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## Note on Union Budget

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### We remain constructive on Bond yields in the medium term as fiscal consolidation continues

The bond markets, going into the Union Budget, were optimistic about the fiscal deficit coming in below 5.10%, the fiscal deficit target as given in the Interim Budget. The fiscal deficit did come in lower at 4.94% but the borrowings through dated securities (G-sec) were down only by INR 120bn which in a way, disappointed the bond market as traders were expecting a reduction of INR 40000-60000 cr given the reduction in the fiscal deficit to 4.90%.

The benchmark 10yr Bond yield touched a low of 6.93% after the announcement of the fiscal deficit numbers but gave up the gains after the borrowing numbers were out. The gross and the net borrowings have been kept at INR 14.01 trn and INR 11.63 trn, respectively. The consolidated fiscal deficit (center plus state) narrows to 7.70% of GDP, which is a 5yr low. The Budget assumes the growth in nominal GDP to be at 10.50%.

In financing the fiscal deficit, there is a reduction in the amount of borrowing through T-bills, small savings and other receipts which has kept the share of market borrowings (G-secs) in financing the fiscal deficit at 72% compared to 70% in the Interim Budget. Overall, the tax assumptions are conservative with tax revenue growth pegged at 10.80% and though the capex spend was kept unchanged the overall expenditure has been increased by INR 650 bn. Hence the increased head room from additional RBI dividend was used almost equally to increase revenue expenditure and to cut fiscal deficit which is lower by INR 700 bn compared to the Interim Budget.

#### Bond Market View:

We remain constructive on Bond yields in the medium term as fiscal consolidation continues and the finance minister also highlighted the resolve to bring debt to GDP lower after the FY26 fiscal deficit target of 4.5% of GDP is achieved. As the yield curve has bull flattened over the last two quarters, we see scope for some tactical steepening of the yield curve as the reduction in T-bill borrowing will support the shorter end of the curve. Overall, we expect market to continue to trade in a range till clarity emerges on RBI's monetary stance and timing of the rate cut. Also, the switch amount (financing the buyback of shorter maturity securities by issuing longer maturity securities) has been budgeting higher at INR 1.5 trn compared to INR 1 trn in the Interim Budget which increases the overall duration supply in the market. We expect the benchmark 10yr Bond yield to continue to trade in a range of 6.90% to 7.05% over the course of the next couple of months and expect a gradual shift lower in yields and expect the benchmark 10yr bond yield to trend lower gradually towards 6.50% over the next one year.