Fiscal policy complements monetary accommodation

1QFY27 Center (INR3.4t) + States' capex (INR1.1t) = INR4.5t/15.4% YoY

- **Capex-led fiscal support remains intact.** The Center's capital expenditure increased 23.7% YoY in 1QFY27 to INR3.4t, while states' capex rose 4.8% YoY to INR1.1t, taking the combined Center-state capex to INR4.5t (+15.4% YoY) during 1QFY27. The Center continued to front-load investment despite geopolitical and commodity price uncertainties, while states are expected to accelerate spending in the coming quarters.
- **The composition of capital expenditure remains growth-supportive.** Central capex during 1QFY27 was driven by railways (+30.6% YoY), defense (+42.3% YoY), and a sharp increase in capital transfers to states (+223% YoY), while road spending remained broadly flat owing to project timing. Importantly, the Center's current capex run rate of INR1.1t per month remains well above the budgeted monthly run rate of ~INR0.9t, indicating that infrastructure spending is comfortably on track. The key takeaway is that the government has accommodated the temporary rise in revenue expenditure without compromising its infrastructure-led investment strategy, preserving the quality of expenditure even amid elevated geopolitical and commodity price uncertainties.
- **Fiscal consolidation remains on track despite higher public investment.** Strong growth in total receipts, led by resilient direct tax collections, higher non-tax revenues, and divestment receipts, helped keep the Center's fiscal deficit at 18.2% of the FY27BE in 1QFY27. Although states' fiscal deficit widened modestly due to weaker central transfers, the overall fiscal position remains manageable, providing room to sustain the public investment cycle.

Outlook:

- Fiscal policy continues to complement the RBI's accommodative monetary stance. Strong revenue collections, healthy progress in fiscal consolidation and sustained capital expenditure have enabled the govt. to support growth without compromising fiscal discipline. This also provides a supportive backdrop for the RBI to maintain its accommodative policy stance and improve monetary policy transmission.
- We expect the RBI to keep the repo rate unchanged at 5.25% in its upcoming policy while retaining its FY27 GDP growth forecast at 6.6% and CPI inflation forecast at 5.1%. Notably, average CPI inflation during 1QFY27 (3.9%) remained below the RBI's forecast of 4.2%, providing the MPC with additional comfort to maintain the status quo while monitoring the evolving domestic and global macroeconomic environment.
- We continue to expect the Center's fiscal deficit to widen to around 4.6% of GDP in FY27, compared with the Budget target of 4.3%, implying a slippage of around 30bp. Although the de-escalation of tensions in West Asia and the US-Iran peace agreement have reduced the risk of a prolonged commodity shock, the fiscal impact has already been embedded in government finances through the reduction in fuel excise duties and the front-loaded increase in fertilizer and food subsidies. Additional downside risks stem from a potential shortfall in disinvestment receipts and weaker corporate tax collections.
- Nevertheless, we view the expected slippage as manageable rather than structural. The government has protected the quality of expenditure, with capital expenditure rising 23.7% YoY during 1QFY27 and running ahead of the pace required to meet the Budget target.
- We do not expect the expected fiscal slippage to lead to additional dated G-sec borrowings, as the government has sufficient financing flexibility through cash balances, small savings and other funding sources. While higher US 10-year Treasury yields may keep some upward pressure on Indian bond yields, we expect the 10-year G-sec yield to remain broadly range-bound at 6.8-7.0%, with our end-FY27 target of 7.0%. A move towards 7.2% is possible only if geopolitical tensions in West Asia escalate again and crude oil prices remain above USD100/bbl for a sustained period. This is not our base-case scenario.

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Center’s finances (monthly)

Key takeaway: **The Center's fiscal position improved in Jun'26, supported by strong revenue collections and higher capital expenditure, resulting in a sharp decline in the fiscal deficit.**

- **The Center's fiscal position improved in Jun’26, with total receipts increasing 58.6% YoY to INR3.3t, driven by a broad-based improvement across tax revenues, non-tax revenues, and non-debt capital receipts, aided by a favorable base effect.**
- **Gross tax revenue rose 6.4% YoY in Jun’26, led by a 13.0% YoY increase in direct taxes, with corporate tax collections rising 17.5% YoY and income tax collections increasing 6.9% YoY. In contrast, indirect tax collections declined 6.8% YoY in Jun’26 due to weaker GST (-8.2% YoY) and excise duty (-24.8% YoY) collections, while customs duty receipts remained robust, growing 33.1% YoY.**
- **Non-tax revenues increased 65.6% YoY in Jun’26, while non-debt capital receipts surged 449.0% YoY, supported by divestment proceeds of INR113.1b during the month.**
- **On the expenditure side, total expenditure remained broadly unchanged in Jun'26 at INR4.8t vis-à-vis Jun’25 (0.01% YoY). Revex declined 8.4% YoY in Jun’26 to INR3.9t, primarily due to a 30.8% YoY decline in interest payments, although subsidy expenditure remained elevated, rising 21.6% YoY.**
- **In contrast, capital expenditure increased sharply by 66.0% YoY to INR0.9t, reflecting a pickup in infrastructure spending and the government's continued emphasis on capital formation.**
- **Consequently, the Center recorded a monthly fiscal deficit of INR1.5t in Jun’26 vs. a deficit of INR2.7t in Jun’25.**

Exhibit 2: Total receipts surged in Jun’26

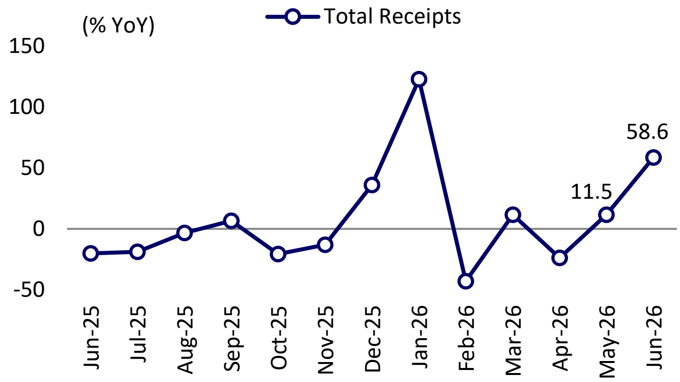
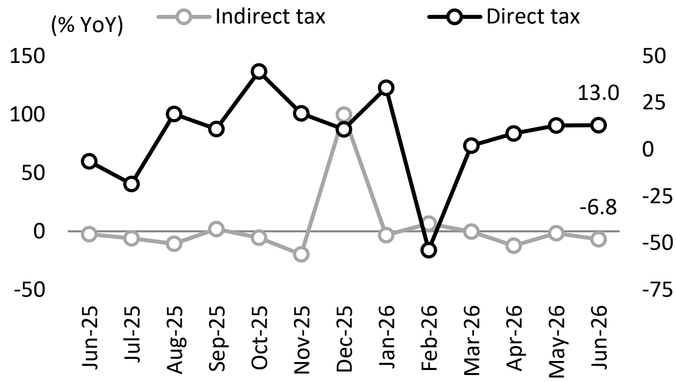


Exhibit 3: Direct taxes remained at 13% in Jun’26



Source: CGA, CEIC, MOFSL

Exhibit 4: Corporate tax collections growth decelerated in Jun’26, but still strong

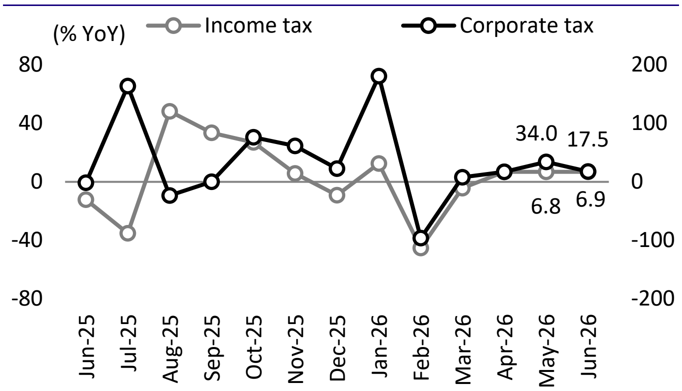
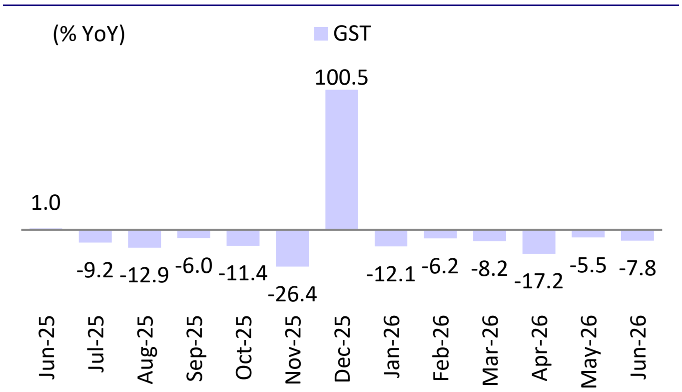


Exhibit 5: GST collections contracted for the sixth straight month (-7.8% YoY) in Jun’26



Source: CGA, CEIC, MOFSL

Exhibit 6: Excise collections contracted 24.8% in Jun'26

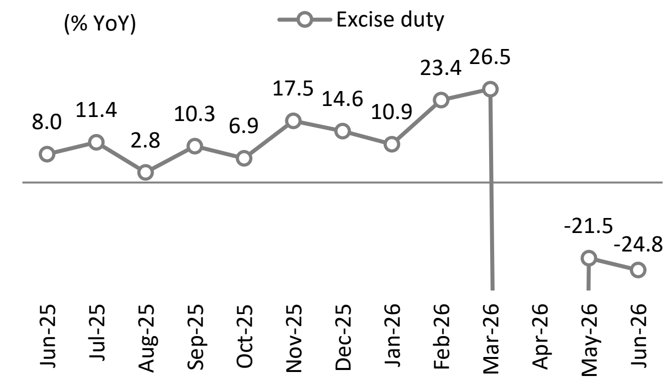
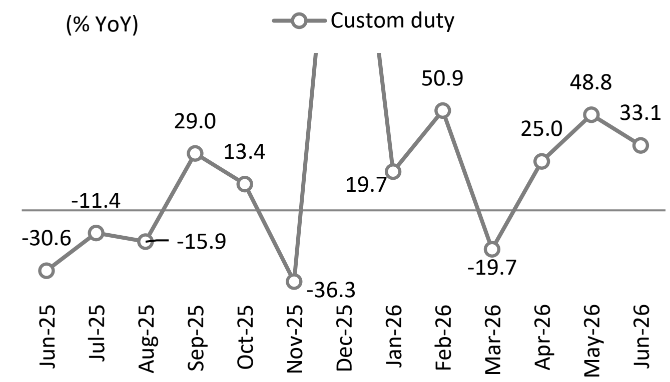


Exhibit 7: Customs duty collections grew 33.1% in Jun'26



Source: CGA, CEIC, MOFSL

Exhibit 8: Total spending growth remained flat in Jun'26

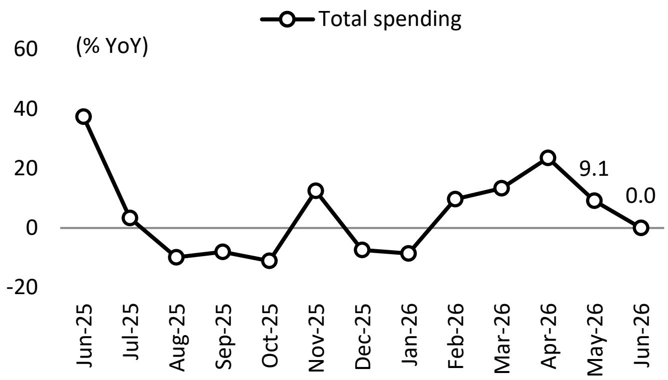
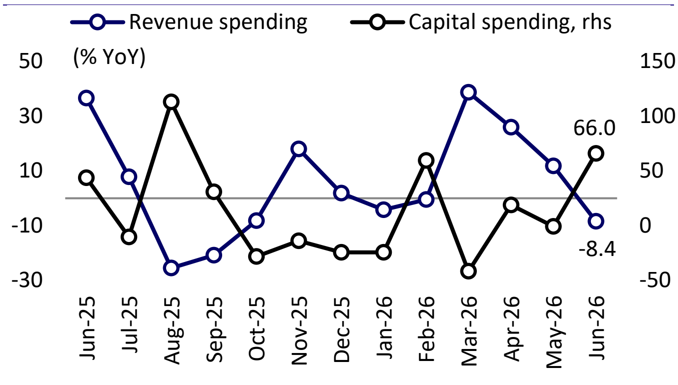


Exhibit 9: Capital spending increased sharply by 66% YoY in Jun'26 (INR0.9t), while revex declined 8.4%



Source: CGA, CEIC, MOFSL

Exhibit 10: Interest payments contracted, while subsidies posted double-digit growth in Jun'26

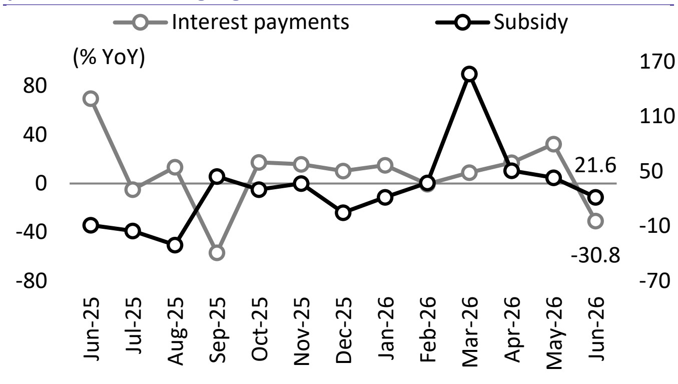
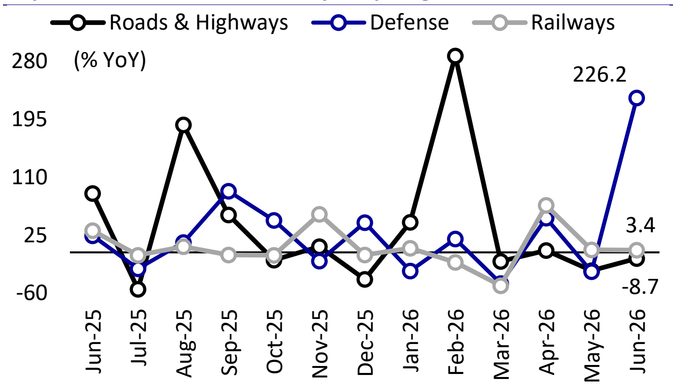


Exhibit 11: Defence capex grew 226.2% YoY in Jun'26; roads capex contracted and railways capex growth moderated



Source: CGA, CEIC, MOFSL

Exhibit 12: Fiscal details of the Central government for Jun'26 (Monthly)

	(INR t) Jun-26	(INR t) Jun-25	(INR t) May'26	(% YoY) Jun-26	(% MoM) Jun-26
Gross tax revenue	**3.8**	**3.5**	**2.6**	**6.4**	**45.7**
Direct Taxes	**2.5**	**2.2**	**1.2**	**13.0**	**110.1**
Corporate Tax	1.5	1.3	0.3	17.5	376.9
Income Tax	1.0	0.9	0.9	6.9	14.5
Indirect Taxes	**1.2**	**1.3**	**1.3**	**-6.8**	**-10.0**
Custom	0.2	0.1	0.2	33.1	-23.1
Excise Duty	0.2	0.3	0.2	-24.8	5.8
GST	0.8	0.8	0.9	-8.2	-10.9
Net tax revenue	**2.9**	**1.9**	**1.7**	**52.2**	**70.0**
Non Tax revenue	**0.3**	**0.2**	**3.3**	**65.6**	**-91.8**
Non debt capital receipts	**0.2**	**0.0**	**0.1**	**449.0**	**57.0**
Total Receipts	**3.3**	**2.1**	**5.1**	**58.6**	**-34.7**
Total Expenditure	**4.8**	**4.8**	**3.1**	**0.0**	**55.6**
Revenue expenditure	**3.9**	**4.2**	**2.4**	**-8.4**	**58.0**
Interest Payments	1.6	2.4	0.7	-30.8	129.4
Subsidies	0.4	0.3	0.3	21.6	23.1
Capital expenditure	**0.9**	**0.5**	**0.6**	**66.0**	**45.9**
Loans Disbursed	0.3	0.1	0.2	187.3	90.8
Fiscal Deficit	**1.5**	**2.7**	**-2.0**		
Revenue deficit	**0.7**	**2.2**	**-2.5**		
Primary deficit	**-0.2**	**0.3**	**-2.7**		

Source: CEIC, MOFSL

Center's finances (FYTD; Apr'26-Jun'26)

- **The Center maintained a healthy fiscal position during 1QFY27, with total expenditure increasing 11.0% YoY to INR13.6t (vs. 52% YoY in 1QFY26), broadly in line with the 11.5% YoY growth in total receipts. The fiscal deficit stood at INR3.1t in 1QFY27, or 18.2% of the FY27BE (vs. 17.9% of FY26BEs achieved in 1QFY26), indicating that fiscal consolidation remains on track despite continued support for growth through public investment.**
- **The increase in expenditure was primarily driven by capital spending, which rose 23.7% YoY to INR3.4t in 1QFY27, significantly outpacing the 7.4% YoY growth in revenue expenditure. Within revex, subsidy payments increased 37.4% YoY in Jun'26, reflecting higher fertilizer prices, while interest payments declined 10.3% YoY, helping contain overall revenue spending.**
- **The composition of spending was encouraging, with capital transfers to states surging sharply (INR0.5t or 223.0% YoY) in 1QFY27, railway capex rising 30.6% YoY (INR1t), and defense capital outlay increasing 42.3% YoY (INR0.5t), reinforcing the government's focus on infrastructure and strategic sectors. However, housing & urban affairs (-40.6% YoY) and road transport (0.2% YoY) spending remained subdued.**
- **The Center has already utilized 31.1% of its FY27 capital expenditure budget by the end of June. Importantly, the current capex run rate of INR1.1t per month is well above both the budgeted monthly run rate of INR0.9t and the required run rate of around INR0.8t per month for the remainder of FY27 to achieve the annual capex target, underscoring the government's continued emphasis on infrastructure creation.**
- **On the receipts side, gross tax revenue increased 3.7% YoY in 1QFY27 to INR9.0t (vs. 4.6% in 1QFY26). Direct tax collections remained the key growth driver, rising 11.7% YoY, supported by a 19.7% increase in corporate tax collections and a 6.8% rise in income tax receipts, reflecting resilient corporate profitability and stable income growth. In contrast, indirect tax collections declined 6.9% YoY in 1QFY27, mainly due to weaker GST (-11.1% YoY) and excise duty (-22.4% YoY) collections, although customs duty receipts remained robust, increasing 36.1% YoY. Consequently, net tax revenue increased 17.8% YoY in 1QFY27 (-1.7% in 1QFY26), aided by lower tax devolution to states (-19.5% YoY in 1QFY27).**
- **Non-tax revenues remained broadly stable, increasing 1.2% YoY in 1QFY27 (vs. 33.2% YoY in 1QFY26), while already achieving 56.6% of the FY27BE, reflecting front-loaded dividends and other non-tax receipts.**
- **Non-debt capital receipts increased 24.9% YoY in 1QFY27 and have already reached 54.7% of FY27BE. The improvement was largely driven by an active disinvestment program, with the Center raising around INR212.0b through stake sales in several CPSEs—including Coal India, NHPC, GIC, IRFC and Central Bank of India—along with strategic disinvestment and SUUTI remittances, indicating a strong start to the government's asset monetization program.**

- **The Center's fiscal deficit stood at INR3.1t in 1QFY27, reaching 18.2% of FY27BE. The revenue deficit was almost eliminated, amounting to only 0.5% of the annual target, while the government recorded a primary surplus of INR0.4t in 1QFY27, compared with a primary deficit in the corresponding period last year.**
- **The key takeaway is that the government has absorbed the temporary increase in subsidy expenditure without compromising its infrastructure-led investment strategy. With crude oil and fertilizer prices easing following the de-escalation of tensions in West Asia, subsidy pressures are expected to moderate, allowing the government to maintain its capital expenditure program while remaining broadly on track to achieve its FY27 fiscal deficit target.**

Exhibit 13: Total receipts contracted in Apr-Jun'26…

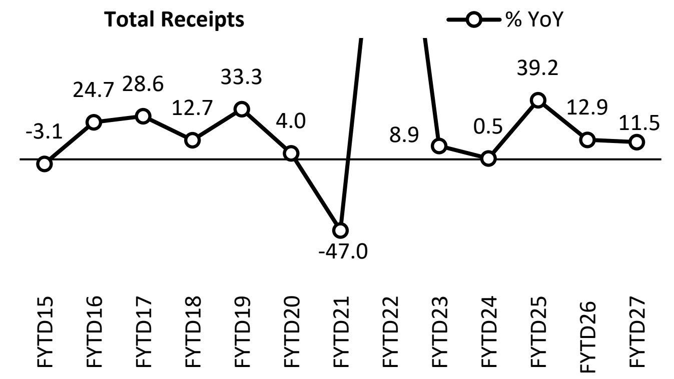


Exhibit 14: …reaching 29% of FY27BEs

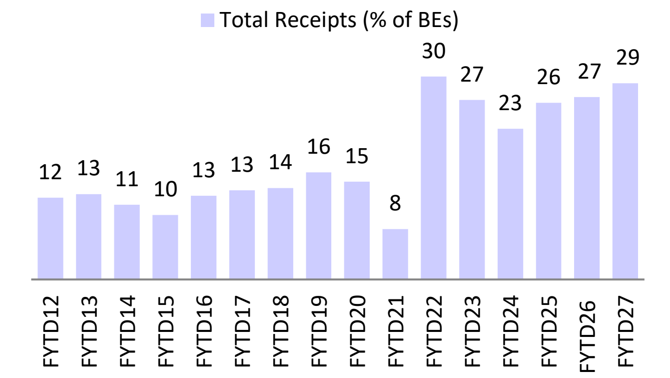


Exhibit 15: Total spending grew 4.6% YoY in Apr-Jun'26…

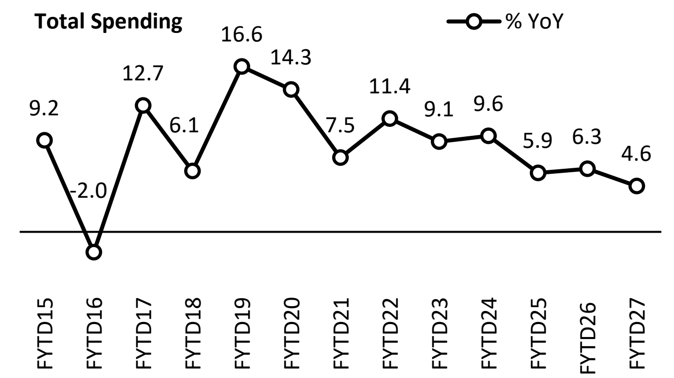


Exhibit 16: …reaching 25.4% of FY27BEs

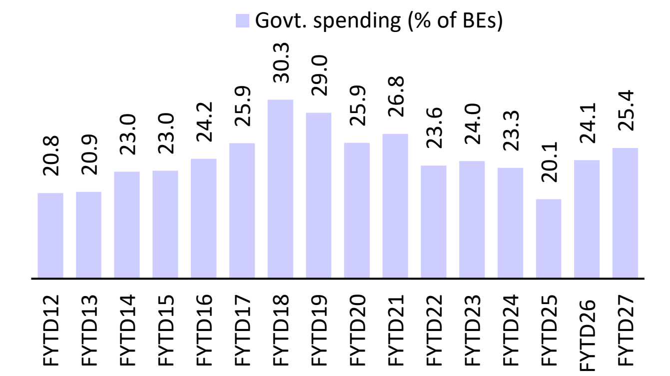


Exhibit 17: Capital spending grew 23.7% in 1QFY27

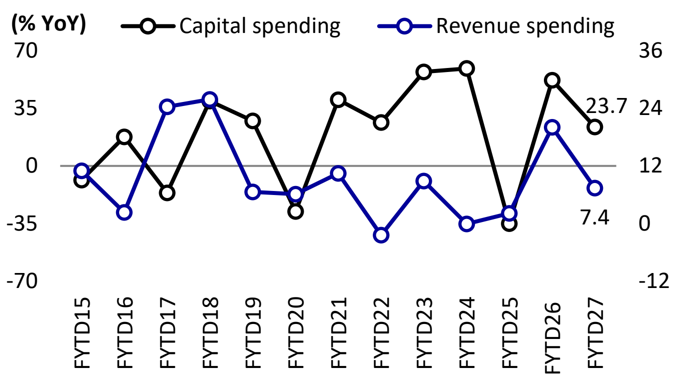


Exhibit 18: Revex stood at 24.6% of FY27BEs in Apr-Jun'26

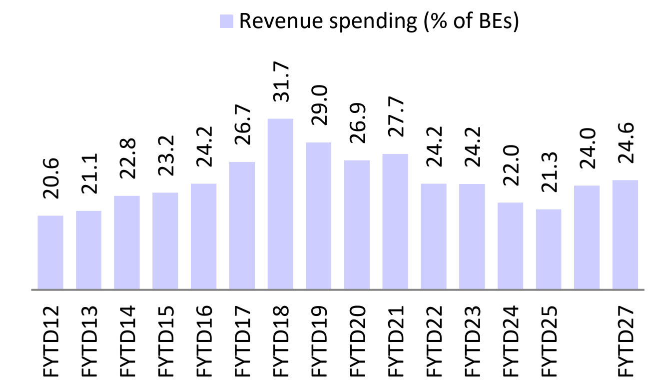


Exhibit 19: Capex stood at 27.8% of FY27BEs in Apr-Jun'26, higher than 24.5% in Apr-Jun'25

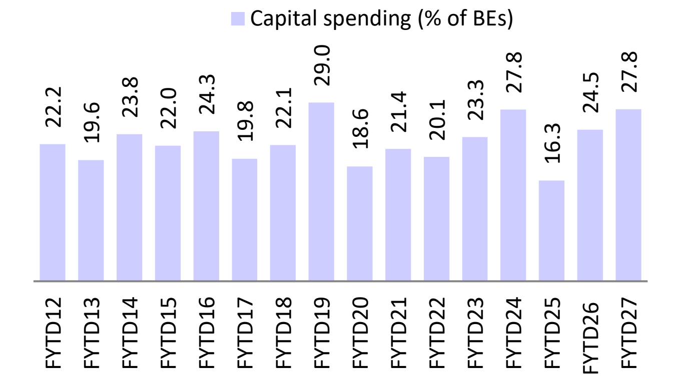


Exhibit 20: Breakup of the Center's capex in 1QFY27 (%)

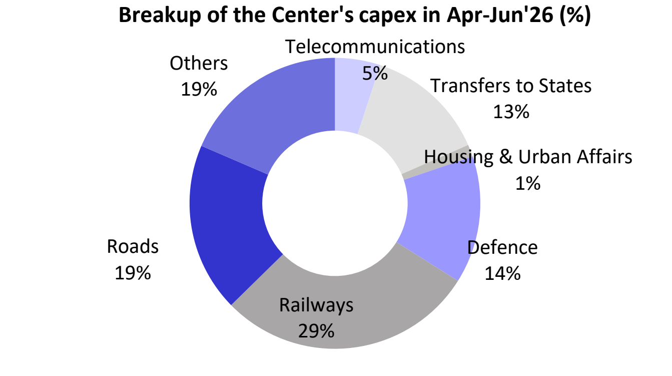


Exhibit 21: Railways, transfers to state and defense capex remained buoyant, while roads capex remained muted

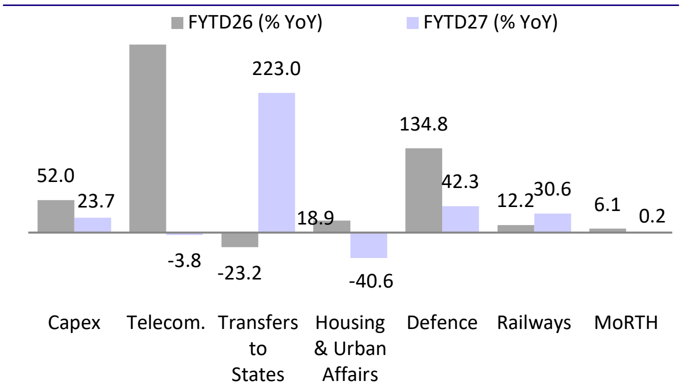
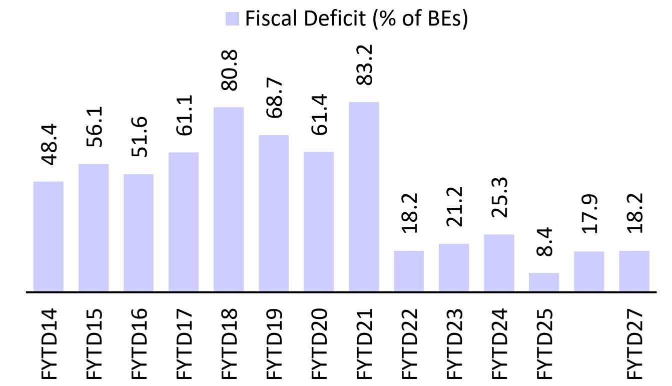


Exhibit 22: Fiscal deficit stood at 18.2% of BEs in Apr-Jun'26, vs. 17.9% in Apr-Jun'25



Note: Data is from Apr'26-Jun'26 for all years; Source: CGA, CEIC, MOFSL

Exhibit 23: Fiscal details of the Central government (FYTD basis)

								FY2027 (INR t)		
	(INR t) 3MFY27	(INR t) 3MFY26	(INR t) 3MFY25	% YoY 3MFY27	% YoY 3MFY26	(INR t) FY27BE	(% of BE) FY27BE	Current run rate	Required run rate as per budget	Required run rate for remaining months
Gross tax revenue	**9.0**	**8.7**	**8.3**	**3.7**	**4.6**	**40.8**	**22.1**	**3.0**	**3.4**	**3.5**
Direct Taxes	**5.1**	**4.6**	**4.6**	**11.7**	**-0.8**	**24.2**	**21.2**	**1.7**	**2.0**	**2.1**
Corporate Tax	2.1	1.7	1.7	19.7	-1.2	11.1	18.6	0.7	0.9	1.0
Income Tax	3.1	2.9	2.9	6.8	-0.5	13.1	23.3	1.0	1.1	1.1
Indirect Taxes	**3.7**	**4.0**	**3.6**	**-6.9**	**11.3**	**16.6**	**22.3**	**1.2**	**1.4**	**1.4**
Custom	0.6	0.4	0.5	36.1	-9.9	2.4	24.1	0.2	0.2	0.2
Excise Duty	0.4	0.6	0.5	-22.4	8.3	6.7	6.5	0.1	0.6	0.7
GST	2.6	3.0	2.6	-11.1	16.2	10.5	25.3	0.9	0.9	0.9
Net tax revenue	**6.4**	**5.4**	**5.5**	**17.8**	**-1.7**	**26.7**	**23.8**	**2.1**	**2.2**	**2.3**
Non Tax revenue	**3.8**	**3.7**	**2.8**	**1.2**	**33.2**	**6.7**	**56.6**	**1.3**	**0.6**	**0.3**
Non debt capital receipts	**0.4**	**0.3**	**0.0**	**24.9**	**519.9**	**0.6**	**54.7**	**0.1**	**0.1**	**0.0**
Total Receipts	**10.5**	**9.4**	**8.3**	**11.5**	**12.9**	**34.1**	**30.8**	**3.5**	**2.8**	**2.6**
Total Expenditure	**13.6**	**12.2**	**9.7**	**11.0**	**26.0**	**49.6**	**27.3**	**4.5**	**4.1**	**4.0**
Revenue expenditure	**10.2**	**9.5**	**7.9**	**7.4**	**20.0**	**38.7**	**26.3**	**3.4**	**3.2**	**3.2**
Interest Payments	3.5	3.9	2.6	-10.3	46.2	12.7	27.2	1.2	1.1	1.0
Subsidies	1.1	0.8	0.9	37.4	-7.3	4.7	24.5	0.4	0.4	0.4
Capital expenditure	**3.4**	**2.8**	**1.8**	**23.7**	**52.0**	**11.0**	**31.1**	**1.1**	**0.9**	**0.8**
Loans Disbursed	1.0	0.7	0.3	44.0	132.7	2.1	48.3	0.3	0.2	0.1
Fiscal Deficit	**3.1**	**2.8**	**1.4**			**15.6**	**19.8**	**1.0**	**1.3**	**1.4**
Revenue deficit	**0.0**	**0.3**	**-0.4**			**5.3**	**0.5**	**0.0**	**0.4**	**0.6**
Primary deficit	**-0.4**	**-1.1**	**-1.3**			**2.8**	**-13.6**	**-0.1**	**0.2**	**0.4**

Source: CEIC, MOFSL

Finances of 23 states (FYTD; Apr'26-Jun'26)

- **For the 22 states combined, Jan'26 revenue was mixed. Total receipts increased compared to last year, but revenue receipts declined, mainly due to a sharp drop in states' share of Union taxes. Tax revenue contracted 14.9% YoY in Jan'26, although stamp duties and state excise collections remained strong.**
- **The fiscal position of the 23 major states remained broadly stable during 1QFY27, with total receipts and total expenditure both expanding 4.2% YoY to INR11.1t and INR11.0t, respectively. Budget execution remained gradual, with states utilizing only 17.2% of their FY27 Budget Estimates (BE) on both the receipts and expenditure sides.**
- **Revenue receipts increased a modest 3.3% YoY to INR9.0t in 1QFY27, slowing sharply from 11.9% growth in 1QFY26. The moderation was largely attributed to a 14.6% decline in states' share of Union taxes and a 32.2% contraction in grants-in-aid from the Center, reflecting weaker central transfers during the quarter. Despite this, states have already mobilized 17.3% of their annual revenue receipt target, suggesting that collections remain broadly on track.**
- **States' own tax revenues remained the key source of fiscal strength, rising 4.5% YoY to INR7.8t in 1QFY27. Growth was supported by healthy collections across major tax heads, with SGST increasing 10.3% YoY, state excise duties rising 10.9%, sales tax/VAT growing 6.3%, and stamp duty and registration fees expanding 13.7%.**
- **Total expenditure increased 4.2% YoY during 1QFY27, with revenue expenditure rising 4.1% YoY despite higher interest payments (+13.4% YoY) and pension outgo (+13.1% YoY). Importantly, capex outpaced revex, rising 4.8% YoY to INR1.1t, despite heightened geopolitical uncertainties and elevated commodity prices, reflecting states' continued commitment to infrastructure spending. However, with only 10.7% of the FY27 capex budget utilized by end-June, capital outlay has started on a relatively slow note and is expected to accelerate over the coming months, in line with the typical back-loaded spending pattern of state governments.**
- **The combined fiscal deficit of 22 states widened to INR2.1t, equivalent to 17.8% of the FY27BE. The higher deficit primarily reflects weaker central transfers and increased borrowings rather than a deterioration in expenditure discipline.**

Exhibit 24: Fiscal details of 23 states

	(% YoY)		(INR t)		(% YoY)		(INR t)	(% of BEs)
23 State Finances	**Jun-26**	**Jun-25**	**3MFY27**	**3MFY26**	**3MFY27**	**3MFY26**	**FY27BE**	**3MFY27**
Total Receipts	**-0.6**	**27.4**	**11.1**	**10.6**	**4.2**	**11.9**	**64.3**	**17.2**
Revenue Receipts	**-17.2**	**6.4**	**9.0**	**8.7**	**3.3**	**2.5**	**51.8**	**17.3**
Tax Revenue	**-17.0**	**3.2**	**7.8**	**7.4**	**4.5**	**2.8**	**40.7**	**19.1**
State Goods and Services Tax	-11.3	20.0	2.7	2.5	10.3	6.3	13.1	20.8
Stamps and Registration Fees	5.5	39.9	0.7	0.6	13.7	18.7	3.4	20.9
Land Revenue	38.0	-1584.5	0.0	0.0	1.4	49.5	0.3	16.7
Sales Tax	11.5	33.6	1.0	1.0	6.3	14.2	5.0	20.3
State Excise Duties	3.6	7.7	0.8	0.7	10.9	8.7	3.6	21.7
State's Share of Union Taxes	-52.3	19.9	1.9	2.2	-14.6	7.6	12.7	14.9
Other Taxes and Duties	12.8	43.0	0.5	0.4	16.5	15.0	2.6	18.7
Non Tax Revenue	33.0	-0.7	0.8	0.7	21.0	6.1	4.7	16.9
Grant in Aid and Contribution	-43.0	39.4	0.4	0.6	-32.2	-3.7	6.6	5.9
Capital Receipts	**133.3**	**-365.6**	**2.1**	**1.9**	**8.5**	**89.1**	**12.2**	**17.3**
Recovery of Loans and Advances	-39.3	371.3	0.0	0.0	-51.8	129.1	0.3	5.4
Other Receipts	-48.9	-45.1	0.0	0.0	-41.5	-17.6	0.2	0.1
Borrowings and Other Liabilities	505.2	-202.0	2.1	1.9	9.4	89.1	11.7	17.9
Total Expenditure	**0.3**	**27.4**	**11.0**	**10.5**	**4.2**	**12.4**	**63.6**	**17.2**
Revenue Expenditure	**-0.5**	**26.2**	**9.8**	**9.4**	**4.1**	**11.1**	**52.9**	**18.6**
Interest Payments	18.0	-8.1	1.2	1.1	13.4	5.2	6.8	18.3
Salaries and Wages	11.1	3.7	2.2	2.2	2.4	2.9	10.4	21.4
Pension	10.2	14.7	1.6	1.4	13.1	5.7	6.3	25.6
Subsidy	4.6	27.2	0.7	0.9	-18.6	27.3	4.3	16.6
Capital Expenditure	**16.7**	**26.5**	**1.1**	**1.1**	**4.8**	**29.7**	**10.4**	**10.7**
Loans and Advances Disbursed	-4.8	71.3	0.1	0.1	-13.6	-13.8	1.2	10.2
Fiscal Balance	**234.5**	**-261.3**	**-2.1**	**-1.9**	**8.3**	**92.8**	**-11.9**	**17.8**

Source: CEIC, MOFSL; Note: Excluding Punjab, West Bengal, Arunachal Pradesh, Nagaland, and Manipur

NOTES

Explanation of Investment Rating	
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BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
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