

DEFICIT DECODED

India's Fiscal Story

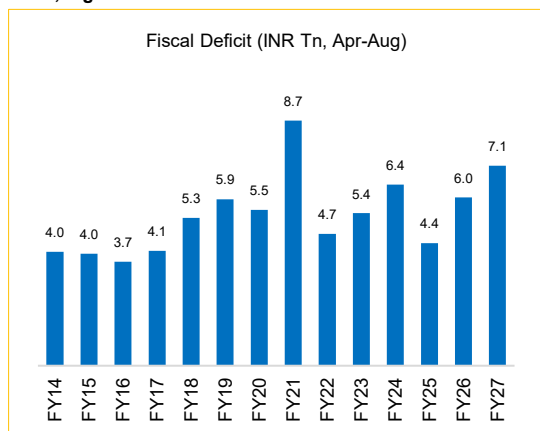


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Deficit Up 18.7% as the Deferrals Came Due

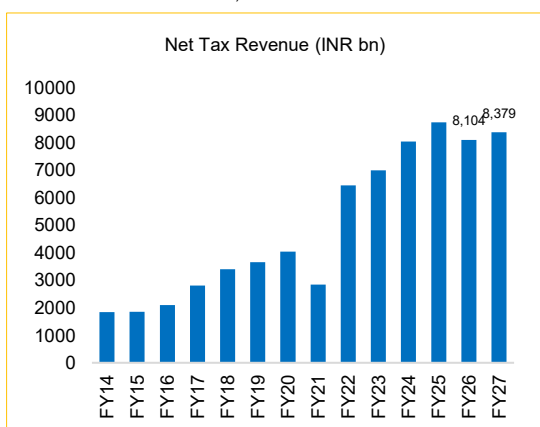
October 05, 2026

Fiscal deficit surged to INR 7.1 Tn YTD vs INR 6 Tn in FY26, highest since COVID



Source: CMIE, Choice Institutional Equities

Net Tax Revenue Collection has flattened as the tax refunds that were held back earlier, are released



Source: CMIE, Choice Institutional Equities

August alone added INR 2.55 Tn to the deficit, nearly double the INR 1.30 Tn of August last year.

One devolution instalment was enough to take monthly net tax revenue below zero. The buoyancy was never there.

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Our View

The consolidation was a deferral, and August is when the deferrals started coming due. The Centre bought its first four-month print by withholding refunds and compressing devolution, and both reversed in a single month. What is left for H2 is a recurring revenue base growing 3.3%, a sticky subsidy bill that will overshoot, and an interest line about to reprice into a market where India has already spent its spread cushion over Treasuries. The deficit number can still be met, but only by cutting capex, which means the adjustment falls on the most productive line in the budget. The bond market is where this gets expensive. India has absorbed only part of the move in a US 10-year at a 19-year high, leaving the differential at 189 bps against an FY26 average near 235 bps, and reversion alone puts the India 10-year near 7.5%. The October hike is priced; a stance shift is not, and it would hit the long end where the Centre has just concentrated its H2 borrowing.

Key Takeaways -

- **The Apr–Aug deficit widened 18.7% YoY to INR 7.10 Tn**, the widest five-month print since COVID, at 41.9% of BE against 38.1% a year ago. August alone accounted for INR 2.55 Tn of it, nearly double the INR 1.30 Tn booked in August last year.
- **Two of the three cushions we flagged have already deflated.** An extra August devolution instalment of INR 2.18 Tn exceeded the Centre's own retained collections, taking monthly net tax revenue to negative INR 66 Bn and five-month net tax growth to 3.4% from 27.6%. Refunds are being released, with the GST refund share down from a record 15.6% to 14.5%.
- **The revenue base is weaker than the headline.** Gross tax grew 6.5% and sits at 33.5% of BE at the five-twelfths mark, behind last year's 35.0%. Indirect tax fell 0.3% and net indirect tax 7.3%, with customs up 28.2% the only prop. Recurring revenue receipts grew just 3.3%, while headline non-debt receipts grew 6.6% on one-off capital receipts now at 5.5% of total receipts.
- **Capex is the only flexible line left, so it is the one that gives way.** At 22.5% of BE it needs INR 2.51 Tn a month in H2 against INR 1.02 Tn delivered. Subsidies, up 24.4% and already at 43.9% of BE, are supporting rural households and will overshoot rather than adjust.
- **The last cushion is interest, and the Centre does not control it.** Payments are down 2.6% on coupon timing while the India 10-year has moved to 7.21% from 6.75% in Jun'26 and the India-US differential has compressed to 189 bps, the narrowest monthly reading since 2008 bar May'25.
- **The borrowing cut is a switch, not a saving.** Gross borrowing is down INR 1.2 Tn to about INR 16.0 Tn, but net borrowing is unchanged at INR 11.73 Tn and the reduction is entirely funded by INR 1.11 Tn of switches. Redemptions moved out; they were not retired.

August Reversed the Story

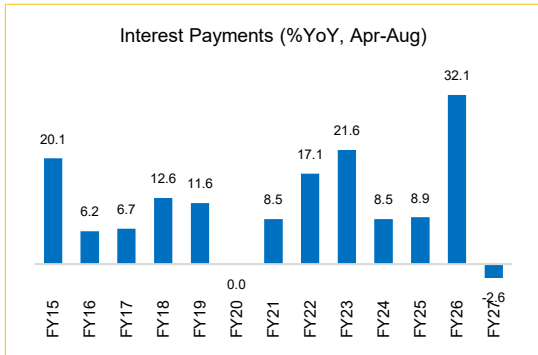
The five-month deficit of INR 7.10 Tn is 18.7% above last year, with expenditure at 38.9% of BE running ahead of non-debt receipts at 37.5%. The swing from the Apr–Jul print is not an economic event. It is the release of two accounting cushions that were suppressing the number, which is exactly what the composition of that print implied.

Receipts: The Buoyancy Was Never There

Net tax revenue grew 3.4% to INR 8.38 Tn against gross tax growth of 6.5%. The wedge that flattered the July print has not just narrowed, it has inverted: devolution rose 11.4% to INR 5.90 Tn and now absorbs 41.2% of gross collections against 39.4% last year. The Centre's earlier net-tax strength was a function of what it was withholding, and one instalment proved it.

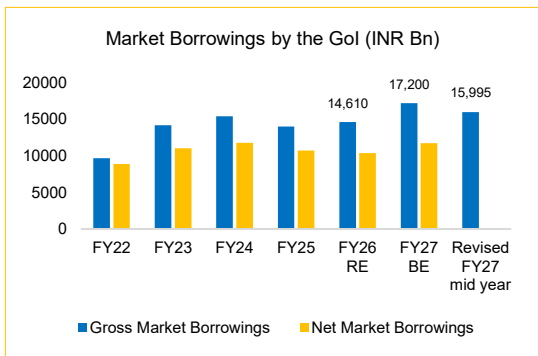
The forward problem is the gap to BE. Gross tax at 33.5% sits eight percentage points behind the elapsed year and 1.5 points behind last year's pace, and last year's gap was itself closed partly by holding refunds. That lever is now being reversed rather than reloaded. Corporate tax at 24.4% of BE against income tax at 34.5% means the H2 burden falls disproportionately on the line most exposed to margin compression, with WPI running near 10%.

Growth in interest payments has contracted recently. But given the rising bond yields, we expect this to reverse going forward



Source: CMIE, Choice Institutional Equities

Core revenue expenditure rises even as interest payments remains elevated



Source: CMIE, Choice Institutional Equities

A 2.6% fall in interest payments is a coupon calendar, not debt relief.

Net borrowing is unchanged. The INR 1.2 Tn cut is a switch, not a saving.

Two composition points flatter the headline and should not be read as revenue strength. Non-debt capital receipts, non-recurring by definition, are doing the work on the receipts side. And the GST recovery is a refund-timing artefact: gross GST remains stuck in a 6% to 8% range despite the strength in recent IIP prints, which is the signal worth watching.

Expenditure: Subsidies Support Households, Capex Bears the Cut

Capex composition is genuinely improving, with railways up 22.9% and defence up 36.7% broadening the impulse beyond roads, which were flat at 2.1%. But capex has been the shock absorber in every recent year of revenue stress, and the arithmetic leaves no alternative this year either.

Meanwhile core revenue expenditure accelerated to 14.4% growth on a subsidy bill rising 24.4%, and the spending mix is doing something defensible with it. Food subsidy growth of 29.7% and fertiliser growth of 20.7% route support directly into household budgets, and disproportionately into rural ones, at a point where income growth has stagnated and CPI has been above target for three months with WPI near 10%. Fertiliser spending also absorbs elevated global input prices on behalf of the kharif and rabi cycles rather than passing them to farm margins. This is transfer spending arriving where the pressure actually is, and it buys real consumption support in the half of the economy with the least cushion. The fiscal point is simply that it is sticky, so once this allocation is committed it will not be the line that gives way in H2.

Interest Payments: The Last Cushion Standing

Interest payments fell 2.6% YTD against a 32.1% base, which is coupon timing rather than debt management. This is the third of the cushions we flagged in September, and the only one left. It is also the only one the Centre does not control, because its reversal is being driven from outside the fiscal account. Interest already absorbs about 33% of revenue expenditure and close to 40% of revenue receipts, so the base this relief is suppressing is large.

The External Leg: India Has Spent Its Spread Cushion

The US 10-year rose from 4.42% in Jun'26 to 5.29% in Sep'26, the highest in nineteen years, after the Fed hiked 25 bps in September to 3.75% to 4.00%. The Treasury curve bear-flattened to a 41 bps 10s2s from 71 bps in January, which is the market pricing inflation that has not been beaten.

India absorbed only part of that, and this is the risk rather than the comfort. The India 10-year rose 24 bps in September against 54 bps in the US, compressing the differential to 189 bps. Against an FY26 average near 235 bps, reversion at an unchanged US yield puts the India 10-year around 7.5%. India did not escape the global repricing; it spent the cushion that delayed it, and that cushion cannot be spent twice.

The domestic curve confirms where the pressure sits. The 1-year is up 29 bps since Jun'25 while the 10-year is up 71 bps, and the 9-month and 12-month T-bills are at 6.04% and 6.05% against a 1-month at 5.03%. Short-end liquidity is comfortable; the price of duration is not. FI debt flows have turned negative across both the general and FAR routes after the Jun'26 surge, so a larger share of a longer calendar now lands on domestic balance sheets.

The Borrowing Calendar: A Switch, Not a Saving

Gross dated borrowing was cut INR 1.2 Tn to about INR 16.0 Tn, with INR 7.86 Tn in H2. The headline reads as relief for the bond market and at the margin it is, but it is not fiscal consolidation. Net borrowing is unchanged at INR 11.73 Tn, and the entire reduction comes from switches worth INR 1.11 Tn that cut FY27 repayments to INR 4.36 Tn from INR 5.47 Tn. Redemptions were pushed into later years, which is the same mechanism as the deficit print, applied to the debt stock.

The composition makes it costlier. The 15-year share rises to 17.6% from 14.5% in H1, with higher allocations to 30, 40 and 50-year paper. The Centre is extending duration into the steepest part of a curve that is still repricing higher, locking today's long yields in for decades, and none of that cost appears in this year's deficit.

The hike is in the price. The stance is not.

The deficit was never smaller. It was simply not due yet.

The MPC: The Hike Is Priced, the Stance Is Not

The upcoming RBI MPC meeting is expected to deliver a 25 bps rate hike to 5.50%, with CPI trending above RBI's 4% target, WPI at 9.92% and the rupee down about 6% this year. The move itself is in the price, with the India 2-year up 65 bps since June and the 12-month T-bill up 57 bps, more than a single hike warrants. The unpriced variable is the stance. A hike delivered with a shift away from neutral signals a series rather than insurance, and it reprices the belly and the long end, which is exactly where H2 issuance has been concentrated.

The near-term fiscal arithmetic is small, and the compounding is not. Every 50 bps on the INR 7.86 Tn H2 calendar is roughly INR 39 Bn of annual coupon, immaterial against a INR 17 Tn deficit. But every year of issuance above 7% replaces maturing paper written at materially lower coupons, so the average cost of the stock ratchets up and does not come back down when yields eventually do. This year's 2.6% relief is borrowed from next year's interest line exactly as August's devolution was borrowed from July's.

Outlook - Target Met on Paper, 10-Year to 7.35% to 7.50%

We expect FY27 to land at or marginally above BE on the headline, with the composition deteriorating: capex undershooting INR 22.67 Tn visibly, subsidies overshooting, and interest re-accelerating in Q4 as the coupon calendar normalises. On rates, we see the India 10-year biased to 7.35% to 7.50% over two quarters, driven less by October's decision than by differential reversion and a long-end-heavy calendar meeting a thin foreign bid, with the curve steepening further before it stabilises. For the states, August improved the level but not the predictability. General government arithmetic, which is what the debt trajectory and the risk premium actually respond to, is not improving in line with any of the Centre's optics. The deficit was never smaller. It was simply not due yet.

Growth in revenue collection (6.6%) slowed vs expenditure (10.5% YoY YTD), which led to a surge in the fiscal deficit by 18.7% YoY. Core capex grew more than core revex, despite a surge in subsidy spending

Apr-Aug (%YoY)	Fiscal Deficit	Non-Debt Receipts	Revenue Receipts	Govt Exp	Revex	Revex - Interest Payments	Capex	Capex - Loans
FY20	-6.3	29.6	29.8	9.8	10.7	14.0	3.0	10.3
FY21	57.1	-39.3	-38.6	6.2	7.1	6.8	-1.3	-5.4
FY22	-46.2	114.3	114.1	2.3	-0.8	-5.6	27.8	31.9
FY23	15.7	4.9	2.9	8.9	3.0	-3.3	46.8	48.2
FY24	18.7	21.3	24.1	20.3	14.1	16.4	48.1	35.3
FY25	-32.3	18.3	19.2	-1.2	4.1	2.2	-19.5	-17.3
FY26	37.5	5.4	3.5	13.8	7.2	-3.2	43.4	23.2
FY27	18.7	6.6	3.3	10.5	8.2	14.4	18.2	15.2
Actual YTD (INR bn)								
FY26	5,982	12,827	12,507	18,809	14,493	9,206	4,316	3,217
FY27	7,102	13,677	12,925	20,780	15,680	10,532	5,099	3,705
Budget Estimates (INR bn)								
FY26	15,689	34,964	34,204	50,653	39,443	26,679	22,417	
FY27	16,958	36,452	35,268	50,653	39,443	27,215	22,667	

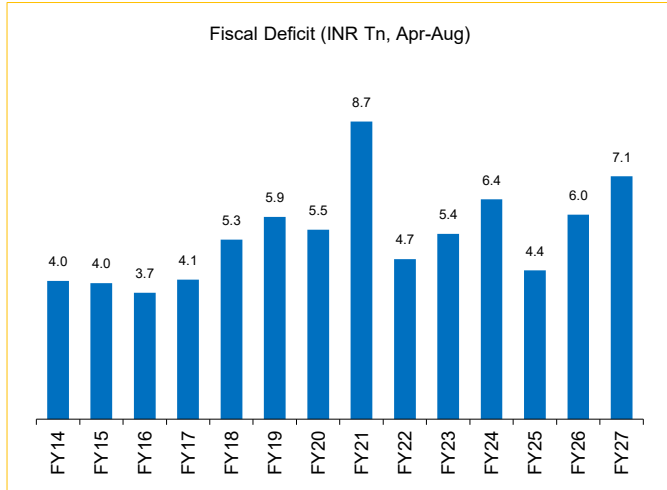
Source: CMIE, Choice Institutional Equities

Direct tax collection grew 13.4% while indirect taxes contracted by 0.3% YTD. A 24% surge in subsidy led to 7.3% contraction in net indirect tax collection. Growth in net tax < gross tax as states share in total tax collection increased substantially in Aug'26

	Apr - Aug (%YoY)				Actual YTD (INR bn)		Budget Estimates (INR bn)		As % of BE	
	FY24	FY25	FY26	FY27	FY26	FY27	FY26	FY27	FY25	FY26
Net Tax Revenue	14.8	8.7	-7.3	3.4	8,104	8,379	25,835	28,374	31.4	29.5
Gross Tax Revenue	16.5	12.1	0.8	6.5	13,440	14,319	38,402	42,702	35.0	33.5
Income Tax	35.7	25.5	-2.5	12.3	4,410	4,955	11,870	14,380	37.2	34.5
Corporate Tax	15.1	-6.0	2.1	15.4	2,293	2,645	10,200	10,820	22.5	24.4
Custom Duties	27.8	12.9	-11.9	28.2	831	1,065	2,377	2,400	34.9	44.4
State's Share	20.4	19.1	16.3	11.4	5,301	5,904	12,472	14,224	42.5	41.5
Subsidy	32.5	-1.2	-15.8	24.4	1,504	1,870	4,284	4,262	35.1	43.9
Direct Tax	26.6	12.9	-1.0	13.4	6,703	7,600	22,070	25,200	30.4	30.2
Indirect Tax	7.8	11.2	2.7	-0.3	6,737	6,719	16,332	17,502	41.2	38.4
Net Indirect Tax	-0.4	16.6	9.7	-7.3	5,233	4,849	12,047	13,240	43.4	36.6

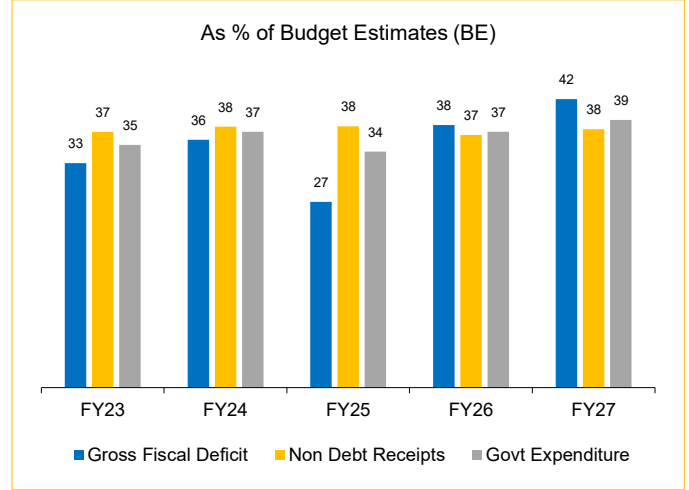
Source: CMIE, Choice Institutional Equities

Fiscal deficit surged to INR 7.1 Tn YTD vs INR 6 Tn in FY26, highest since COVID



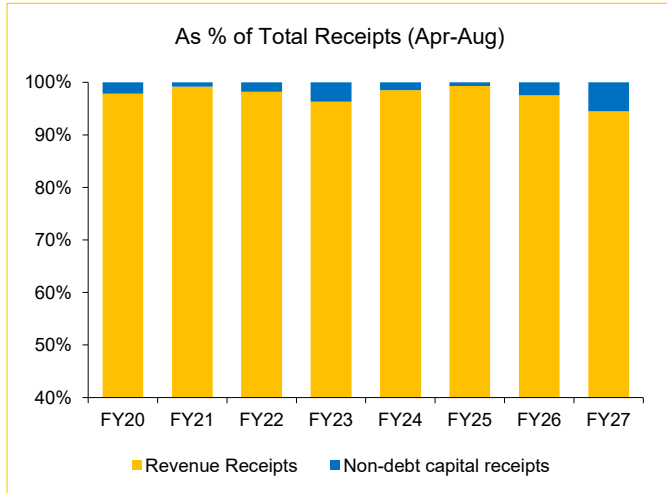
Source: CMIE, Choice Institutional Equities

As % of BE, fiscal deficit surges to 42% as govt spending (39%) remains much higher than the non-debt receipts (37.4%)



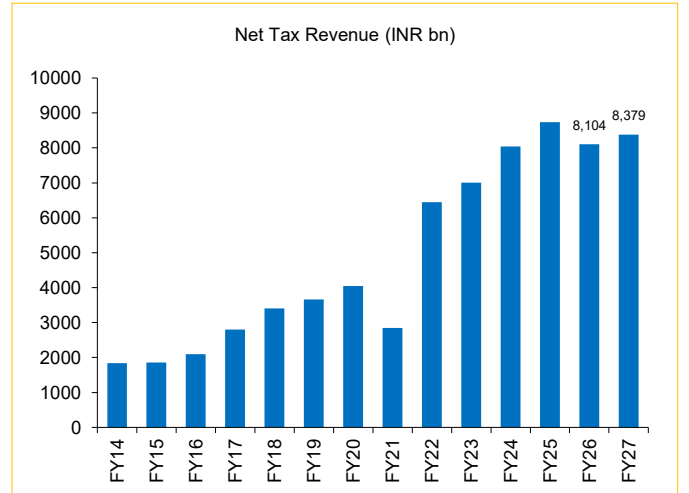
Source: CMIE, Choice Institutional Equities

Front-loading of Capital Receipts amounting to 5% of total receipts (vs 1.5% in FY24) has supported total receipts



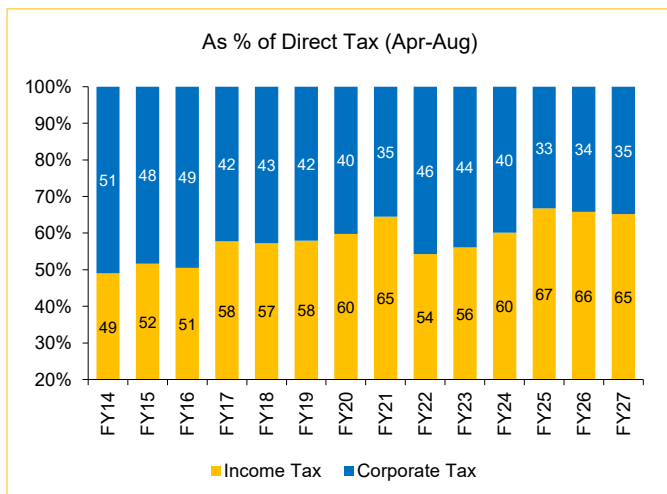
Source: CMIE, Choice Institutional Equities

Net Tax Revenue Collection has flattened as the tax refunds that were held back earlier, are released



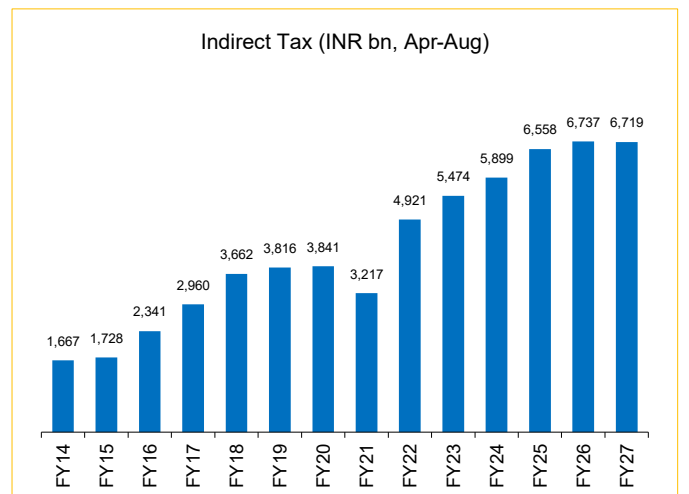
Source: CMIE, Choice Institutional Equities

Corporate tax collection is increasing which is at 35% of Direct Tax (vs 33% in FY25) compared to income tax which remains the largest contributor



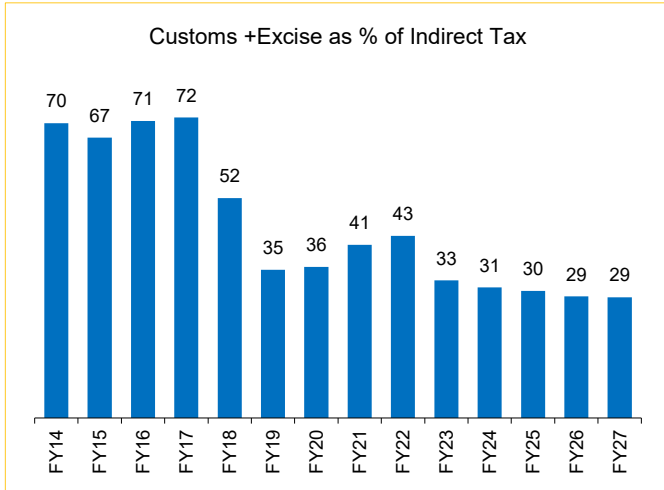
Source: CMIE, Choice Institutional Equities

Indirect tax collection continues to decline as GST collections and excise duty cuts bear it down



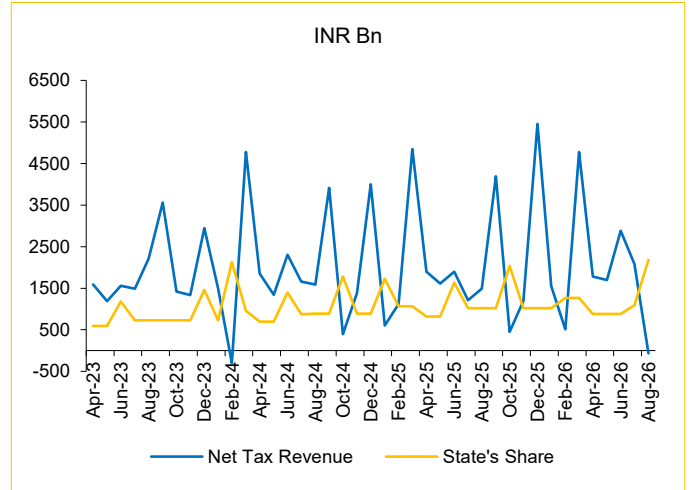
Source: CMIE, Choice Institutional Equities

Share of excise and customs collection in indirect tax has been declining despite the recent surge in both components



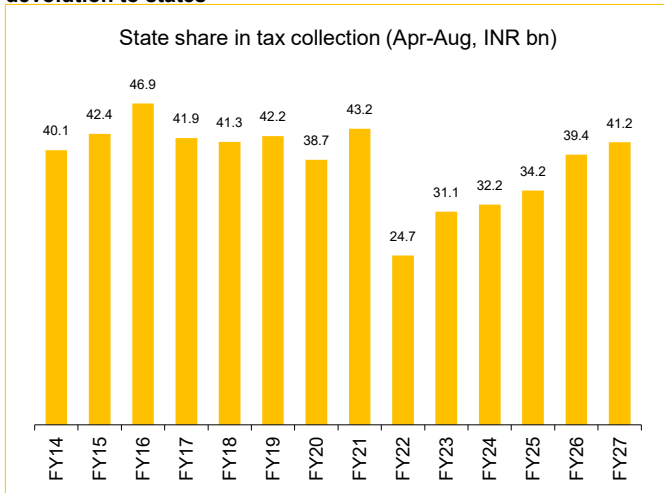
Source: CMIE, Choice Institutional Equities

Net tax Revenue has plummeted as the tax devolution to states has surged



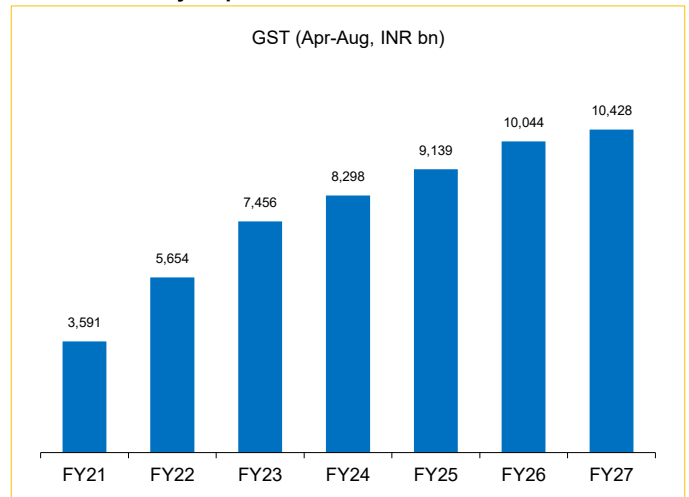
Source: CMIE, Choice Institutional Equities

State's share in overall tax collection rose in Aug after remaining weak till July after the govt allocated additional tax devolution to states



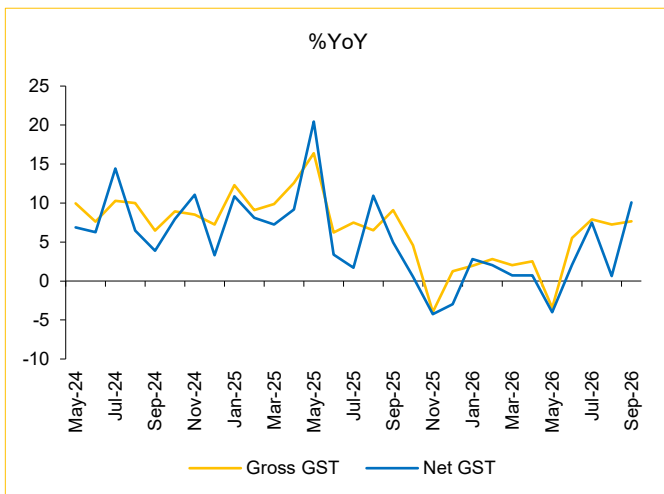
Source: CMIE, Choice Institutional Equities

Gross GST collection has been flattening despite buoyant industrial activity as per the latest IIP trends



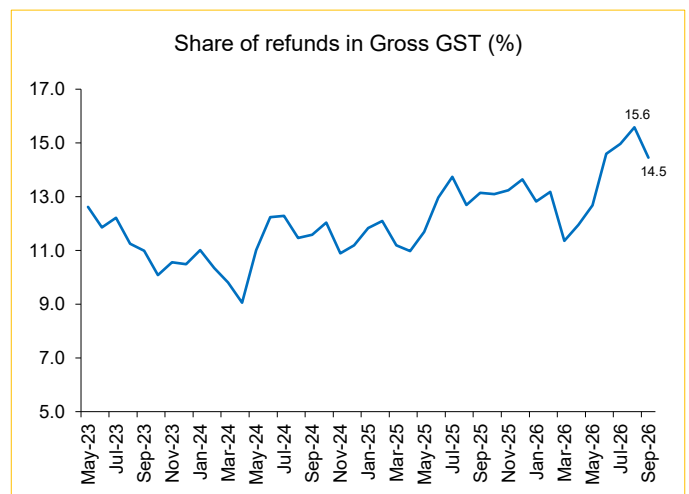
Source: CMIE, Choice Institutional Equities

Rebound in Net GST collection while the gross GST collection remains stable largely due to fall in refunds

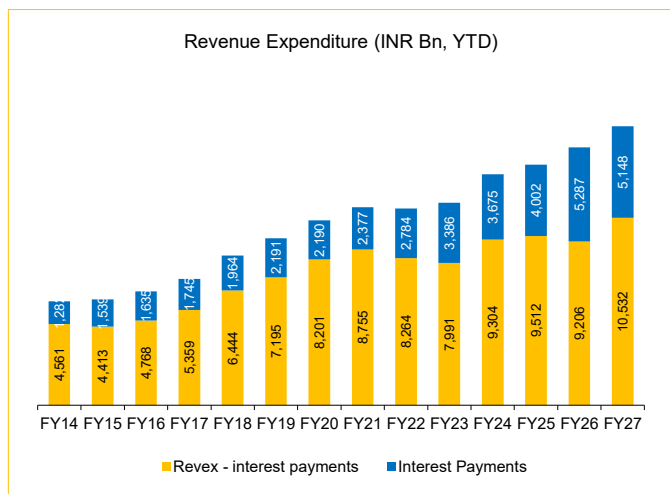


Source: CMIE, Choice Institutional Equities

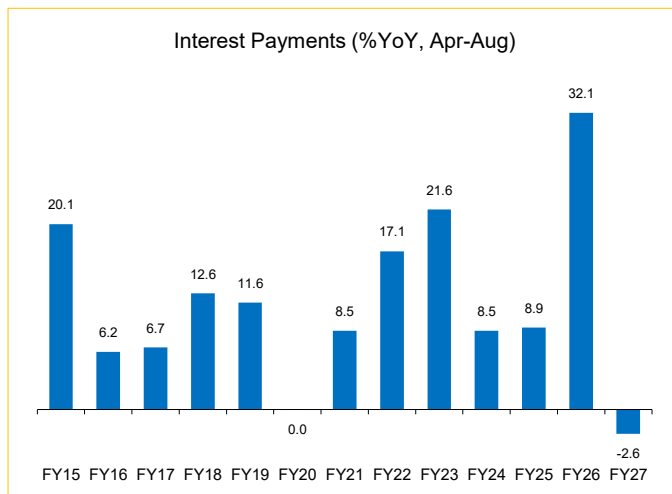
...leading to a fall in share of refunds to gross GST collection from 15.6% in Aug'26 to 14.5% in Sep'26



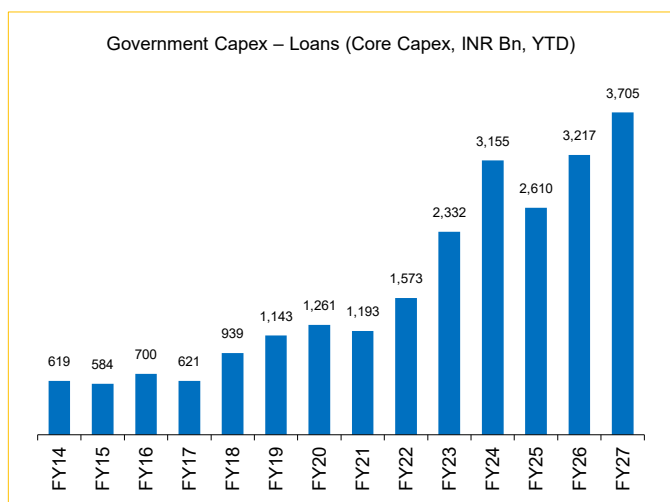
Source: CMIE, Choice Institutional Equities

Core revenue expenditure rises even as interest payments remains elevated

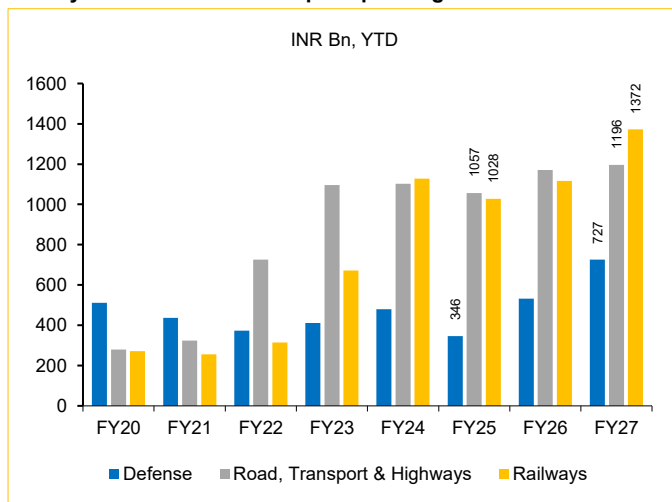
Source: CMIE, Choice Institutional Equities

Growth in interest payments has contracted recently. But given the rising bond yields, we expect this to reverse going forward

Source: CMIE, Choice Institutional Equities

Core Govt capex increased to INR 3.7 Tn, up 15% YTD

Source: CMIE, Choice Institutional Equities

Capex spending for defense continues to rise, but spending for railways drives the overall capex spending

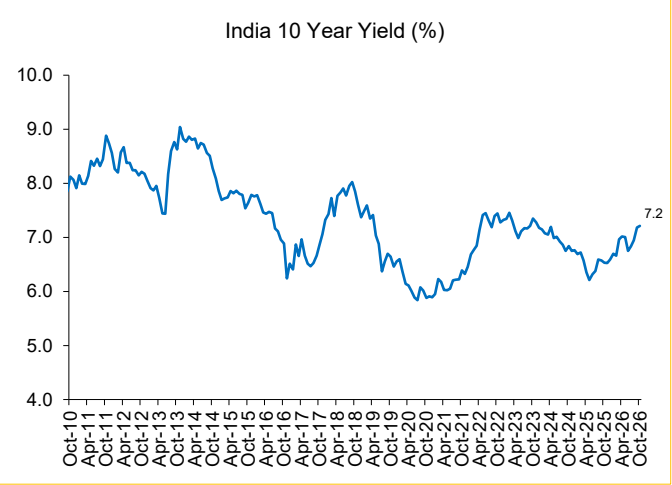
Source: CMIE, Choice Institutional Equities

Surging fertiliser subsidies to support domestic consumption and shield from elevated global prices

	Apr-Aug, INR bn				%YoY			
	Subsidies	Food	Fertiliser	Petroleum	Subsidy	Food	Fertiliser	Petroleum
FY24	1,807.4	829.2	970.8	7.4	32.5	10.3	59.1	
FY25	1,786.2	1,137.9	611.7	36.6	-1.2	37.2	-37.0	397.4
FY26	1,503.8	644.1	854.6	5.1	-15.8	-43.4	39.7	-86.2
FY27	1,870.4	835.1	1,031.4	3.9	24.4	29.7	20.7	-23.2

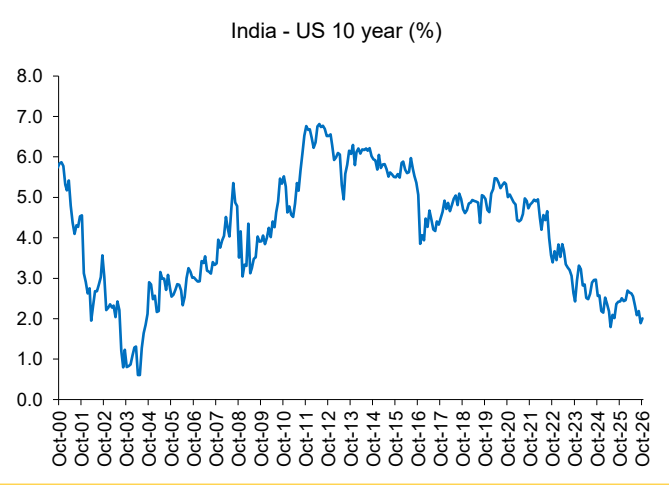
Source: CMIE, Choice Institutional Equities

India 10-year bond yields have risen to 7.2%; it continues to rise since Apr'25



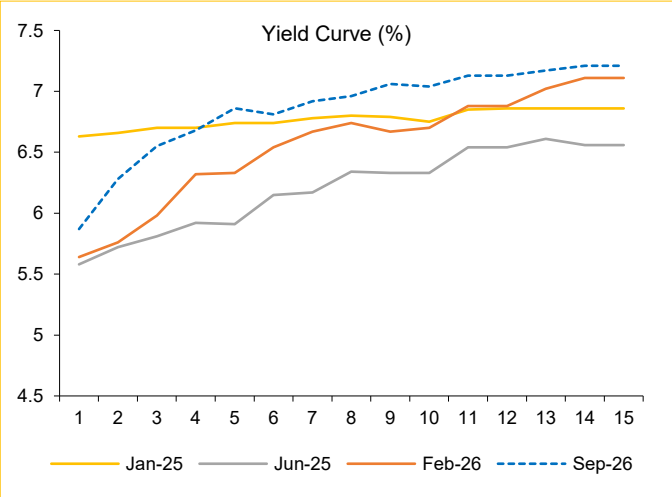
Source: CMIE, Choice Institutional Equities

The yield differential between India and the US has fallen to the lowest levels that were seen before the GFC 2008



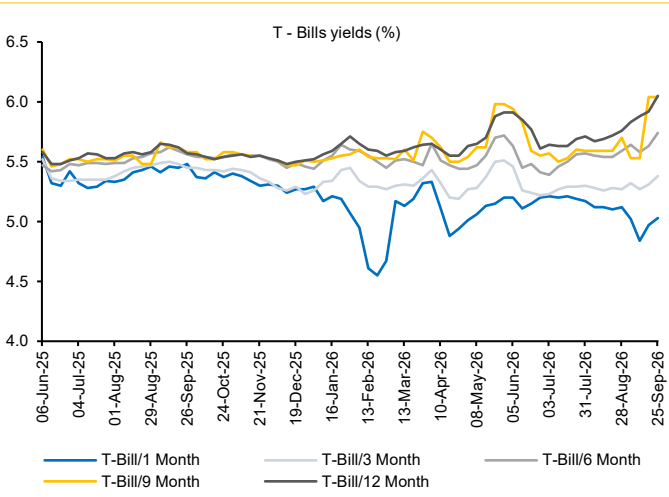
Source: CMIE, FRED, Choice Institutional Equities

Treasury yield curve appears to have been bear-flattening



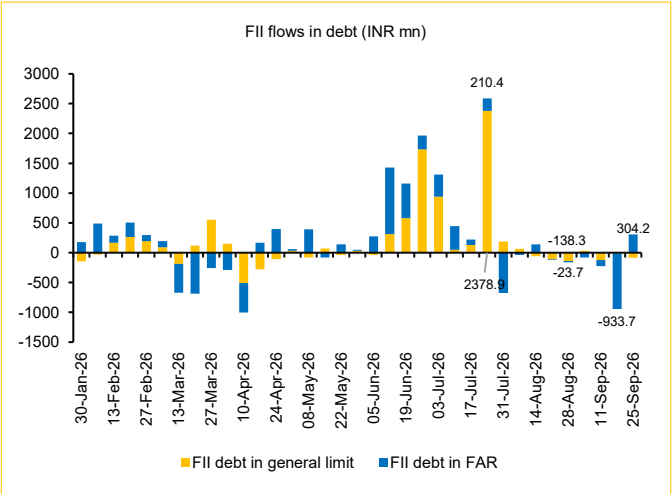
Source: CMIE, Choice Institutional Equities

Widening gap between short-term T-Bill yields and 6-month and above T-Bill yields; sharp rise in 9 Month T-Bill yield



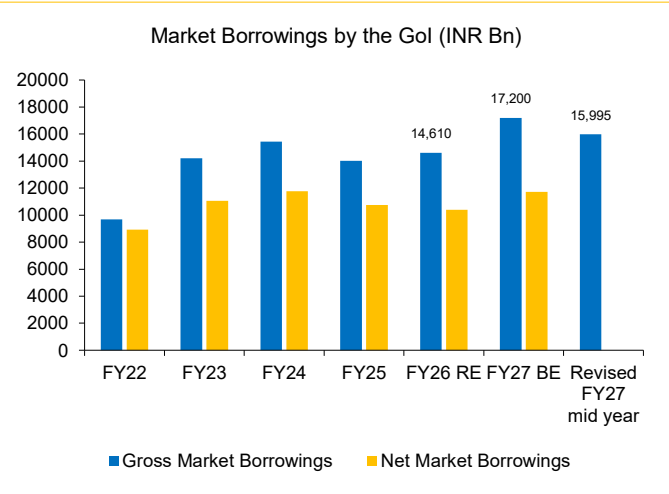
Source: CMIE, Choice Institutional Equities

FII flows in debt collapsed after a surge post the policy announcement in Jun'26



Source: CMIE, Choice Institutional Equities

Lower market borrowings by the Gol vs BE largely due to switching but expected to provide some breather to bond yields



Source: CMIE, RBI, Choice Institutional Equities

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Choice Rating Distribution & Methodology

Large Cap*	
BUY	The security is expected to generate upside of 15% or more over the next 12 months
ADD	The security is expected to show upside returns from 5% to less than 15% over the next 12 months
REDUCE	The security is expected to show upside or downside returns by 5% to -5% over the next 12 months
SELL	The security is expected to show downside of 5% or more over the next 12 months
Mid & Small Cap*	
BUY	The security is expected to generate upside of 20% or more over the next 12 months
ADD	The security is expected to show upside returns from 5% to less than 20% over the next 12 months
REDUCE	The security is expected to show upside or downside returns by 5% to -10% over the next 12 months
SELL	The security is expected to show downside of 10% or more over the next 12 months
Other Ratings	
NOT RATED (NR)	The stock has no recommendation from the Analyst
UNDER REVIEW (UR)	The stock is under review by the Analyst and rating may change
Sector View	
POSITIVE (P)	Fundamentals of the sector look attractive over the next 12 months
NEUTRAL (N)	Fundamentals of the sector are expected to be in stasis over the next 12 months
CAUTIOUS (C)	Fundamentals of the sector are expected to be challenging over the next 12 months

*Large Cap: More Than INR 20,000 Cr Market Cap
*Mid & Small Cap: Less Than INR 20,000 Cr Market Cap

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