HSBC Mutual Fund

The Macro Sphere
India Budget PREVIEW

Limited policy levers

January 2026

Limited policy levers…

Key expectations

- No changes expected on the tax policy,
- The 16th Finance Commission report details would be closely watched to assess Revenue implications for Centre and States
- Transfers to States and long-dated interest-free loans from Centre to States also watched
- Unlikely to see major policy changes or big-bang policy measures at this Budget given the limited policy levers
- On expenditure front, we may continue to expect continuity in Centre’s commitment to CapEx
- From spending angle, the Ministries that may be in focus are Defence (~2% of GDP), Agriculture (~0.5% of GDP), and Rural development (~0.5% of GDP), Tech/Artificial Intelligence also likely to draw attention in the budget
- Fiscal discipline and policy continuity following last years’ Budget may in itself be growth supportive
- Having said that, given the persistently high tariffs, we think the govt. might come up with steps to support tariff-hit export sectors – either by way of subsidies, incentives or targeted support, possibly, in its recently established Export Promotion Mission.
- Production Linked Incentive scheme could be expanded to include more sectors

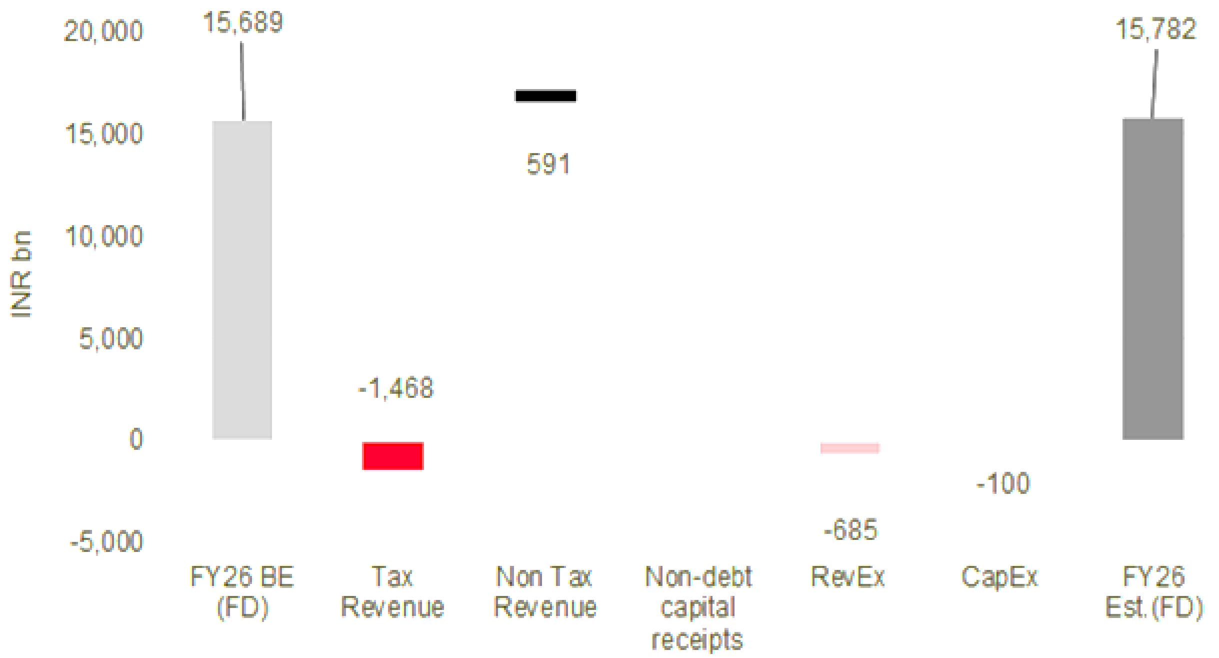
Policy continuity amid gradual consolidation, Expect targeted spending & incentives

Source: Indian Union Budget Document, Bloomberg, 21-Jan’26

Fiscal deficit ratio – Met or Missed?

FY26: No slippage

- Fiscal deficit in absolute numbers is modestly higher, but fiscal deficit to GDP is expected to be met at 4.4% for FY26.
- Weaker net tax collections from budgeted levels esp. low single digit increase in GST tax collection would be a drag
- Higher non-tax revenue driven by RBI dividend of ~INR 2.7 lakh crore provides cushion
- The total tax mop-up would still fall short by ~INR 900bn from its budgeted levels…
- Weaker RevEx offset the tax impact on fiscal deficit.
- We believe, the govt. is likely to meet its budgeted CapEx levels



Source: Indian Union Budget Document, Bloomberg, 21-Jan'26

Fiscal mapping: A Changed Avatar…

FY27: Walking the tightrope - Tax mop-up steady, Spending cautiously

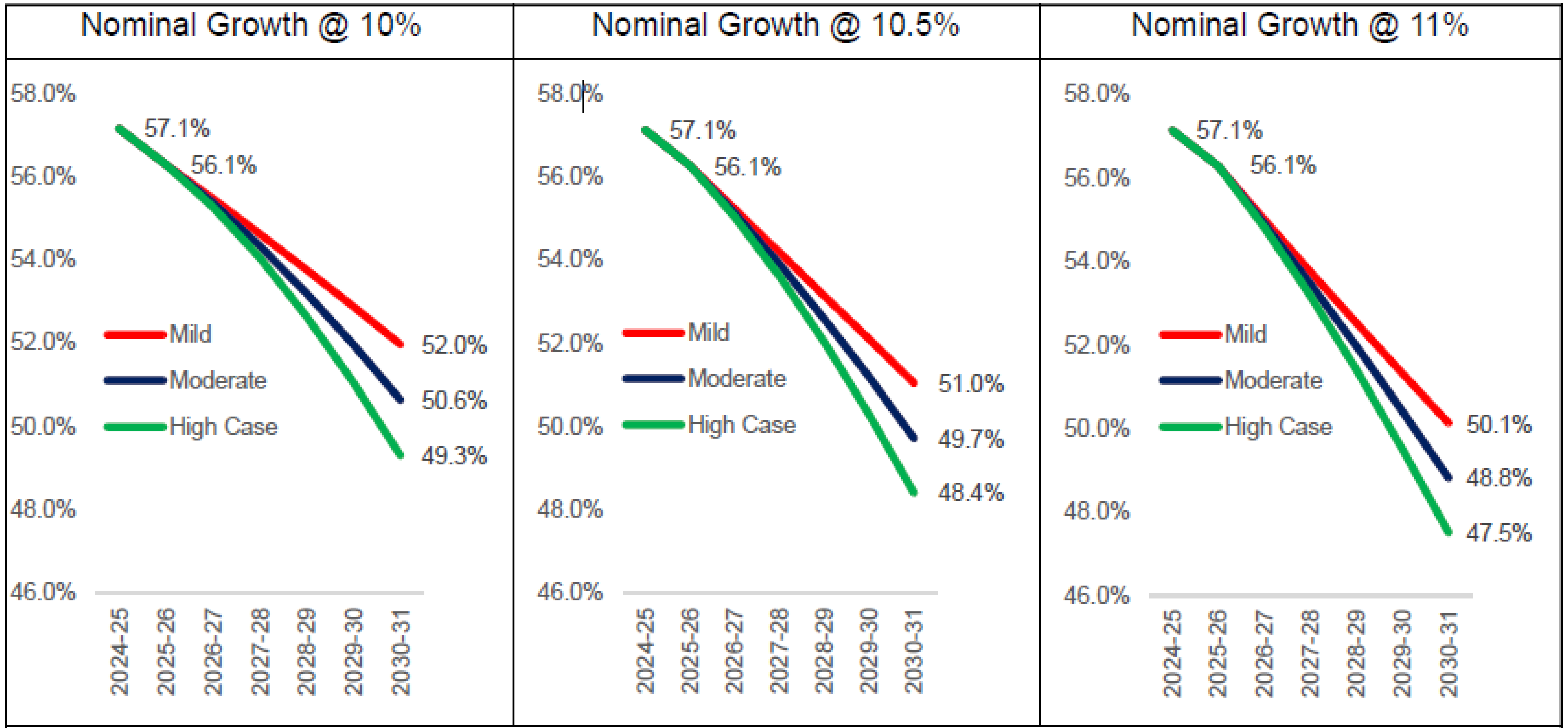
- From FY27 the Union Budget would now shift to targeting Debt-to-GDP ratio from Fiscal Deficit to GDP ratio
- Our assumptions indicate that the govt. may continue with fiscal consolidation, and reach a fiscal deficit target of 4.2% of GDP for FY27
- We assume Nominal GDP growth at 10% YoY, the debt-to-GDP ratio is likely to consolidate 0.5-0.7% to ~55.5% of GDP from 56.1% in FY26
- Net tax collection to GDP may increase ~10.5% YoY, but as % of GDP it would be lower at 9.35% following the changes individual tax policy and GST rate rationalization
- Non-tax revenue may continue to add to revenue coffers in FY27
- The 16th Finance commission recommendations key to assess the impact on Net tax revenue
- Total Receipts (net of borrowing) for FY27 is estimated at ~INR 37 trn or ~9.5%, largely similar to estimated FY26 levels
- Total expenditure is estimated to increase by 8.5% taking the budget size to INR 54 tn as per our base case -
    - RevEx is estimated at ~INR 42 tn at 10.7% of GDP, Interest payments & subsidies continue to take up ~43% of RevEx
    - CapEx to rise by 10% to INR 12.2 tn at 3.1% of GDP
- Subsequently, fiscal deficit is estimated at INR 16.6 tn or 4.2% of GDP (as per our base case)
- If we assume that the govt. funds 71% of the deficit via market loans, then the **net borrowing is likely to be ~INR 11.8 tn**
- **With redemptions at INR 5.5 lakh crore, if we assume that the govt. either switches/buybacks or retires ~INR 1tn of it, the Gross borrowing comes to INR 16.3 lakh crore**

Focus shifts to reducing liabilities

Source: Indian Union Budget Document, Bloomberg, 21-Jan'26

Medium-term glide path under FRBM

A shift in anchor to debt-to-GDP to consolidate over the years, Projected to reach pre-Covid levels by FY2031

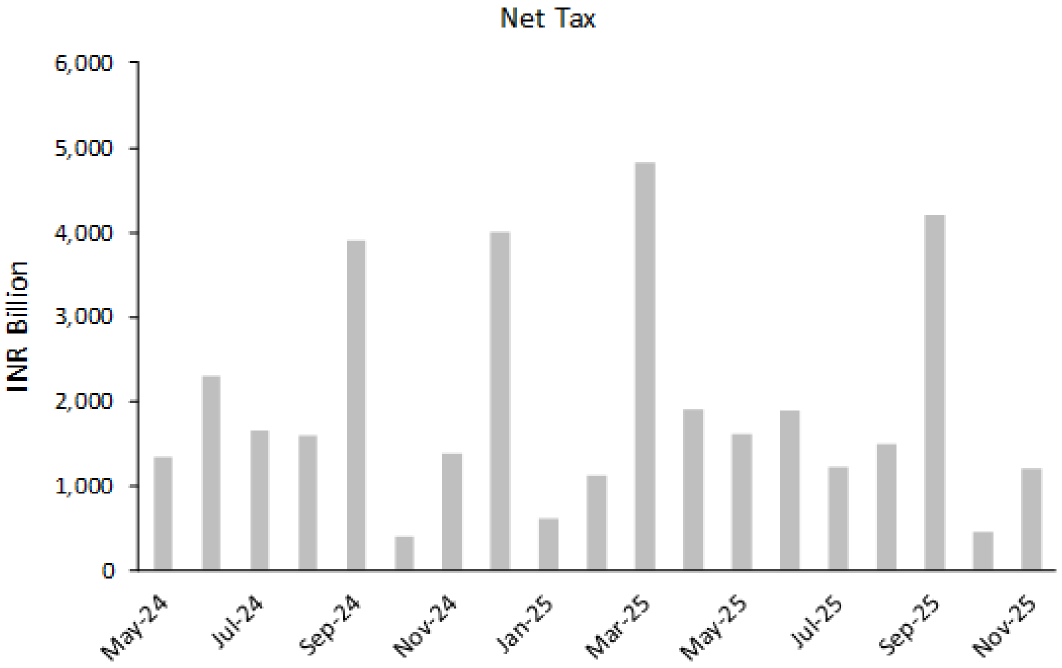


Note: Mild/Moderate/High case refer to degrees of fiscal consolidaton.

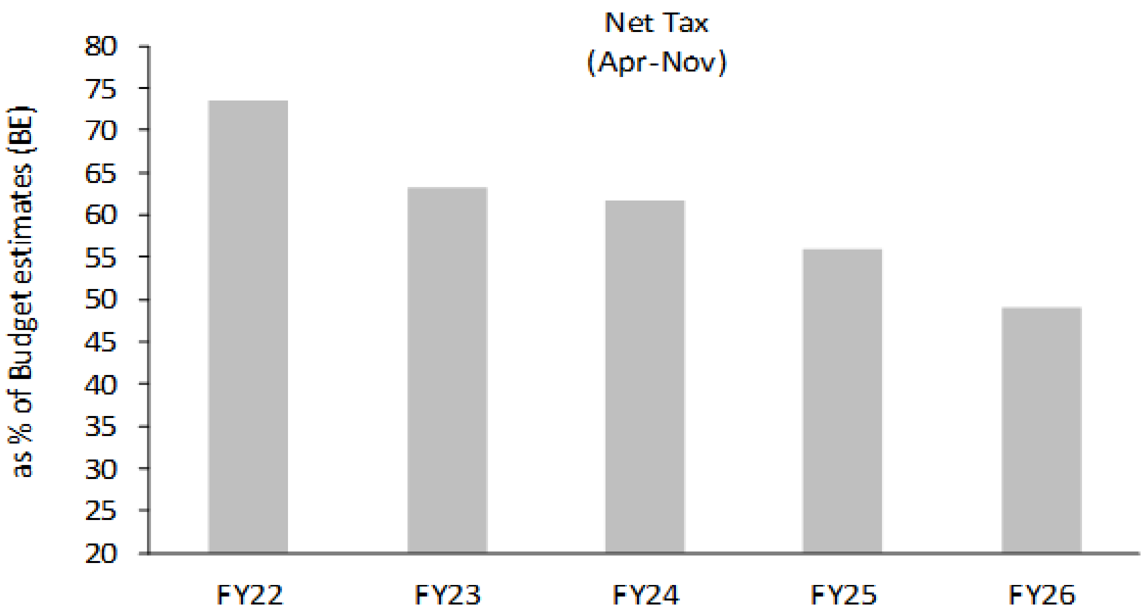
Source: Indian Union Budget Document, Bloomberg,

Net Tax collections are on a softer footing

Net tax collection momentum soft, monthly trend



Net tax as % of BE is lowest in 5-years, Apr-Nov period



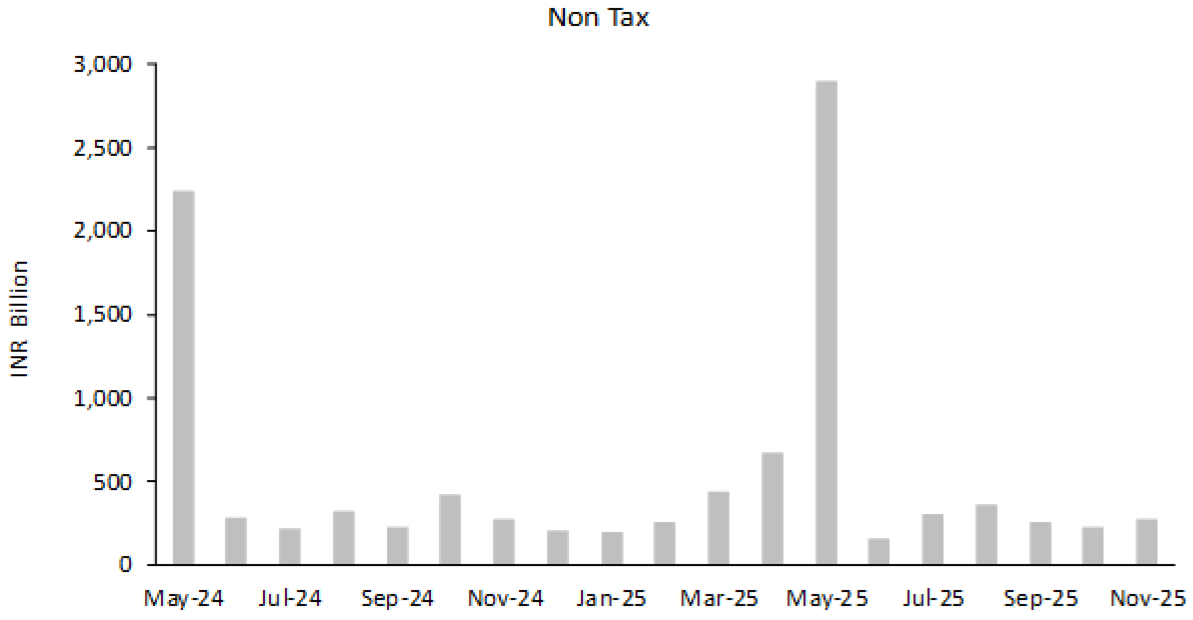
- For 8MFY26, Net tax revenue growth was at -3.4% YoY and at 49% of FY26 BE with higher devolution. Gross tax revenue growth remained weak at 4%
- Net tax mop-up softer mainly due to a fall in indirect taxes, for FY26 YTD
- For 8M FY26, Direct tax collections rose 6.8% YoY (at 53% of FY26 BE) due to personal income tax growth of 6.1% and corporate tax growth of 7.8% YoY. Indirect tax mop-up declined 1.2% YoY as GST collections contracted 2.3% YoY and customs duty collections contracted by 7.3%.

Source – CMIE Database, HSBC FI Economic Research Desk

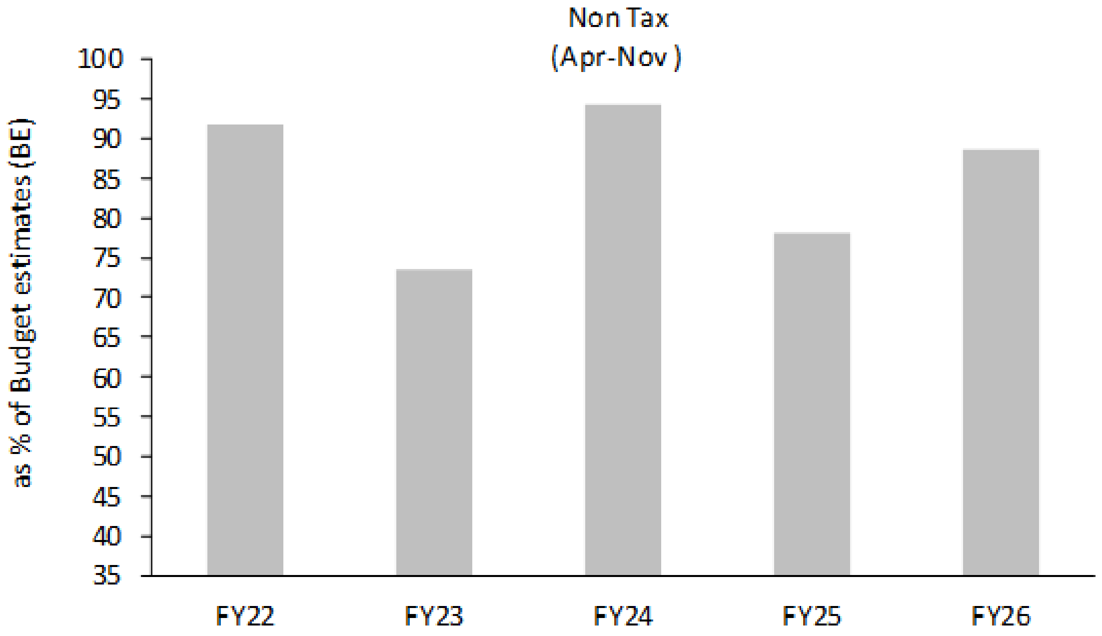
Past performance may or may not be sustained in future and is not a guarantee of any future returns.

Non-Tax Revenue tracking higher

Non-tax revenue, monthly trend



…8M FY26 at ~89% of BE, Apr-Nov period



- The major contributor so far to Non-tax Revenue (NTR) is the RBI Dividend which continues to keep the NTR well in the positive, for 8M FY26
- NTR is tracking ~89% of FY26 BE vs 78% in 8M FY25, providing cushion from slower accretion on Net tax revenues, so far

Source – CMIE Database, HSBC FI Economic Research Desk

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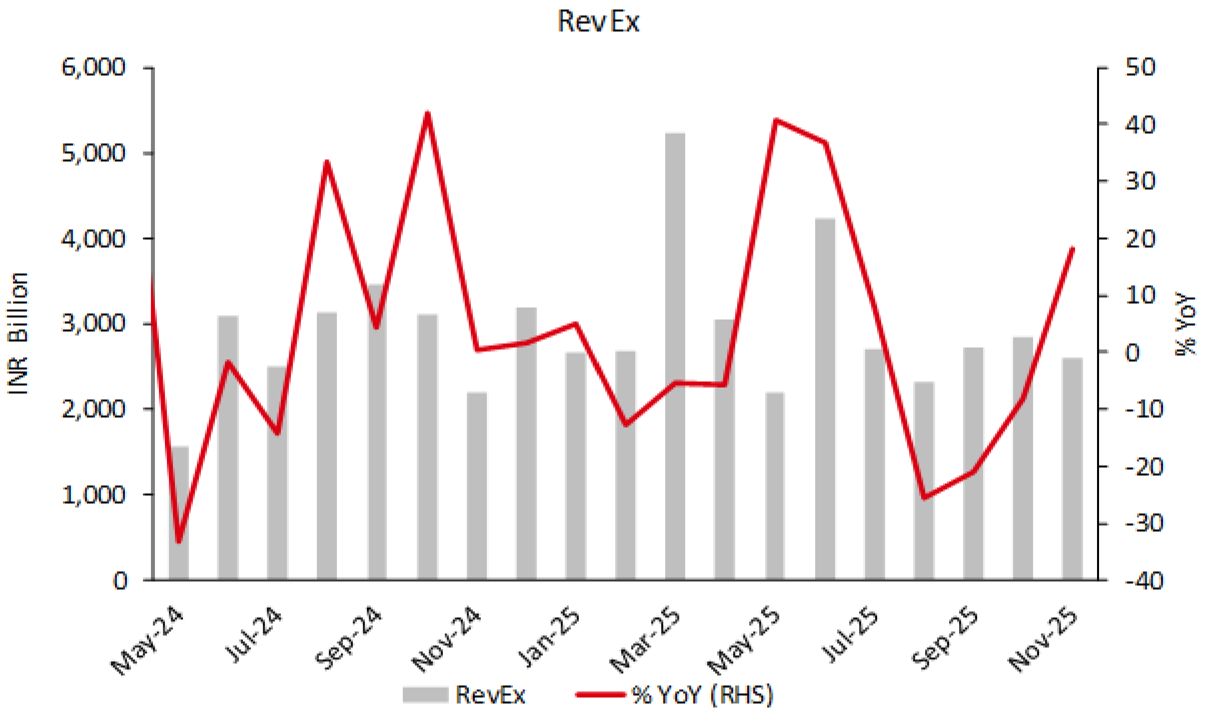
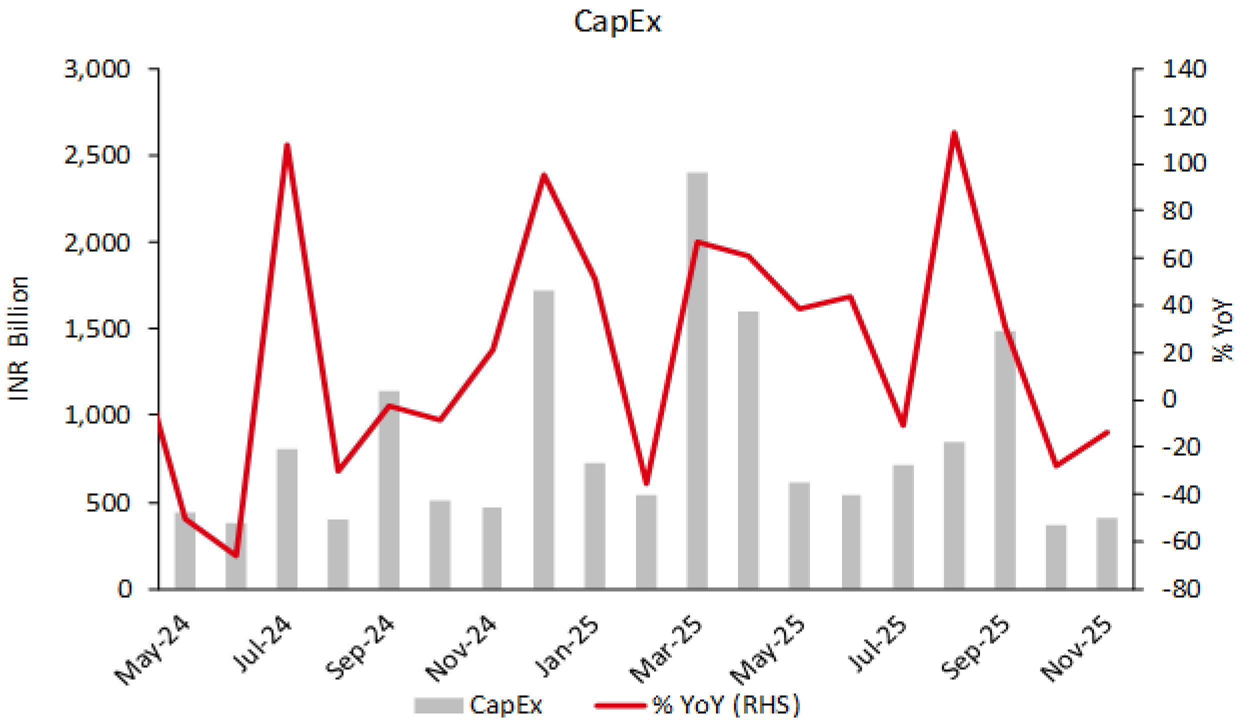
Govt. spending pattern

RevEx steady, monthly trend…



..while CapEx has been robust, Apr-Nov period



- Revenue expenditure (RevEx) growth was up 1.8% YoY in Apr-Nov (~58% of FY26BE).
- Capital expenditure (CapEx) spend sustained at 9.4% MoM, up ~28% YoY in Apr-Nov of FY26 and stands at 59% of BE vs 46% in 8MFY25 (last year was election year which had slowed-CapEx).

Source – CMIE Database, HSBC FI Economic Research Desk

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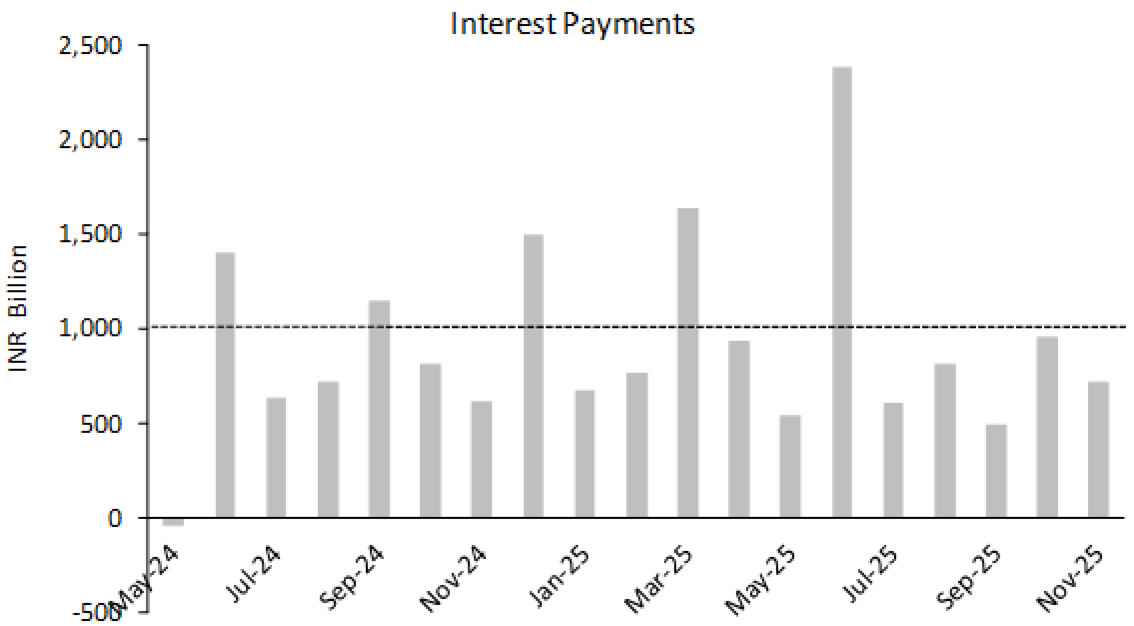
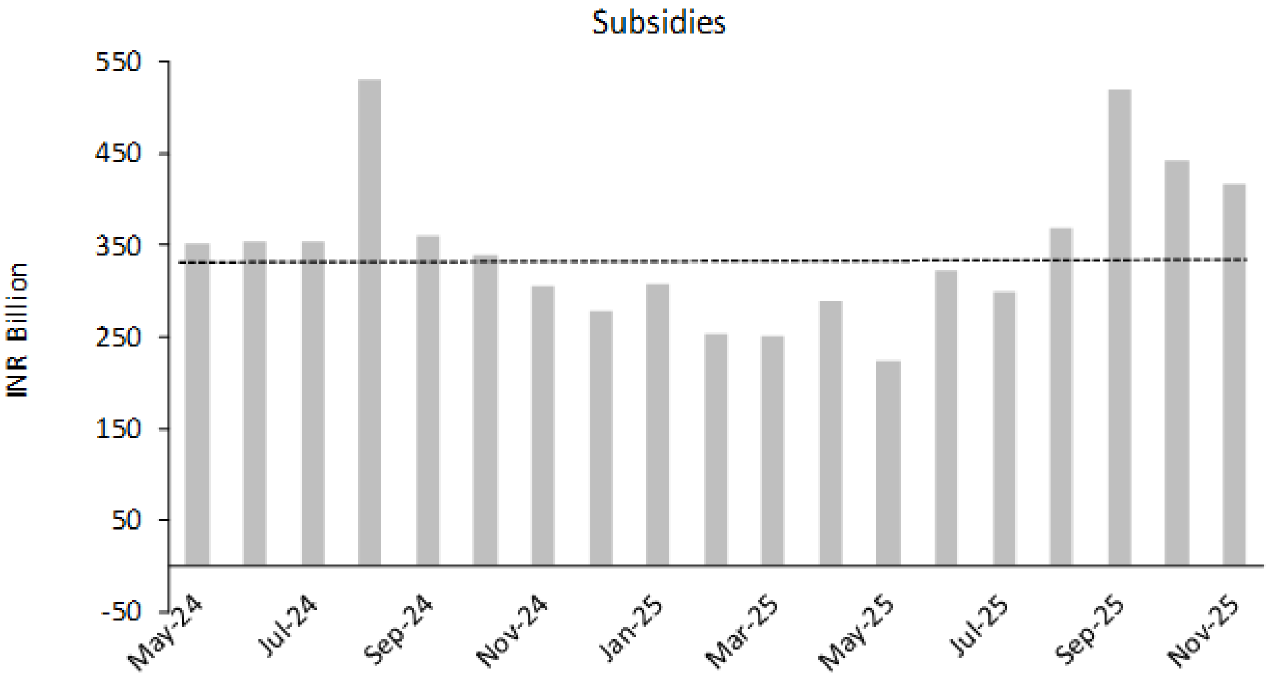
Recurring spends: Interest payments & Subsidies

Monthly trend - Debt servicing elevated, but easing



Monthly trend - Subsidy outgo steady outflows



- Interest payments till Nov were 58% of BE vs 56% in 8M FY25, Quarter ends appear to have higher outgoes in interest payments
- Subsidy outgo picked-up in last 3M and maximum outgo YTD is visible in fertilizer and oil, total outgo so far at 75% of FY26 BE.

Source – CMIE Database, HSBC FI Economic Research Desk

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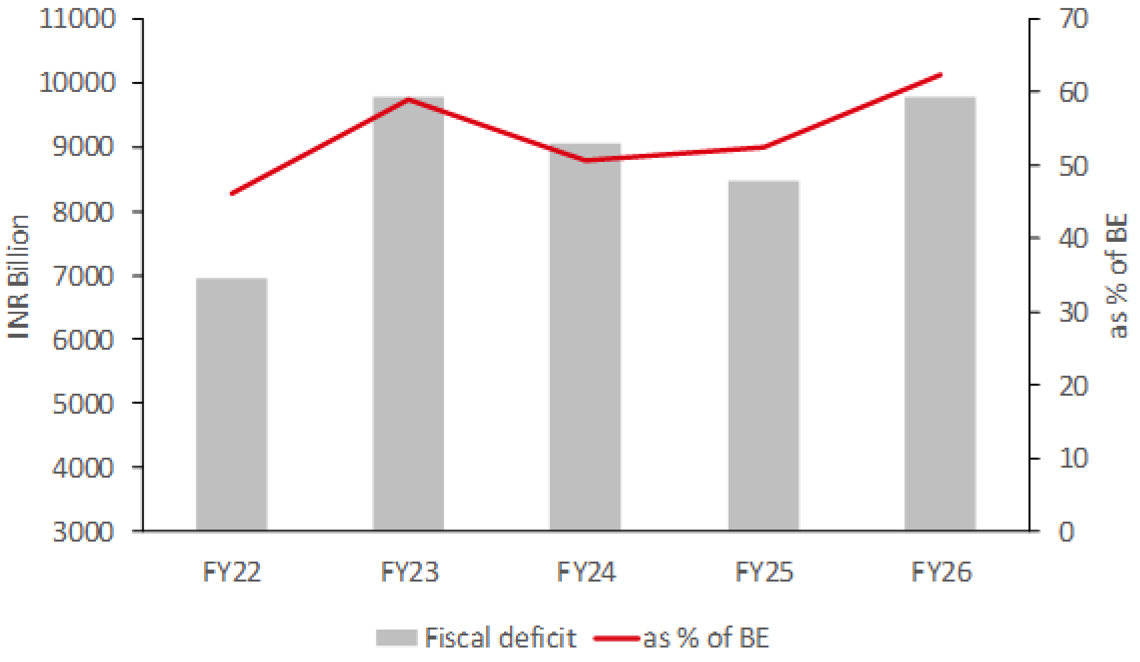
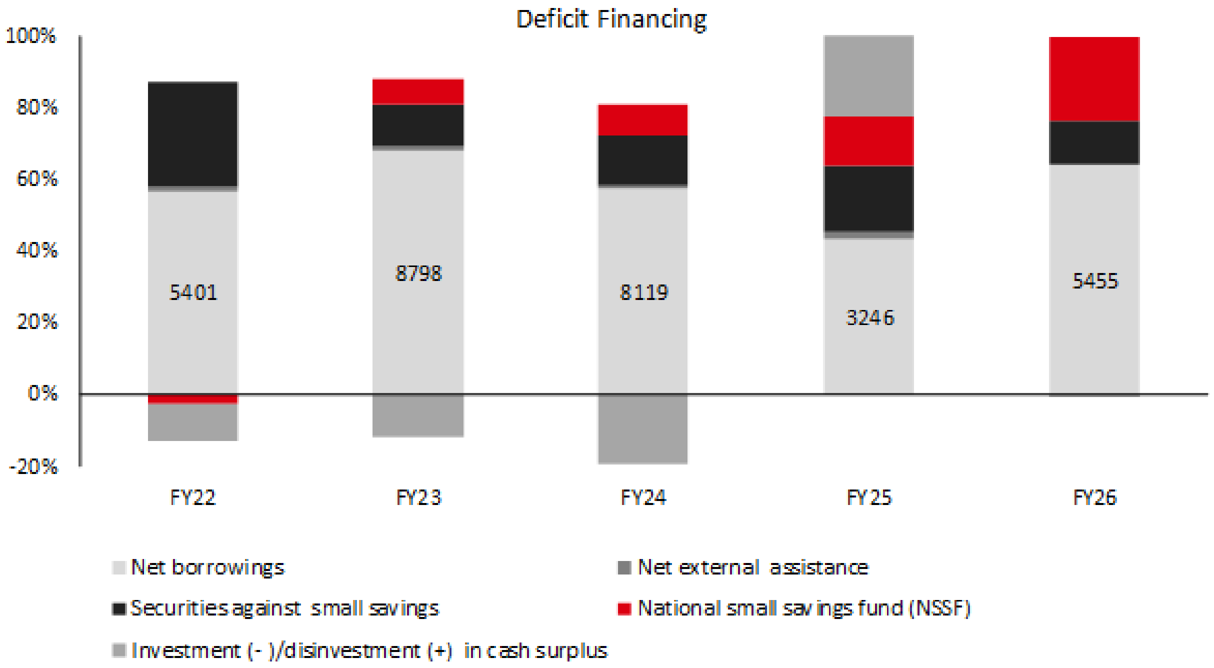
Fiscal deficit tracking higher, Deficit financing comfortable

Fiscal deficit at 62% of BE for 8M FY26



Market loans & NSSF funds key to financing, 8M FY26



- For 8M FY26, weaker net tax collections due to lower GST and import duty have lowered indirect taxes which coupled with CapEx spend has widened fiscal deficit to 62% of FY26 BE, higher than 52% of FY25 BE
- Deficit financing remains manageable, and the govt. retained its 2H FY26 borrowing calendar, the Q4FY26 State debt issuances of INR 4.99 tn weighed on market sentiments
- Fiscal deficit facing headwinds from weaker net taxes, Tax collection trends watched

Source – CMIE Database, HSBC FI Economic Research Desk

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The Fiscal Math: Our Estimates - Budget At A Glance

% of GDP					Base Case	Alt. Case
Fiscal @ glance	**FY24**	**FY25 RE**	**FY26 BE**	**FY26 Est.**	**FY27 Est.**	**FY27 Est.**
Revenue receipts	**9.24%**	**9.58%**	**9.58%**	**9.33%**	**9.34%**	**9.34%**
- *Tax revenues*	7.88%	7.88%	7.95%	7.53%	7.59%	7.59%
- *Non-tax revenues*	1.36%	1.70%	1.63%	1.80%	1.76%	1.76%
Non-debt capital receipts	**0.20%**	**0.24%**	**0.21%**	**0.21%**	**0.18%**	**0.18%**
Total Receipts	**9.44%**	**9.82%**	**9.79%**	**9.54%**	**9.52%**	**9.52%**
Total expenditure	**15.04%**	**14.75%**	**14.19%**	**13.96%**	**13.77%**	**13.86%**
- *Revenue account*	11.83%	11.37%	11.05%	10.85%	10.65%	10.75%
- *Capital account*	3.21%	3.36%	3.14%	3.11%	3.11%	3.11%
Fiscal deficit	**5.60%**	**4.84%**	**4.40%**	**4.42%**	**4.24%**	**4.34%**
Revenue deficit	**2.59%**	**1.9%**	**1.47%**	**1.52%**	**1.44%**	**1.55%**

- FY26 fiscal deficit target of 4.4% of GDP to be met, FY27 consolidation to continue
- We have laid out two scenarios for FY27 –
  - As per our base case, the RevEx restraint is expected to lower fiscal deficit to 4.2% of GDP
  - Alternate case, if govt. goes for higher budget size, consolidation could be slower with FD/GDP at 4.3% of GDP

Source: Indian Union Budget Document, Bloomberg, CMIE, RBI Database, HSBC MF FI, Economic Research Desk

Fiscal Funding: Redemptions to keep Gross Borrowing Higher

	Alt. Case	Base Case	Financing via (INR bn)				Pre-Covid
INR bn	*FY27 Est.*	*FY27 Est.*	*FY26 Est.*	*FY26 BE*	*FY25RE*	*FY24*	FY19
Gross Market Borrowings	16,578	16,303	14,820	14,820	14,007	15,430	5,710
*- Redemptions**	4,468	4,468	3,282	3,282	2,378	3,625	1,483
- Net Market Loans (G-Sec)	***12,110***	***11,835***	***11,538***	***11,538***	***10,745***	***11,778***	***4,227***
Short term borrowings (T-Bills)	500	500	-	-	(1,200)	532	**69**
External Assistance (Net)	235	235	235	235	320	551	-49
Securities issued against Small Sa	3,599	3,599	3,527	**3,434**	**4,119**	**4,514**	**1,250**
State Provident Fund (Net)	50	50	50	50	50	51	161
Other Receipts (Net)	500	500	407	407	260	(887)	740
Drawdown of Cash Balance	-	-	-	25	1,401	8	-13
Fiscal Deficit	**17,057**	**16,669**	**15,782**	**15,689**	**15,695**	**16,546**	**7,040**
FD/GDP	**-4.3%**	**-4.2%**	**-4.4%**	**4.4%**	**4.7%**	**5.6%**	**3.4%**
Debt/GDP	**55.6%**	**55.5%**	**56.1%**	**56.1%**	**56.2%**	**57.6%**	**49.6%**

*For FY27 assuming some switches/buybacks reduces redemptions from INR 5.5 to INR 4.5 lakh crore

Note: For FY27 Alt. case, it may not add up 100% as we assume same entry for all other sources of funding

- FY27 Redemptions at INR 5.5 lakh crore, Gross Borrowing results to INR 16.3 tn
  - As per our base case, if 71% is met via market loans, Net borrowing is estimated to be INR 11.8 tn
  - Alternate case, if deficit was marginally higher, net borrowing could be ~INR 12 tn
- Debt-to-GDP would be at 55.5-55.6% of GDP and we assume it to be lower than the budgeted levels of 56.1% for FY27

Source: Indian Union Budget Document, Bloomberg, CMIE, RBI Database, HSBC MF FI, Economic Research Desk,

Sources of Funding: Market Loans and Small Savings to be the key sources

	Base Case	% of Fiscal Deficit				Pre-Covid
INR bn	FY27 Est.	FY26 Est.	FY26 BE	FY25RE	*FY24*	FY19
Gross Market Borrowings	**98%**	**94%**	**94%**	**89%**	**93%**	**81%**
- *Redemptions**	27%	21%	21%	15%	22%	21%
- Net Market Loans (G-Sec)	***71%***	***73%***	***74%***	***68%***	**71%**	**60%**
Short term borrowings (T-Bills)	**3%**	**0%**	**0%**	**-8%**	3%	1%
External Assistance (Net)	1%	1%	1%	2%	3%	-1%
Securities issued against Small Sa\	**22%**	**22%**	**22%**	**26%**	27%	18%
State Provident Fund (Net)	0%	0%	0%	0%	0%	2%
Other Receipts (Net)	3%	3%	3%	2%	-5%	11%
Drawdown of Cash Balance	0%	0%	0%	9%	0%	0%
Fiscal Deficit	**100.0%**	**100%**	**100%**	**100%**	**100%**	**100%**

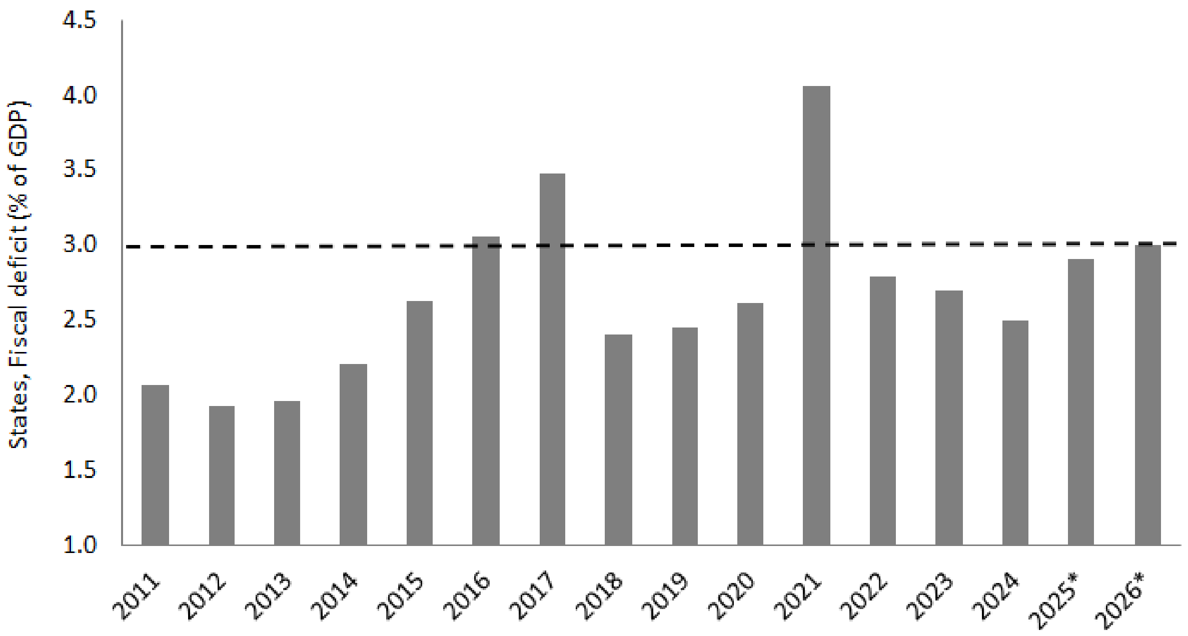
Note: **For FY27 Alt. case**, we have assumed similar proportion of deficit funding,

- Main sources of financing are assumed to be market loans, small savings scheme and short-term borrowing
- We have laid out two scenarios for FY27 –
  - As per our base case, we assume that market loans finance 71% of the fiscal deficit, and
  - Small savings finance ~22% of fiscal deficit (base case) at INR ~3.6 tn
- A higher supply than the ~INR 11.5-12.0 tn could further weigh on bond market sentiments

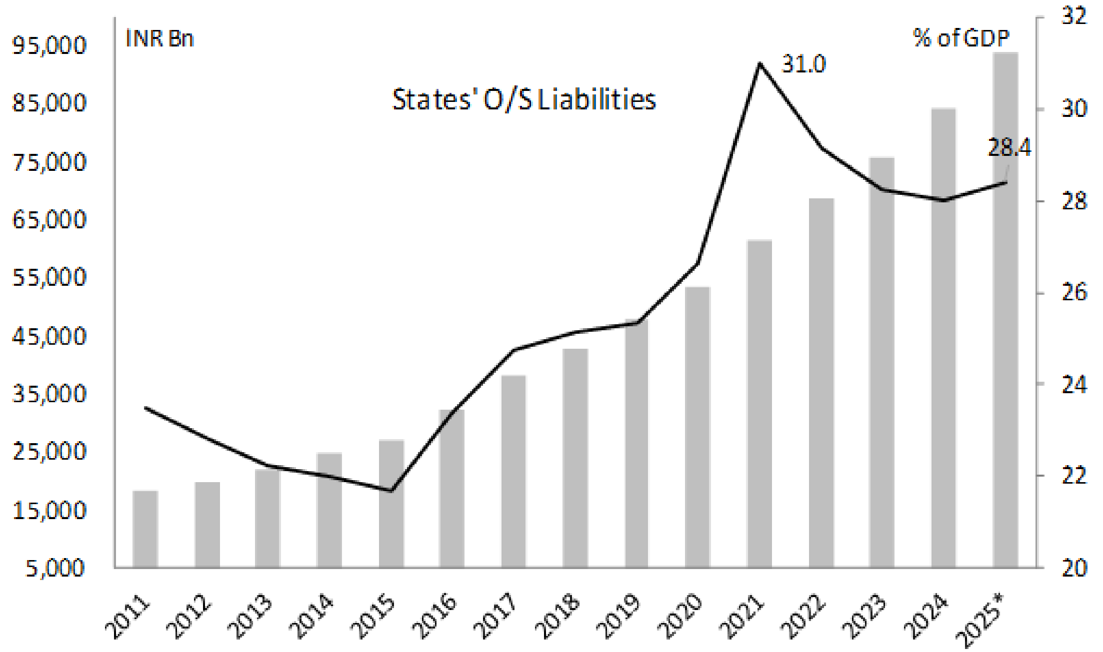
Source: Indian Union Budget Document, Bloomberg, CMIE, RBI Database, HSBC MF FI, Economic Research Desk

States Deficit and Debt, watched…

Trends in States Fiscal Deficit to GDP



Trends in States Outstanding Liabilities (O/S) to GDP



- Over the last few years, States fiscal deficit have inched higher and outstanding liabilities too have increased at a faster clip (but, varying across States)
- States have relied on market borrowing to meet the gap and following the recent GST Rate rationalization, which could impact States' revenue flows, have further exasperated the worries around increased deficit and debt, at State level
- Each State, however, stacks up differently on certain fiscal metrics, at aggregate level, the deficit and debt remain elevated

Source – CMIE Database, HSBC FI Economic Research Desk, Note" * in Chart for 2025, 2026 is budgeted levels, Date is for fiscal year
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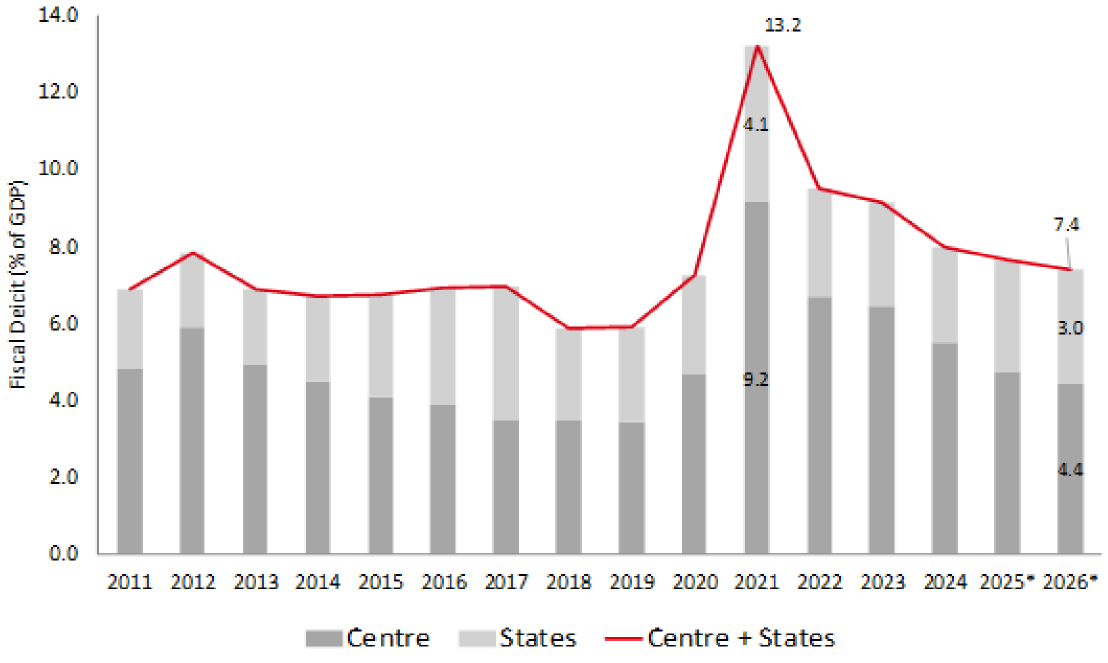
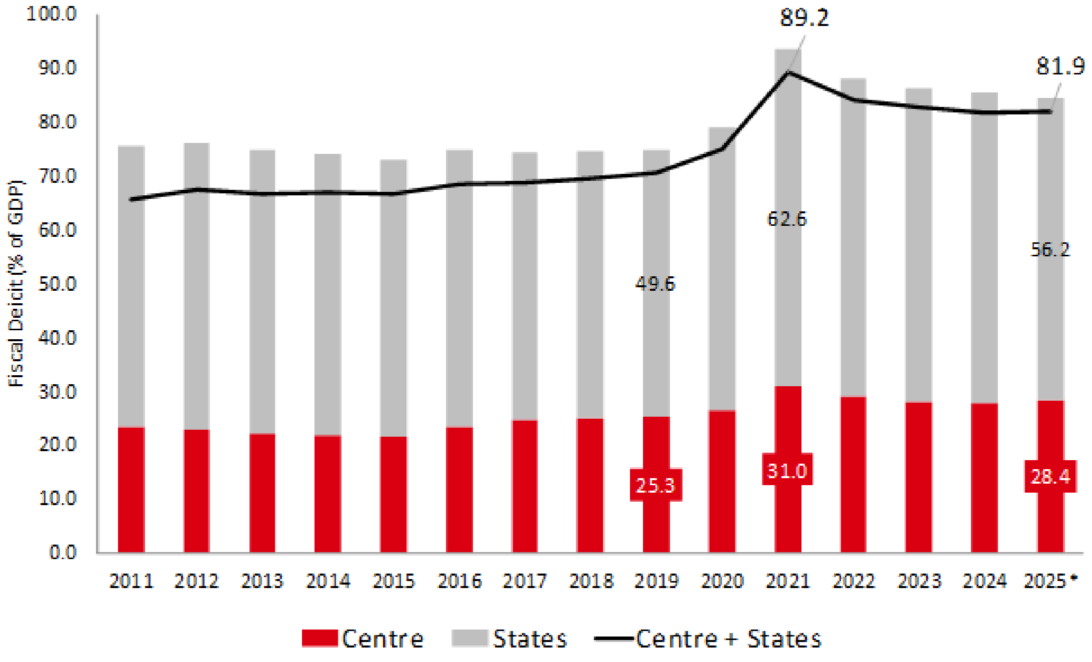
Combined Fiscal Deficit and Debt ratio of the government

Combined fiscal deficit tracking higher..



…Combined Debt-to-GDP ~82% of GDP



- Combined fiscal deficit is budgeted to be at ~7.5% of GDP for FY26
- Debt-to-GDP is 82% of GDP, data as of FY25, The Centre indicates fiscal consolidation, for it to ease in total, States need to be on board too
- On the positive side, post the pandemic, the deficit and debt burden have been gradually brought down, both at Centre and State level
- While the Centre has been better positioned to consolidate, the trajectory and commitment at State level is watched in the ensuing years.

Source – CMIE Database, HSBC FI Economic Research Desk, Note" * in Chart for 2025, 2026 is budgeted levels, Date is for fiscal year
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Conclusion

1. **No negative surprises, as such:** In the last few years, the Union Budget has had fewer surprises and if anything, it had been mostly positive, at the margin. At the upcoming budget, we do not expect any big-bang measures or announcements, however, any positive surprises on reforms would be welcome move.
2. **Market borrowings in focus:** For markets, however, the key would be any positive surprises on the fiscal math, mainly fiscal consolidation and consequently, the deficit funding via market loans.
3. **Tax devolution in focus:** 16^{th} Finance Commission recommendations will be of interest to assess the tax implications and the combined fiscal deficit and debt to GDP ratios.
4. **Centre and States:** In the last couple of years, while the govt. has made good progress on fiscal consolidation and kept borrowings contained, the States aggregated fiscal health and market borrowings have emerged as the real devil, especially from the bonds market perspective.
5. **The shift to Debt-to-GDP:** While Centre shifts to debt-to-GDP, we remain watchful on States fiscal finances. Additionally, it remains to be seen whether the States too would shift to debt-to-GDP from fiscal deficit, as a fiscal metric.

Source: Indian Union Budget Document, Bloomberg, CMIE, RBI Database, HSBC MF FI, Economic Research Desk

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