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Macroeconomic Outlook and Medium-Term Growth Prospect after the Budget

Ashima Goyal

Indira Gandhi Institute of Development Research, Mumbai

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Email(corresponding author): ashima@igidr.ac.in

Abstract

The slowdown and its reversal that followed government capital expenditure confirm that the quality of government expenditure creates stimulus even with overall fiscal consolidation. The latter as well as focus on improving vegetable supply chains in the budget enables monetary accommodation, which adds to the stimulus. So do mechanisms to multiply the impact of public funds and use more resources available in a growing economy to create incentives to bring states and private enterprise on board. But an eye needs to be kept on global volatility and compensatory domestic measures taken. Post-pandemic policy demonstrated this capacity. Given the many areas where states have to deliver, formal coordination frameworks may be necessary.

Keywords: Consolidation; stimuli; supply-side action; states; PPP; coordination; global volatility

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Ashima Goyal

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Emeritus Professor

Indira Gandhi Institute of Development Research
Gen. Vaidya Marg, Santosh Nagar,
Goregaon (E), Mumbai-400 065
Tel.: (022) 28416512, Fax: (022) 28402752
ashima@igidr.ac.in
http://www.igidr.ac.in/faculty/ashima

Abstract

The slowdown and its reversal that followed government capital expenditure confirm that the quality of government expenditure creates stimulus even with overall fiscal consolidation. The latter as well as focus on improving vegetable supply chains enables monetary accommodation, which has resumed. Larger resources available in a growing economy are used well through incentives to bring states and private enterprise on board. There are mechanisms to multiply the impact of public funds. But an eye needs to be kept on global volatility and compensatory domestic measures taken. Post-pandemic policy demonstrated this capacity. Given the many areas where states have to deliver, formal coordination frameworks may be necessary.

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1. Introduction

After the pandemic, despite overall fiscal consolidation with falling deficit and debt ratios, a higher share of capital expenditure (capex) in the centre's budget helped give an average rate of GDP (gross domestic product) growth of 8.8% over 2021-24. Last year's slowdown provided an inadvertent proof of the effectiveness of this demand stimulus that also reduces bottlenecks and sustains medium-term growth.

Government capex slowed during the election months. Upto end November 2024 the centre had spent only 46.2% of its capex target compared to 58.5% in the previous year, although revenue expenditure (revex) was about 1% higher. States had spent only 0.88tr of the 1.5tr made available for capex. And India's economic growth slowed from 9.2 in FY24 to 6.5 and 5.6% in Q1 and Q2 of FY25 before recovering to 6.2% in Q3 as government capex revived. Tight monetary-financial conditions since Q4 FY24 also contributed to the slowdown. These were only reversed from February 2025.

Fiscal consolidation is India's escape route to build fiscal space and release resources for more productive spending after decades of procyclical overspending (Goyal, 2024). It also essential since India's combined fiscal deficit, at above 7% of GDP, is one of the highest in the world. Interest payments account for as much as 25% of the centre's expenditure and are 3.6% of GDP. Lower debt and deficit ratios will reduce risk premia and interest rates spreads for all. Indian private sector borrowing is less than its peers, while government borrowing is higher. As households begin to borrow more; governments should borrow less to sustain financial stability.

Since growth averaged 8.8% despite lower deficits, while a slowdown followed that in public investment although revex was maintained, it is clear that better quality of spending itself provides stimulus—so with this, and other measures in the budget to sustain growth that we explore, it is not necessary to increase deficits for revival. Fiscal conservatism also enables monetary accommodation, which resumed in February. It raises the government expenditure multiplier (Goyal and Sharma, 2018). Countercyclical rudential regulation ensures financial stability.

The slowdown, however, revived views that sustaining growth requires widespread structural reforms as well as a consumption stimulus. But the early turnaround suggests the slowdown was cyclical not structural.

Global shocks continue, however. The Trump years can be expected to be volatile, although initial outflows reversed by March relieving pressures on the rupee and the stock market. The post-pandemic period showed that India has sufficient buffers and diversity to smooth external shocks and maintain growth. Therefore periods of outflows do not sustain despite ongoing global stresses. Their impact of outflows on domestic variables has also reduced.

There is evidence that as smoothening growth reduces uncertainty, it sustains private sector investment and employment. Therefore macroeconomic policy has to be countercyclical, agile and respond to incoming data as necessary.

The remainder of the paper is structured as follows. Section 2 examines how the quality of spending affected growth in the past few years. Section 3 turns to other growth-enhancing strategies in the budget; Section 4 briefly draws out implications for the outlook before Section 5 concludes.

2. The impact of spending-quality on past growth

Tables 1-3 give the actual growth of different budget components over 2021-24 (based on actuals reported in successive budgets), the three years that saw 8.8% growth. For the year of the slowdown, 2024-25, actuals are not yet available so the column reports the growth of revised expenditure (RE) over the previous year's actuals. The last column is growth projected in budget estimates (BE) for the current year.

While analysts focus on the fiscal impulse or deficit-financed rise in expenditure as the indicator of government's contribution to raising demand, we see that peak growth coincided with falling deficits (Table 1). But high growth of capex as well as expenditure on major items minus subsidies supported high growth. These two items were the ones that slowed in 2024-25 and are set to reverse next year (Table 2).

Table 1: **Fiscal health**

	2021-22	2022-23	2023-24	2024-25	2025-26
	Actuals on actuals	**Actuals on actuals**	**Actuals on actuals**	**RE on actuals**	**BE on RE**
Revenue deficit	-28.9	3.8	-28.5	-20.3	-14.1
Fiscal deficit	-12.9	9.7	-4.8	-5.1	-0.04
Tax revenue	26.5	16.2	10.9	9.9	11.0
Total receipts	8.1	10.6	6.0	6.1	7.4
Borrowings and other Liabilities	-12.9	9.7	-4.8	-5.1	0.0
Interest payments	18.5	15.3	14.6	7.0	12.2

Footnote: Tables 1-3 are estimated from budget documents (GOI, 2025) available at https://www.indiabudget.gov.in/

Table 2: Quality of expenditure and growth

	2021-22	2022-23	2023-24	2024-25	2025-26
	Actuals on actuals	**Actuals on actuals**	**Actuals on actuals**	**RE on actuals**	**BE on RE**
Total expenditure (TE)	8.1	10.5	6.0	6.1	7.4
Grants in aid for creation of capital assets	5.1	26.2	-0.8	-1.3	42.4
On capital account	39.1	24.8	28.3	7.3	10.1
Effective capital expenditure (on cap acc +grants)	27.1	25.2	19.8	5.2	17.4
Expenditure on revenue account (TE-on cap acc)	3.8	7.9	1.2	5.8	6.7
Expenditure on major items	8.1	10.5	5.9	6.2	7.4
Expenditure on 3 subsidies	-37.0	19.0	-22.3	-7.0	-0.003
Expenditure on major items-sub	16.6	10.0	17.7	-3.6	15.7
Nominal GDP growth	18.9	14.2	9.6	9.7	10.1
Real GDP growth	9.7	7.6	9.2	6.4	
CPI headline inflation	5.5	6.7	5.4	4.8*	4.2*

Footnote: * indicates these figures are Monetary Policy Committee projections

Table 3 gives growth of expenditure on some of the major items. Again we see that most of these were strongly positive during the high growth years, had turned negative in 2024-25 and are due to grow again this year. Total expenditure on major schemes grew at 6.2% last year against the 7% promised, but is expected to be 7.4% this year, with double digit increase in allocations for agriculture, human capital, social welfare, rural and urban development. Expected growth doubles when subsidies on fuel and fertilizer are excluded.

Table 3: Sectoral expenditure

	2021-22	2022-23	2023-24	2024-25	2025-26
	Actuals on actuals	**Actuals on actuals**	**Actuals on actuals**	**RE on actuals**	**BE on RE**
Agriculture and allied activities	-43.1	64.6	16.0	-3.5	21.7
Education	-4.6	22.7	25.2	-7.5	12.8
Health	5.1	-12.5	10.9	7.9	11.7
Rural Development	6.8	4.2	1.2	-20.9	39.9
Social Welfare	8.1	-0.3	3.9	10.5	29.2
Transport	53.2	17.5	34.9	2.8	1.3
Urban Development	128.8	-27.6	-11.3	-7.1	52.0

It follows quality of expenditure matters more for growth and can compensate for less aggregate expenditure growth. Capex is slated to increase at 10.1% over the under-delivery last year (when the increase was 7.3% compared to the 16.9% promised). Was the latter due to elections or due to state capacity limits? Table 2 offers a useful clue. States underperformed more than the centre last year in capex growth. Their utilization of central assistance for capex actually fell. But this assistance is to grow above 40% this year. So states must deliver now for targets to be met.

RBI (2024) reports that state capital outlay did increase from 2.2 % of GDP in FY22 to 2.6% in FY24 largely due to the central loans, but the expected rise to 2.8% in FY25 BE may not be realized since over April-October FY24 capex growth was -2.1% compared to 43.5% in the same period last year. Growth had, however, recovered in October. States vary in their absorptive capacity so efforts have to be made to enhance convergence. There are plans also to re-invigorate PPP using public resources to multiply private spending. If these are successful, budget targets may be met again.

Growth had fallen somewhat in 2022-23 due to Ukraine war related oil and food price shocks. Real repo rates were quickly raised to unity to counter inflation persistently above the tolerance band, but these did not prevent a growth recovery to 9.2% in 2023-24. Growth fell, however, as real rates rose towards 2% when the nominal repo stayed at 6.5% but expected inflation fell. Liquidity also tightened due to unspent government cash balances. Easing in these monetary-financial conditions finally in 2025 augurs well for the outlook, as do the other supportive initiatives in the budget explored in the next section.

3. Other strategic budget stimuli

A second stimulus the budget delivers is income tax cuts, which will support middle class purchasing power and the rise in discretionary consumption required at this juncture. For those selecting the new scheme, income tax will be nil uptil 12lakhs pa income and there is some restructuring of other slabs. It will benefit 80% of taxpayers—about 80m households or 320m people. Lower slabs have a higher propensity to spend.

Income tax collections had overshot targets (23% growth compared to an expected 16%) giving scope for some reduction. It was also fair since inflation had raised real taxes[1]. The state has foregone 1tr of tax but income tax is still expected to grow at a healthy 14.4% on RE. In the last 10 years both number of taxpayers and their average weighted income has increased 3 times and will continue to grow. Increasing formalization and linking of PAN and aadhaar databases will also close loopholes. Low tax rates on a rising base, together with focusing tax collection efforts on large taxpayers, which is the government's strategy, can give adequate revenue growth in India, while encouraging compliance and strengthening the lower middle class.

Agriculture is rightly given the first place among 4 engines of development identified. It has to restructure to supply to and benefit from diversifying diets. Lower food price spikes will facilitate monetary easing that is a high impact stimulus in Indian conditions of large interest elasticity of demand. Among many schemes the speech mentioned improving production and supply efficiency of vegetables and fruits in partnership with states.

The emphasis on simplifying regulations is another effective stimulus, but it also requires the states to be on board. The high level committee that is to be set up must keep this in mind. The centre has already simplified many archaic laws but businesses do not find life to

[1] In 2018 nil tax was upto 3 lakhs, to compensate for 7%pa inflation this should become 5 lakhs. It was under-corrected all these years. But in 2024 tax upto 12lakhs was lowered to 10%.

be any easier. The simplification has to percolate down to the 2nd and 3rd tier of government reaching local officials who interface with firms.

Better resource allocation by the centre alone, however, is inadequate for India to reach its potential growth. Well-designed incentives and better public goods are an essential additional stimulus to improve resource allocation more widely.

There are many examples of these. Despite underutilization, perhaps due to elections, the 1.5tr is again made available for state capex. These conditionalities helped sustain a rise in states' capex despite a splurge on freebies. Power distribution reforms make an additional 0.5% of GDSP borrowing available. An investment friendliness index is to be created for states. Facilities for MSMEs are conditional on registration. Incentives for corporate investment come from creating more demand, while lower interest rates would penalize idle funds.

There are special funds to promote private innovation, education, including use of AI, skilling and development of cities. Innovative financial structures help deliver more from public resources. For example, asset monetization, to reach 10tr over 5 years, converts public assets into resources to create more assets, while the privatized assets are run more efficiently. Public fund of funds bring in private funds that multiply reach and efficiency[2]. Credit guarantee cover is extended for MSMEs and a partial credit enhancement facility started for corporate infrastructure bonds.

A digital public infrastructure, Bharat Trade Net, promises effective trade facilitation. The vast network of India Post is to be activated to offer a range of services to the rural economy. Simplifications announced in taxes and tariffs, all contribute to productivity.

The post budget outlook and medium-term growth depends on how effective these incentives and financial structures will be in enabling states and private contributions. We examine that in the next section.

[2] An example of this is the fund of funds for startups the government launched in 2016. Seven years later 11688 crs committed through 151 alternate investment funds (AIFs), which must double contributions had enabled over 81000crs of capital that supported 1173 startups (Gupta, 2025).

4. Outlook

Given the many dimensions of possible coordination with states and its importance, the formal framework promised last year would have helped achieve this but is still missing. The budget explicitly mentions working with states on vegetable supply chains, on GCC centres and tourism facilities and sharply increases the grant for states investment. Simplifying de-regulation, another priority area, also requires states to participate.

Last year there were double digit shortfalls in expenditure growth targets in effective capital expenditure and in rural development where states play a large role.

States are more open to reforms as they compete for GCC centres. Many states have notified the new labour codes as well as agricultural marketing reforms, which require a final concerted push. Recent consumption surveys show the food share of consumption has fallen below 50%, and even in that processed foods have the largest share, followed by milk products. Cereals share has fallen below that of vegetables. Demand for diversified foods is rising as government schemes transfer more to lower income groups. Modernization of vegetable supply chains and transport is essential to prevent the sharp vegetable price spikes observed in 2023 and 2024.

Agricultural marketing reforms are progressing at the state level—26 states have adopted private markets and allowed direct farm gate sales, although only 14 have notified the rules. There is movement also on other measures to develop agricultural supply chains and a unified market (GOI, 2024). Research shows that even small farmers who diversified production made more profits than those who relied on MSP sales (Nuthalapati et. al. 2024). Easing sales of diverse produce and improving marketing infrastructure is the best way states can help their farmers. Conditions are ready for a meaningful change.

Corporate investment has not responded much to tax cuts, showing that resources alone need not deliver, complementary incentives are required. High growth and profits have raised the ratio of private corporate savings from around 1% of GDP before the 1990s to an average of 10.7% after 2005-06. But private sector fixed capital formation peaked at 27.5% in 2007-08, then fell averaging only 21.5% over 2015-21. As a result the share of corporate non business income has increased 4 times. Forty percent of capital gains in AY23 went to corporates and the rationalization of capital gains tax correctly targets this income. Additional carrots and sticks can be devised to make capex relatively more attractive.

Just as domestic savings are underutilized so are foreign savings. Inflows to the economy normally exceed our current account deficit, which is the excess of investment over savings financed by foreign savings. So it is investment, not resources, that is the constraint government has to relieve.

Corporates themselves should be rethinking their strategy since recent data does not support the K-shaped recovery and low consumption growth as a constraint on expansion. A number of independent as well as official surveys show good overall consumption growth (8-9% last year, GOI GDP data has 7.6% growth in FY 25 compared to 5.6% in FY24) and recovery of consumption in lower income groups.

A rise in rural incomes, falling inflation, as well as government transfers and tax cuts are raising incomes for the lower middle class. The numbers are very large and rising with more entry into this class as poverty shrinks to 5% of the population. While about 30% (400m) is recognized as the middle class MNCs sell to, some premiumization strategies focus only on the narrower top of 100m. They complain of low volumes, while corporates who priced for and created products for the much larger lower middle classes made large profits (examples are Reliance Fresh and Tata Trent) and built brand loyalty. The budget boost will add more heft to the low margin large volumes strategy. Indian middle classes are mobile upwards. Numbers have doubled in 15 years (Krishnan, 2024). As incomes grow, many will continue to escape tax and have more spending power. And many more will begin to pay taxes.

A fall in household savings ratio is consistent with the rise in consumption. Household net financial savings are about 2% lower than their average pre-pandemic level because household financial liabilities have increased by 2.7% over FY21-FY24 but they have largely financed a rise of 2.2% in physical savings over the same period. More ownership of houses and cars will increase future household income streams.

An RBI study shows household financial assets increased more than financial liabilities so their financial net worth was 97.2% of GDP in FY23 compared to 88.4% in December 2019.

Their leverage (ratio of debt to financial assets) has been constant since FY12 at about 28%. A more diversified portfolio of savings has reduced some risks. Deposits still had the largest share in household gross financial assets in FY23 at 43%, down from 51% in FY12, while the share of equity & investment funds increased to 17.6% in FY23 from 11.2% in FY12 (Prakash *et.al*. 2024). Retail investors are coming into equity on dips, through mutual funds, as foreign investors exit in times of global shocks. This prevents large fall in indices and gives them capital gains as indices recover. Foreign investors lose less on exit but gain less on re-entry. Their share of investment is falling while households are gaining more from India's growth. Gross domestic savings ratio remains a respectable 31.3% of GDP in FY24 since firms are saving more.

Some low income households are borrowing for consumption, although prudential regulation is ensuring that lending is sustainable, risk-based and financial entities have strong balance sheets. They have already charged higher interest rates and can absorb any fall in asset quality. But India still needs to update the colonial times personal bankruptcy act to limit the losses debtors bear and help them recover.

The real problems for corporates seems to be uncertainty due to repeated external shocks, the latest being Trump tariffs and their implications for business plans. The pro-active attempt to negotiate a trade deal with the US may help, as will many factors making for a natural alignment between Indian and US interests.

But policy has to be sufficiently countercyclical to neutralize these shocks, thus creating certainty to enable corporate strategy. The argument that conservative macroeconomic policy is required in response to Trump and geo-economic fragilities, goes back to the old way of thinking that neglects our ability, demonstrated during the pandemic, to counter external shocks using our size, economic diversity and strategic policy stimuli.

Budget priorities also continue to facilitate an improvement in conditions of production. As cost-push inflation falls, interest rates can come down. Low real interest rates are one of the most effective incentives to increase demand, with the large number of India's young buying houses and equipping them. It will lower stress in the microfinance sector where lending rates are high. As debt and deficit ratios fall towards peer East Asian economies so will country risk premiums and borrowing costs for all Indian entities. While resources are not the major bottleneck, their cost and opportunity cost matters.

5. Conclusion

Although this budget is presented during a slowdown, growth remains high enough so that the opportunity for fiscal consolidation and building buffers for future counter-cyclical responses does not have to be compromised. Central government borrowing is now only for capex since the fiscal deficit equals effective capital expenditure. This is the best type of fiscal consolidation. Better quality of expenditure, multiplication of its impact, continued coordination with monetary policy and incentives for the private sector and states to contribute, give adequate counter-cyclical stimulus for reversal of the slowdown, but an eye needs to be kept on global volatility and compensatory domestic measures taken. Q3 growth numbers give early signs of a reversal.

Surprisingly, the budget seems to have delivered on almost all expectations, reconciling fiscal consolidation with providing varied types of stimulus, while meeting demands for consumption stimulus without compromising on human and physical capital formation or social welfare spending. One reason is the larger resources available in a growing economy and a second is using them well through incentives to bring states and private enterprise on board and mechanisms to multiply the impact of public funds. Continuing fiscal consolidation also reduces borrowing requirements. A less than forecast growth in interest payments released some funds and will release even more as debt levels and interest rates fall.

If slippages in capex last year were also due to capacity constraints in states, implementation may continue to be a challenge. For targets to be achieved, the states and the private sector must also perform. Although well-designed incentives will help, formal frameworks for centre-state coordination, capacity-building and convergence across states may be necessary.

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