MOTILAL OSWAL FINANCIAL SERVICES

ECOSCOPE
The Economy Observer

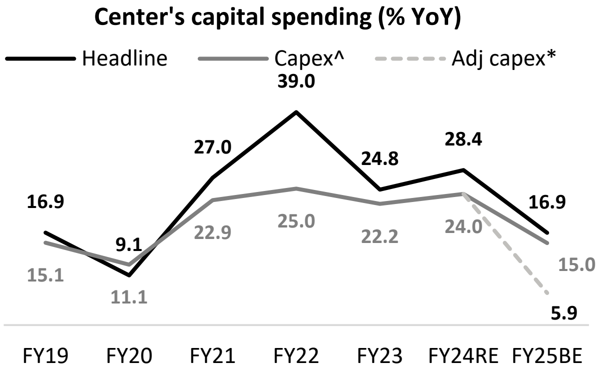
Decoding India's capex budget!

Combined capex kept unchanged at 3.6% of GDP in FY25BE

- **The Government of India (GoI) has sent a loud and clear message with the interim Union Budget 2024-25 – its priority is to focus on long-term macroeconomic stability, even if it means a sacrifice of growth over the short term. We have highlighted the restricted ability of the GoI to support economic growth if it is serious about its fiscal deficit consolidation path. However, like every year, more time needs to be spent to understand the nuances of the capex Budget.**
- **The GoI has not only prioritized the deficit consolidation path but also continued to focus on improving the quality of expenditure by raising its total capital spending by 16.9% YoY to INR11.1t in FY25BE, up 3.3x in just five years from INR3.4t in FY20. If achieved, the GoI's capital spending would jump to 3.4% of GDP in FY25BE, doubling from 1.7% of GDP during the pre-Covid period (FY18-FY20).**
- **However, two or three important adjustments are needed to understand the true extent of the investment push by the GoI: 1) capital spending has two parts – capital outlays/expenditure (or capex) and loans and advances (L&As). The GoI has budgeted INR1.4t of capital spending as L&As to the states; 2) The GoI has included the equity infusion of INR829b to Bharat Sanchar Nigam Ltd. (BSNL) in FY25BE under capex; and 3) there is a new entry totaling INR704b called 'New Schemes' under the Ministry of Finance (MoF), for which we could not find any details. After the first two adjustments, the GoI's capex is budgeted to grow 15% YoY. The growth will ease to 6% in FY25BE, if we exclude 'New Schemes' also.**
- **Further, the capex of central public sector enterprises (CPSEs), excluding the Department of Food and Public Distribution (DF&PD), must also be included to estimate the true investment plan of the GoI. After declining for four consecutive years (averaging 10% per annum), CPSEs' capex is budgeted to grow 2.4% YoY next year, led by the Ministry of Power.**
- **Overall, the combined capex (of the Center and CPSEs) is budgeted to grow 11.5% next year (or just 5% if we exclude INR704b under 'new schemes') vs. 12.5% YoY growth in FY24RE (and 9% CAGR in the previous three years). It also means that the combined capex is budgeted at 3.6% (or 3.4%) of GDP in FY25, same as in FY24RE but lower than ~4% of GDP in the pre-Covid years.**

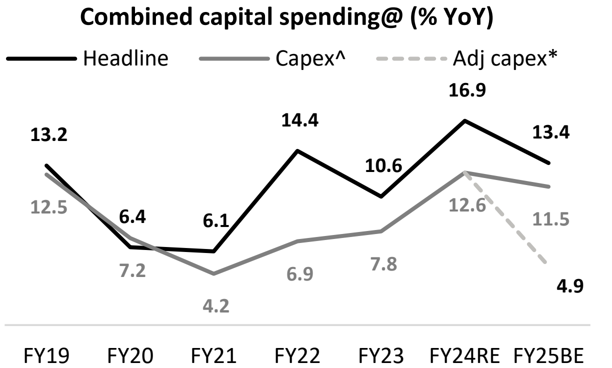
The GoI continued to focus on improving the quality of expenditure by raising its total capital spending by 16.9% YoY to INR11.1t in FY25BE, up 3.3x in the last five years. If achieved, the GoI's capital spending would jump to 3.4% of GDP in FY25BE, doubling from 1.7% of GDP during the pre-Covid period (FY18-FY20).

Exhibit 1: Center's capex budgeted to grow 6-15% YoY in FY25BE



^Excluding Loans & advances (L&As) and capital infusion to PSUs
*Excluding 'New schemes' under the Ministry of Finance

Exhibit 2: Combined capex, with CPSEs#, is targeted to grow 5-11.5%



#Excluding Department of Food & public distribution
@Center + CPSEs
Source: Budget documents, MOFSL

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What is the Center's true capex budgeted for FY25BE? After growing at an average of 30% during the past four years (FY21-FY24RE), the GoI's total capital spending is budgeted to increase by 17% YoY next year, compared to just 6% growth in total spending. Thus, capital spending is budgeted to contribute more than half to total spending growth for the fourth successive year in FY25BE. Nevertheless, two or three adjustments need to be made to extract the true investments of the GoI from the reported capital spending allocation. Let's discuss them one by one.

a. **Segregate capital outlays (investments) from L&As:** A detailed ministry-wise capital spending by the GoI has two components – capex and L&As. The latter accounted for 7-9% of the GoI's total capital spending in FY18-20 (pre-Covid), which increased to 15-16% in the past three years, including FY25BE.

Excluding L&As to states, GoI's capex is budgeted at INR9.7t in FY25BE, up 16.1% YoY, following 26.4% growth in FY24RE

The GoI has budgeted L&As worth INR1.7t, including a transfer of INR1.4t to states. These L&As will be eventually counted as states' capex, and thus, they must be excluded from the GoI's capex. Excluding L&As to states, the GoI's capex is budgeted at INR9.7t in FY25BE, up 16.1% YoY, following an average growth of 26.4% during FY21-FY24RE.

Exhibit 3: Detailed analysis of capital outlays by CG and CPSEs (figures in INR b, unless mentioned otherwise)

	FY22	FY23	FY24BE	FY24RE	FY25BE
Central government capital spending (Budgeted allocation)					
Ministry of Defense	**1,380**	**1,429**	**1,626**	**1,572**	**1,720**
Ministry of Railways	**1,173**	**1,593**	**2,400**	**2,400**	**2,520**
Ministry of Road Transport & Highways	**1,168**	**2,060**	**2,445**	**2,645**	**2,722**
Department of Telecommunications	**39**	**566**	**618**	**704**	**844**
Capital infusion to BSNL	0	264	529	648	829
Ministry of Civil Aviation	**624**[1]	**1**	**1**	**1**	**1**
Others	**960**	**609**	**1,281**	**748**	**1,590**[2]
Loans and advances (L&As)	**584**	**1,153**	**1,638**	**1,432**	**1,715**
States/UTs/foreign governments	225	927	1,374	1,156	1,424
Total capital spending	**5,928**	**7,400**	**10,010**	**9,502**	**11,111**
Capital outlays (Capex)[3]	5,079	6,207	8,106	7,699	8,856
Central Public Sector Enterprises (CPSEs)					
Ministry of Defense	29	28	31	29	28
Ministry of Railways	734	447	528	200	130
Ministry of Road Transport & Highways	652	0	0	0	0
Ministry of Power	481	574	608	591	673
Ministry of Petroleum & Natural Gas	1,067	1,190	1,064	1,123	1,185
Ministry of Coal	197	234	210	210	195
Others	607	1,003	1,049	1,033	989
Total capital outlays (Capex)[4]	**3,764**	**3,322**	**3,424**	**3,032**	**3,104**
Department of Food & Public Distribution	612	309	1,454	230	326
Combined capital outlays (Capex)					
Ministry of Defense	1,408	1,457	1,657	1,601	1,748
Ministry of Railways	1,907	2,040	2,928	2,600	2,650
Ministry of Road Transport & Highways	1,819	2,060	2,445	2,645	2,722
Combined capital outlays (as a percentage of GDP)	**8,843 (3.8)**	**9,529 (3.5)**	**11,530 (3.8)**	**10,731 (3.6)**	**11,960 (3.6)**
YoY (%)	**6.9**	**7.8**	**20.7***	**12.6**	**11.5**

[1]Includes INR624b on account of equity infusion in AIAHL

[2]Includes INR704b as 'New Schemes' under other expenditure in the Ministry of Finance (Demand no. 30)

[3]Excluding capital infusion to PSUs and L&As to states/UTs/FGs

[4]Excluding Department of Food & Public Distribution, primarily Food Corporation of India (FCI)

*Over FY23RE

Source: Union Budget documents, MOFSL

b. **Equity infusion in PSUs must also be excluded:** A detailed ministry-wise analysis of the capex also reveals the following:

   i. More than a third of the rise in the GoI's capex from FY21 to FY22 was on account of the equity infusion in AIAHL (Air India Assets Holding Ltd). This was the primary reason why the GoI's capital spending surpassed INR1.1t in Dec'21 – the highest ever in a single month. We have excluded this amount from FY22 to estimate the true GoI capex (along with L&As to the states).

A total of INR1.74t has been allocated during the past three years as capital infusion in BSNL under the GoI's capital spending

   ii. Further, the Department of Telecommunications has included financial relief/capital infusion totaling INR164b in BSNL in FY23 (down from INR447b/INR333b in FY23BE/FY23RE), INR648b in FY24RE (down from INR529b in FY24BE) and another INR829b in FY25BE. Thus, a total of INR1.74t has been allocated during the past three years as capital infusion in BSNL under the GoI's capital spending. This pushes the allocation under the Ministry of Communications drastically from less than INR40b in FY22 and previous years. Interestingly, the GoI had budgeted capital infusions worth INR204b in BSNL/MTNL (for 4G spectrum) in FY22BE as well, which were then de-allocated in FY22RE.

After excluding L&As to the states and financial support to various PSUs, the GoI's capex is budgeted to rise 15% YoY in FY25BE

After excluding L&As to the states and financial support to various PSUs, the GoI's capex is budgeted at INR8.9t, up 15% YoY in FY25BE, following an average growth of 23.5% during FY21-FY24RE *(Exhibit 3 on the preceding page)*.

c. **What are 'New Schemes' under the MoF:** Finally, the details of the GoI's capital spending reveal that the allocation under 'other general economic services' is budgeted at INR711b in FY25, up from INR5b in FY24RE (and even lower in the previous years). When we dug deeper, we found that the GoI has allocated a sum of INR704b as 'New Schemes' under other expenditures in the MoF's Department of Economic Affairs.

   Unfortunately, we could not find any details regarding these 'New Schemes'. However, it is possible that it pertains to *"a new scheme"* that the finance minister referred to in her scheme for strengthening deep technologies for defense purposes and expediting 'atmanirbharta'. The FM mentioned that a corpus of INR1.0t will be established with a 50-year interest-free loan to provide long-term financing or refinancing to the private sector to scale up research and innovation in sunrise domains. We are not sure if our understanding is correct, and thus, not confident about the potential multiplier impact of this spending. It is, therefore, not clear if this sum of INR704b (included under Others in Exhibit 3) should be a part of the Center's capex or not.

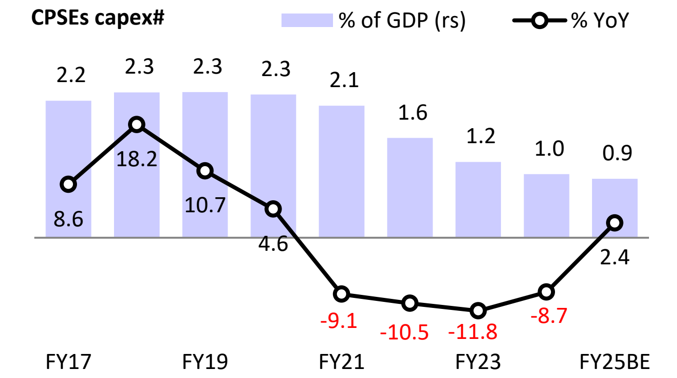
If we do not exclude 'New Schemes', the GoI's capex is budgeted to grow 15% YoY in FY25BE, slower than in the previous years, but still a reasonably decent growth considering their commitment to deficit consolidation. However, if we exclude INR704b, the GoI's adjusted capex is budgeted to grow at a significantly slower pace of only 6% YoY next year *(please see Exhibit 1)*.

Internal and Extra Budgetary Resources (IEBR) of CPSEs also budgeted to grow after four years of contractions: Budget allocations only account for a portion of the total capital spending by the GoI. The planned capital outlays (or capex) by CPSEs, and their likely financing are also provided for in the Union Budget. From an economic perspective, what matters is the combined capital outlay of the GoI and CPSEs.

Excluding DF&PD, IEBR of CPSEs is budgeted to increase 2.4% YoY in FY25BE, marking its first growth in the last five years

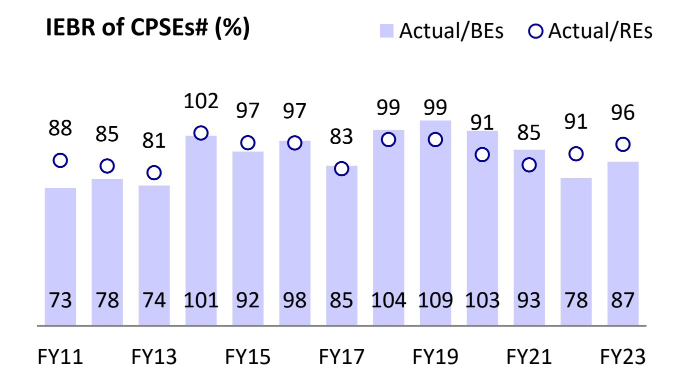
After making the above-mentioned adjustments in the GoI's investment spending, we have also made one adjustment in CPSEs' capex. Since FY18, the DF&PD (which includes the allocation to FCI) has undertaken the maximum capital outlays among CPSEs, amounting to about INR2t each year during FY18-FY20. As the GoI cleared all the arrears in FY21 and took over FCI debt on its books, the off-budget capex by the DF&PD was reduced to about INR600b in the following two years, i.e., FY21-FY22, before cutting further to INR300b in the last three years (FY23-FY25BE). This, we believe, must be excluded from the aggregate IEBR of CPSEs to understand the true extent of the infrastructure push by the GoI. Accordingly, we look at IEBR's capex, excluding the DF&PD.

Exhibit 4: CPSEs capex (ex DF&PD) is budgeted to increase 2.4% YoY in FY25BE, after four successive declines



#Excluding DF&PD

Exhibit 5: Actual CPSEs capex has been mostly lower than the budgeted allocation



Source: Budget documents, CSO, MOFSL

Excluding the DF&PD, IEBR of CPSEs is budgeted to increase 2.4% YoY in FY25BE, marking its first growth in the last five years *(Exhibit 4)*. CPSEs' capex (excluding the DF&PD) had fallen to INR3.0t in FY24RE from its peak of INR4.6t in FY20. In other words, from an average of 2.3% of GDP in the entire decade of FY11-FY20, CPSEs' capex declined continuously in the next four years to just 1% of GDP in FY24RE – the lowest in at least the past two decades for which the data is available. It is budgeted to fall further to 0.9% of GDP in FY25BE *(Exhibit 4)*. At its peak, CPSEs' capex (excluding DF&PD) amounted to 3.3% of GDP in FY09.

Actual capex by CPSEs tends to be 90-95% of the BEs/REs, with much sharper cuts vs. BEs in FY22 and FY23

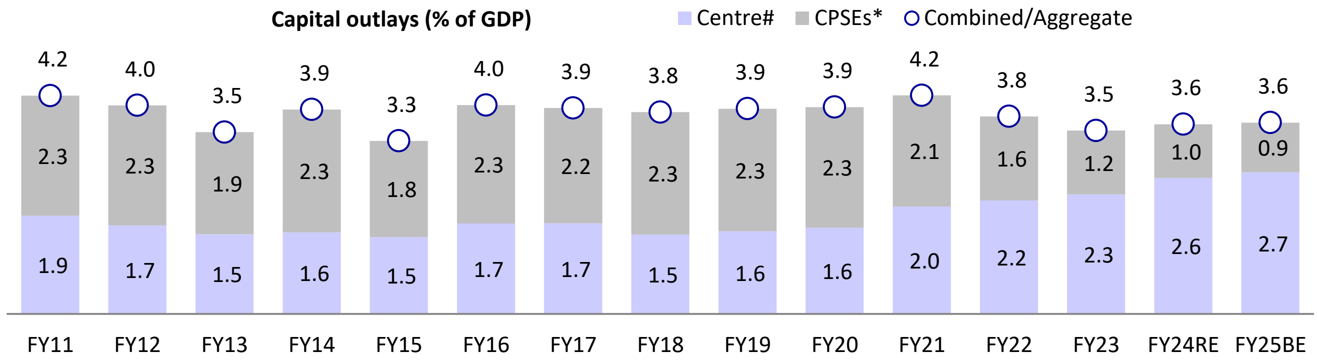
At the same time, it is also important to note that historical data suggests that actual capex by CPSEs tends to be about 90-95% of the budgeted and revised estimates (BEs/REs), with much sharper cuts vs. BEs in FY22 and FY23 *(Exhibit 5)*. CPSEs' capex is already revised down to INR3t as per FY24RE from INR3.4t in FY24BE, and thus, a downward revision in FY25 as well would not be a surprise.

Combined capex budgeted at 3.6% of GDP in FY25, same as in FY24RE but lower than ~4.0% of GDP in the pre-Covid period: Overall, from an economic perspective, what matters is the combined capex of the GoI (on-budget) and IEBRs of CPSEs (off-budget). With various adjustments (excluding L&As to states, capital infusion in PSUs and DF&PD from CPSEs), our estimates suggest that the combined capital outlay would grow by 12.6% YoY in FY24RE and 11.5% YoY in FY25BE. This follows 7-8% growth each in FY22 and FY23 *(Please see Exhibit 2 above)*.

The combined capex is budgeted at 3.6% of GDP in FY25BE, same as that in FY24RE, but still lower than ~4.0% of GDP in the pre-Covid period

Effectively, a large part of the increase in the GoI's capex (excluding L&As) to 2.7% of GDP in FY25BE from 1.6% of GDP in FY20 is offset by lower budgeted capex by CPSEs at 0.9% of GDP from 2.3% during the corresponding period. The Center's higher capex is, therefore, a reallocation of the off-budget capex, rather than additional spending. Accordingly, the combined capex (of the Center and CPSEs) is budgeted at 3.6% of GDP in FY25BE, same as that in FY24RE, but still lower than ~4.0% of GDP in the pre-Covid period *(Exhibit 6)*.

Exhibit 6: Combined capital outlays of the government and CPSEs



#Excluding L&As to states and equity infusion in PSUs

*Excluding DF&PD

Source: Union Budget documents, CSO, MOFSL

After adjusting the Center's capex by INR704b allocated as 'New schemes' under the MoF, the combined capex will fall to 3.4% of GDP next year, the lowest in a decade

If we further adjust the Center's capex by INR704b allocated as 'New Schemes' under the Ministry of Finance, then the Center's capex growth will decelerate to just 6% and the combined capex growth will be only 5% YoY in FY25BE, instead of 11.5% YoY without this adjustment *(please see Exhibit 2 above)*. Accordingly, the combined capex will fall to 3.4% of GDP next year, the lowest in a decade.

Defense is budgeted to grow decently, with much weaker growth in railways and road transport & highways: Three sectors – roads, railways and defense – account for about four-fifths of the total capex by the Center. However, the Ministry of Road Transport & Highways (MoRTH), Ministry of Railways (MoR) and the Ministry of Defense (MoD) also incur capex on their own account, shown as off-budget spending under IEBR of CPSEs. It is important to understand that while the Center has been showing strong capex growth in these areas in the last few years, what matters is the combined capex (on-budget and off-budget) in these areas, including spending by these ministries outside the budget allocation.

As shown earlier, in order to improve transparency and provide relief to the National Highways Authority of India (NHAI), the GoI had decided to include NHAI's borrowings in its own books in FY23, reducing it to nil by CPSEs from INR652b in

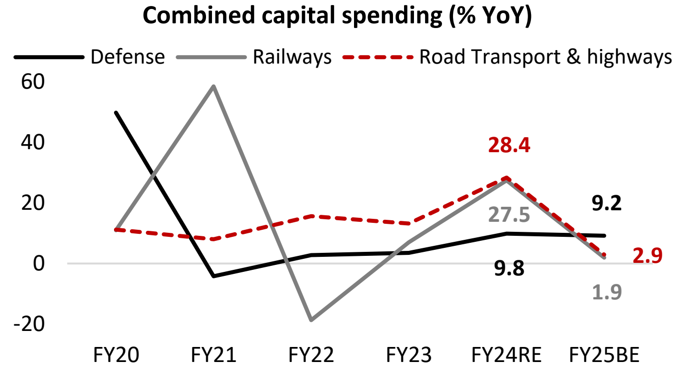
FY22 *(Exhibit 3 above)*. Consequently, while the Center showed a massive 76% YoY rise in capex of MoRTH in FY23, the combined capex of MoRTH grew 13.2% YoY in FY23. The growth in the combined capex on the roads sector is estimated to grow 28.4% in FY24RE, before falling sharply to just 3% YoY in FY25BE *(Exhibit 7)*.

In FY25, the capex growth in the roads and railways sector is budgeted at just 2-3%, from ~28% YoY each in FY24RE

Similarly, while the GoI's capex for roads grew 36% YoY in FY23 and 51% YoY in FY24RE, the combined capex for railways increased by only 7% YoY in FY23 and 27.5% YoY in FY24RE. This was because of the massive reduction in CPSEs' capex *(Exhibit 3 above)*. With almost negligible capex planned by the MoR, the combined capex of MoR is budgeted to grow by just 2% YoY in FY25BE *(Exhibit 7)*.

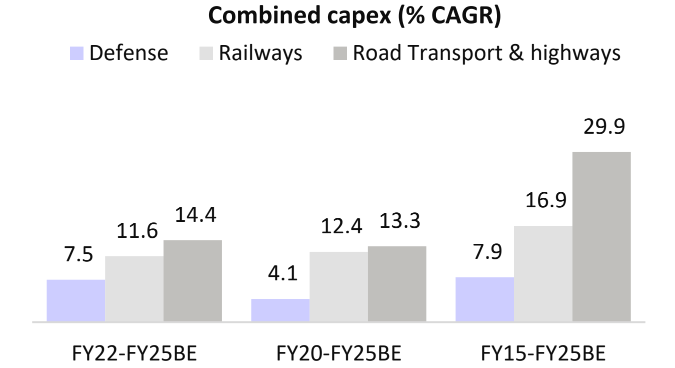
Further, the combined capex in the defense sector is budgeted to grow 9.2% YoY in FY25BE, not very different from 9.8% YoY in FY24RE.

Exhibit 7: Capex by 'Railways' and 'Roads & Highways' budgeted at just 2-3% next year…



Including Centre and CPSEs

Exhibit 8: …but the 3-yr, 5-yr and 10-yr CAGRs in these areas are considerably strong



Source: Budget documents, MOFSL

Over the past five (and ten) years, the CAGR in the roads and railways capex stands at 13.3% and 12.4% (29.9% and 16.9%), respectively

Although the annual growth in the roads and railways sector is budgeted at a muted pace in FY25BE, a look at the CAGR confirms a strong bias of the GoI toward its capex commitment *(Exhibit 8)*. Over the past five (and ten) years, the CAGR in the roads and railways capex stands at 13.3% and 12.4% (29.9% and 16.9%), respectively. **The long-term average growth in the defense sector, however, is modest, and thus we expect the GoI to focus more on this area in the coming years**.

Overall, as highlighted in our analysis of the interim Union Budget 2024-25, the GoI has rightly prioritized long-term macroeconomic stability, even if it implies a growth sacrifice in the short run. Accordingly, although the capex growth has also weakened in FY25BE (especially in the roads and railways sector), it has grown at a considerably strong pace over the past five or ten years.

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