ILLUSTRATION: BINAY SINHA

Budget 2026: Too many known unknowns

Amid data and fiscal uncertainties, the govt faces the difficult task of creating conditions to boost private capex

The 2026-27 Budget is being presented against a turbulent backdrop. On the international front, in response to persistent uncertainty over the level of tariffs facing Indian exports to the United States, the government is working hard to negotiate and conclude a series of trade agreements. The European Union-India free trade agreement (FTA) is the latest to be concluded. A number of countries are also making efforts to diversify their trade relations in a bid to navigate emerging uncertainties. The gains from these agreements, however, won't be immediately apparent. Ratification of the agreements, as well as the creation of demand in new markets, may take time. In other words, the short-term challenges from international trade for the Indian economy are not entirely alleviated.

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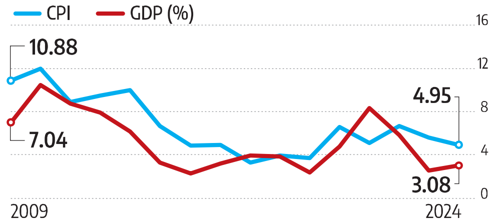
On the domestic front, there are two broad uncertainties to contend with. The first relates to uncertainties regarding gross domestic product (GDP) numbers. The first advance estimates for 2025-26 indicate nominal GDP growth of 8 per cent, while real growth is estimated at a relatively high 7.4 per cent. Government revenue performance is usually correlated with nominal GDP growth. For assumptions on expected nominal GDP growth for 2026-27, it is important to note that while inflation forecasts suggest a pickup in consumer-price index-based (CPI) inflation — returning to the Reserve Bank of India's tolerance band — average inflation based on GDP deflator has trended below CPI inflation. In other words, realistic assumptions for nominal growth might trend lower than 10 per cent.

Another element of uncertainty here is the release of the new GDP series. The Ministry of Statistics and Programme Implementation is in the process of releasing the new GDP series calibrated to 2022-23 as the base year. While the new series does not change the underlying economic activity, and hence has no material impact on the taxes that the government can mobilise, it does create some measurement and perception challenges. A significantly higher nominal GDP level — which could result from expanded coverage to include more sectors — would lower fiscal deficit-to-GDP and debt-to-GDP ratios along with the tax-to-GDP ratio. While the first two outcomes are desirable, the last is not.

Against this backdrop, the receipts available for the Budget are constrained. Two major constraints are mentioned below.

1. The fiscal anchor for the Fiscal Responsibility and Budget Management (FRBM) Act is the debt-to-GDP ratio. The objective spelt out in the last Budget is to reduce the debt-to-GDP for the central government to 50 per cent by 2030. The short-term objective is to ensure a reduction in the debt-to-GDP ratio. With the current debt-to-GDP ratio at 55.1 per cent (based on outstanding debt at the end of the year as reported in the Budget for 2025-26 and the First Advance Estimates of GDP), a 1 percentage point reduction in the debt-to-GDP ratio would imply a fiscal deficit of about 3.5 per cent, assuming nominal GDP growth of 9 per cent. A higher nominal GDP growth creates more space for fiscal deficit (*see chart*). For allowing a higher fiscal deficit, the government has to choose a lower correction in debt-to-GDP or a higher nominal GDP growth rate.

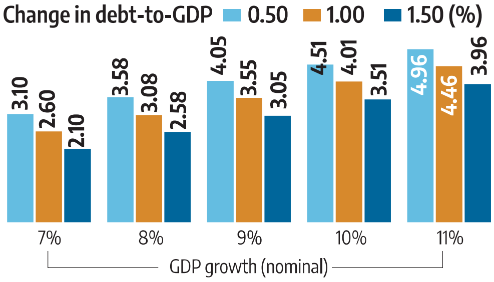
Inflation: CPI versus GDP deflator



Source: World Development Indicators

Fiscal deficit space

(% of GDP)



2. Turning to the major source of revenue for the government — taxation — revenue performance in the current financial year has moderated. Towards supporting demand in the economy, during the last financial year, the government introduced lower income-tax as well as goods and services tax rates. The former was targeting the upper-middle class, while the latter was meant to provide "relief" to all consumers. These changes have stimulated some demand, but have resulted in a moderation in revenue growth. Considering GST revenues net of cess — since revenues from cess do not accrue to either of the governments — growth in revenues dropped from over 14 per cent year-on-year for the first two months in the current financial year to below 2 per cent in November and December. The moderation in revenue performance suggests that either the pass-through of lower taxes in prices is incomplete or the elasticity of demand for a range of commodities is less than unity. Similarly, for direct taxes, the gross collections have grown by 7.7 per cent for corporation tax and 1.2 per cent for personal-income tax. Net collections, however, report higher growth at 12 per cent and 6 per cent, respectively till January 11, 2026. Given this context, further reforms in domestic taxes do not seem warranted. For the current financial year, one would expect the Budget to seek to stabilise revenue collections. Given the moderation in GDP growth rate, a slowdown in revenue growth too might be expected.

Within these constraints, the government faces the difficult task of balancing growth stimulus through capital expenditure with supporting a framework for augmenting private sector investment in the economy. In this context, the extensive ongoing review of various schemes implemented by the government is a space to watch with interest. Rationalisation of these schemes can create an opportunity to assess their suitability and design, while also freeing up space for emerging priorities.

The author is director, National Institute of Public Finance and Policy, New Delhi. The views are personal