciously balancing the need to maintain high economic growth. Both these aspects (of the government's continued commitment towards fiscal consolidation and emphasis on boosting the economy's overall growth potential) support our rating of India at '**CareEdge BBB+/Stable'**[1]. At the same time, CareEdge Global believes that more needs to be done to address other credit weaknesses, such as high interest-to-revenue metrics and low-income levels over the coming decade.

Central Government Remains Committed to Fiscal Consolidation

The Centre has stayed on the path of fiscal consolidation with fiscal deficit-to-GDP budgeted at 4.4% in the fiscal year ending March 31, 2026 (FY26), in line with the glide path envisioned in the previous budget announcements, thus strengthening its overall fiscal credibility. The other noteworthy aspect is the continuation of the capex focus. Revenue expenditure-to-GDP is budgeted to moderate to 11% in FY26 from 11.4% in FY25, while the capex-to-GDP is budgeted to remain steady at 3.1%.

Exhibit 1: Centre's Fiscal Deficit Trajectory



Source: Union Budget Documents; Note: (A): Actuals; (RE): Revised Estimate; (BE): Budget Estimate

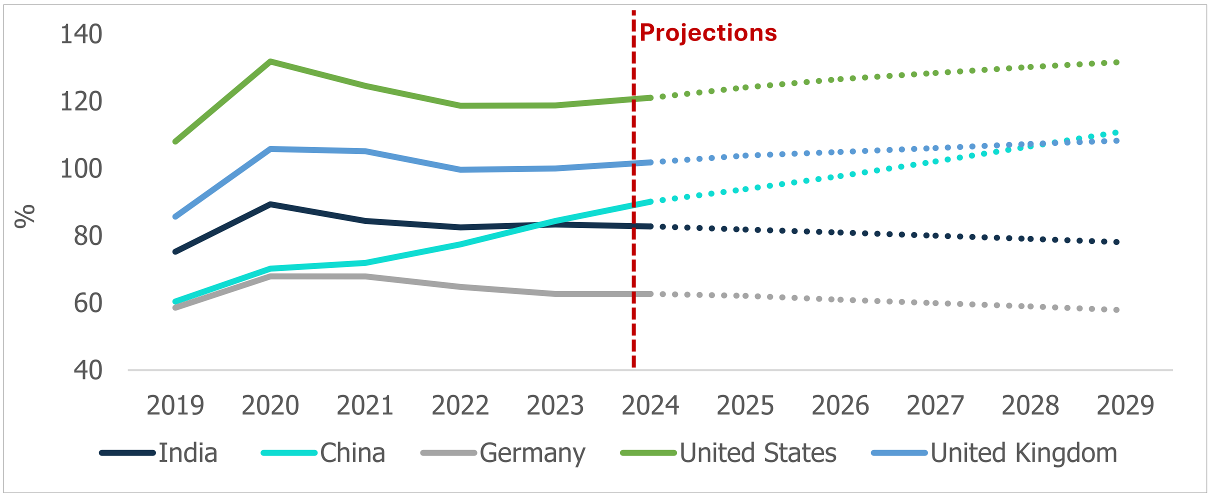
Going forward, the Centre plans to shift to a new metric of 'debt-to-GDP' as a fiscal anchor from 'fiscal deficit' so far. The Budget provided the future roadmap for the Centre's debt-to-GDP, which remains on a downward trajectory to reach 50±1% by end-FY31, from the estimated 57.1% in FY25. This debt trajectory of the Central Government is in line with our forecasts.

[1] Unsolicited; Long Term Foreign Currency rating

Overall, we project India's General Government Gross (GGG) debt, which includes state government debt (currently at ~83% of GDP), to remain on a downward trajectory in the medium term, moderating to below 80% of GDP by FY30 and declining further to under 75% of GDP by FY35.

Globally, the GG debt-to-GDP levels of most other major economies are projected to show a rising trend going forward. However, India is among a few major economies where the GGG debt-to-GDP is projected to fall.

Exhibit 2: General Government Gross Debt-to-GDP Trajectory (%)

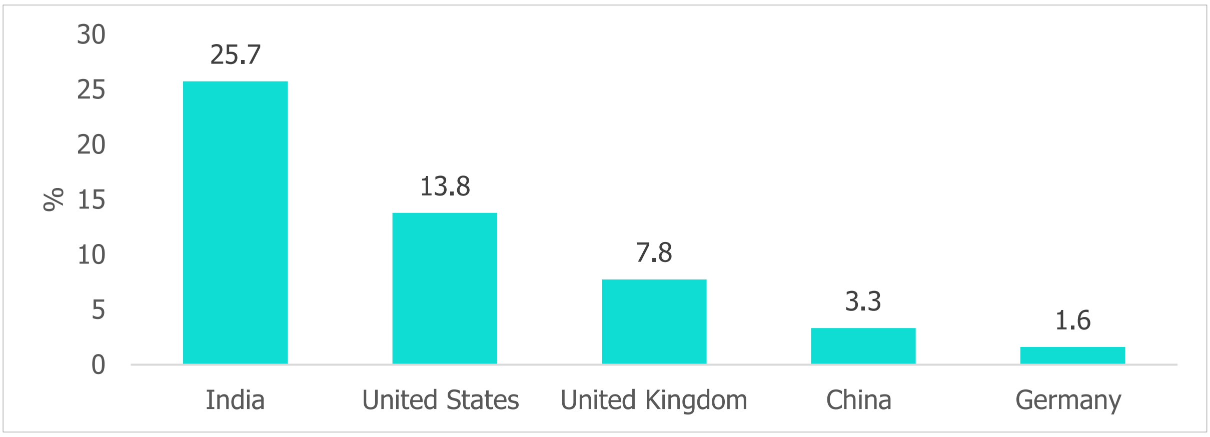


Source: International Monetary Fund (October 2024 Update); Data for India is on a fiscal year basis, and projections for India are CareEdge Global projections

Debt Affordability Remains a Challenge

India fares poorly in terms of debt affordability, with the combined interest payments of Centre and State governments averaging at 25.7% of revenue receipts during the last five years, notably higher than the other major economies. Though India's GGG debt is projected to moderate going forward, the challenge of debt affordability is unlikely to abate for the economy over the medium term.

Exhibit 3: Debt Affordability (Interest Payments as % of Revenue) Average for Latest Available Five Years*



Source: International Monetary Fund; National Sources; Data for India is on a Fiscal Year Basis

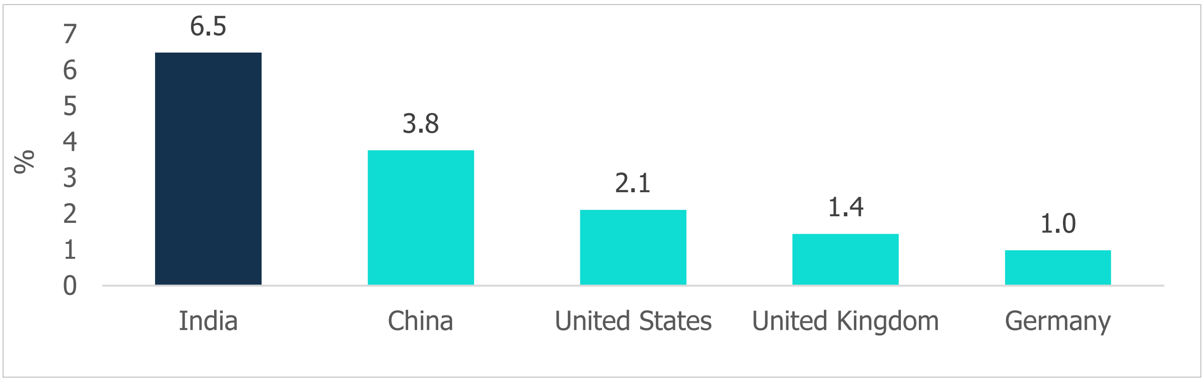
* India: FY20-24; United States: 2019-2023; United Kingdom: 2019-2023; China: 2017-21; Germany: 2019-2023

India's Growth Projections Remain Healthy

India continues to remain the world's fastest-growing major economy. The Centre's focus on capex-led growth has supported economic growth post-pandemic. However, the economic momentum witnessed some deceleration, with real GDP growth estimated at a four-year low of 6.4% in FY25, as per the First Advance Estimate released last month.

Despite some signs of growth moderation, India remains the world's fastest-growing major economy. Furthermore, the Budget FY26 addressed some key economic concerns on the growth front, viz., improvement in consumption and capex.

Exhibit 4: Projected Real GDP Growth (Future Five Years*)



Source: International Monetary Fund (October 2024 Update); Data for India is on a fiscal year basis

*2025-2029

India's Income Levels Lag Other Large Economies

Though India's economic performance remains largely resilient vis-à-vis other major economies, it faces challenges from its low per capita income at USD 9,221 (Constant

Purchasing Power Parity Terms) in 2023. While India's per capita income is likely to improve gradually going forward, it is estimated to trail below other economies. Thus, focusing on reforms and policies that will boost India's income levels remains critical.

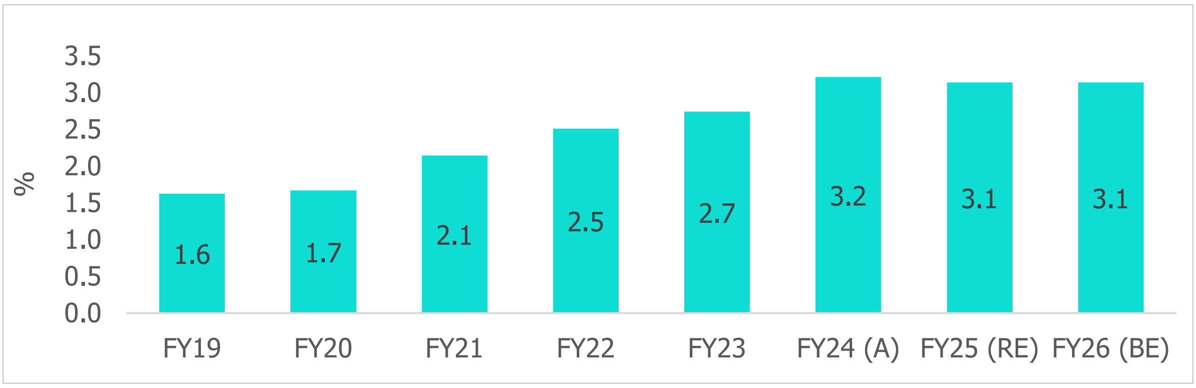
Budget Focuses on Consumption & Capex

Consumption GDP growth is estimated to improve to 7.3% in FY25 from 4% in FY24, supported by a pick in rural demand, offset by moderation in urban consumption. The Indian economy is largely domestic-driven, with private final consumption expenditure contributing more than 55% of the GDP. The domestic consumption scenario becomes even more critical at the time of persistent weakness in the external demand. It also remains pivotal to spur private investments in the economy. Given this background, the reduction in income tax announced in the budget will likely provide the much-needed impetus to domestic consumption.

On the receipt front, the Centre has budgeted a strong 10.8% growth in the gross tax revenue collections for FY26. This factored in a 14.4% growth in income tax collections, lower than the estimated 20.3% growth in FY25. However, factoring the estimated revenue loss amounting to Rs1 trillion on account of the announced tax relief, achieving the budgeted growth in income tax collections could pose a challenge.

Along with the consumption boost to keep the near-term growth impulses intact, the Budget also emphasises capex to augment the economy's long-term growth potential. The Centre's capex is budgeted to grow at 10% compared to the revised estimate, rising to Rs 11.2 trillion in FY26. This translates into a capex-to-GDP ratio of 3.1% in FY26, unchanged from the previous year and much higher than the pre-COVID level of 1.6% seen in FY19. The government's continued capex focus is a positive and will help spur private investments in the economy. This should bode well for the overall investments measured by gross fixed capital formation, a key parameter in our assessment.

Exhibit 5: Capex (% GDP)



Source: Union Budget Documents; Note: (A): Actuals; (RE): Revised Estimate; (BE): Budget Estimate

Overall, Budget FY26 reiterates the Centre's commitment to fiscal consolidation and targets a gradual reduction in debt over the medium term. Furthermore, the Centre has managed to deliver on its near-term aim of supporting consumer spending while staying committed to capex to boost the economy’s long-term growth potential. While the Budget tackles several critical economic issues, a sustained reform orientation over the medium to long term remains imperative to address other credit challenges.

Please refer to the following link for the previous detailed rationale Click Here

Solicitation Status
The rating is unsolicited, but with issuer participation, including interaction with relevant ministries of the Government of India.

Criteria Applied
CareEdge Sovereign Rating Methodology

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