

Policy tailwinds to drive 15% CAGR in defence production

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Amidst rising defence spending by East European and West Asian countries, a new report from Axis Capital Research focuses on India's defence production and indigenisation programme. It predicts that the compounded annual growth rate (CAGR) of India's defence outlay is likely to grow at 12 per cent to ₹14,700 crore over FY2025-29E.

The Axis report draws on the data from India's Annual Budget, the Ministry of Defence (MoD) media releases, the World Bank and international bodies such as the Stockholm International Peace Research Institute (SIPRI).

The government's ongoing policy push for import substitution and exports is a big propellant, driving the 15 per cent CAGR in India's defence production turnover.

"Evolving geopolitical equations will strongly influence growth in defence spending and trade relationships," stated a media release from Axis Capital.

The report maps the capabilities of key players in the defence sector. Sixteen defence public sector undertakings, or DPSUs, of which seven are listed, account for more than 70 per cent of India's defence production.

A consolidated Profit & Loss for the 13 stocks in the Nifty Defence Index has seen a 19 per cent CAGR in revenue to ₹70,000 crore and a 25 per cent profit-after-tax (PAT) CAGR to ₹11,600 crore over FY21-23.

Sumit Kishore, lead analyst of Axis Capital Research says geopolitical equations and GDP are key growth drivers for military spending. Global defence spending was at a median of 2.3 per cent of global GDP in the past 25 years.

Asia's rapid economic growth, territorial disputes, and political tensions have increased its share in global defence spending from 24 per cent to 34 per cent over the past decade.

According to SIPRI, India's annual military spending of ₹7,700 crore ranked a distant third in 2021, after the US (₹80,100 crore) and China (₹29,300 crore). The shift from a unipolar to a multipolar world is visible from the shift in the US-China defence spending ratio.

China's defence spending ratio shifted from 6:1 in 2011 to 2.7:1 in 2021.

Report highlights defence trade in multipolar world

The global arms trade was ₹12,700 crore in 2021. Six countries accounted for 80 per cent of global defence exports over 2018-22. These include the US (40 per cent), Russia (16 per cent), France (11 per cent), China (5 per cent), Germany (4 per cent), and Italy (4 per cent).

Over this period, Asia and Oceania accounted for over 70 per cent of defence imports, led by India (13 per cent) and Saudi Arabia (12 per cent).

In a multipolar world, India is shifting imports away from Russia to France and the US. Russia is China's main import partner while China is Pakistan's. Geopolitics, more than products, determines EXIM deals.

Channelling India's growth dividend

Over the past decade, India's gross budgeted defence spending saw a 9 per cent CAGR to ₹5.93 trillion in FY24 at 1.95 per cent of GDP, the lowest in a decade, down 31 bps from FY14.

Only 27 per cent of the FY24 defence spending was earmarked for capital procurement. While India has the world's largest number of defence personnel (3 mn plus).

"Pensions/pay & allowances and capital outlay have seen 10.1 per cent and 7.5 per cent CAGR, respectively, over the past decade. Technology-driven optimisation of revenue expenditure and innovative schemes like 'Agnipath' to reduce pension outgo are imperative to realise the full potential of India's growth dividend," says the Axis Capital release.

Indigenisation and export push

The government has prioritised local procurement and announced time-bound import embargoes for a large list of products. It has offered R&D support, liberalised FDI norms, set up two defence manufacturing corridors, and is also fast-tracking export authorisations.

A progressive increase in the share of indigenous procurement for defence is one of the key levers for the expected increase in defence production growth rate – from 6.6 per cent CAGR over FY17-23 to 15 per cent CAGR over FY23-29E.

Defence exports, led by private companies, have grown to ₹15,900 crore in FY23 (FY26 target is ₹35,000 crore) from just ₹1,500 crore in FY17. The share of exports in defence production turnover has increased from 2 per cent in FY17 to 15 per cent in FY23.

DEFENCE EXPORTS ON THE RISE

India's defence spend has been rising at a compound annual growth rate of 11.3% (2001-2021)

Exports as % of production

