

5. Low Inflation and Growth Dynamics – Economy

India is experiencing low inflation, which helps consumers by keeping prices stable but creates fiscal challenges for the government. Slower nominal GDP growth, driven by low inflation, is leading to lower-than-budgeted tax revenues, complicating efforts to meet deficit targets.

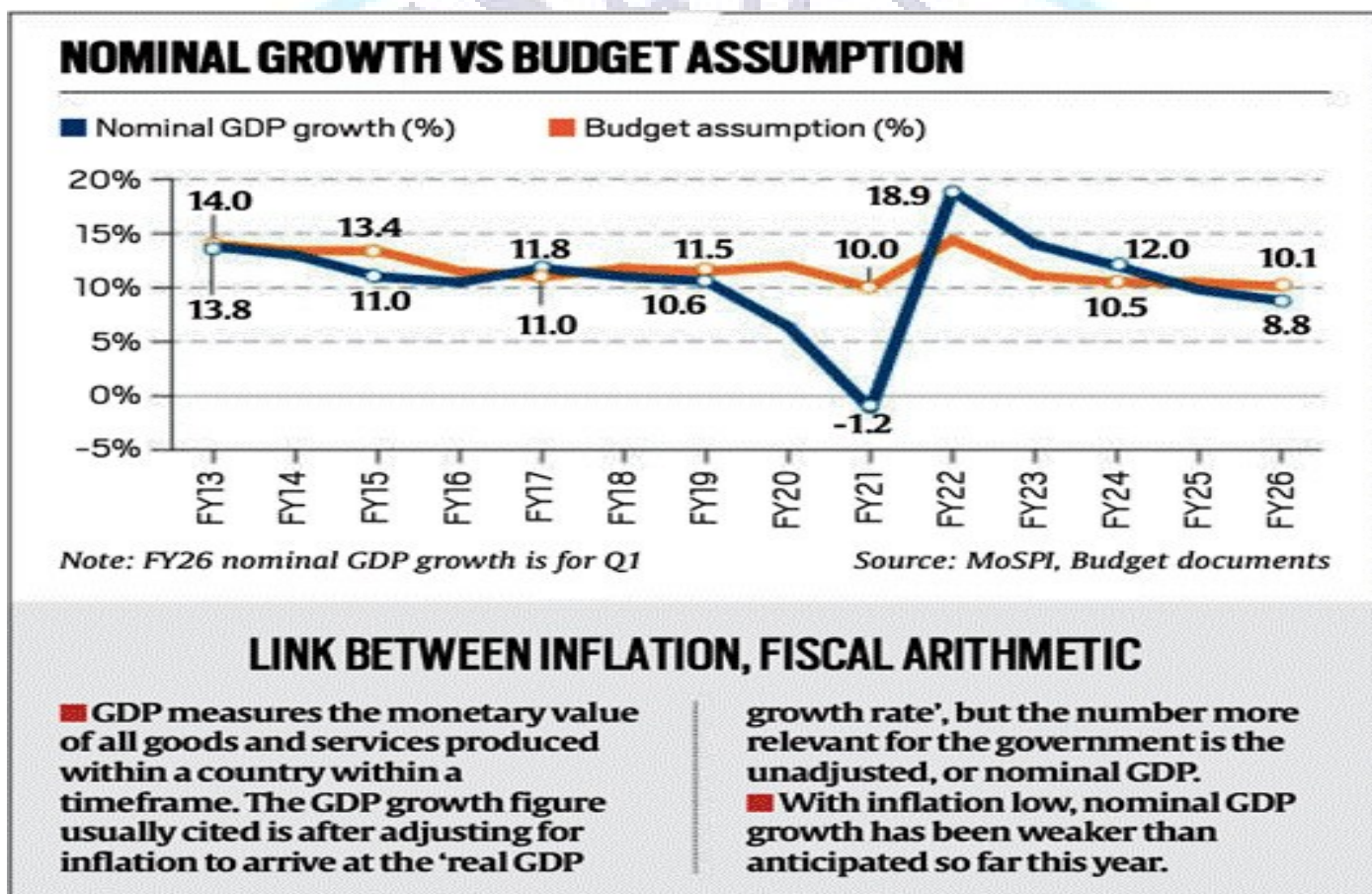
Current Economic Context – Low Inflation and Growth Dynamics

India is currently navigating a complex economic landscape where low inflation, while beneficial for consumers, poses significant challenges to the government's fiscal management and budget calculations.

Latest Inflation Data (August 2025) –

Consumer Price Index (CPI) – Inflation stood at a low **2.07%**.

Wholesale Price Index (WPI) – Inflation was **0.52%** compared to the previous year.



Understanding GDP Metrics –

Real GDP – This is adjusted for inflation and measures the actual physical growth of goods and services produced.

Nominal GDP – This is the unadjusted monetary value of all goods and services. It is a critical metric for the government's fiscal calculations, including tax revenue, fiscal deficit, and debt ratios.

Union Budget Assumptions (2025–26) – The budget was framed assuming a nominal GDP growth of 11%. Fiscal deficit target was set at 4.4% of nominal GDP. The Debt-to-GDP ratio was projected at **56.1%**.

The Two-Sided Impact of Low Inflation

Low inflation presents a dual scenario with distinct effects on consumers and the government.

Positive for Consumers and Households – When inflation is low, the prices of goods and services rise slowly, which increases the purchasing power of consumers. It directly reduces the cost-of-living pressures on households, leaving them with more disposable income.

Challenges for Government Finances – Low inflation leads to slower nominal GDP growth, which in turn results in lower-than-expected tax revenue collection. This makes it significantly harder for the

government to achieve its fiscal targets (like the deficit and debt-to-GDP ratios) without either finding additional revenue sources or cutting planned expenditure.

Nominal GDP Growth and the Budget Arithmetic

The government's entire financial planning is heavily dependent on nominal GDP growth projections.

Current Trends (Q1 FY26) -

Real GDP growth was strong at a 5-quarter high of 7.8%. However, Nominal GDP growth was at a 3-quarter low of 8.8%, falling short of the 11% budget assumption.

Significance for Fiscal Health - The government's projections for tax revenue are directly tied to the rate of nominal GDP growth. Weak price growth (low inflation) reduces the overall monetary value of the nation's output, which negatively affects revenue calculations. This creates a paradox where the economy can experience strong real (physical) growth, but low inflation can still depress the nominal GDP and strain government finances.

Historical Perspective & The Base Effect

Nominal GDP Regularly Misses Budget Targets - Historical data shows that in the last 13 years, nominal GDP has matched the Union Budget's assumptions in only 4 years, highlighting that economic forecasting is inherently uncertain.

The Base Effect of FY25 - The GDP figure for the previous fiscal year (2024-25) was revised upwards from ₹321 lakh crore to ₹331 lakh crore. This higher base means that to meet the absolute nominal GDP target for 2025-26, the required growth rate is now only around 8%, which is lower than the initial 11% projection. While this makes the target technically easier to achieve, it underscores the critical dependency of fiscal arithmetic on these nominal GDP benchmarks.

Causes of the Current Low Inflation

Several factors are contributing to the current low inflation environment.

Corporate Profitability (April-June 2025) - Corporate sales rose modestly by ~5.3-5.5%. However, net profits surged by an impressive 17-27%. This divergence indicates that profits are rising much faster than sales, likely due to cost-cutting or other efficiencies rather than strong productivity gains or high consumer demand. This can be a sign of underlying demand weakness.

Other Key Factors - A significant moderation in global commodity prices. Weak private investment (capex), which reduces demand pressure in the economy.

Consequences for Fiscal and Monetary Policy

Short-Term Fiscal Impacts - Slower nominal growth will almost certainly lead to tax revenue falling below projections. This puts immense pressure on the government to adhere to its stated fiscal deficit and debt targets.

Medium-Term Considerations - If low inflation persists, it may limit the government's capacity for new spending or for providing an economic stimulus if needed.

Monetary Policy Implications - The Reserve Bank of India (RBI) may be inclined to maintain an accommodative monetary policy (i.e., keeping interest rates low) to help support and stimulate nominal GDP growth.

Broader Economic Implications

The Central Policy Tension - There is a clear tension between two desirable goals. Low inflation benefits consumers, but it simultaneously constrains the government's fiscal space, making it difficult to balance growth stimulus against fiscal discipline.

Market Signals - The combination of strong corporate profits with weak sales growth suggests an uneven economic expansion. This is a potential indicator of demand-side weakness, even though the supply-side appears stable.

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