Navigating uncertainty

Budget has tried to achieve objectives of accelerating growth, invigorating private investment, enhancing middle-class spending power

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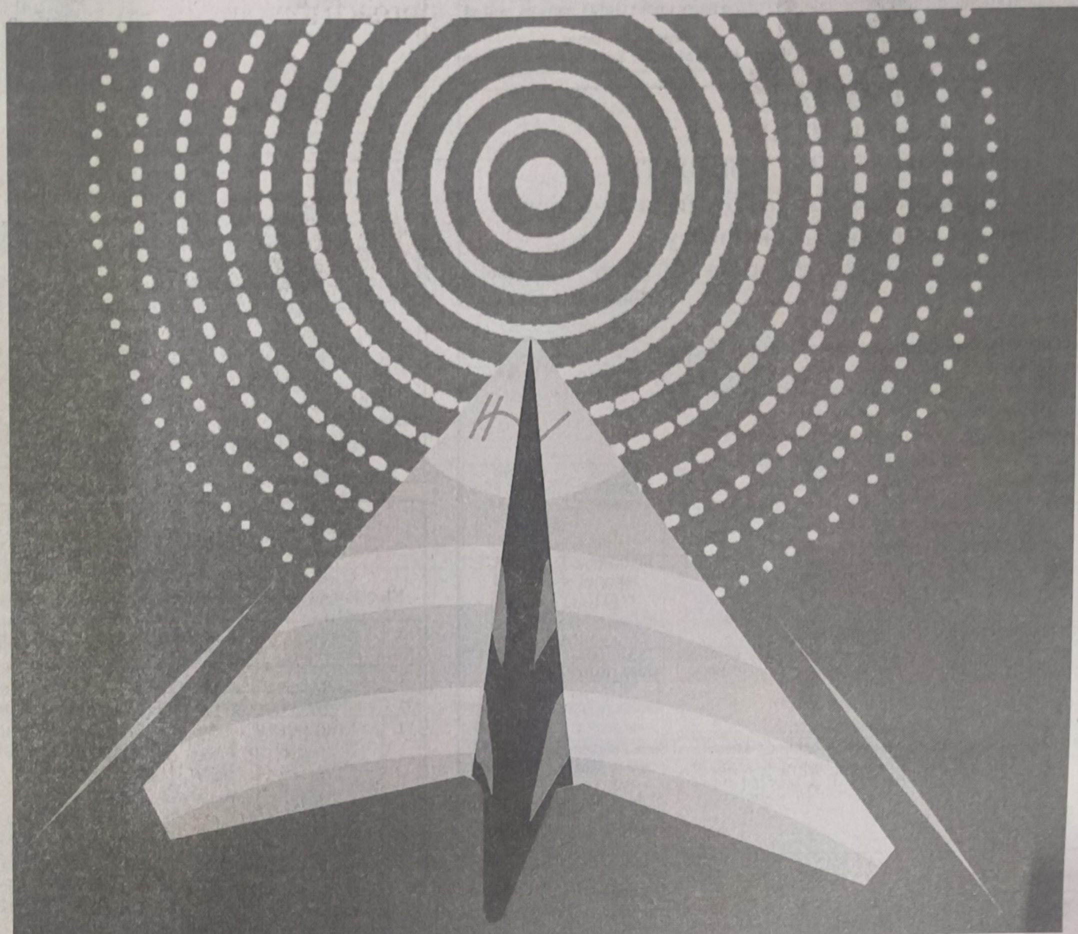

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THOUGH INDIA RECOVERED well from the Covid-19 shock, the current slowdown, as observed in the quarterly GDP numbers, needed calibration of the fiscal stance in a manner that supports an upturn in growth and addresses concerns for fiscal and macroeconomic stability. The Union Budget has been presented in a macro environment characterised by declining growth, a falling savings rate, slower corporate earnings and rising household debt. The budgetary stance for the year 2025-26 tried to strike a balance between fiscal expansion and consolidation. The budget speech emphasised that the Union Budget would initiate reforms in key areas, namely taxation, urban development, mining, the financial sector, power and regulatory frameworks.

Fiscal consolidation needs to be adhered to under the fiscal responsibility framework. This has largely been achieved. As per the 2025-26 Budget Estimates, the fiscal deficit is expected to be 4.4 per cent of GDP. On the revenue side, we have seen significant announcements with regard to both direct taxes and the rationalisation of some customs duties. The income tax slabs have been significantly revised upward, which will provide tax relief to the middle class. Second, simplification of the tax structure, as expected, should aim at ease of compliance and help improve the base. The intent, probably, is to continue the process of reforms to have a direct tax structure that is less complicated when it comes to compliance.

Broadly speaking, both expenditure- and revenue-side announcements in the budget are on predictable lines when it comes to fiscal consolidation and continuity with past policy. However, the current context in India — after the last three years of buoyant growth and post-Covid recovery — seems to suggest that proactive interventions are necessary to arrest the slide in growth, and some of these interventions could be outside the budget. In order to catalyse growth, the Economic Survey emphasised deregulation of various sectors of the economy. These sectors predominantly fall in states' domain. In other words, a Centre-state coordination mechanism is essential to carry out next-generation reforms. So, the second-generation reforms and their smooth implementation require a framework where all the stakeholders are brought together and a consultative mechanism is instituted. Such measures cannot be done through the budget but through a consultative, trust-based framework.

The Union Budget highlighted the following objectives: Accelerate growth, secure inclusive development, invigorate private sector investments, uplift household sentiments, and enhance the spending power of India's rising middle class. The tools deployed to achieve these objectives are two kinds of fiscal expansion: More disposable income in the hands of personal income taxpayers by reworking the income tax slabs, and providing relief to those at the tail end of the distribution of income through the expenditure side of the budget. The overall impact of these two types of fiscal expansion is not significant. The fiscal deficit is expected to be 4.4 per cent of the GDP while expenditure will decline to 14.6 per cent in 2025-26 (BE). A marginal increase in tax-to-GDP ratio is expected in the fiscal year 2025-26 as compared to 2024-25 (RE). The decline in the Union government's revenue deficit in recent years is significant, and this trend is expected to continue in the fiscal year 2025-26 (BE). These broad numbers of deficits and expenditures indicate that the primary focus of this year's budget is fiscal consolidation and in conformity with the past trends, and at an aggregate level, it is not expansionary.

While acknowledging the impact of global geopolitical headwinds on economic growth, the budget speech emphasised that India remains one of the fastest-growing economies in the world. The nominal GDP growth was assumed in the budget to be 10.1 per cent for the year 2025-26. If we assume that the Indian economy will grow at six per cent or more in real terms, the nominal GDP assumed in the budget makes an assumption about inflation at four per cent or less in the next year. Given the elevated level of inflation, bringing it down to four per cent or lower will be a challenge. If not, a higher nominal GDP growth can improve fiscal prudence.

As we enter the next fiscal year, one important concern that requires attention is the rising indebtedness of households. India has not been able to return to pre-Covid levels of household-debt-to-GDP ratio in the past three years. On the contrary, we see a rising trend post Covid. It is true that India's household-debt-to-GDP ratio is far lower than in many of the developed economies. Even though this increase in debt is not alarming, this phenomenon needs to be seen in conjunction with the decline in the savings rate and the transfer of safe savings to risky assets like stocks and other speculative investments. The risk of household safe savings shifting to speculative investments is a concern and the macroeconomic risk associated with such a move cannot be ignored; continued regulatory monitoring is necessary.

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Thus, we need to take a balanced view of the changing preference of "financialisation" in the economy — a concern raised in the Economic Survey 2024-25 as well. Rising personal loans are a major indicator of increasing household financial stress. These issues require active policy considerations by the government beyond the budget and fall in the domain of fiscal, monetary and financial-sector policies. A policy consideration that would encourage household savings, reduce excessive financialisation and provide safe saving opportunities for the households would ensure greater financial stability and would also help navigate global shocks better in the current uncertain environment.

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