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FY26 Budget Preview

For the fiscal year 2025-26, Union budget will skilfully balance fiscal consolidation, and measures for advancing growth. We expect centre to achieve or maybe even undershoot (by ~10bps) its fiscal deficit target of 4.9% (% of GDP), owing to expected savings on the expenditure side. From these levels, government is expected to reduce deficit target by ~50bps in FY26BE, thus targeting 4.3-4.4% range in our base case scenario. In order to support growth, amidst slowing global growth scenario, government will focus on boosting consumption (both rural and urban). For this, enhanced spending on MGNREGA, PM KISAN, and PMAY can be expected. In addition, certain tax incentives may also be announced. Driving investment growth will be another focus area for the government. We thus expect Rs 1-1.5 lakh crore incremental increase in capex for the next year over the revised estimate for FY25. Markets will also keep a watchful eye on government's borrowing program, which is anticipated to increase only marginally next year (to ~Rs 15 lakh crore). As a result, bond yields will remain stable.

Expectations from FY26 Budget

Consolidation amidst supporting growth

In the latest budget presentation for 2025-26 (FY26) government is expected to announce significant measures to boost domestic consumption and private investment, as the economy braces for headwinds from muted global growth. This agenda will be achieved without compromising upon the fiscal health of the government, as it has shown commitment towards fiscal consolidation even in the past. Normalisation of nominal GDP, higher revenue growth following revival in consumption, and rationalisation of subsidies will give the government much needed fiscal room to lower deficit levels.

Quality of expenditure is unlikely to be compromised upon for two reasons—one, to crowd in private investments by boosting government capex, and two, to support growth and maintain continuity of key social schemes. We thus expect central government to announce ~50bps reduction in fiscal deficit target for FY26.

Challenges that may emerge include: Tariffs announced by President-elect Donald Trump leading to rise in commodity prices/dent export growth, and imported inflation risk due to stronger US$. We give here our expectations, which have been placed forth keeping in mind the practical side of fiscal space that will be available.

Key themes: Driving consumption and investment

Given slight moderation in real GDP growth and signs of strains in urban consumption (as per corporate commentaries), government through its budget will aim to give both rural and urban growth a boost. Government capex is also expected to maintain a healthy pace of growth to give a nudge to private investment. To support these agendas, government may:

- Increase the budget allocation for MG-NREGA scheme from Rs 86,000 crore in FY24RE to ~Rs 95,000-1 lakh crore in FY26.
- Significant jump can be expected in provisioning for affordable housing (rural and urban), given rising construction costs. Budget allocation may touch ~Rs 1 lakh crore from ~Rs 85,000 crore as per FY25BE.
- Increase the budget allocation for PM Kisan Samman Nidhi (PM-KISAN) scheme from Rs 60,000 crore in FY25BE to ~Rs 70-75,000 crore in FY26, in order to increase income support for farmers.
- Expect ~40-50% jump in allocation for skill India program (FY25BE: Rs 2,686 crore) to improve employability.
- Introduce PLI scheme for MSMEs.
- Incentivise EV charging and agriculture warehouse infrastructure.
- Increase Kisan Credit Card loan limit from currently Rs 3 lakh to Rs 5 lakh.
- Retain focus on capex and increase it to ~Rs 11-11.5 lakh crore.

On the **taxes side**, certain proposals may get importance:

- To help sustain consumption growth, and lighten the burden of consumers due to elevated prices in recent years, government may increase limit under standard deductions.
- Savings under section 80C can be increased from Rs 1.5 lakh to Rs 2.5 lakh. Limit for additional savings under pension contribution may also be hiked.
- Savings under 80D for health insurance premiums can be hiked from Rs 25,000 to Rs 50,000, given rising cost of healthcare and insurance premiums.
- Life insurance premiums can also be included under 80D exemption, to increase penetration.
- In order to attract more tax payers to adopt the new tax regime, tax rate can be reduced for under Rs 15 lakh income bracket.
- To boost sustainable tourism, tax incentives for hotels/home stays adopting environment friendly practices can also be expected.
- Custom duties on raw materials may be reduced to correct the inverted duty structure. Automobile parts, textiles, machinery components and IT hardware sector may benefit.

Fiscal consolidation to continue: FD 4.3-4.4% of GDP in FY26

In FY26, even as global headwinds remain strong—given muted growth conditions in Europe and China, and expectation of announcement of inflationary policies by President-elect Donald Trump, Indian economy is still expected to remain well insulated. As inflation is projected to get normalised and RBI may start cutting rates soon, domestic consumption will get a further boost. Jump in government spending is expected to encourage private investments. As a result, government's revenues will be able to maintain a stable growth rate.

Assuming this, nominal GDP is estimated to register ~10.5% growth in FY26 (up from 9.7% in FY25), and fiscal deficit is expected to come in at ~Rs 15.2-15.7 lakh crore, implying a deficit of ~4.3-4.4% (~50bps less than FY25's estimate of 4.8-4.9%).

Gross borrowing programme

For FY25, government is expected to meet its gross borrowing target of Rs 14.01 lakh crore and net borrowing target of Rs 11.63 lakh crore. Despite savings on the expenditure side, government will maintain the target, and lower the capital off-take from other sources, such as small savings.

In FY26, even as revenue collections are expected to normalise further, net borrowing is estimated to ease to ~Rs 10.8 lakh crore. Along with repayments of ~Rs 4.2 lakh crore, this implies a gross borrowing of around ~Rs 15 lakh crore. We expect slight moderation as limiting government's debt levels begins to take centre stage of policy formulation. Also, with RBI set to embark upon the rate cutting cycle, deposit rates are expected to come down, giving the government another avenue (small saving funds) to tap for funds.

Subsidy levels

Following higher than budgeted increase in subsidies in FY25, on account of food and fertilizers, they are expected to be rationalised to some extent in FY26. In FY25, government had budgeted Rs 3.8 lakh crore for major subsidies (food, fertilizer and petroleum). However, following the increase in MSP for Rabi crops in the marketing season 2025-26, government is expected to exceed its budgeted estimate (BE) by ~10%. Other factors that are contributing to rise in subsidy cost, include higher cost of storage and transportation.

Fertilizer subsidy is also expected to be higher than BE by 9-10%. A stronger US$ is pushing import costs higher, requiring greater support by government to prevent rise in retail prices. Taking both factors into account, overall subsidy burden is expected to rise to ~Rs 4.1-4.2 lakh crore in FY25. From that level, the burden is expected to come down to ~Rs 4 lakh crore in the next financial year. Trimming will be visible mainly in case of food subsidy, which is projected to be contained in the range of Rs 2-2.1 lakh crore. We believe fertilizer subsidy will be maintained at ~Rs 1.7-1.8 lakh crore, as stronger US$ will continue to impact import prices for the large part of the next fiscal year as well.

Fig 1 – Subsidy breakdown

(Rs lakh crore)	FY24PA	FY25BE	FY25E	FY26E
Food	2.12	2.05	2.25	2.10
Fertilizer	1.89	1.64	1.79	1.80
Fuel	0.12	0.12	0.10	0.10
Total	4.14	3.81	4.14	4.00

Source: CEIC, Union Budget Documents, Bank of Baroda Research | Note: PA- Provisional Actuals, BE-Budget Estimates, E-Bank of Baroda estimates

Interest payments

With interest rates remaining elevated in recent past, interest cost burden is estimated to increase at a steady pace in FY26. Following estimated 9.3% increase in FY25 (Rs 11.6 lakh crore), interest payment is expected to increase to Rs 12.4 lakh crore (+7%) in the next fiscal year.

Fig 2 – Interest burden

(Rs lakh crore)	FY24PA	FY25BE	FY25E	FY26E
Interest payments	10.64	11.63	11.63	12.44

Source: CEIC, Union Budget Documents, Bank of Baroda Research | Note: PA- Provisional Actuals, BE-Budget Estimates, E-Bank of Baroda estimates

Focus on capital expenditure to continue

In order to move closer to realising the dream of 'Viksit Bharat', Union Government will continue to prioritize capex to push investments and improve the quality of expenditure. Furthermore, as global growth is projected to remain muted even in CY25 (2.8%), unchanged from CY24 as per UN World Economic Prospects), and pick up only marginally in CY26 (2.9%), centre and states' government spending will be critical to drive domestic growth. Government is expected to enhance its capex not only infrastructure projects (ports, roads, railways and power), and defence, but also on health (hospitals, pharma), education (skilling institutes) and space technology.

We thus estimate ~11% jump (Rs 10.0 lakh crore revised estimated in FY25) in capex to Rs 11.1 lakh crore in FY26. Revenue expenditure on the other hand is estimated to increase less substantially to Rs 38.7 lakh crore from estimated Rs 36.7 lakh crore in FY25. The increase will be driven by higher allocations for PM-Awas Yojna and MGNREGA.

Fig 3 – Capex

(Rs lakh crore)	FY24PA	FY25BE	FY25RE €	FY26E
Capital spending	9.5	11.1	10.0	11.1

Source: CEIC, Union Budget Documents, Bank of Baroda Research | Note: PA- Provisional Actuals, BE-Budget Estimates, E-Bank of Baroda estimates

Size of the budget

Size of the budget is likely to range between Rs 49-50 lakh crore in FY25.

Fig 4 – Budget size

(Rs lakh crore)	FY24PA	FY25BE	FY25E	FY26E
Size	44.4	48.2	46.7	49.8

Source: CEIC, Union Budget Documents, Bank of Baroda Research | Note: PA- Provisional Actuals, BE-Budget Estimates, E-Bank of Baroda estimates

Revenue receipts to stabilize

On the revenue side, tax receipts would be critical in determining the extent to which fiscal consolidation can be achieved next year. Coming off from a high base, we expect revenue growth to stabilize in FY26.

In FY25, centre's net revenue collections are expected to register 12.5% growth (+Rs 3.4 lakh crore) over FY24PA versus 14.7% estimated in the budget. This is owing to buoyancy in indirect tax collections, led by GST. Excise duty and custom duty receipts are also projected to meet their budgetary targets in FY25. On the other hand, direct tax collections are expected to miss budgeted targets, led by weaker corporate tax receipts.

Non-tax revenues will be broadly steady in FY25, noting only minor shortfall on account of communication receipts. Dividend and profits component is expected to meet budgetary estimates, which includes the extra Rs 1 lakh crore surplus paid by RBI to the government. Higher (Rs 2.11 lakh crore) than expected (~Rs 1 lakh crore) surplus was announced by RBI, much before the final budget for FY25 was presented in Jul'24.

In FY26, centre's net revenue (which includes tax and non-tax revenue) is estimated to clock in 10% growth and reach ~Rs 33.5-34 lakh crore. This will be led by 10.4% growth in centre's tax revenues and 8.3% increase in non-tax revenues.

Fig 5 – Tax receipts

(Rs lakh crore)	FY24PA	FY25BE	FY25E	FY26E
Centre's net tax revenue	23.3	25.8	25.4	28.1
Growth (%YoY)	*10.9*	*11.0*	*9.3*	*10.4*
Centre's net revenue	27.3	31.3	30.7	33.8
Growth (%YoY)	*14.5*	*14.7*	*12.5*	*10.0*

Source: CEIC, Union Budget Documents, Bank of Baroda Research | Note: PA- Provisional Actuals, BE-Budget Estimates, E-Bank of Baroda estimates

In conclusion:

The budget presented on 1 Feb 2025 will stick to its path of fiscal consolidation, without compromising on quality of expenditure. In the wake of moderating domestic GDP growth, headwinds from weakening global growth, and risks emerging from stronger US$ and tariffs threats by President-elect Donald Trump, this budget will lay down policies to ensure our growth prospects remain insulated. Important schemes such as PM-KISAN, MGNREGA, Housing for all, free food grains, will continue to hold significant importance. In addition, tax incentives and greater focus on skilling India's youth will also garner attention. Focus on infra spending will continue. On the receipt front, growth is expected to stabilize, in line with nominal GDP growth. Higher consumption, given policy support and lower inflation will push government's revenues in a comfortable position. Borrowing program will also remain relatively unchanged, as lowering debt levels begins to take centre stage of policy formulation. Lower bond yields, and deposit rates (as RBI embarks upon rate cut cycle in FY26), will also help lower the debt burden.

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