



Pre-Budget Expectations

January 2026

Economic Research Department, Bank of Baroda



Budget 2026-Key Focus



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Fiscal prudence

Maintaining steady growth
path

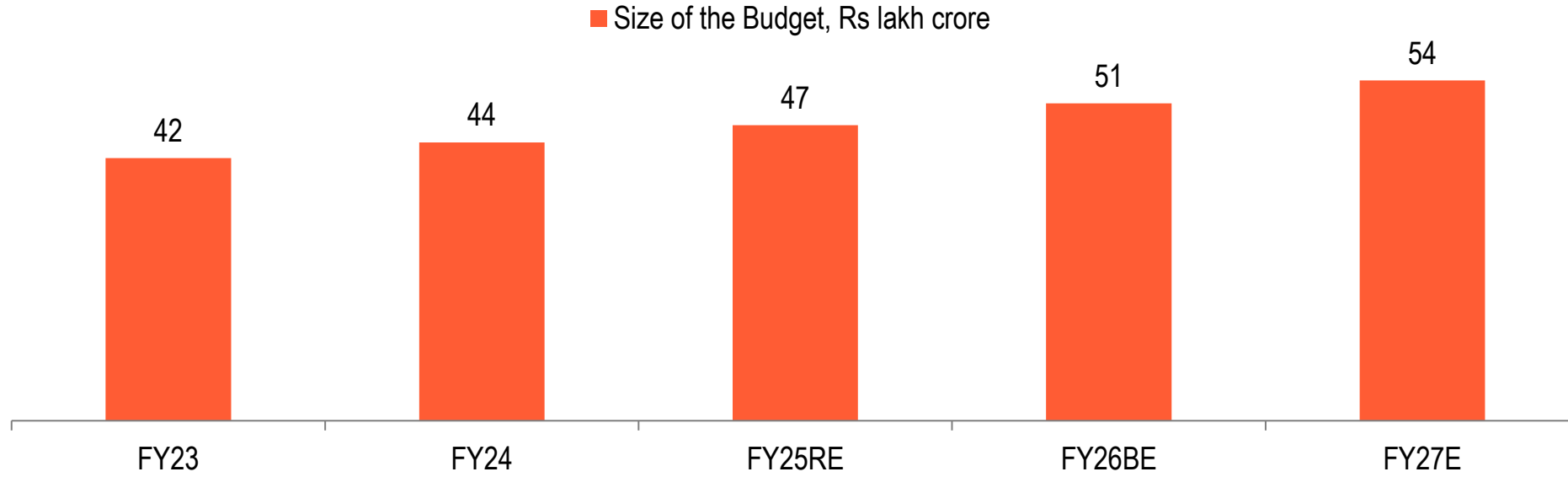
Crowding in private
investment

Export promotion

Domestic manufacturing



Budget-Size



Source: CEIC, Bank of Baroda Research | *RE: Revised Estimates, BE: Budget Estimates, E: BoB Estimates*

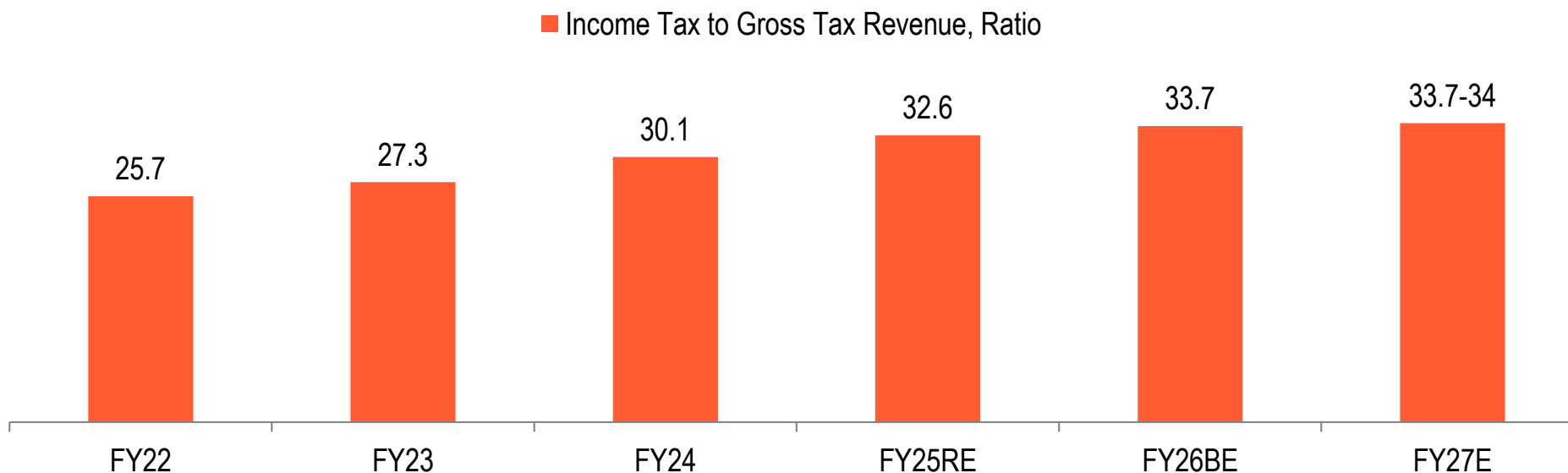
- Overall size of the Budget is expected to grow at a modest pace of ~7-7.5% in FY27.
- We expect it to settle at ~ Rs 54 lakh crore.
- As a percent of GDP, the size of Budget is expected to come down at ~13.8%, speaking of prudent expenditure management.



Steady Tax collections...



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Source: CEIC, Bank of Baroda Research | *RE: Revised Estimates, BE: Budget Estimates, E: BoB Estimates*

- Income tax to Gross tax revenue is expected to have reached its all time high as per budgeted figures of FY26.
- What has been the major driver?
 - Faster growth in income with GDP growth going up



...Expectations on income tax



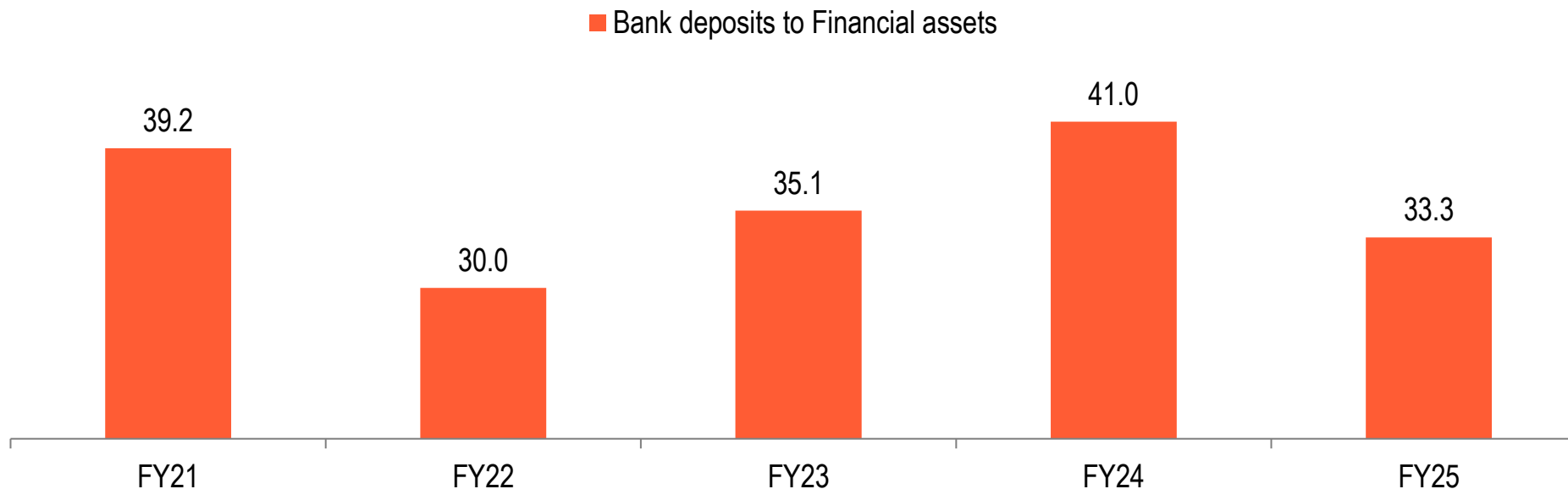
- We expect the income tax buoyancy to persist at ~0.9-1.1 in FY27 as major government reforms are redirected towards widening tax base and improving tax administration.
- Further structural reforms such as labour will act concomitantly in improving the numbers.
- **On income tax front, we expect:**
 1. Increase in standard deduction for salaried persons to Rs 1 lakh from the current level of Rs 50,000 (old regime) and Rs 75,000 (new regime). This will also boost disposable income of taxpayers.
 2. Increase in long term capital gains on equity and equity Mutual Funds (MFs) to Rs 2 Lakh. The current level is Rs 1.25 lakh and any amount above that level is taxed at 12.5%. This will give equity market the desired band of comfort in an uncertain global policy environment.
- **For Households**
 1. Sovereign green bonds issued by the central government may offer a premium (instead of greenium) of +25bps above the prevailing G-Sec rate for retail investors. This will be beneficial for not only raising funds for critical growth spurring activities but will also attract greater retail participation.



...Deposit mobilisation



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Source: RBI, Bank of Baroda Research

2. Deposit mobilization in the current easing cycle has been challenging. Thus, Budget should focus on exploring the idea of giving tax breaks on interest on bank deposits.

- ❑ At present, only long-term deposits, i.e. term deposits with a maturity of over 5 years can be claimed for tax exemption. This limit can be lowered to 3 years.



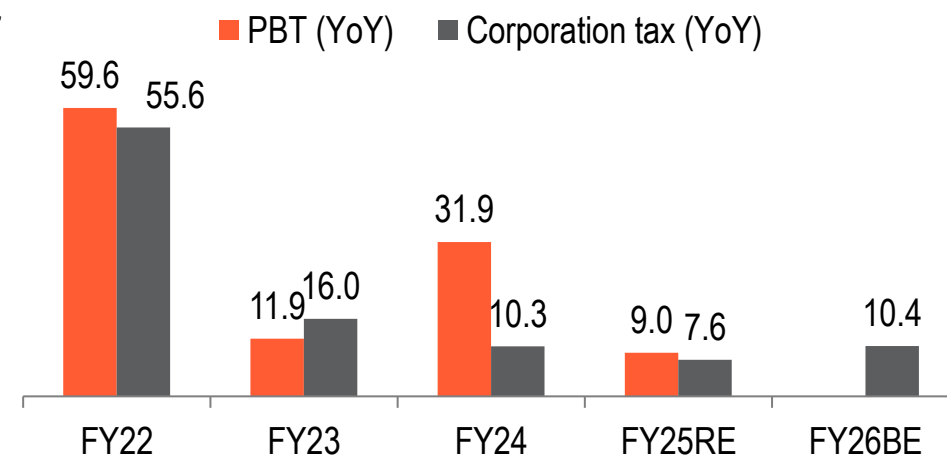
Changes in Corporate Tax



- There should be provisions for investment allowance based on turnover.

[Interestingly investment allowance was first introduced in the Union Budget of 2013-14. Under this manufacturing companies were given a provision of investment allowance of 15% given that they invest more than Rs 100 crore in plant and machinery between 1 Apr, 2013 to 31 Mar, 2015.]

- Similar allowance might be provided. Some range might be prefixed based on PBIT for companies.
- For companies having PBIT less than Rs 100 crore, an allowance of 15-20% might be provided, for Rs 100-500 crore, an allowance of 10-15% and for above Rs 500 crore, an allowance of less than 10%. This should be for investments within 3 years.
- This might help in an environment when manufacturing is facing headwinds from elevated tariff rates.



Source: CMIE, Bank of Baroda Research | RE: Revised Estimates, BE: Budget Estimates, E: BoB Estimates



Focus on Green & Tech(G&T) Economy



- An ESG metrics-based ranking of industries may be brought into vogue. Direct tax holiday of 3-years should be provided based on ranking.
- This 3-year tax holiday should be in consonance to tax breaks already available for specific projects such as solar, EV etc.
- The share of PLI for sectors such as electronics, auto and pharma have been the highest. We believe the budget should focus on expanding the scope of PLI from traditional industries to sectors investing heavily in AI, ML, space, robotics. An allocation of Rs 1,000 crore may be made for the same.
- The scope of R&D should be expanded for rare earth minerals.
 - R&D allocation for Pharma, textiles and semi conductor should be increased.
- A separate skill fund may be designated under R&D to increase employment and bridge skill gap.



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Introduction of export compensation Fund

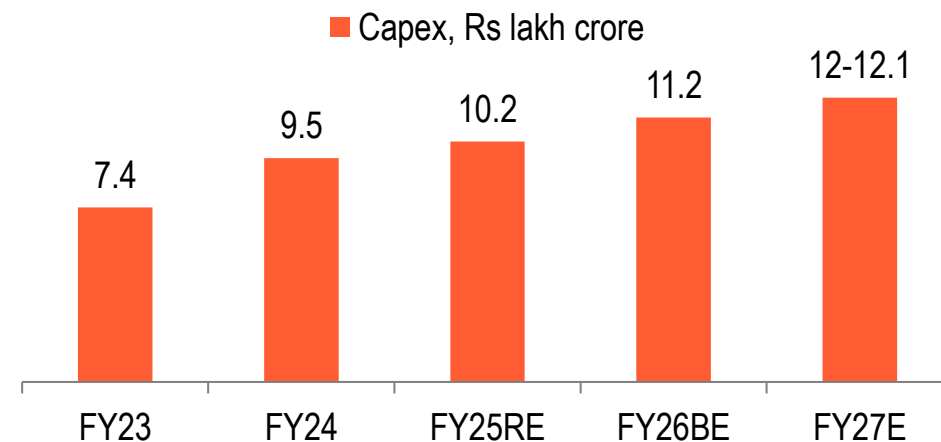
- The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) has been operational since 2000, providing partial guarantee to banks and NBFCs for collateral free loans provided to MSEs. In the last Budget, government raised the maximum guarantee cover under the scheme from Rs. 5 crore to Rs. 10 crore. Additionally, for well-run exporting MSMEs, this limit was enhanced to Rs. 20 crore.
- Given the likely impact of tariffs on this sector, this limit can be enhanced further, which will help MSMEs to navigate this challenge.
- This can be along the lines of the Emergency Credit Line Guarantee Scheme (ECLGS) announced by the government in 2020, to help MSMEs mitigate the impact of Covid-19 crisis.
 - ECLGS 2.0 can target export oriented MSMEs facing liquidity crunch due to tariffs, 100% collateral free loans up to Rs. 10 crores or more (based on annual turnover).
- With the threat of higher US tariffs, a targeted sector specific support might be needed from the Budget. Major focus should be on leather products, gems and jewellery, ready-made garments and marine products where the exposure in terms of exports to the US is the highest.
- For this, an alternate compensation linked scheme (CLI) may be proposed in the upcoming Budget which compensates MSMEs for loss of business due to entry barriers in the USA.



Multiplier effect through higher capex



- Budget's focus on higher quality capital spending would continue.
- We expect capital expenditure to increase to Rs 12-12.1 lakh crore in FY27.
- As a percentage of GDP, capex is expected to be ~3.1%.
- The continued upward trajectory of capex reflects government's intention to give investment cycle the desired impetus.
- Allocation is expected to increase for defense, railways and roads.
- Increased focus in the Budget through PPP mode of project implementation will crowd in private investment
- This will continue to provide confidence to private sector.



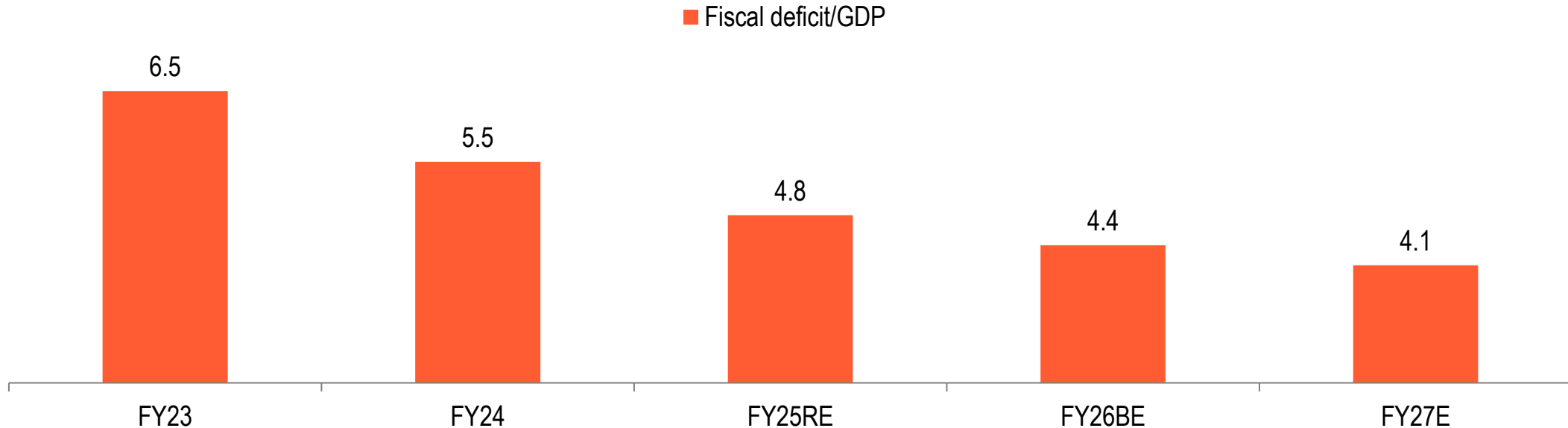
Source: CEIC, Bank of Baroda Research | RE: Revised Estimates, BE: Budget Estimates, E: BoB Estimates



Fiscal Consolidation-The main priority



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Source: CEIC, Bank of Baroda Research | RE: Revised Estimates, BE: Budget Estimates, E: BoB Estimates

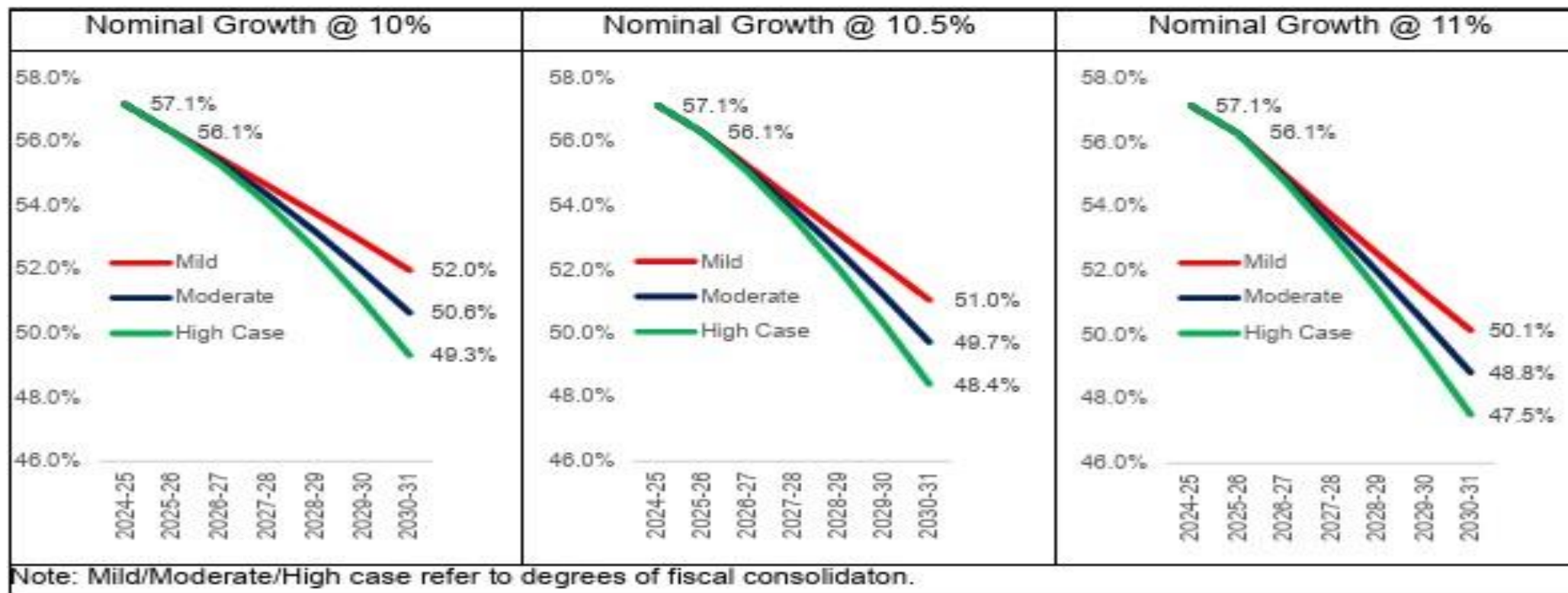
- Targeted reduction of fiscal deficit to GDP ratio to continue.
- The ratio is expected to be ~4.1% in FY27.
- Our baseline assumption of nominal GDP is ~10%.



Debt consolidation to continue



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- The above figures show different scenarios in which debt-GDP ratio can be brought down to 50%.
- By 2031, government to lower its debt-GDP ratio below 50% from 56.1% as per FY26BE, as recommended by the 16th Finance Commission.



Centre's Financing of Fiscal deficit



(Rs lakh crore)	FY23	FY24	FY25RE	FY26BE	FY27E
Gross Borrowings	14.2	15.4	14	14.8	15.5-16.0
Repayments	-3.1	-3.6	-2.4	-3.3	5.5
Net-Market Loans	11.1	11.8	11.6	11.5	10-10.5

Source: Union Budget, RBI, Bank of Baroda Research | RE: Revised Estimates, BE: Budget Estimates, E: BoB Estimates

- We expect Gross borrowing to be in the range of Rs 15.5-16.0 lakh crore.
- FY27 has a higher repayment burden which the government will finely balance through conducting occasional switches to smooth out the repayment profile.
- The frequency of switches is likely to be more in H1FY27 on account of higher maturity of outstanding securities.
- The Budget will ensure fine balancing of fiscal deficit to resist any untoward pressure on yields.
- Average borrowing cost is likely to be ~6.6-6.8% .



Customs duty



- Government has continually focused on rationalizing the customs duty structure in the last few years.
- Customs duty rates are likely to be rationalized further in light of the FTAs signed.
- The customs duty structure is expected to be simplified with a focus on reducing compliance burden and address the issue of inverted duty structure.
- Focus will be on lowering/rationalizing duties while supporting domestic manufacturers and exports.
- Lower duty rates are unlikely to have a major impact on government's revenue.
 - Customs revenue account for about 5% of the government's total receipts.



Subsidies



- Government is likely to increase its subsidies marginally this year.
- Fertilizer subsidy is likely to see an increase.
 - Global prices of key inputs have increased sharply
 - Domestic production still has room to expand.
- Petroleum subsidy is likely to be scaled back.
 - Oil prices have continued to remain benign
 - LPG subsidy might also come down as several OMCs are said to have sourced cheaper supplies from the US
- Food subsidies are likely to continue at similar pace.
 - Allocation under the Pradhan Mantri Garib Kalyan Yojana is likely to continue



Other focus areas



- On the lines of the Makhana Board set up last year, the government is likely to focus on promoting production of other crops such as:
 - Jute
 - Tea
 - Rubber
 - Bamboo
- A comprehensive policy on the exploration, extraction and preservation of rare earth minerals.
 - This will reduce dependence on imports
 - Promote domestic manufacturing
- Tourism sector is also expected to get a boost.
 - Experience economy and eco-tourism are booming
 - Health and religious tourism also expected to grow rapidly
- A special package for Gig workers can also be explored
 - To provide gig workers with a safety net, the government can mandate companies to provide insurance for these workers
 - The government can pay 50% of the premium for the first year.



Conclusion



- Fiscal math will primarily focus on consolidation.
- We expect fiscal deficit to GDP ratio to come down to 4.1% in FY27.
- Debt consolidation will also be a top priority, and we expect government to stick to the pipeline of reduction in debt to GDP ratio to 50% by 2031.
- Gross market borrowings are likely to be ~Rs 15.5-16.0 lakh crore.
- Fine management of finances of fiscal deficit will resist any untoward pressure on yields.
- On expenditure profile, quality capital spending will continue. We expect capital expenditure of ~ Rs 12-12.1 lakh crore.
- Focus will be on sectors such as defence, railways and road.
- On revenue side, structural reforms will boost tax collections.
- We expect a budget driven by structural reforms for a better integration with global supply chain in an uncertain global policy environment.

Thank you

