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EcoScope
The Economy Observer

FY27 Budget Preview: Defense-led capex growth

We expect the FY27 Union Budget to mark a pivotal moment in India's fiscal framework, with the gross fiscal deficit targeted at 4.3% of GDP, lower than 4.4% in FY26. This underscores the government's commitment to gradual fiscal consolidation and its shift toward debt-to-GDP as the primary fiscal anchor, in line with global best practices. Given the emphasis on fiscal discipline, we do not expect any populist measures or large tax giveaways in this budget. The budget is likely to be framed around a nominal GDP growth assumption of about 10.1%, providing some headroom to balance discipline with growth support.

<u>On the expenditure side</u>, we expect a clear prioritization of capital expenditure, which should grow at 10.3% YoY and remain close to 3.1% of GDP, with higher allocations for defense and allied industries, infrastructure-linked manufacturing, pharma, power, nuclear, electronics, critical minerals, and trade tariff-affected labor-intensive sectors. At the same time, revenue expenditure is likely to be tightly managed, with limited growth in subsidies and non-essential spending.

<u>On the revenue front</u>, we expect steady but unspectacular growth, with direct taxes broadly tracking nominal GDP, GST collections remaining muted, and continued reliance on non-tax revenues, particularly a strong dividend from the RBI.

<u>On the financing side</u>, borrowing requirements for both the Centre and states are likely to remain elevated. We expect the Centre's gross market borrowings to be ~INR16.5t in FY27 (net borrowings of about INR11.9t), while state governments are likely to raise roughly INR13.2t through gross SDL issuances (net borrowing of ~INR9.7t). Together, this keeps aggregate gross market borrowing elevated through FY27 at INR29.7t. This heavy supply, combined with relatively subdued demand, is likely to limit any sharp decline in yields. We expect the 10-year G-sec yield to trade broadly in the 6.5-6.7% range in FY27.

Bond market was hoping for inclusion in the Bloomberg Global Index, but for now, the inclusion is postponed. With the global rate cut cycle nearing an end or having ended in most countries, we note a synchronous rise in global yields. Japan's latest rate hike has also pushed the yields upwards. The key event to track next would be the announcement of a new US Fed Governor. Although US fiscal metrics are worsening, any sharp revision in market expectations of interest rate cuts (from the current 50bp) can lead to some moderation in US yields, impacting India at the margin. More than that, we see limited reasons for any softening of India yields.

<u>NOTE:</u> We have a special insight for our readers appended towards the end of the report titled, 'A Day in the North block, New Delhi!'. It details the discussions happening in the North Block ahead of the Union Budget. Hope you enjoy reading it!

- The FY27 Union Budget is likely to be a historic document, as India will start using debt as the primary target for fiscal policy, aligning itself with global standards[1].
- The budget will prioritize the government's commitment toward fiscal consolidation by lowering the gross fiscal deficit (GFD) marginally to 4.3% of GDP in FY26 from 4.4% in FY25, though it is not bound by the Fiscal Responsibility and Budget Management Act, 2003 (FRBM Act), unlike previously.
- The budget math is likely to be realistic assuming 10.1% YoY as the nominal GDP. It would clearly focus on the next set of reforms for further building the 'Viksit Bharat' narrative while extending benefits to sectors such as defense, nuclear, and critical minerals – the roadmap of which has already been placed in the winter session of the parliament.
- We do not expect any populist measures or direct tax code changes this year (CY25: income tax cuts, GST rationalization) given that the government is attempting fiscal consolidation; however, we see scope for an increase in capital expenditure (capex) in non-traditional or sunrise sectors, especially defense and allied sectors. This is due to India's shift to tracking the debt-to-GDP ratio as its primary fiscal policy goal (the trajectory for which we will see in the budget

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document). India plans to reduce this ratio to 50% (+/- 1%) by FY31 from 56% currently.

- **FY26 Budget recap:** The outstanding contribution from non-tax revenue receipts, backed by the record RBI dividend of INR2.7t alone, has helped the government sail the boat in FY26. The dividend contribution by PSUs is also likely to be more than INR800b, as per media reports, almost double the budget estimate. Tax receipts were dragged down primarily by lower income tax and GST collections.
- On the expenditure side, we expect the capex target of INR11.2t to be met and expect a slight slowdown on the non-subsidy-non-interest revenue spending. On net basis, we expect the deficit target of 4.4% of GDP to be met (FD est.: INR15.9t; FD BE: INR15.7t).
- **FY27 Budget preview**: Dividends by the RBI and PSUs may once again skyrocket to INR3.8t in FY27E from INR3.7t in FY26 due to heavy RBI dollar sales (adding to the RBI's profitability). With nominal GDP growth assumed at 10.1%, we expect the direct tax receipts to be broadly in line with the growth rate at INR25.7t in FY27E (FY26E:7.4% YoY). Indirect tax collections are likely to be boosted by a probable hike in excise duty collections, while GST collections are likely to see muted growth. We assume a disinvestment target of INR450b, marginally lower than last year's INR470b. In our view, revenue expenditure (revex) would moderate, though capex may grow by 10.3% YoY or INR12.4t, representing 3.1% of GDP.

Overall, GFD is expected to see a marginal reduction of 10bp in FY27 to 4.3% of GDP. Here are the broad budget expectations for FY27:

- **Expenditure:** Total expenditure growth rate is assumed at 7% YoY. Capital expenditure is assumed at INR12.4t (10.3% YoY). Revex is expected to grow by 6% on a yearly basis.
- **Receipts:** Total receipts growth rate is assumed at 6.8% YoY. Direct tax collection is expected to grow by 10.2% and indirect tax collection would rise by 6.3%.
- **Centre's Gross borrowing:** It is expected at INR16.5t vs. INR14.6t in FY26E.
- **Centre's Net borrowing:** It is expected at INR11.9t vs. INR11.3t in FY26E.
- **Centre+State Borrowing:** Gross borrowing is expected at INR29.7t vs. INR27.0t in FY26E. Net borrowing is expected at INR21.7t vs. INR20.3t in FY26E.

Exhibit 1: Fiscal deficit target at 4.3% in FY27E

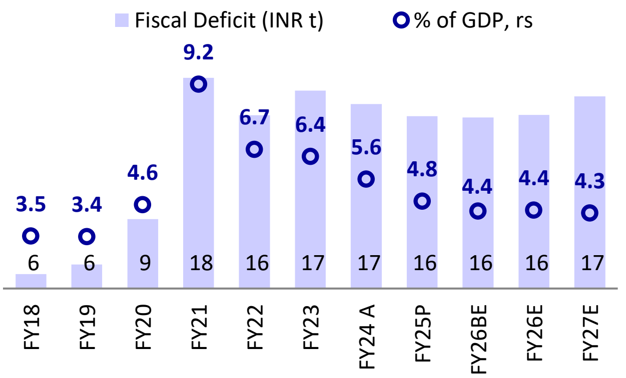
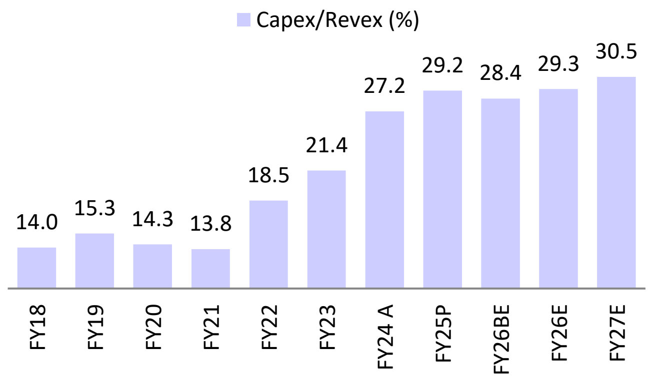
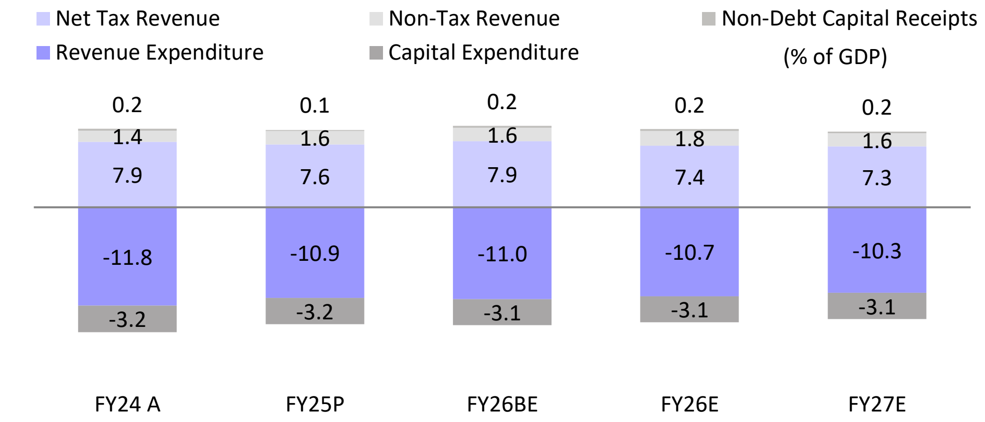


Exhibit 2: Capex to be higher, revex to be lower in FY27E



Source: CEIC, MOFSL

Exhibit 3: Detailed composition (as % of GDP)



Source: CEIC, MOFSL

Detailed budget projections

FY26 budget review: GoI to meet target on high RBI + PSU dividends and low revex

We expect the Central government to achieve its GFD/GDP target of 4.4% of GDP with a marginally higher fiscal spending of INR168b. This was possible due to a decline in revex and outstanding contribution by non-tax revenue receipts, backed by a record RBI dividend of INR2.7t.

On the revenue receipt side, we expect direct tax collection to miss the FY26BE by INR1.9t, with corporate tax collection expected to be at INR10.5t (FY26BE: INR10.8t). Income tax collection is expected to undershoot FY26BE by INR1.6t at INR12.8t. Indirect tax revenue is likely to fall short of FY26BE by INR860b, with a larger slip expected in GST collections of INR1t. Overall, gross tax collections are expected to fall short by INR2.8t. After accounting for the state's share and surcharge for NCCF, net tax collection is likely at INR26.5t (FY26BE: INR28.4t). On the non-tax revenue front, we expect a surplus of INR436b in FY26BE of INR5.8t, with a receipt of INR3.7t from the RBI (INR2.7t) and PSUs (INR1t). Telecom revenue is expected to meet the target and come in at INR824b.

Non-debt capital receipts are assumed to meet the target of INR760b.

Even as revenue receipts are expected to fall short of FY26BE by INR1.4t, the government is expected to meet the fiscal target for FY26 thanks to a cut in revex. Revex is expected to see a miss of INR1.2t at INR38.2t (10.7% of GDP vs. 11% assumed in the budget).

Overall, we see GFD at INR15.9t vs. FY26BE of INR15.7t.

FY27 budget preview: Focus on capex and RBI dividends with fiscal consolidation

Given the US tariff-led uncertainty, there is a call for a policy push to continue to support the growth. The main question is – who would do the heavy lifting and would it be effective? The FY27 budget would have to remain in a consolidation mode, despite moving to the debt-to-GDP ratio as the key target metric. It would signal the government's commitment, as laid out in the last budget, to achieve the debt-to-GDP ratio of 50% (+/- 1%) by FY31 from 56% currently.

Thus, the FY27 budget is likely to see a tightrope walk between showing the intended fiscal consolidation and providing a push for capex growth, which we believe is the need of the hour. The First Advance Estimate indicates that nominal

GDP growth remains low. For FY26, the government estimates nominal GDP growth at 8% as against the budget expectation of 10.1%.

For FY27E, we see the government pressing the pedal once again on capex. We see capex as a percentage of GDP to be at 3.1% in FY27E, unchanged from FY26 but clocking a higher growth of 10.3% YoY vs. 6.6% YoY in FY26. This implies a capex budget of INR12.4t.

We expect the upcoming budget to place a strong emphasis on emerging priority sectors that can drive long-term growth and strategic resilience. **In particular, defense and allied industries are likely to receive heightened focus, building on recent momentum in start-ups and the Centre's formation of a dedicated committee to nurture allied defense capabilities**. **Digital technologies**, especially solutions that integrate **advanced tech into agriculture, healthcare, and related social sectors**, should remain key pillars of reform-oriented allocation. The pharmaceuticals sector, leveraging India's deep R&D talent pool, is also expected to be highlighted as a strategic growth engine, with broader science-led competitiveness (notably **GCC in science**) emerging as a thematic priority. On the public sector front, we anticipate continued evolution of the **government's disinvestment & PSU strategy, shifting from outright asset sales toward business revamps and selective stake monetization;** this includes the anticipated restructuring of IDBI Bank, potential stake changes in LIC, and consolidation of smaller PSU banks to create larger, more robust entities akin to SBI and HDFC. Moreover**, traditional focus areas such as defense, nuclear, electronics, and power are expected to retain strong budgetary support** as part of the government's structural reform agenda.

For FY27E, our fiscal calculations are based on an expected nominal GDP growth of 10.1%. Our detailed expected numbers for FY27E for various components of revenue and expenditure are enumerated below (Exhibit 4).

Exhibit 4: Budget at a glance – FY26BE and FY27 estimates

	Budget at a Glance (INR t)					As % of GDP				
	FY24 A	FY25P	FY26BE	FY26E	FY27E	FY24 A	FY25P	FY26BE	FY26E	FY27E
Total Receipts	**27.9**	**30.8**	**35.0**	**33.6**	**35.8**	**9.4**	**9.3**	**9.8**	**9.4**	**9.1**
Revenue Receipts	27.3	30.4	34.2	32.8	35.1	9.2	9.2	9.6	9.2	8.9
Gross Tax Revenue	34.7	38.0	42.7	39.9	43.4	11.7	11.5	12.0	11.2	11.0
Direct tax	19.6	21.7	25.2	23.3	25.7	6.6	6.6	7.1	6.5	6.5
Corporate Tax	9.1	9.9	10.8	10.5	11.6	3.1	3.0	3.0	2.9	2.9
Income Tax	10.4	11.8	14.4	12.8	14.1	3.5	3.6	4.0	3.6	3.6
Indirect Tax	15.1	15.7	17.5	16.6	17.7	5.1	4.8	4.9	4.7	4.5
Customs	2.3	2.3	2.4	2.4	2.4	0.8	0.7	0.7	0.7	0.6
Excise	3.1	3.0	3.2	3.6	4.3	1.0	0.9	0.9	1.0	1.1
Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other taxes+UT+Wealth	0.1	0.1	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0
GST	9.6	10.3	11.8	10.7	11.0	3.2	3.1	3.3	3.0	2.8
CGST	8.2	9.1	10.1	10.0	10.2	2.8	2.7	2.8	2.8	2.6
IGST	0.0	-0.3	0.0	0.0	0.0	0.0	-0.1			
Compensation Cess	1.4	1.5	1.7	0.7	0.8	0.5	0.5	0.5	0.2	0.2
(-)Surcharge for Financing NCCF	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
(-)Less state share	11.3	12.9	14.2	13.3	14.4	3.8	3.9	4.0	3.7	3.7
Net Tax Revenue	23.3	25.0	28.4	26.5	28.8	7.9	7.6	7.9	7.4	7.3
Non-Tax Revenue	4.0	5.4	5.8	6.3	6.3	1.4	1.6	1.6	1.8	1.6
RBI Dividend	1.1	2.1	2.6	2.7	3.0	0.4	0.6	0.7	0.8	0.8
Non-Debt Capital Receipts	0.6	0.4	0.8	0.8	0.8	0.2	0.1	0.2	0.2	0.2
Disinvestments	0.3	0.2	0.5	0.5	0.5	0.1	0.1	0.1	0.1	0.1
Total Expenditure	**44.4**	**46.6**	**50.7**	**49.4**	**52.9**	**15.0**	**14.1**	**14.2**	**13.8**	**13.4**
Revenue Expenditure	34.9	36.0	39.4	38.2	40.5	11.8	10.9	11.0	10.7	10.3
Interest payments	10.6	11.2	12.8	12.8	13.8	3.6	3.4	3.6	3.6	3.5
Subsidies	4.3	4.3	4.3	4.2	4.1	1.5	1.3	1.2	1.2	1.1
of which, Food	2.1	2.0	2.0	2.1	2.1	0.7	0.6	0.6	0.6	0.5
Fertilizer	1.9	1.7	1.7	1.9	1.9	0.6	0.5	0.5	0.5	0.5
Petroleum	0.1	0.1	0.1	0.2	0.1	0.0	0.0	0.0	0.1	0.0
Revenue Expenditure ex. subsidy, interest	20.0	20.5	22.4	21.3	22.6	6.8	6.2	6.3	6.0	5.7
Capital Expenditure	9.5	10.5	11.2	11.2	12.4	3.2	3.2	3.1	3.1	3.1
Gross Fiscal Deficit	**16.5**	**15.8**	**15.7**	**15.9**	**17.0**	**5.6**	**4.8**	**4.4**	**4.4**	**4.3**
Revenue Deficit	**7.7**	**5.7**	**5.2**	**5.4**	**5.4**	**2.6**	**1.7**	**1.5**	**1.5**	**1.4**
Primary Deficit	**5.9**	**4.6**	**2.9**	**3.1**	**3.3**	**2.0**	**1.4**	**0.8**	**0.9**	**0.8**
GDP	**295.4**	**330.7**	**357.0**	**357.1**	**393.2**					

Source: CEIC, MOFSL

RBI dividends to once again boost revenue in FY27

In FY27, we estimate direct tax collection to grow by 10.2% YoY to INR25.7t (or 6.5% of GDP). Indirect tax collection is estimated to grow by 6.3% to INR17.7t (4.5% of GDP). Overall, we expect gross tax collection to grow to INR43.4t. After accounting for the state's share and surcharge for NCCF, net taxes are estimated at INR28.8t.

1. Within direct tax, income tax collection is expected to grow by 10% YoY (or 3.6% of GDP) to INR14.1t. Corporate tax collection is expected at INR10.6t, registering a growth of 10.4% YoY (or 2.9% of GDP).
2. Within indirect tax, GST collection is expected to grow by a meagre 2.8% to INR11t (2.8% of GDP) vs. INR10.7t in FY26BE (3.0% of GDP). Note FY26BE was INR11.8t, registering a growth of 14.8%. Customs duty and excise duty collections are expected at INR2.4t and INR4.3t, respectively.
3. Non-tax revenue is expected at INR6.3t, and we expect increased reliance on the RBI dividend for the government to achieve the fiscal deficit of 4.3% in FY27. We calculate the RBI dividend to be at INR3.0t for FY27.
4. Non-debt capital receipts are assumed to grow by INR770b, with disinvestment receipts target slightly lower at INR450b.

Exhibit 5: Revenue receipts lower as a % of GDP

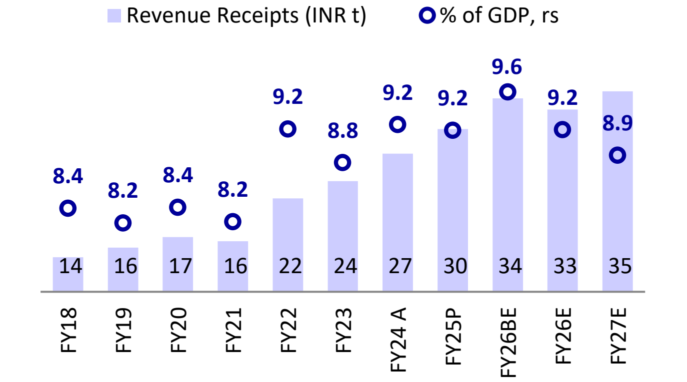
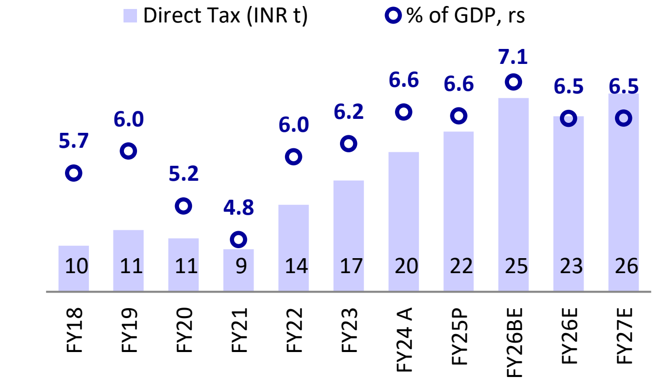


Exhibit 6: Direct tax collections fall (income tax cut!)



Source: CEIC, MOFSL

Exhibit 7: Lower income and corporate tax in FY27

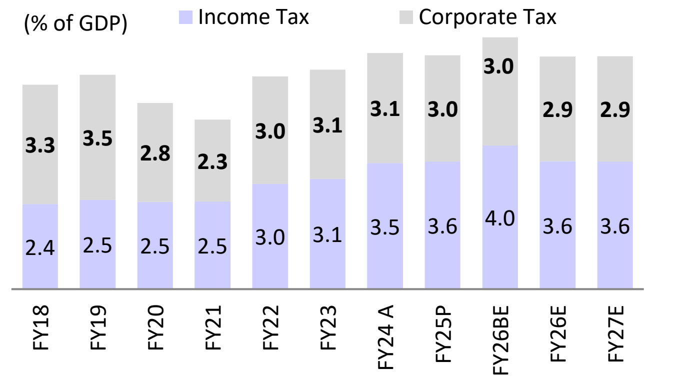
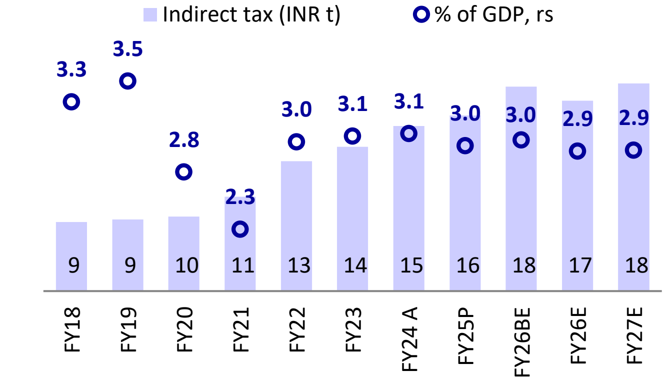


Exhibit 8: Indirect tax collection to stabilize assuming excise duty hike



Source: CEIC, MOFSL

Exhibit 9: Meagre growth in GST collection in FY27

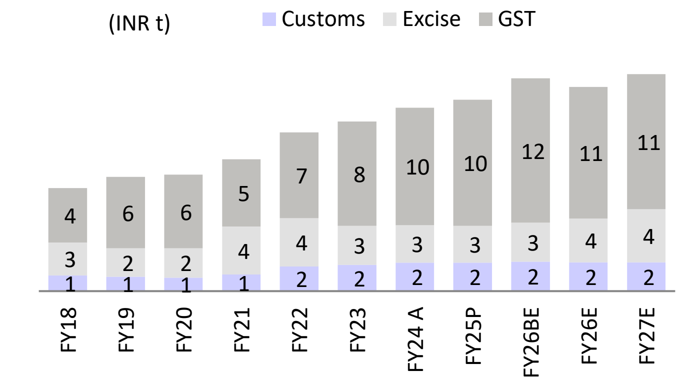
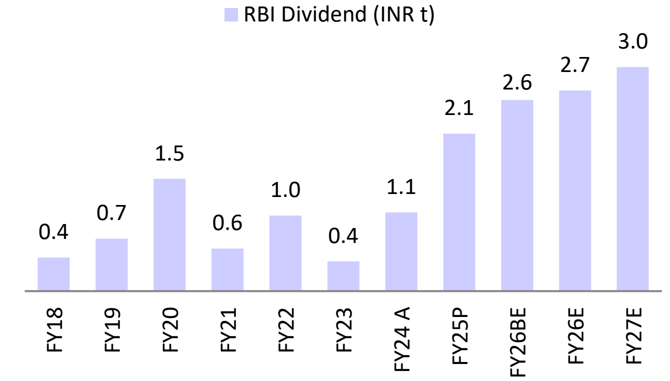


Exhibit 10: RBI dividend to increase sharply



Source: CEIC, MOFSL

Capex push to continue to support growth

We estimate total expenditure to grow by 7.0% YoY in FY27 to INR52.9t (or 13.4% of GDP). For FY27, we expect revex at INR40.5t (or 10.3% of GDP). Subsidy bill is expected at INR4.1t (or 1.1% of GDP), with higher subsidy outgo for food at INR2.1t and fertilizer at INR1.9t.

We model capex of the Centre to be at INR12.4t (10.3% YoY or 3.1% of GDP) in FY27, led by defense expenditure increase of 15% over estimated INR1.8t spending in FY26. There was a one-time emergency procurement of INR400b in FY26.

Recently, India's Defense Acquisition Council (DAC) has approved capital acquisition proposals worth INR790b in its winter session, taking FY26 YTD approvals to ~INR3.3t, nearly double the FY26BE capital outlay on defense of INR1.8t.

Exhibit 11: Revex to moderate

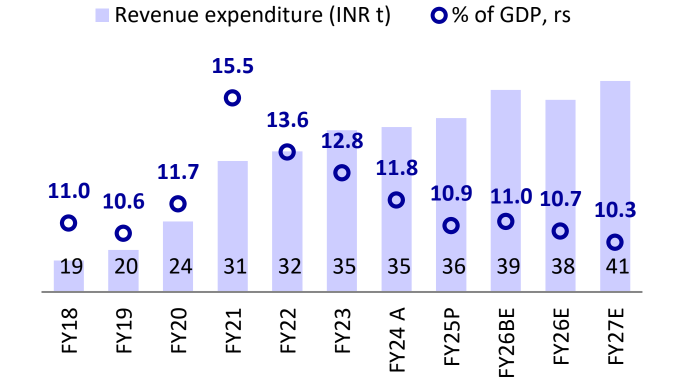
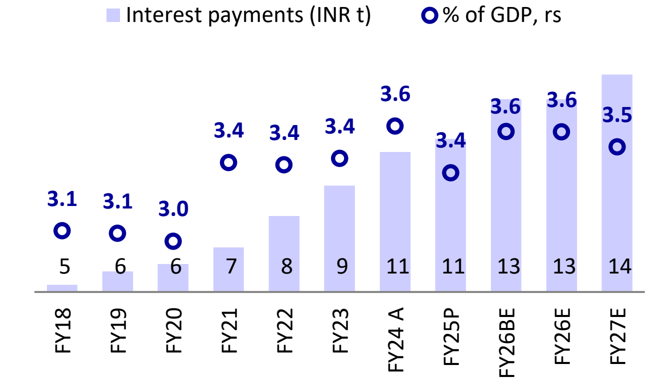


Exhibit 12: Interest payments rise with substantial share



Source: CEIC, MOFSL

Exhibit 13: Subsidies to moderate marginally

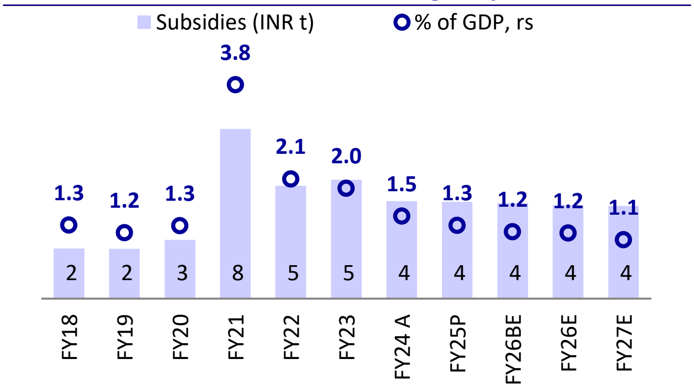
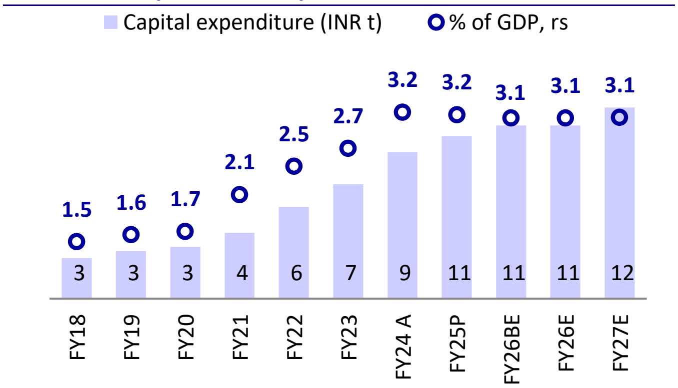


Exhibit 14: Capex to inch up to INR12.4t



Source: CEIC, MOFSL

Centre's net market borrowings expected at INR11.9t in FY27E; Centre + State borrowing at INR21.6t

- Overall, we model the GFD/GDP for FY27E at 4.3%, after achieving 4.4% for FY26E. However, calculations indicate a GFD of INR17t for FY27E, higher than our FY26E of INR15.9t. For FY27E, we expect the government to meet 70% of its fiscal deficit through market borrowings, assuming small savings collections remain strong at INR4.8t. Consequently, net borrowings of the Central government via dated securities for FY27E are estimated at INR11.9t, a shade higher than INR11.3t for FY26E. Redemptions in FY27E are estimated at INR4.6t (assuming INR870b as GST loans to states during the pandemic, which are likely to be paid through the GST compensation cess. This brings down the redemptions from INR5.5t to INR4.6t). Gross borrowings of the Centre through dated securities are likely at INR16.5t.
- For FY27E, we estimate a GFD/GSDP of 3.3% for states. Net borrowings of states for FY25E are likely at INR9.7t, assuming 80% of GFD will be covered through SDL issuances. Gross SDL issuances will be around INR13.2t. Total gross supplies of government papers through dated securities (G-Secs + SDLs) for FY27E should thus amount to INR29.7t. Net supplies are expected at INR21.7t.

- In FY27, we expect the 10Y yield to trade in a range of 6.5%-6.7% (6.63% at the time of writing). The yield expectation includes assumption of the last insurance rate cut of 25bp in Feb'26.
- The bond market is in a state of conundrum. Despite a 125bp rate cut, the benchmark 10Y yield has only fallen by 2bp (practically unchanged). This is due to the demand-supply mismatch, which we believe is likely to continue in FY27 as well. Demand for bonds from pension funds, insurance companies, MFs and banks has declined. The expectation of INR30t of gross market borrowings for FY27E is also preventing yields from inching any lower. The OMO purchases by the RBI are reducing the demand-supply mismatch to an extent (Jan'26 OMO purchases: INR1.5t), but the supplies in 4QFY26 are large due to state governments' large issuance calendar (INR5t for 4QFY26). Even with the assumption of continuous OMO purchases by the RBI in Feb-Mar'26 and FY27, maintaining the demand-supply balance will always remain challenging in FY27, which is why we believe the yields would remain elevated through FY27. With FIIs becoming net sellers in debt so far, the inclusion of India in the Bloomberg Global Aggregate Index could bring in fresh demand. But for now, the inclusion is postponed. India's bond yield movement is in line with global bonds, with most of the central banks inching toward the end of the interest rate cut cycle. Japan's latest rate hike has also put upward pressure on the yields. The key event to track here will be the announcement of a new US Fed Governor. Although US fiscal metrics are worsening, any sharp revision in market expectations of interest rate cuts (from the current 50bp) can lead to a moderation in US yields, impacting India at the margin. More than that, we see limited reasons for any softening of India yields.

Exhibit 15: Market borrowings elevated

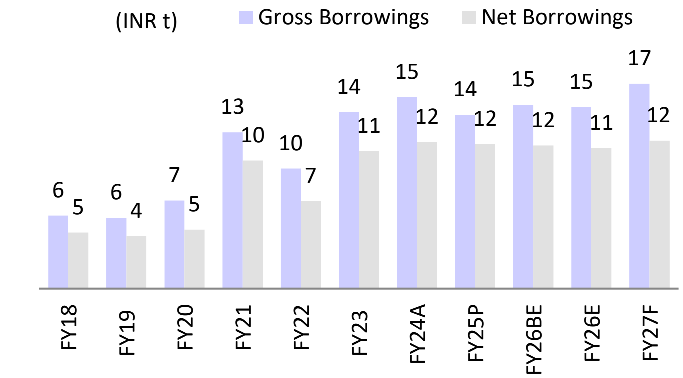
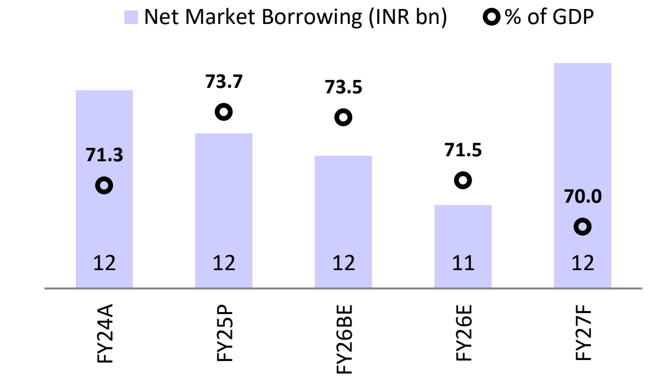


Exhibit 16: High supply of Gsec bonds



Source: CEIC, MOFSL

Exhibit 17: Financing the fiscal deficit

Financing of Fiscal Deficit (INR b; % of FD)	FY24A	FY25P	FY26BE	FY26E	FY27F
Fiscal Deficit	**16,547**	**15,773**	**15,689**	**15,857**	**17,021**
Sources of Funding:					
External	551	473	235	238	255
	(3.3)	*(3.0)*	*(1.5)*	*(1.5)*	*(1.5)*
Domestic	15,996	15,300	15,454	15,619	16,766
	(96.7)	*(97.0)*	*(98.5)*	*(98.5)*	*(98.5)*
Dated Borrowings (Net)	11,805	11,629	11,538	11,338	11,915
	71.3	*73.7*	*73.5*	*71.5*	*70.0*
Repayments	-3,625	-2,378	-3,282	-3,282	-4,598
Dated Borrowings (Gross)	15,430	14,007	14,820	14,620	16,513
Short-Term Borrowings (Net)	532	-1,200	0	0	0
	(3.2)	*(-7.6)*	*(0.0)*	*(0.0)*	*(0.0)*
Small Savings & Others	3,651	3,470	3,891	4,249	4,817
	(22.1)	*(22.0)*	*(24.8)*	*(26.8)*	*(28.3)*
Draw-Down of Cash Balances	8	1,401	25	32	34
	(0.0)	*(8.9)*	*(0.2)*	*(0.2)*	*(0.2)*

Exhibit 18: Trend in repo rate and GSec yield

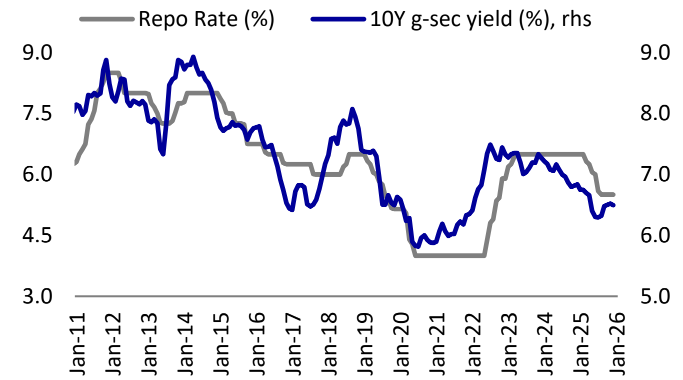
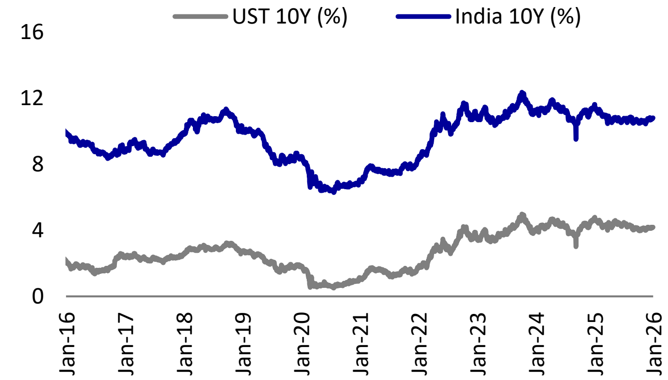


Exhibit 19: Trend in US and India 10Y yields



Source: Bloomberg, MOFSL

A day in the North Block, New Delhi

This month, we spent some time inside North Block, New Delhi, meeting with some of the most influential policymakers and economic strategists shaping India's macroeconomic and trade trajectory ahead of the Union Budget 2026.

What emerged was not textbook economics but a raw, real-time picture of decision-making behind closed doors — trade negotiations, currency swings, capex hesitations, and fresh policy thinking. Here's what they actually said:

Trade Tariffs: What's going on?

- India's bureaucratic prep work for trade agreements is done, but politics and sector sensitivities, especially agriculture, remain a roadblock. Agriculture continues to be non-negotiable, given past experiences where opening dairy and agro sectors in FTAs led to dumping and competitive pressures. This has made negotiators cautious, especially in discussions with the US.
- To mitigate export challenges, India has pursued market diversification — for instance, marine food exports are rebounding as shipments shift from the US to markets like Australia and Russia, helped by regulatory changes. For Russia, non-military exports face no barriers, although defense and related machinery remain contentious due to US sanction fears.
- The US-India tariff issue is more than just restricted to the known sectors such as gems and jewelry, textiles, auto components, etc.

Trade negotiations with the US focus on:

1. Removing punitive tariffs (up to 25%) — likely attainable by FY26 end.
2. A comprehensive FTA — a longer, complex process.

INR depreciation: Concern or opportunity?

INR depreciation is unsettling but not alarming. "Our growth fundamentals — strong GDP expansion, low inflation, high reserves — can absorb this shock."

Here's the nuance most headlines miss:

- A weaker INR does not magically boost exports, because global demand is the real driver, not price alone.
- Domestic macro conditions matter more — and they are still sound.

In other words, INR weakness is a signal of stress, not a collapse.
It is a wake-up call on trade, not the economy itself.

This means the best time for such depreciation to happen is now, when we are fundamentally strong.

The high-impact risks that everybody is underestimating

The biggest risk is not inflation or debt. It is India's limited leverage with the US, both economically and strategically. Even a moderate reduction in tariffs (e.g., to 25%) leaves Indian exporters distorted relative to global peers.

India can diversify export markets, but losing preferential access to the US could have lasting strategic costs.

Private capex: What's not working?

Capex is occurring, but selectively. Brownfield investments and mergers & acquisitions are more visible than new greenfield projects. Firms are acquiring stressed assets (which is also a form of capex) rather than undertaking entirely new expansion.

Take on consumption

It is happening in spurts. But the government is moving in the right direction. Over the last three months, the government has found a purpose to revive the economy – hence GST, labor reforms, etc. More will come. The trade deal will go through. The government is doing things slowly but in the right direction, and it will reflect in the economic growth. Rural will continue to do well. States' spending is a problem and will continue until the Center does not tighten the strings on states' revex (through changes in law).

PLI: Winners, losers — and where the next big opportunities lie

Not all sectors have reaped PLI benefits, and neither were they expected to. Electronics, mobile phones and drones (newest sector) have done well.
Food processing, footwear, textiles, and other traditional industries have lagged due to HS classification issues, eligibility limits, and MSME definition confusion.
The rare-earth magnet PLI scheme (INR72.80b already approved) and the critical minerals mission (Mines and Minerals Development and Regulation bill passed) should come under the government's focus.

Sectors poised to be India's next growth engines

Emerging priority sectors include:

1. Defense and allied industries (military, social, agri dones) — A lot of start-ups are coming up in Bangalore on allied activities around defense. The Center has formed a separate committee on allied defense.
2. Digital technologies, especially those that embed tech into agri, med, and health sectors.
3. Pharmaceuticals, leveraging India's R&D talent pool (GCC in science can be the next big theme).

- **Factor market reforms:** Labor reforms are done; capital and land reforms remain priorities. Land reforms are politically sensitive, while capital reforms, especially power sector restructuring, are progressing but they are complicated as power is a state subject.
- **Credit growth & financial sector dynamics:** Banks alone cannot meet rising credit demand; India must develop deep corporate bond markets. NBFCs are key growth drivers but are not yet full substitutes for banks beyond a few large ones.
- LIC, pension funds, AIFS, and REITS/INVEITS are sitting on a pile of cash. When they bring this cash to equity or debt for longer than 10 years, this would be the key turnaround movement for Indian markets and India's growth story.
- **Disinvestment & PSU strategy:** The government is slowly moving beyond the concept of 'disinvestment' of public assets. It appears that they want to revamp the businesses and then stake share with the private sector. IDBI Bank's share sale will go through by next year. LIC is also likely. There are 12 PSU banks in the government's radar to work on. They are thinking of merging smaller PSU banks to strengthen the balance sheets. Things are in progress. But to support healthy growth, they look forward to more big banks similar to SBI/HDFC.

Views on AI

India is not in the AI space yet. This is a good thing. If the AI bubble bursts globally, we will be protected. For now, we need to do more in labor-intensive sectors like footwear, textiles, and gems and jewelry.

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Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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