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UNION
BUDGET - A PREVIEW

2025 - 2026

Need to balance growth with fiscal prudence

Executive Summary:

While the Government prepares to present the Union Budget for 2025-26, it is likely to consider two fundamental factors which have slowed down GDP growth in the current fiscal – one, the weakness in urban demand and two, the sluggish pace of private sector investments. Nevertheless, the focus on fiscal consolidation will remain as the third theme. We would also like to believe that there will be a renewed endeavour to bring in agricultural reforms which can structurally help to bring down food inflation in India.

The first advance estimates for India's GDP growth released recently showed a notable growth moderation from FY24 at 6.4% for FY25. The disappointing 5.4% GDP growth in the second quarter of the fiscal year has been partly carried forward into the third quarter. While the agriculture sector has shown a strong recovery, with improved rural demand, urban demand has been weaker than anticipated, which has affected discretionary spending in the economy.

On demand facilitation, we would expect some steps to enhance the disposable income of the salaried taxpayers by realigning and reducing the existing income tax slabs. The mid-income urban population has seen limited inflation adjusted income growth in the post Covid period which has impacted discretionary purchases – higher tax savings can lead to stronger urban consumption demand. This can also strengthen demand for more affordable housing projects in the urban areas. In the earlier budget, the Government had brought out schemes to incentivize employment by the private sector – further measures may be taken in the current budget to ensure that such employment generation witnesses an acceleration.

While Gross Fixed Capital Formation or Investments have been steady at 36% of GDP in FY24, it has been largely driven by the rise in public Capital Expenditure. Private sector investments in the Indian economy have not picked up as per expectations and some policy tweaks can be expected to speed up such investments. Additional fiscal benefits may be provided for investments in areas which require use of new technology and innovation. Towards the goal of Viksit Bharat, the government would need to encourage innovation in every sector which would make domestically manufactured goods and services globally competitive. We also expect more steps to expedite the investments in alternative and renewable energy particularly in areas such as pumped hydro storage and bio-energy to make progress towards the Sustainable Development Goals (SDGs).

While making an endeavour to push up growth and investments, the Government is also likely to reinforce its commitment to fiscal consolidation with a fiscal deficit target of 4.5% or even slightly lower in FY26. In line with such a target, the growth in public capital expenditure may see some moderation along with that in subsidies.

Lastly, new policy reforms may be on the anvil in the agricultural sector which will improve productivity particularly in vegetables, improve supply chain efficiencies and mitigate food inflation risks in India.

Personal Taxation

The upcoming budget holds promise for low- and middle-income earners with a likelihood of some tax savings. To give a boost to the urban economy and consumption, the post-tax incomes of the salaried class need to see some material uplift. The Government may consider lower tax rates or some other kind of relief for those in the income category between Rs 7 lakh and Rs 15 lakh. In a continued attempt to shift more people towards the New Tax Regime, the tax rate relief may be provided only in the latter.

Simplifying taxes on pension products (Including those under NPS) is expected to encourage more people to invest in retirement planning. Given the steadily increasing premiums on health insurance, there is an expectation that there will be an increase in the deduction limits under Section 80D. Such a step will also help to enhance the penetration of health insurance and coverage in the country.

Overall, we expect the government to take new measures to further simplify the direct income tax laws and improve the level of compliance.

Private Sector Investments

We expect the Union Budget 2025 to especially focus on the manufacturing sector, with the sector posting a meagre growth of only 2.7% YoY in Q2 FY2025. As geo-political dynamics change and the US imposes higher tariffs on goods from China, there is clearly a great opportunity for India to capitalize, in part if not full, the demand for manufactured goods in US and other developed economies. Timely investments by the private sector is critical for that perspective.

The Production Linked Incentive (PLI) Policies and Gati Shakti Master Plan are already in place and have got partial traction. The FDI inflows in India have risen from $45.1 billion in 2014-15 to $70.9 billion in 2023-24, reflecting a steady rise in foreign investors' confidence in establishing operations within the country.

- **Electronics Sector:**

The government's PLI schemes for manufacturing electronics, particularly in mobile phones, semiconductors, and IT hardware, have seen very significant progress. To build on this success and help in acceleration of manufacturing investments, the upcoming Budget should extend this scheme for the next five years.

It should also broaden its scope to include emerging product categories such as consumer electronics, wearables, IoT devices, and more. In addition, a focus on investing in R&D for electronics system design and manufacturing through the Public Private Partnership model might help foster innovation.

- **Automobile Sector:**

In Budget 2024, the PM-E drive was introduced, aiming to reduce the sector's dependency on subsidies. However, the EV industry continues to face challenges such as infrastructure limitations and high adoption costs. In the upcoming Union Budget, the focus could shift to performance-linked incentives for battery and related auto-component production. Also, push for GST parity on EV spare parts, essential components to be taxed at the same rate as other automotive parts (EV spare parts, currently under unlisted goods, are taxed at 28%, while the other automotive spare parts are taxed at 18% GST rate). This move will help give the EVs a more competitive edge as they are still looking to be cost competitive in the automobile industry.

- **Pharma and Health Care Sector:**

India has already earned a name in medical tourism. A dedicated fund to position India as a leader in healthcare and medical tourism might give some additional boost to the sector. The pharmaceutical sector has reduced import dependence by boosting domestic production, while the medical devices industry has benefited from technology transfers. So, the budget could further enhance medical equipment manufacture and exports by supporting ‘Make in India’, funding R&D, offering tax incentives, and streamlining regulations, positioning India as one of the key players in medical equipment.

- **Other Manufacturing Sectors:**

The forthcoming budget is poised to sustain its emphasis on the manufacturing sector, with a particular focus on high-impact industries such as semiconductor production, telecom equipment, space and defence technologies, aircraft manufacturing, and solar cell production.

- **SME Sector:**

In addition, we also see the expansion of schemes such as Pradhan Mantri Mudra Yojana, which supports micro and small businesses particularly in the rural areas. Given the importance of SMEs in employment generation, the coverage of the available Credit Guarantee may be enhanced in the upcoming budgets.

Continuing focus on Infrastructure along with Sustainability

Despite the focus on fiscal consolidation, the budget will continue to give a thrust on infrastructure creation in the economy given its role in long term economic growth.

The government is likely to prioritize those categories of infrastructure projects that can reduce logistics costs and enhance supply chain efficiency. It may also formulate policies that balance the need for economic growth with environmental sustainability as we near the timeline for some of our SDG targets by 2030. Sustainable infrastructure, including green buildings and waste management under the Smart Cities Mission, to foster eco-friendly, growth-oriented cities may be encouraged.

Key initiatives like Housing for All, Pradhan Mantri Gram Sadak Yojana (PMGSY), Bharat-Mala Pariyojana, the National Infrastructure Pipeline (NIP), and the Smart Cities Mission will continue to be extended with higher allocations for a few.

The central government will most likely increase capital expenditure for the Ministries of Road Transport and Highways (MoRTH) and Railways by 10%. A significant portion of highway projects, 20-25%, is expected to be granted under the Build-Operate-Transfer (BOT) toll model to revive public-private partnerships. Additionally, the Budget will emphasize multimodal connectivity, with investments in electrification, infrastructure upgrades, and dedicated freight corridors for faster transport. AI adoption and modern rail coaches like Vande Bharat will also be prioritized.

In the shipping and ports sector, the Budget is anticipated to focus on strengthening India’s maritime infrastructure as part of the Maritime Amrit Kaal Mission 2047. This includes expanding port capacities, upgrading ports for larger ships, and supporting green transitions. The government has begun a comprehensive review of its ports and is moving forward with ambitious projects, such as the construction of a large port in Maharashtra's Vadhavan, Palghar district. The budget may also further push for a digital economy, coupled with a young, tech-savvy population, which is propelling sectors such as fintech.

The government's flagship scheme, PMAY, under the "Housing for All" vision, will also receive another boost similar to the last budget. It provides financial support to economically weaker sections and takes the burden of housing from the private companies in the real estate market.

The renewable energy sector should also see some announcements on both the household and industry levels. Promotion of rooftop solar installations under schemes like the PM Surya Ghar Yojana, which aims to provide free electricity for up to 300 units to one crore households to promote green and clean energy. Additionally, the budget is likely to allocate funds to strengthen power infrastructure, including the development of new transmission as well as distribution networks. This would help align with India's commitment to achieving net-zero carbon emissions by 2070.

Boost to Agricultural Sector

The upcoming Budget will likely honour its commitment by substantially increasing agricultural R&D allocations, targeting an uplift from under 0.5% to at least 1% of agricultural GDP. Additionally, fertilizer reforms are anticipated as the government focuses on enhancing domestic production, particularly of nano-liquid urea, to stabilize prices and reduce import dependency.

The Budget is also expected to promote natural farming, self-sufficiency in pulses, shrimp production, and vegetable clusters to boost productivity and meet changing consumer demands. Moreover, a significant emphasis is likely to be placed on promoting biofuels and ethanol to support sustainable farming practices.

Budget 2025 will likely expand schemes such as "AgriStack", which include digitalization across all sectors, along with its flagship scheme KCC. This would also streamline processes and eliminate existing trade barriers to ensure fair pricing for farmers.

The budget is likely to focus on agriculture infrastructure, with an emphasis on higher yields, agriculture cluster development, cold storage, warehousing, and supply chain improvements to reduce post-harvest losses and enhance market access, alongside measures for water management, climate change mitigation, and investments in technologies like solar pumps, drones, and precision farming to drive efficiency and innovation.

The flagship crop insurance scheme, Pradhan Mantri Fasal Bima Yojana, which saw unchanged allocation last year, might see a higher budget.

Social Sector Expenditure

The social sector has always been one of the key priorities in most of the Union Budgets. In pursuit of Viksit Bharat, we expect the social sector to receive significant attention in the Union Budget 2025, especially with state elections queued up in one of the most populous states, Bihar, as well as Delhi.

In healthcare, one of the major central schemes, the National Ayush Mission scheme, has so far shown promise. The government is likely to increase funding for the Ayushman Bharat scheme to expand its coverage and improve access to secondary and tertiary healthcare, particularly in rural and underserved areas. Investments in preventive healthcare campaigns, mobile health clinics, and the National Digital Health Mission will aim to strengthen the healthcare infrastructure and enable wider access to telemedicine and digital health solutions.

In education, the primary focus would be on skilling than education. Ongoing schemes such as Pradhan Mantri Kaushal Vikas Yojana, Vocational training programmes for women as well as Skill loan schemes may be expanded to align with job market demands.

With economic growth this year being slightly slower, focus on schemes such as MNREGA will be crucial. With the scheme benefiting about 5 Cr families last year and the majority of its beneficiaries being women, MNREGA will continue to provide support to vulnerable groups.

Social welfare programs for women and children are likely to see stable funding. However, we don't envisage the introduction of any new social benefit programme amidst the compulsions on fiscal consolidation.

The budget is also anticipated to continue its emphasis on digital inclusion and digital literacy campaigns to empower citizens in an increasingly digital world.

Fiscal Consolidation

On the fiscal consolidation front, the Union Budget is expected to reiterate its commitment to maintain fiscal discipline while balancing growth. The Indian government is well on its way to reduce its fiscal deficit to 4.9% of GDP (which stood at Rs 8.47 Lakh Cr as of April-Nov) in the current financial year, down from 5.6% in FY24.

The government is expected to stay on track to reduce the fiscal deficit further to 4.5% of GDP for FY26 and may even aim for further improvements. With uncertainties around the extent of GDP growth in FY26 and the need for a capex push, a greater focus on asset monetization is anticipated to bridge fiscal gaps and support sustainable growth.

Revenue mobilization is likely to play a significant role in achieving this goal. Efforts to improve tax compliance (with more rebates and concessions as well as simplifying the new tax regime) are already expected. Reforms in GST, specifically simplification of the process, will help enhance the collections.

About Acuité Ratings & Research Limited:

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