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First Budget of Modi's Third Term: Emphasis on Boosting Consumer Consumption

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Summary

The Narendra Modi government has presented its first full budget of the present term. The emphasis continues to be on fiscal stabilisation and eschewing populist policies. Income tax exemption limit has been substantially enhanced to encourage higher levels of consumption. Infrastructure development, ease of doing business and liberalising regulatory control have also been given priority.

The first full budget of the third term of Indian Prime Minister Narendra Modi's government was awaited with much anticipation as it was expected to signal the path of economic growth over the next five years. The budget was presented on 1 February 2025 under a shadow of global macroeconomic uncertainty, declining growth, falling savings rate and lower corporate earnings. Added to these factors were the wars in Europe and policies of the Donald Trump administration, yet to be made known. In this context, it must be said to the credit of the government that eschewing the path of populist measures, it has stood firm in its commitment to fiscal prudence. The revised estimate for the fiscal deficit for Financial Year (FY) 2024-25 at 4.8 per cent is within the targeted 4.9 per cent. For the next FY, the project deficit of 4.4 per cent will also be below the 4.5 per cent target. While this may restrict its spending on infrastructure, the government has taken care to ensure that its borrowing does not crowd out the private sector. This would also indicate a lower debt-to-GDP ratio, thereby improving the government's credit rating.

The government is cognisant of the fact that to arrest the decline in growth after the buoyant levels seen post-COVID-19, measures beyond the budget are necessary. The Economic Survey has emphasised further deregulating various sectors of the economy. Some of these areas fall within the domain of the states, and an era of close centre-state coordination to make the next generation reforms successful will be necessary. To accelerate growth, measures will be necessary to encourage private sector investment, uplift the household savings sentiment and simultaneously encourage consumer spending. Thus, fiscal expansion will have to be dovetailed with monetary measures.

To give a fillip to consumer spending, the Indian government has provided significant direct tax relief to the middle-income class. The tax relief to this sector could be in the range of ₹700 billion (S$10.9 billion) to ₹1.1 trillion (S$17.2 billion), with foregone tax revenue of about ₹1 trillion (S$15.6 billion). This will put additional purchasing power in the hands of the middle class, thereby increasing consumption demand and may even lead to mortgages for housing loans. The proposal is to exempt income up to ₹1.2 million (S$18,801) from income tax. Tax slabs and rates have been changed across the board to benefit all taxpayers. Further, to enhance the ease of paying income tax and simplify the tax law, the government proposes to introduce a new Income Tax Bill. There is also the intent to improve the ease of doing business and set up a high-level committee to review compliance and regulatory control. This has been a well-thought-out move as combined with the recommendations that are likely to accrue from the Eighth Pay Commission, purchasing power in the hands of the middle class is bound to perk up in the medium term. This could generate animal spirits in the economy with the infusion of private investment capital, which was not forthcoming due to weak demand.

The government has been laying emphasis on capital expenditure (capex) to overcome the deleterious effects of COVID-19. The pace of capex had slowed down due to the general election and the model code of conduct. As a result, out of the budget estimate of ₹11.11 trillion (S$174.1 billion) in FY2024-25, only ₹10.18 trillion (S$159 billion) was spent. To continue the momentum, the budget has proposed a 10 per cent increase, and an amount of ₹11.21 trillion (S$175.6 billion) has been provided. The increase is conservative but appears to have been restricted with an eye on fiscal prudence. The stress on capex has targeted not merely the building of infrastructure and the consequent multiplier effects on the economy but also to crowding in private sector investments. On the whole, it is hoped that the multiplier effects of increased consumer spending will partially off take the multiplier effects of the conservative increase in capex expenditure of government. However, exempting from tax – incomes up to ₹1.2 million (S$18,801) – reduces the tax base. India's personal income tax collection is roughly four per cent of the gross domestic product (GDP). It has about 80 million people who file income tax, but with taxpayers being only about 30 million. Thus, very definite regulatory and innovative steps will have to be taken to widen the tax base, a promise which has been made in the budget speech.

The government has announced a new Fund of Funds with an expanded scope of ₹100 billion (S$1.5 billion) which will provide much-needed funds for the start-up sector. The initial Fund of Funds announced by the government in 2016 with an investment of ₹100 billion (S$1.5 billion) succeeded in catalysing ₹910 billion (S$14.3 billion) as alternate investment funds. This gave a huge fillip to the Indian venture capital industry, providing risk capital to hundreds of start-ups. The new fund will reduce the reliance on foreign investments. There is also a proposal to explore a DeepTech Fund of Funds to provide a stimulus to the next generation of start-ups incubated in the country. This fund aims to accelerate advancements in critical technologies such as artificial intelligence, quantum computing and semiconductor research. This will enhance India's vision to lead the global innovation curve, ensuring that homegrown start-ups can compete at the global level.

Considering the financial flexibility available with the government, attempts towards disinvestment and privatisation may need attention. Non-strategic government holdings in listed public sector entities can be considered for monetisation. Continuing on the path for fiscal consolidation, reduction in debt to GDP ratio and enhancing growth through fiscal and monetary policies will provide a fillip to growth.

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