CHAPTER

01

STATE OF THE ECONOMY: GETTING BACK INTO THE FAST LANE

The global economy exhibited steady yet uneven growth across regions in 2024. A notable trend was the slowdown in global manufacturing, especially in Europe and parts of Asia, due to supply chain disruptions and weak external demand. In contrast, the services sector performed better, supporting growth in many economies. Inflationary pressures eased in most economies. However, services inflation has remained persistent. Although commodity prices have stabilised, the risk of synchronised price increases persists. With growth varying across economies and last-mile disinflation proving sticky, central banks may chart varying paths of monetary easing. This will lead to uncertainty over future policy rates and inflation trajectories. This apart, geopolitical tensions, ongoing conflicts, and trade policy risks continue to pose significant challenges to global economic stability.

In this global context, India displayed steady economic growth. As per the first advance estimates of national accounts, India's real GDP is estimated to grow by 6.4 per cent in FY25. Growth in the first half of FY25 was supported by agriculture and services, with rural demand improving on the back of record Kharif production and favourable agricultural conditions. The manufacturing sector faced pressures due to weak global demand and domestic seasonal conditions. Private consumption remained stable, reflecting steady domestic demand. Fiscal discipline and strong external balance supported by a services trade surplus and healthy remittance growth contributed to macroeconomic stability. Together, these factors provided a solid foundation for sustained growth amid external uncertainties.

Looking ahead, India's economic prospects for FY26 are balanced. Headwinds to growth include elevated geopolitical and trade uncertainties and possible commodity price shocks. Domestically, the translation of order books of private capital goods sector into sustained investment pick-up, improvements in consumer confidence, and corporate wage pick-up will be key to promoting growth. Rural demand backed by a rebound in agricultural production, an anticipated easing of food inflation and a stable macro-economic environment provide an upside to near-term growth. Overall, India will need to improve its global competitiveness through grassroots-level structural reforms and deregulation to reinforce its medium-term growth potential.

INTRODUCTION

1.1 Global economic conditions are shaped by changing growth dynamics, fluctuating commodity prices, and evolving monetary policies, which influence domestic inflation, trade balances, and capital flows. At present, this interconnectedness is complicated by unusual levels of geopolitical tensions, supply chain disruptions, and climate-related shocks. Against this background, this chapter is organised broadly into four sections. The first section outlines the global economic scenario comprehensively, highlighting growth and inflation trends, policy stances, and key emerging risks and uncertainties. The second section focuses on the domestic macroeconomic situation, examining developments from the demand and supply sides. The third section delves into the emerging trends in public finances, inflation, external sector, financial markets and employment. The concluding section presents the prospects and outlook for growth in the presence of global headwinds while capitalising on domestic growth drivers.

GLOBAL ECONOMIC SCENARIO

Steady global growth and varied regional dynamics

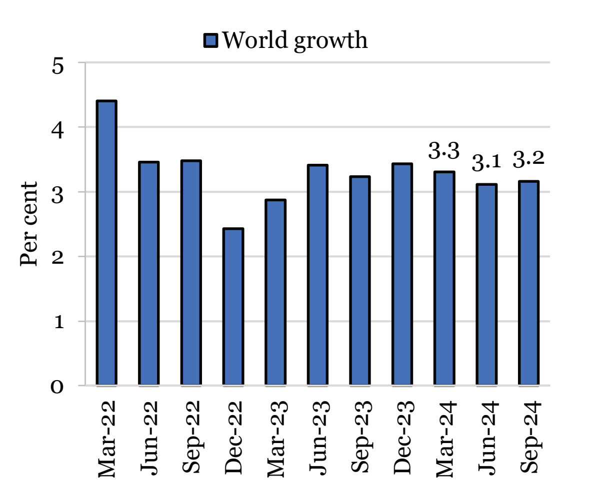
1.2 Globally, 2024 has been an eventful year. The year witnessed unprecedented electoral activity on the political front, with more than half of the global population voting in major elections across countries. Meanwhile, adverse developments like the Russia-Ukraine conflict and the Israel-Hamas conflict increased regional instability. These events impacted energy and food security, leading to higher prices and rising inflation. Cyberattacks also became more frequent and severe, with growing human and financial consequences due to the increasing digitisation of critical infrastructure.[1] Geopolitical tensions, have reshaped global trade. Geopolitical risks and policy uncertainty, especially around trade policies, have also contributed to increased volatility in global financial markets.[2]

1.3 Nonetheless, global economic growth has remained fairly moderate. The global economy grew by 3.3 per cent in 2023. The International Monetary Fund (IMF) has projected growth of 3.2 per cent and 3.3 per cent for 2024 and 2025, respectively. Over the next five years, global growth is expected to average around 3.2 per cent, which is modest by historical standards. While the overall global outlook remains steady, growth varies across different regions.

1 S&P Global. (n.d.). Geopolitical risk. S&P Global. https://tinyurl.com/2yrnnmsp.

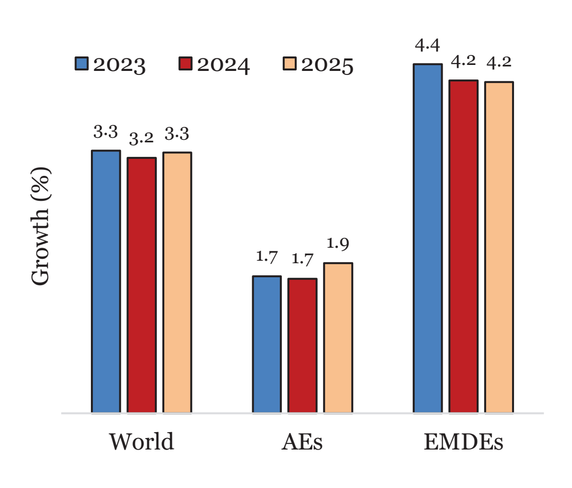
2 Reserve Bank of India. (2024). Press release: Minutes of the Monetary Policy Committee Meeting, December 4 to 6, 2024. https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=59347.

Chart I.1: Resilient global growth trends in 2024



Source: OECD Economic Outlook, Volume 2024 Issue 2.

Chart I.2: Steady growth outlook across country groups



Source: IMF WEO (January 2025)

Note: AEs- Advanced Economies, EMDEs- Emerging market and developing economies

1.4 Despite higher interest rates, advanced economies (AEs) witnessed stable growth in the first half of 2024. This was on account of moderating inflation and sustained employment and consumption.[3] However, the growth outlook differs between the United States (US) and the Euro Area. Growth in the US is expected to remain strong at 2.8 per cent in 2024 and may decline slightly in 2025, reflecting a moderation in consumption and exports.[4]

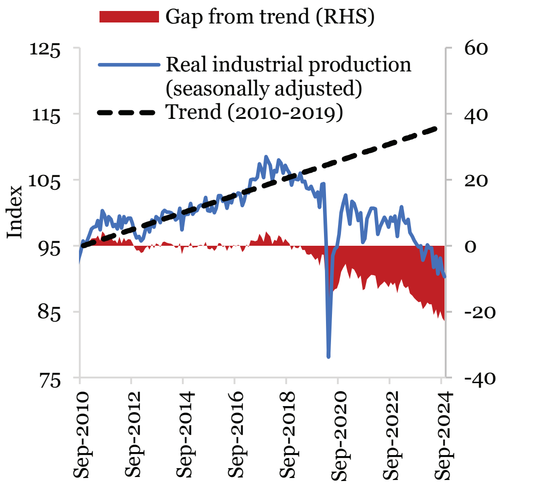
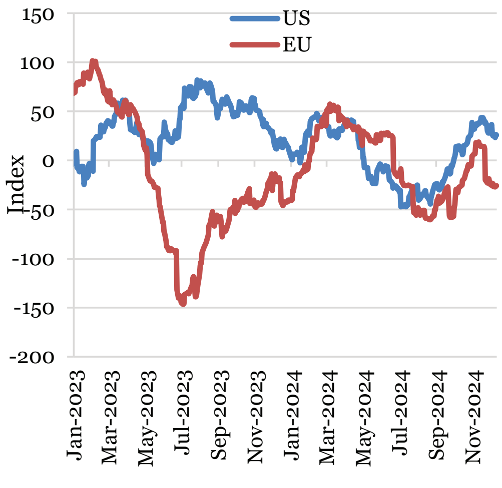
1.5 In the Euro area, growth is expected to improve from 0.4 per cent in 2023 to 0.8 per cent in 2024 and further to 1.0 per cent in 2025 on the back of improving services activity. However, growth outcomes in Europe have been varied. Some countries like Spain, France, Poland, and the United Kingdom have benefitted from the strength of their services sector. Meanwhile, manufacturing-intensive countries like Germany and Austria are being weighed down by weak demand.[5] Germany's structural weaknesses, particularly in manufacturing (Chart I.3), have been noticeable, contributing to the slackness in Europe's manufacturing. Political developments in France and Germany are also adding to policy uncertainty in Europe's major economies.

1.6 The divergence of the growth trajectories of Europe and the US can also be seen in Citi Economic Surprises indices for these countries (Chart I.4). These indices compare actual data releases with analyst expectations. A value above zero indicates the data

3 Euromonitor International. (2024). Global economic outlook: Q3 2024. Euromonitor International. https://www.euromonitor.com/article/global-economic-outlook-q3-2024.

4 International Monetary Fund. (2024). Regional economic outlook: Western Hemisphere, October 2024. https://tinyurl.com/2ep72n66.

5 International Monetary Fund. (2024). Regional economic outlook: Europe, October 2024. https://tinyurl.com/2s377x4z.

Chart I.3: Structural weakness in the German economy	Chart I.4: Citi Economic Surprise Indices indicating unexpected resilience of the US
	

Source: Bloomberg

was stronger than analyst expectations, while a negative value indicates weaker actual data compared to expectations. Between January 2023 and November 2024, data for the US economy continued to present more 'positive' surprises than the EU, compared to the analyst estimates.

1.7 Within Asia, Japan's growth was hindered by domestic supply disruptions in the early part of the year, while China's growth weakened after the first quarter, affected by sluggish private consumption and investment, alongside challenges in the real estate sector.[6]

Services sector growth steady; manufacturing faces challenges

1.8 The global composite Purchasing Managers' Index (PMI) has stayed in the expansion zone for the fourteenth month in a row (as of December 2024). The services sector continues to show strength while manufacturing PMI indicated contraction.[7]

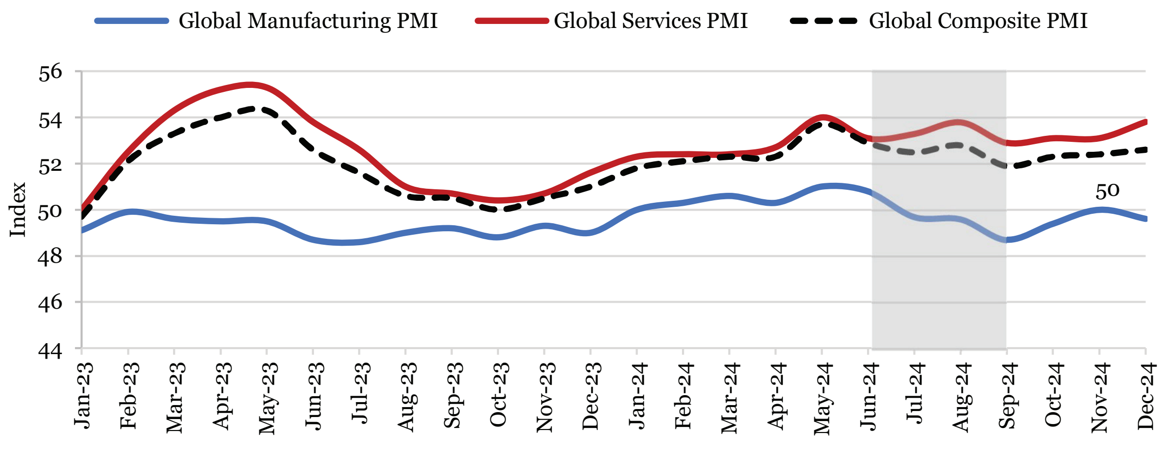
1.9 In 2024, the global manufacturing PMI started strong, moving into expansion for the first time since mid-2023 and remained so through the first half of the year. By July 2024, weaker conditions pushed the PMI back into contraction. Following four months of gradual declines, the global manufacturing sector stabilised in November with an index value of 50.0, indicating no overall change in operating conditions.[8] Output growth in consumer and intermediate goods offset a downturn in investment goods. Increased production was attributed to stabilising new order intakes and the clearance of backlogs of work.

6 International Monetary Fund. (2024,October 31). Regional economic outlook for Asia and the Pacific. October 2024. https://tinyurl.com/ycka65ub.

7 S&P Global. (2025, January 6). Global growth accelerates as solid service sector expansion offsets manufacturing weakness. https://tinyurl.com/mr3pkjmh.

8 S & P Global. Global manufacturing PMI highlights. https://tinyurl.com/bddkyr27.

Chart I.5: Global manufacturing stabilises in November 2024



Source: Bloomberg

1.10 Production trends varied widely across regions in December (Chart I.6 and I.7). Production rose in 13 of the 30 nations for which December PMI data were available. The Eurozone saw the steepest contractions, led by France, Germany, and Austria. North America showed mixed results, with Canada's growth offset by declines in the US and Mexico. India reported the strongest expansion of output. The outlook for global manufacturing also remained subdued in December, with business sentiment dipping to a three-month low.[9]

Chart I.6: PMI manufacturing in advanced economies

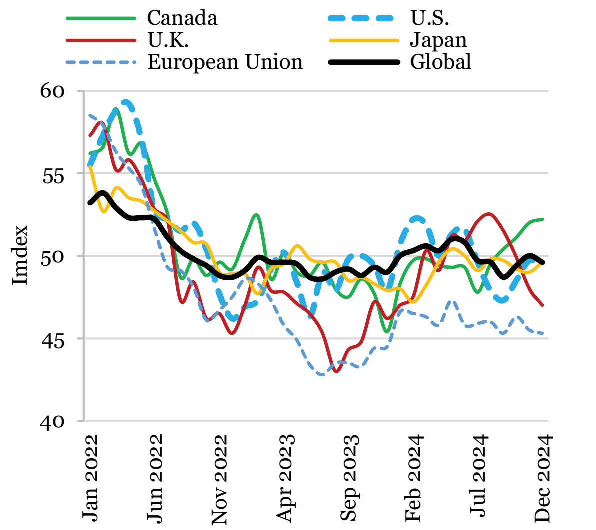
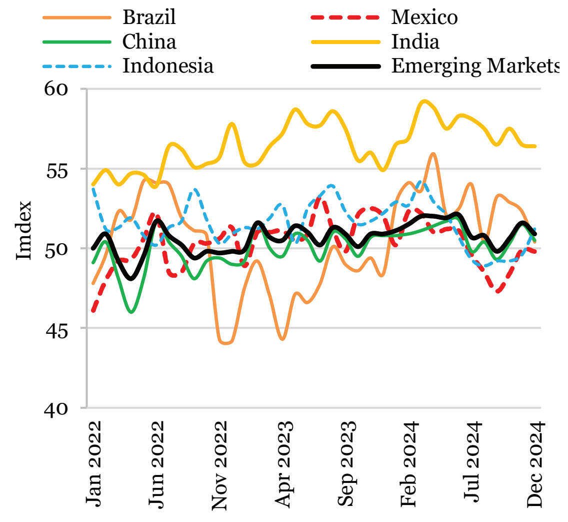


Chart I.7: PMI manufacturing in emerging market economies



Source: Bloomberg

9 S&P Global. (2025, January 2). J.P.Morgan Global Manufacturing PMI: Global manufacturing contracts at end of 2024. https://tinyurl.com/yn3a2fnm.

1.11 On the global services front, the global Services PMI Business Activity Index rose to a four-month high of 53.8 in December. This signals expansion for the twenty-third consecutive month. Expansion was recorded across business, consumer, and financial services. Financial services experienced the fastest pace of expansion.

Inflationary pressures ease, but risks of synchronised price pressures persist

1.12 Inflation rates across economies have trended downward steadily, approaching central bank target levels. This has been the result of tighter monetary policy regimes across the globe and supply chains adapting to higher levels of economic uncertainty. As a consequence, price pressures eased in 2023 due to a reduction in fuel prices. In 2024, it was attributed to a broad-based reduction in goods inflation.

Chart I.8: Inflation in advanced economies

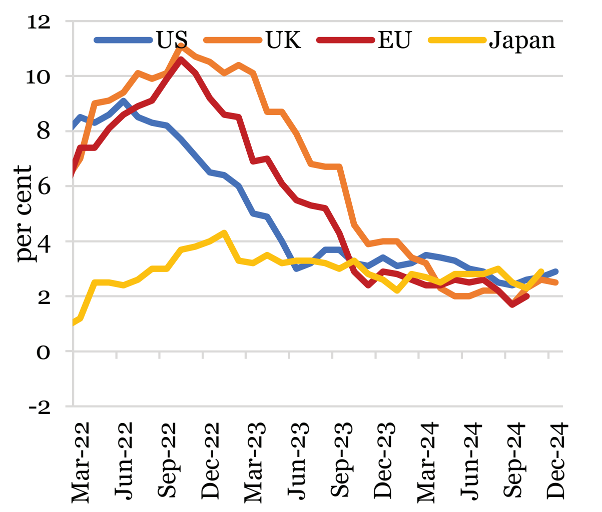
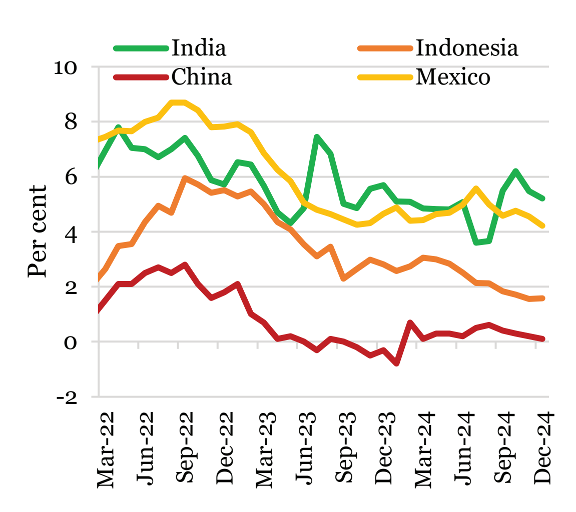


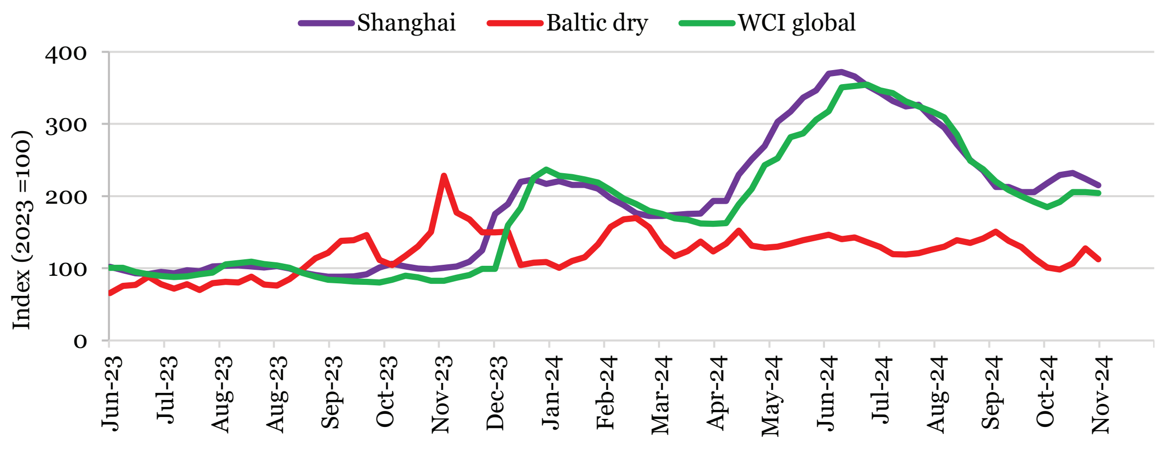
Chart I.9: Inflation in emerging market economies



Source: OECD and MoSPI

1.13 However, disinflation seems to have slowed due to the persistence of services inflation, while core goods inflation has fallen to negligible levels. The IMF World Economic Outlook (WEO) October 2024 reasons that this is on account of higher nominal wage growth as compared to pre-pandemic trends. The report notes that there are early signs that these pressures are abating, thereby aiding the disinflation process.

Chart I.10: Global shipping prices have moderated from their peak



Source: OECD Economic Outlook, Volume 2024 Issue 2

1.14 However, recent disruptions in global shipping have pushed goods prices up. These events have also pressurised the global supply chains. This is reflected in higher levels of the Global Supply Chain Pressure Index (GSCPI) in the quarter ending September 2024. Chart I.10 shows that while container freight rates normalised in 2023, they experienced a significant surge in 2024. This was due to stronger demand, shipping route disruptions in the Red Sea, and delays at the Panama Canal, all of which have partially sustained inflationary pressures.[10]

1.15 The risk to inflation from increases in commodity prices seems limited in 2025-2026. After softening in 2024, commodity prices are expected to decline moderately (Chart I.12). While this easing is a positive sign, the risk of synchronised price increases remains, especially during periods of global economic stress. Although recent shocks like geopolitical conflicts and extreme weather have caused price fluctuations, their impact has largely subsided, leading to more varied commodity prices. However, escalating tensions continue to pose a risk of synchronised price increases, undermining the effectiveness of inflation mitigation.[11]

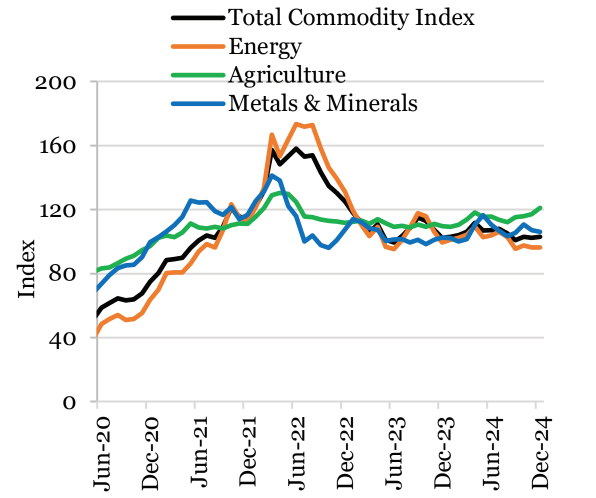
Easing monetary policy stances amidst divergent expectations

1.16 Taking advantage of the steep decline in inflation, major central banks have implemented a policy pivot to lower policy rates. Given the differentials in the trajectories of economic activity across countries, the pace of policy rate reduction is bound to differ. There is also uncertainty regarding the levels of the year-ahead and terminal policy rates across economies at the end of the current monetary easing cycle.

10 United Nations Conference on Trade and Development (UNCTAD). (2024). Trade and Development Report 2024. (Page 51) https://tinyurl.com/2c7tjrxu.

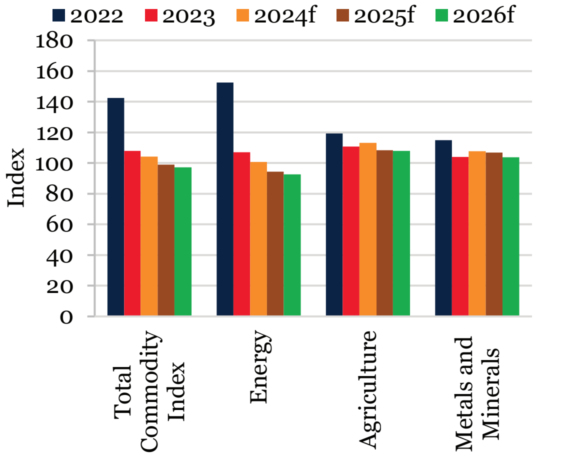
11 World Bank. (2024). 'Commodity Price Synchronization: A New Era?' https://tinyurl.com/nk59hcpx.

Chart I.11: Price movements across commodity groups



Source: World Bank Commodities Price Data (The Pink Sheet)

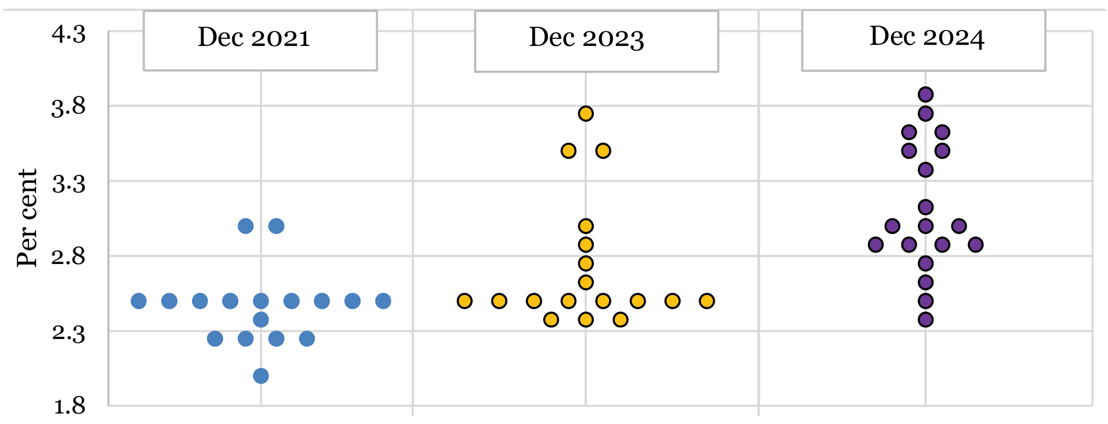
Chart I.12: Commodity prices projected to decline



Source: World Bank Commodity Price Forecasts (October 2024)

Note: 'f' refers to forecast

Chart I.13: Increased uncertainty over the long-term level of Federal Funds rate



Source: Bank for International Settlements (BIS), FOMC. Note: Each dot represents an individual FOMC member's assessment of the federal funds rate five years from the date of assessment.

1.17 In the short term, the US market expectations of the Federal Funds Rate (FFR) were much lower than the actual FFR level for both 2023 and 2024. Similar uncertainty may persist over the course of 2025.[12] One way to visualise the uncertainty regarding the FFR over the long term is through the expectations of policymakers about the 'long-run' policy rate. The Federal Open Market Committee (FOMC) presents a dot-plot of its members' assessment of the direction of the policy rate over different time horizons. Chart I.13 presents the dot-plots that represented the FOMC members' assessments in December 2021, December 2023, and December 2024. The dot-plots show that while

12 Ashworth, M., & Gilbert, M. (2025, January 2). Politics, economics and markets create a 2025 three-body problem. Bloomberg. https://tinyurl.com/mppdkbdr.

the long-run policy rate is likely to be higher, the variance in members' expectations is also larger, indicating increased uncertainty over the terminal policy rate.

Chart I.14: Policy rates in advanced economies

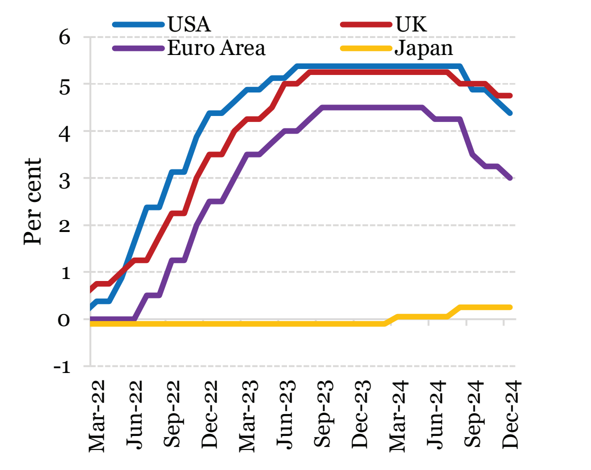
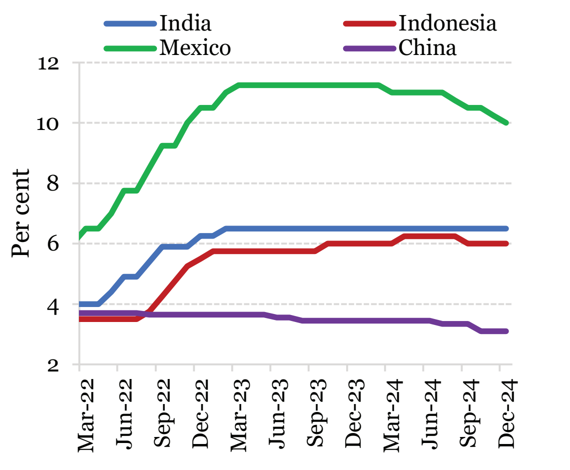


Chart I.15: Policy rates in emerging market economies



Source: Bank for International Settlements (BIS)

1.18 The success in inflation control, the consequent easing of monetary policies, and expectations of lower borrowing costs began to reflect in the downward trajectory of sovereign bond yields of advanced economies between April and September 2024. However, renewed global uncertainty over inflationary pressures and the direction of monetary policies have pushed bond yields up in October - December 2024. Lower growth prospects and deflationary pressures have pushed Chinese sovereign bond yields lower, thereby widening the sovereign yield spread between the world's two largest economies.

Chart I.16: Sovereign bond yields in advanced economies

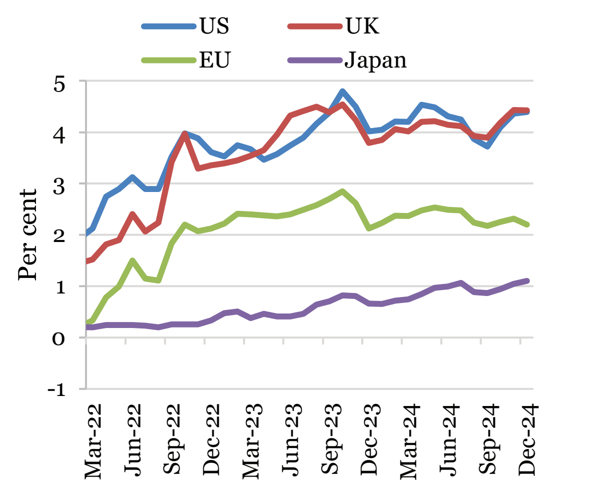
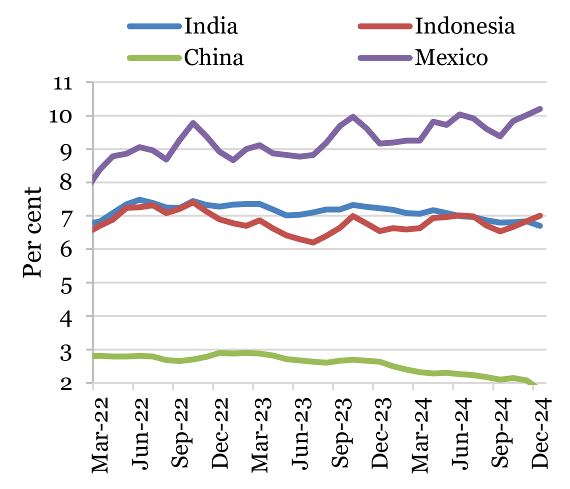


Chart I.17: Sovereign bond yields in emerging market economies



Source: Bloomberg

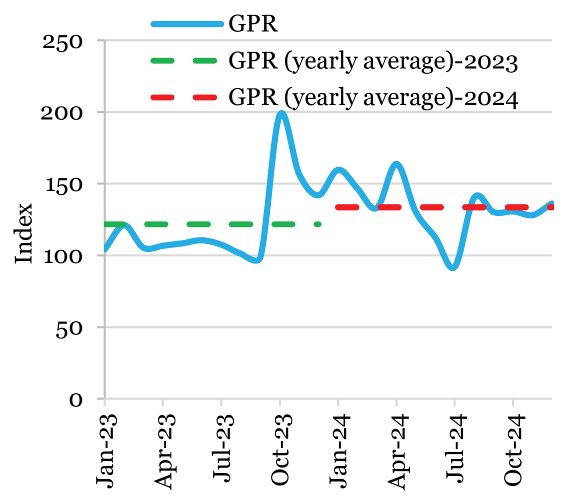
Note: Yield on 10-year sovereign bonds

Geopolitical uncertainties continue to pose risks to the global economic outlook

1.19 Geopolitical risks remain elevated (Chart I.18) due to ongoing conflicts, which pose significant risks to the global economic outlook. These risks can influence growth, inflation, financial markets, and supply chains. An intensification of the evolving conflicts in the Middle East, or the Russia-Ukraine conflict, could lead to market repricing of sovereign risk in the affected regions and disrupt global energy markets. The oil market is well-supplied for now. However, any damage to energy infrastructure could tighten supply, adding uncertainty to the global economic outlook.[13]

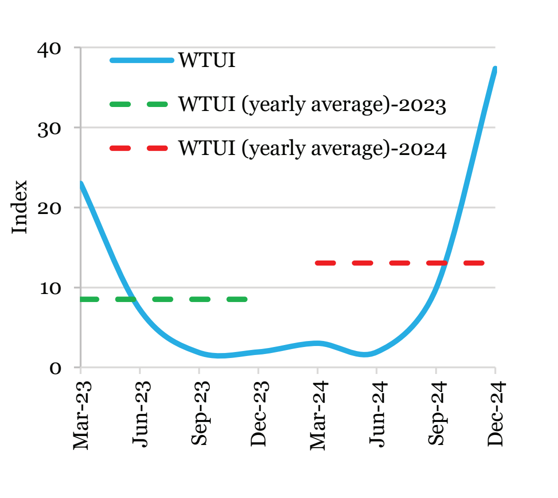
1.20 Tensions in the Middle East have disrupted trade through one of the critical shipping routes – the Suez Canal. About 15 per cent of global maritime trade volume normally passes through the Suez Canal. In response, several shipping companies have diverted their ships around the Cape of Good Hope, which has increased delivery times by 10 days or more, on average. These disruptions have led to higher freight rates along major shipping routes, which in turn impact global trade activity.

Chart I.18: Geopolitical Risk (GPR) Index higher in 2024



Source: Economic Policy Uncertainty https://www.policyuncertainty.com/gpr.html

Chart I.19: World Trade Uncertainty Index (WTUI) elevated in 2024



Source: Economic Policy Uncertainty https://worlduncertaintyindex.com/data/

1.21 Heightened risks are also evidenced by other indices, such as the Geopolitical Economic Policy Uncertainty index, which remains elevated due to global concerns about economic policies. Similarly, the World Trade Uncertainty Index has risen, driven by trade tensions and policy shifts in major economies. Trade policy uncertainty has increased sharply in recent months, though it has not yet reached the levels seen in 2018-19. The stock of import-restrictive measures within G20 economies continues to

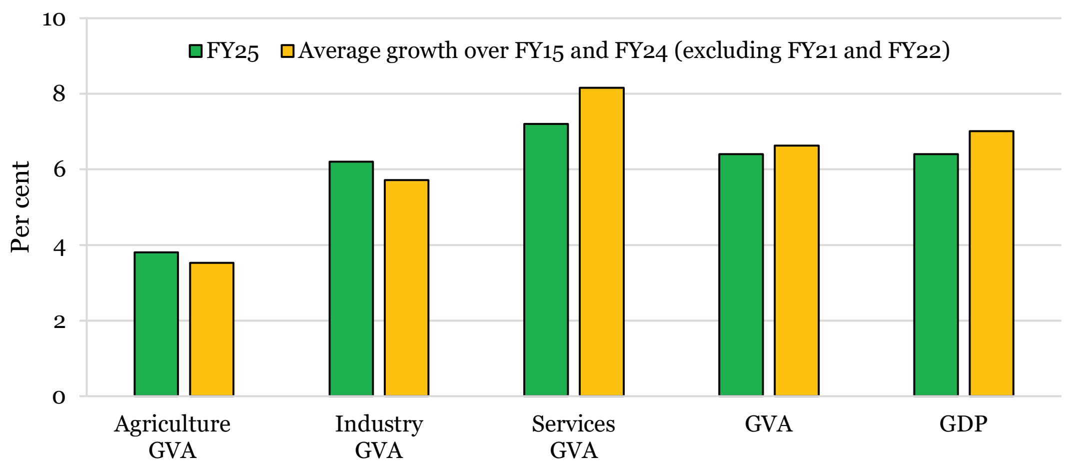
13 OECD. (2024, December). OECD Economic Outlook, Volume 2024 Issue 2. https://tinyurl.com/m6yn9wz2.

grow, now affecting 12.7 per cent of G20 imports—more than three times the coverage of such measures in 2015. If uncertainty persists and trade-restrictive measures continue to rise, they could increase costs and prices, deter investment, hinder innovation, and ultimately reduce global economic growth. In light of these developments, Chapter 5 of the Survey on the Medium-Term Outlook elaborates on the global factors and the importance of strengthening the levers of domestic growth.

DOMESTIC ECONOMY REMAINS STEADY AMIDST GLOBAL UNCERTAINTIES

1.22 As per the first advance estimates released by the National Statistical Office, Ministry of Statistics & Programme Implementation (MoSPI), the real gross domestic product (GDP) growth for FY25 is estimated to be 6.4 per cent. From the angle of aggregate demand in the economy, private final consumption expenditure at constant prices is estimated to grow by 7.3 per cent, driven by a rebound in rural demand. PFCE as a share of GDP (at current prices) is estimated to increase from 60.3 per cent in FY24 to 61.8 per cent in FY25. This share is the highest since FY03. Gross fixed capital formation (GFCF) (at constant prices) is estimated to grow by 6.4 per cent.

Chart I.20: Despite global uncertainty, India's growth remains close to decadal average (at constant prices)



Source: Calculations based on Statement 13: Annual and Quarterly Estimates of GDP at constant prices, MoSPI
Note: FY25 values are First Advance Estimates.

1.23 On the supply side, real gross value added (GVA) is also estimated to grow by 6.4 per cent. The agriculture sector is expected to rebound to a growth of 3.8 per cent in FY25. The industrial sector is estimated to grow by 6.2 per cent in FY25. Strong growth rates in construction activities and electricity, gas, water supply and other utility services are expected to support industrial expansion. Growth in the services sector is expected to remain robust at 7.2 per cent, driven by healthy activity in financial, real estate, professional services, public administration, defence, and other services. The analysis of growth trends in this chapter, hereinafter, is mostly based on the trends in the first half (H1) of FY25, on which the information base is more comprehensive.

Resilient recovery

1.24 The COVID-19 pandemic caused widespread disruptions to economies worldwide. Economic Survey 2023-24[14] compared the post-pandemic trends until Q4 FY24 with the pre-pandemic trajectory and concluded that the economy grew briskly enough to avert any permanent loss of output. This section extends the analysis to Q2 FY25 (ending September 2024) with a sectoral view of the economy.

1.25 The overall picture is encouraging. Aggregate GVA surpassed its pre-pandemic trend in Q1 FY25, and it now hovers above the trend in the H1 FY25 [15]. The agriculture sector remains strong, consistently operating well above trend levels. The industrial sector has also found its footing above the pre-pandemic trajectory. The robust rate of growth in the recent years has taken the services sector close to its trend levels (Chart I.21 to Chart I.24).

1.26 A closer look at industrial sub-sectors reveals a spectrum of performances (Chart I.25). Construction has been a standout, gaining momentum since mid-FY21 and soaring approximately 15 per cent above its pre-pandemic trend—an impressive feat driven by robust infrastructure development and housing demand. The utilities sector, including electricity, gas, water supply, and other services, reached its pre-pandemic trend by the end of FY23 and has consistently stayed above these levels. Manufacturing, while steadily recovering, remains slightly below its pre-pandemic trajectory. Meanwhile, mining continues to operate below its pre-pandemic trend.

1.27 The recovery within the services sector has been uneven (Chart I.26). Financial, real estate and professional services have taken the lead, surpassing pre-pandemic trend levels by the end of FY23. Public administration, defence, and other services followed suit, exceeding the trend for the first time in Q1 of FY25 since the onset of the pandemic. However, trade, hotels, transport, and communication services are gradually catching up with the pre-pandemic trend. These contact-intensive sectors faced challenges due to lockdown, restricted demand for travel, and reduced demand for hospitality, entertainment, and personal services.

14 Economic survey 2023-24, Chapter 1 – State of the Economy, Box I.1: Growth in GDP, GVA, and their components ensure no permanent losses in demand and output. https://tinyurl.com/r8ykzwj6.

15 H1 refers to the first half of the corresponding Financial Year that is April to September.

Chart I.21: Aggregate GVA recovery continues

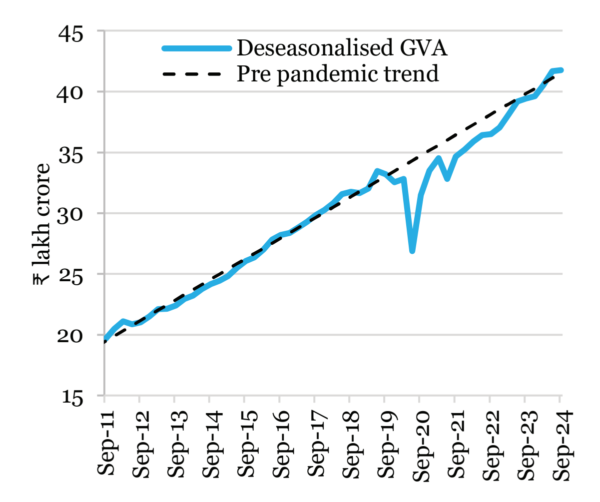


Chart I.22: Agriculture GVA sustained at higher levels

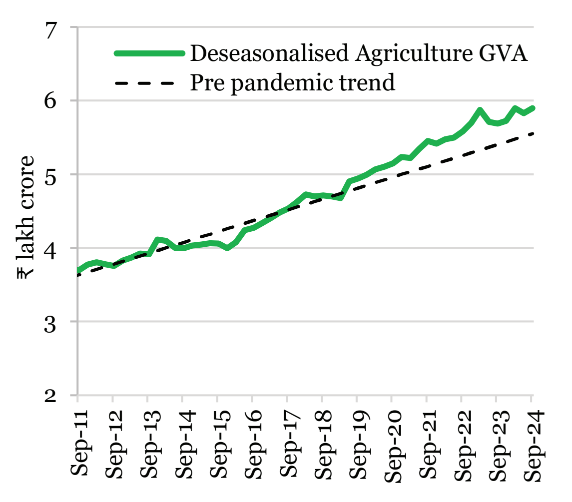


Chart I.23: Industrial GVA operating above the trend level

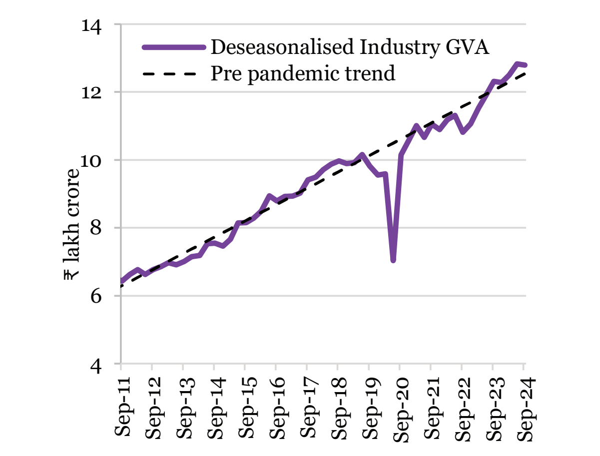


Chart I.24: Services GVA is close to its trend

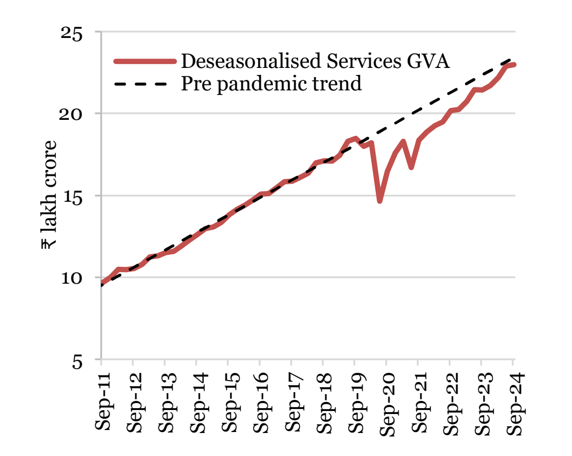


Chart I.25: Construction GVA operating well above trend levels, and manufacturing GVA gradually recovering

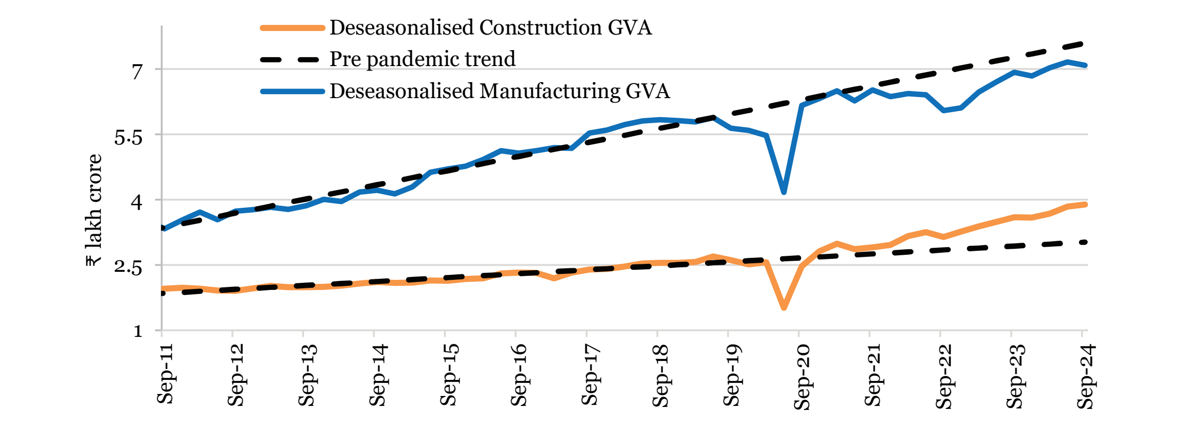
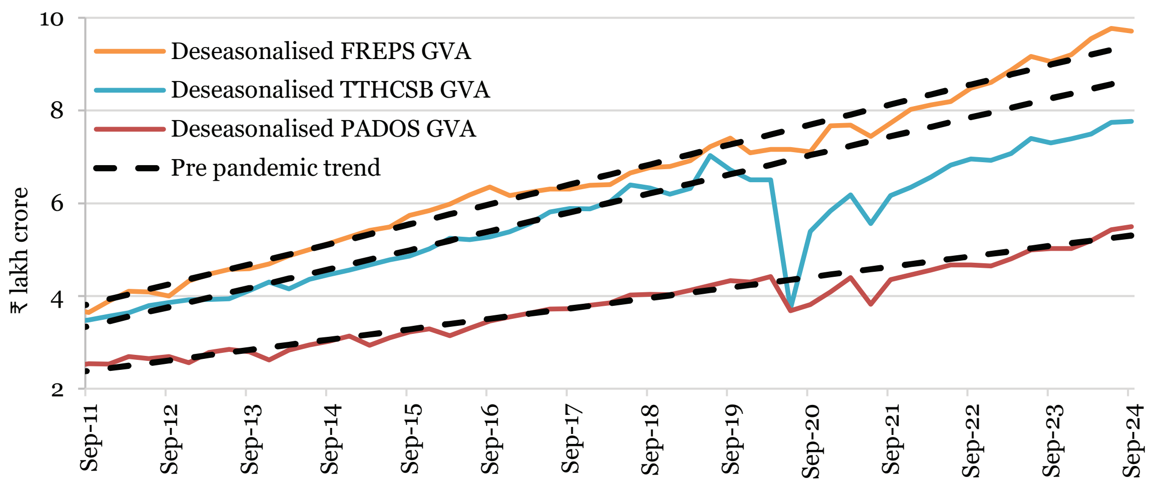


Chart I.26: Uneven recovery within the services sector



Source: Calculations based on Statement 13: Annual and Quarterly Estimates of GDP at constant prices, MoSPI

Note: i) **FREPS**- Financial, real estate and professional services ii) **TTHCSB** – Trade, transport, hotel, communication and services related to broadcasting iii) **PADOS** - Public administration, defence & other services. All de-seasonalised variables are derived from National Accounts variables at constant (2011-12) prices.

Growth in H1 FY25 driven by agriculture and services sector

1.28 The real GVA grew by 6.2 per cent in H1 FY25. A strong growth momentum in Q1 FY25 was followed by a subdued performance in Q2 FY25. The agriculture and services sectors emerged as key growth drivers during this period. However, the overall growth was tempered by moderation in industrial growth, particularly in manufacturing, which faced challenges from slowing global demand and supply chain disruptions.

Improved agricultural prospects in FY25

1.29 Agriculture growth remained steady in H1 FY25, with Q2 recording a growth rate of 3.5 per cent, marking an improvement over the previous four quarters. Healthy Kharif production, above-normal monsoons, and an adequate reservoir level supported agricultural growth. As per the first advanced estimates of agricultural production for 2024-25, total Kharif food grain production is estimated at a record 1647.05 lakh metric tonnes (LMT), higher by 5.7 per cent compared to 2023-24 and 8.2 per cent higher than the average food grain production in the past five years. The estimated increase is mainly on account of the rise in rice, maize, coarse grains and oilseeds output. A normal southwest monsoon in 2024 has improved the water levels in reservoirs, ensuring sufficient water for irrigation during the rabi crop production. As of 10 January 2025, rabi sowing of wheat and gram was 1.4 per cent and 0.8 per cent higher, respectively, compared to the previous year. Improved agricultural prospects also bode well for softening of food inflation pressures over the course of the year.

Manufacturing sector growth moderates but shows positive expectations

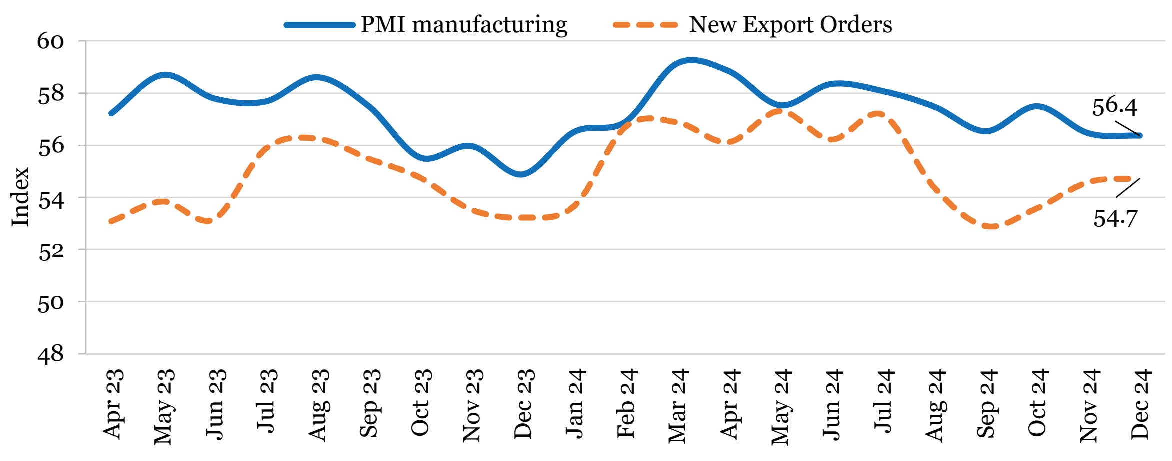
1.30 The industrial sector grew by 6 per cent in H1 FY25. Q1 saw a strong growth of 8.3 per cent, but growth moderated in Q2 due to three key factors. First, manufacturing exports slowed significantly due to weak demand from destination countries, and aggressive trade and industrial policies in major trading nations. Second, the above-average monsoon had mixed effects - while it replenished reservoirs and supported agriculture, it also disrupted sectors like mining, construction, and, to some extent, manufacturing. Third, the variation in the timing of festivities between September and October in the previous and current years led to a modest growth slowdown in Q2 FY25.

1.31 Disaggregated data reveals that while many manufacturing sub-sectors experienced growth, others faced challenges, likely due to global and seasonal factors. Oil companies suffered due to inventory losses and lower refining margins, while steel companies faced price pressures and lower global prices. The cement sector faced weak demand in Q2 due to heavy rains and lower selling prices. However, with the conclusion of the monsoon season and the expected pick-up in government capital expenditure, sectors such as cement, iron, and steel are expected to see a recovery. Further, mining and electricity are expected to normalise after the monsoon-related disruptions.[16]

1.32 Despite various challenges, India continues to register the fastest growth in manufacturing PMI, which is also reflected in Chart I.7 of the previous section. The latest Manufacturing PMI for December 2024 remained well within the expansionary zone. The expansion rate for December 2024 exceeded its long-term average, driven by new business gains, robust demand, and advertising efforts. Meanwhile, international orders grew to a four-month high midway through the third fiscal quarter, signalling recovering external demand, as reported by companies.

16 RBI Governor's Statement: December 6, 2024 https://tinyurl.com/4j6xwp2r.

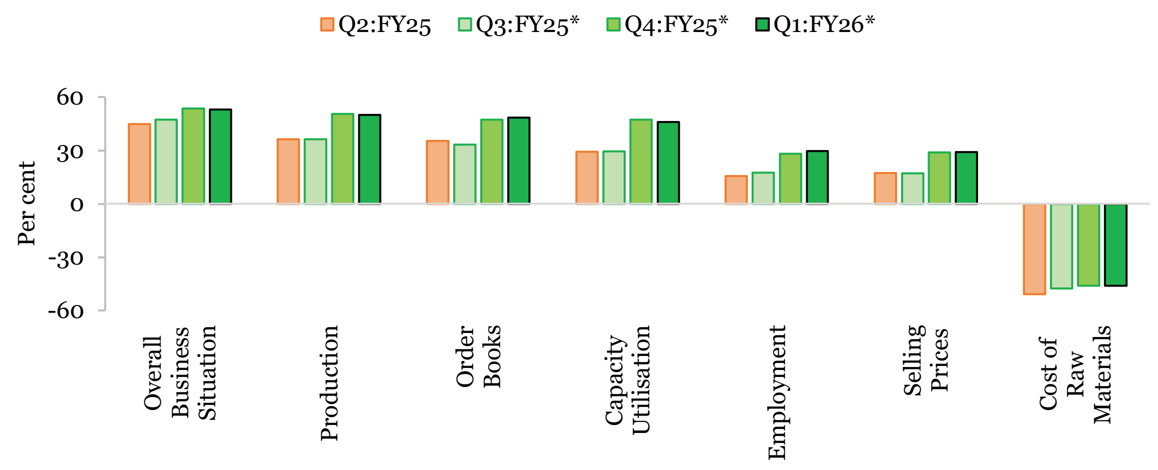
Chart I.27: Global slowdown impacted manufacturing in Q2 of FY25



Source: Compiled from various monthly HSBC India Manufacturing PMI reports

1.33 According to the RBI's Industrial Outlook Survey, manufacturing firms reported improved demand conditions in Q3 FY25 and expect further improvements in Q4 FY25 and Q1 FY26. The survey also reflected better expectations for production, order books, employment, capacity utilisation, and the overall business environment during Q4 FY25 and Q1 FY26.

Chart I.28: Improvement in business expectations



Source: RBI's Quarterly Industrial Outlook Survey

Note: * indicates expectations for the upcoming quarter; The survey results are summarised through a measure called Net Response, constructed as the difference between the proportions of respondents giving 'optimistic' and 'pessimistic' replies.

Robust growth in the services sector

1.34 The services sector continues to perform well in FY25. A notable growth in Q1 and Q2 resulted in 7.1 per cent growth in H1 FY25. Across sub-categories, all the sub-sectors have performed well. The robust performance of the services sector is also reflected in high-frequency indicators (HFIs). PMI services have been in an expansionary zone during H1 FY25, supported by growth in new orders, rise in output, improvement in sales and enhanced employment generation. The hospitality sector performed well, with hotel occupancy rates in H1 FY25 similar to the previous year. Average daily rates and revenue per room increased due to higher corporate and leisure travel. Air cargo activity grew in double digits, while port traffic remained stable. Information Technology (IT) companies also performed better than the previous quarter.[17]

Analysis of GDP by expenditure categories

1.35 India's GDP at constant (2011-12) prices grew by 6.7 per cent and 5.4 per cent in Q1 and Q2 FY25, respectively. This implied a real GDP growth of 6.0 per cent in the first half of the current fiscal.

Chart I.29: GDP growth in H1 FY25 at 6.0 per cent

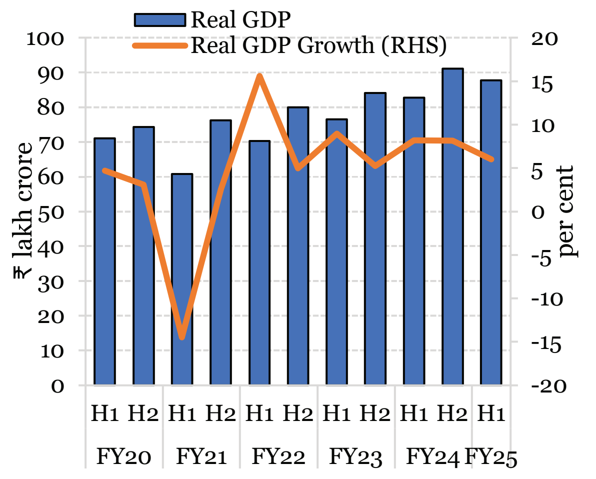
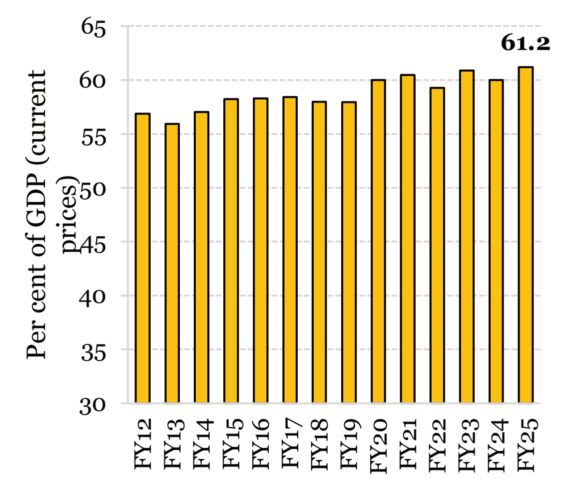


Chart I.30: Highest share of private consumption in H1 across all years



Source: Calculations based on Statement 13: Annual and Quarterly Estimates of GDP at constant prices and Statement 14: Annual and Quarterly Estimates of GDP at current prices, MoSPI

1.36 From a demand perspective, Private Final Consumption Expenditure (PFCE) firmed up in H1 FY25, growing by 6.7 per cent YoY. While National Accounts data is not disaggregated by geography, indicators such as 2-wheeler and 3-wheeler sales and tractor sales signal that rural demand contributed to private consumption growth. This is also reflected in the January 2025 round of National Bank for Agriculture and Rural Development (NABARD's) Rural Economic Conditions and Sentiments Survey, where 78.5 per cent of rural households reported an increase in their consumption expenditure during the last year.[18] The impulse from rural demand is expected to continue in the second half of the fiscal year with the returns from a bumper Kharif crop and higher MSPs for a prospectively good Rabi crop.

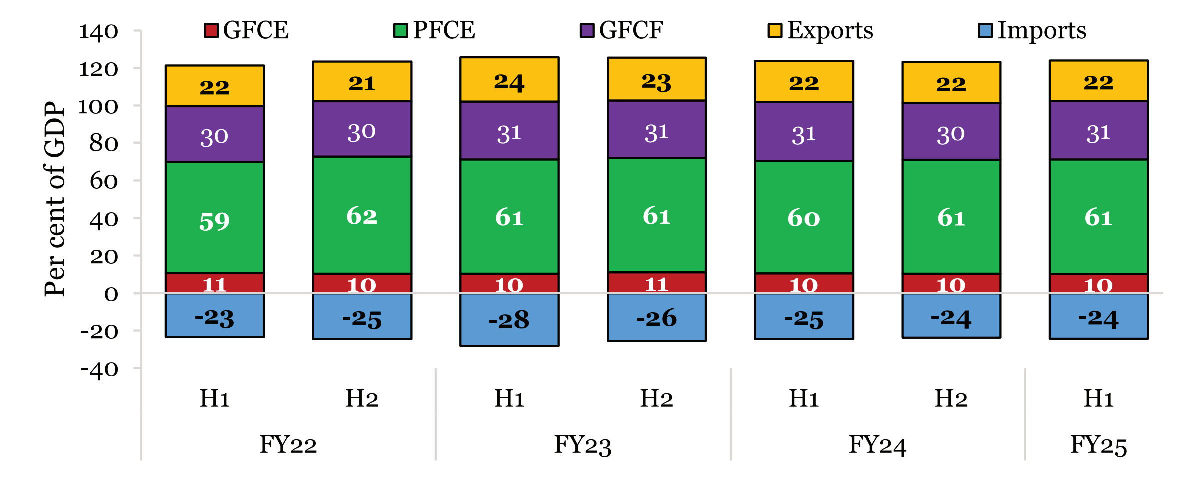
17 Reserve Bank of India. (2024, December 24). RBI Bulletin December 2024. https://tinyurl.com/rur6xe8u.

18 NABARD, Rural economic conditions & sentiments survey. (January 2025) https://tinyurl.com/3cu6pfk9.

1.37 On the other hand, indicators of urban demand presented mixed trends. According to data from the Federation of Automobile Dealers Associations (FADA)[19], the growth of passenger vehicle sales has slowed to 4.2 per YoY cent in April – November 2024 compared to 9.2 per cent in the corresponding period of the previous year. Fast-moving consumer goods (FMCG) sales in urban areas, as per Nielsen IQ, have recorded a moderate growth in H1FY25. However, there is steady growth of 7.7 per cent YoY in air passenger traffic in April – November 2024. The 7.3 per cent YoY growth indicated by the First Advance Estimates for PFCE at constant prices for FY25 indicates a pick-up in the most recent months.

1.38 The moderation in real GDP growth can be traced to a softening of growth in Gross Fixed Capital Formation (GFCF) from 10.1 per cent in H1 FY24 to 6.4 per cent in H1 FY25. Q1 FY25 witnessed a slowdown in capital expenditure across different levels of government on account of the conduct of the general elections. Private sector investment growth may have remained subdued thus far in FY25 on account of the domestic political timetable, global uncertainties and overcapacities.

Chart I.31: Steady shares of investment and consumption in GDP (at current prices)

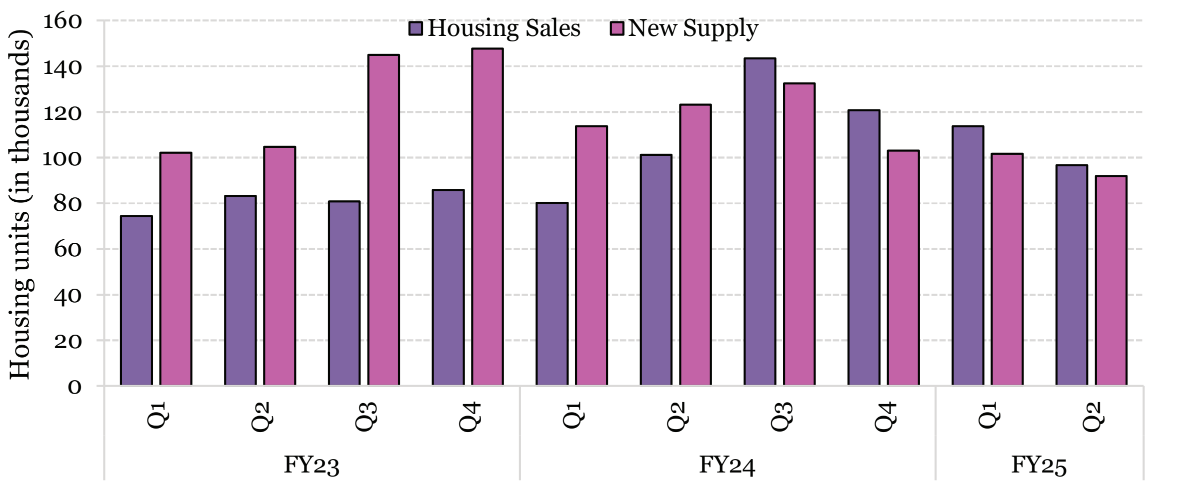


Source: Calculations based on Statement 14: Annual and Quarterly Estimates of GDP at current prices, MoSPI

1.39 An additional reason for the slowdown in capital formation growth in Q2 FY25 may have emanated from the moderation in residential investment by households in this quarter, which is on the back of a sharp uptick over the last few quarters. Industry reports, however, point out that the correction in demand-supply metrics in this sector is indicative of market normalisation after a period of robust performance. An inventory overhang of 23 months signals healthy demand momentum in the segment.

19 FADA November 2024 Press Release - https://tinyurl.com/2rnwzj2r.

Chart I.32: Moderating housing sales and launches on the back of a high base in the top 8 cities[20]



Source: Various Real Insight Residential reports by Proptiger

1.40 The slowdown in investment activity is likely temporary. Green shoots in capital formation are visible. Union government capex is up 8.2 per cent in July – November 2024 and is expected to pick up further pace. Early results of the RBI's Order Books, Inventory, and Capacity Utilisation Survey (OBICUS) show that the seasonally adjusted capacity utilisation (CU) in manufacturing firms was 74.7 per cent in Q2 FY25, above the long-term average of 73.8 per cent.[21] A private sector report's[22] analysis of a sample of capital goods companies indicates that the order books of these companies have registered a sharp increase of 23.6 per cent in FY24 as against a compund anual growth rate (CAGR) of 4.5 per cent in the preceding four years. Moreover, in H1 FY25, there has been a growth of 10.3 per cent compared to the end of FY24. The RBI's report on private investments showed that investment intentions increased to ₹2.45 lakh crore for FY25 as compared to ₹1.6 lakh crore for FY24. Along with fresh investment, some of the existing intentions would spill over and be implemented in FY26.

1.41 On the external front, exports of goods and non-factor services at constant prices increased by 5.6 per cent in H1 FY25, while imports increased by 0.7 per cent. In Q2 FY25, imports of goods and services at constant prices contracted by 2.9 per cent, primarily driven by a decline in commodity prices. As a result, net exports contributed positively to real GDP growth in this period.

1.42 As India's economy continues to expand, the growth process has been ably supported by stability on fronts such as inflation, fiscal health, and balance of payments.

20 The top 8 cities refer to Ahmedabad, Bangalore, Chennai, Delhi-NCR, Hyderabad, Kolkata, Mumbai, and Pune.
21 Footnote no. 19, RBI Governor's Statement: December 6, 2024 https://tinyurl.com/4j6xwp2r.
22 CARE Ratings. (2024, November). India's capex story gives a mixed picture. https://tinyurl.com/54ed858f.

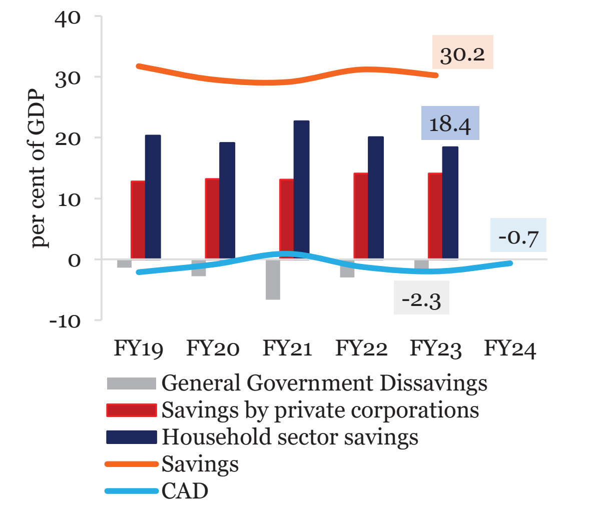
The following section presents a closer examination of these stability factors and provides valuable insights into the resilience and sustainability of the Indian economy in the face of global and domestic challenges.

ECONOMY CHARACTERISED BY STABILITY AND INCLUSIVITY ON MULTIPLE FRONTS

Improving public finances support macro stability

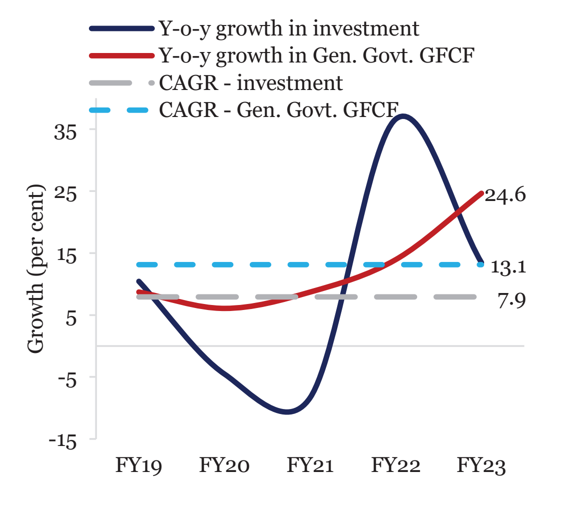
1.43 Since the COVID-19 pandemic, judicious fiscal management has helped to rein in general government dis-savings (Chart I.33). This assumes greater significance in sustaining the overall savings in the economy. With private corporate savings hovering around 14 per cent of GDP, persistent general government dis-savings could have implied a greater reliance on foreign funding. Prudent fiscal management in the last four years kept the overall savings-investment gap from widening and ensured a comfortable financing of the current account deficit, even though the household saving rate moderated. (Chart I.34 below).

Chart I.33: Containment of general government dis-savings has contributed to macro-stability



Source: Statement 1.9, National Accounts Statistics 2024, MoSPI; Table 131: India's Overall Balance of Payments, Handbook of Statistics on Indian Economy, RBI.

Chart I.34: General government GFCF growth has outpaced overall investment growth

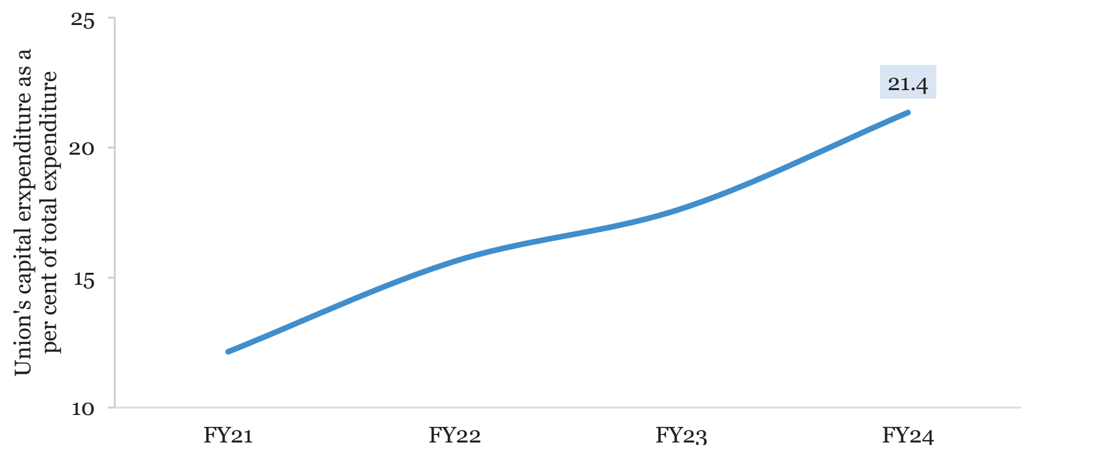


Source: Statement 1.11, National Accounts Statistics 2024, MoSPI.

Fiscal discipline of the union government

1.44 The Union government's indicators of fiscal discipline have improved progressively. Quality of expenditure approximated by capital expenditure as a per cent of total expenditure of the union, has continuously improved since FY21.

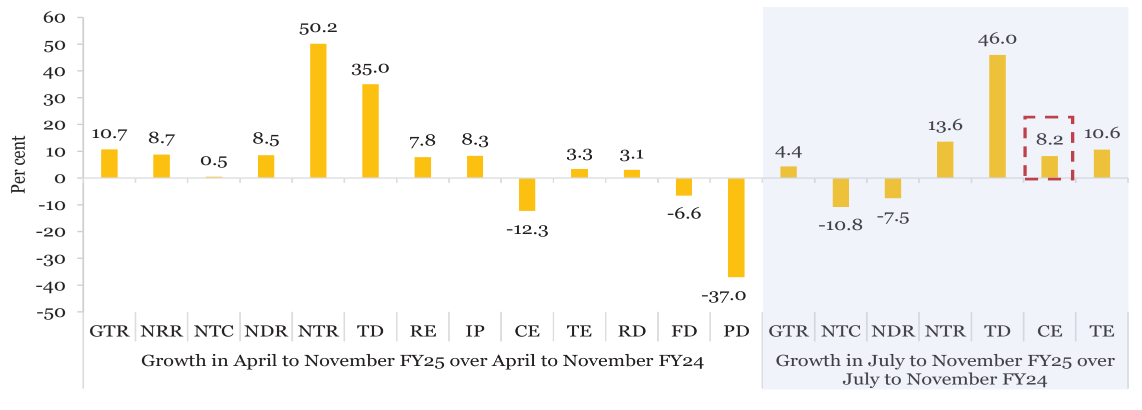
Chart I.35: Strong focus on fiscal discipline



Source: Union Budget documents. Provisional actuals for FY24.

1.45 During April - November 2024 (Chart I.36 below), three major facts stand out in union finances. First, following an unprecedented expansion of capital expenditure in the last four years, it remained subdued during Q1 FY25, owing to general elections. However, it rebounded after July despite a reduction in non-debt receipts owing to an increase in the devolution of taxes to states. Until November 2024, defence, railways and road transport accounted for about 75 per cent of the capital expenditure, whereas significant YoY growth occurred in power and food and public distribution. Second, despite the gross tax revenue (GTR) increasing by 10.7 per cent YoY during April-November 2024, the tax revenue retained by the Union, net of devolution to the states, hardly increased. This was because of increased tax devolution, which helped the states to manage their expenditures smoothly. Thirdly, as of November, the deficit indicators of the union were comfortably placed, leaving ample room for developmental and capital expenditure in the rest of the year.

Chart I.36: Sound and sure footing of union finances in FY25



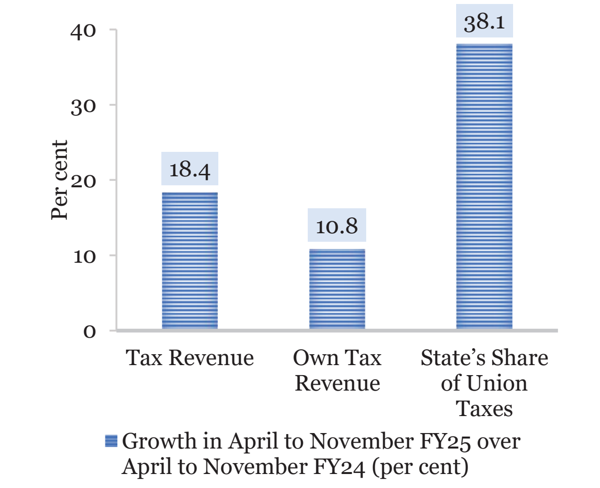
Source: CGA monthly provisional accounts.

Note: GTR- Gross Tax Revenue; NRR-Revenue Receipts (net to Centre); NTC-Tax revenue (net to Centre); NDR-Non-debt receipts; TD-Tax devolution to States; RE-Revenue Expenditure; IP-Interest Payments; CE-Capital Expenditure; TE-Total Expenditure; FD-Fiscal Deficit; RD-Revenue Deficit; PD-Primary Deficit.

Varying patterns in state finances

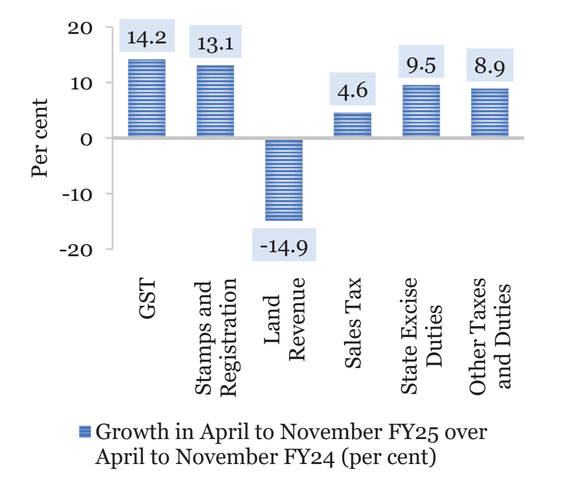
1.46 A review of preliminary unaudited estimates of 27 states[23] for the period April - November 2024[24] corroborates the second point above (Chart I.37). The GTR of the union and own tax revenue (OTR) of the states have increased at comparable pace during this period. However, the overall tax revenue position of the state governments appears better as of November, because of increased tax devolution by the union. Among the state-specific taxes, stamps and registration, sales tax, state excise duties, and other taxes and duties registered positive growth, whereas land revenue[25] declined, for states as a collective (Chart I.38).

Chart I.37: Greater reliance on share in central taxes



Source: CAG monthly provisional accounts[26]

Chart I.38: Growth exhibited by most of own taxes



Source: CAG monthly provisional accounts[27]

1.47 For 15 states[28], OTR accounted for more than half of their total tax receipts (Chart I.39), the highest being Telangana at 88 per cent, followed by Karnataka and Haryana at 86 per cent each. Further, states with a higher ratio of own revenue receipts (ORR) to total revenue receipts also tended to have relatively lower ratios of revenue deficit to total revenue receipts (Chart I.40).

23 Andhra Pradesh (AP), Arunachal Pradesh (AR), Assam (AS), Bihar (BR), Chhattisgarh (CG), Gujarat (GJ), Haryana (HR), Himachal Pradesh (HP), Jharkhand (JH), Karnataka (KA), Kerala (KL), Madhya Pradesh (MP), Maharashtra (MH), Manipur (MN), Meghalaya (ML), Mizoram (MZ), Nagaland (NL), Odisha (OD), Punjab (PB), Rajasthan (RJ), Sikkim (SK), Tamil Nadu (TN), Telangana (TS), Tripura (TR), Uttar Pradesh (UP), Uttarakhand (UK) and West Bengal (WB).

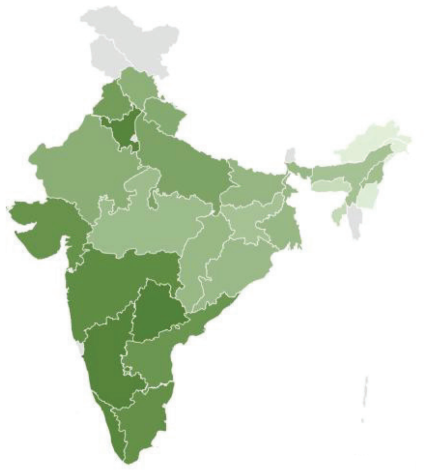
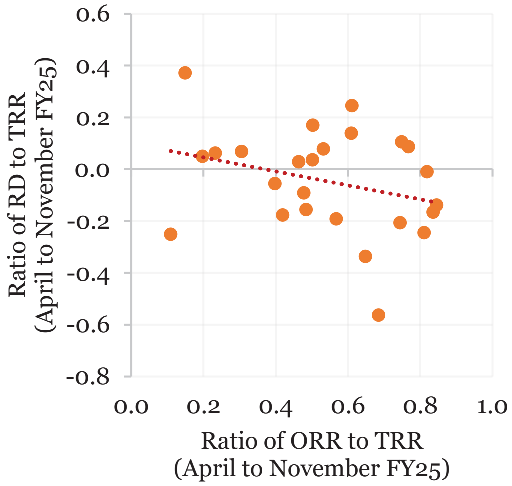
24 April to July reference period for Jharkhand; April to September for Arunachal Pradesh and Manipur.

25 Land revenue for Himachal Pradesh included in 'other taxes and duties'.

26 Share of central taxes for Mizoram and Sikkim included in 'other taxes and duties'.

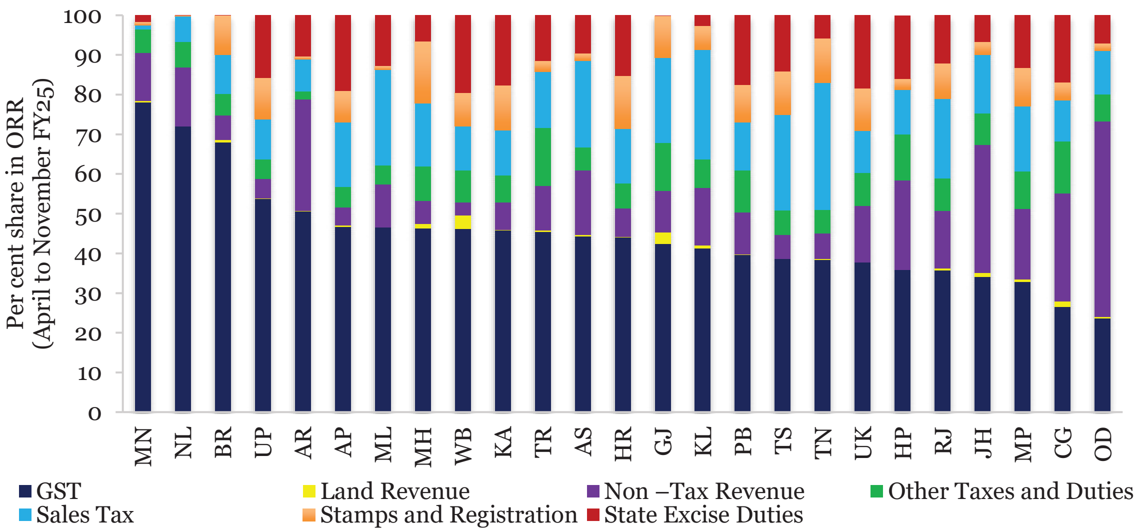
27 Ibid.

28 Out of 25 States; Mizoram and Sikkim excluded.

Chart I.39: Distribution of reliance on OTR – a diverse scenario across states	Chart I.40: Correlation between own revenue collection & revenue account health
	
Source: CAG monthly provisional accounts	Source: CAG monthly provisional accounts RD- revenue deficit, ORR-own revenue receipts, TRR-total revenue receipts.

1.48 For 23 States[29], GST was the main source of revenue amongst ORR with the greatest reliance thereon by Manipur and Nagaland at 78 per cent and 72 per cent, respectively (Chart I.41). States garnering the highest shares in respective ORRs w.r.t. stamps & registration, sales tax and state excise duties were Maharashtra, Tamil Nadu and West Bengal, respectively. Odisha exhibited the highest share of non-tax revenue in ORR at 49 per cent.

Chart I.41: States' own revenue receipts through an assorted lens



Source: CAG monthly provisional accounts

29 Ibid.

1.49 The revenue expenditure of the states grew at 12 per cent (YoY) during April to November 2024 (Chart I.42), with subsidies and committed liabilities[30] registering a growth of 25.7 per cent and 10.4 per cent, respectively (Chart I.43). With expenditure on capital account for states declining by 5.6 per cent, total expenditure grew by 9.5 per cent. However, 11 states witnessed an increase in capex.

1.50 In the quality of expenditure, measured by capital outlay as a per cent of revenue expenditure over the five years ending FY24, states[31] exhibited considerable variation (Chart I.44).

Chart I.42: Pick-up in states' capex expected in H2FY25

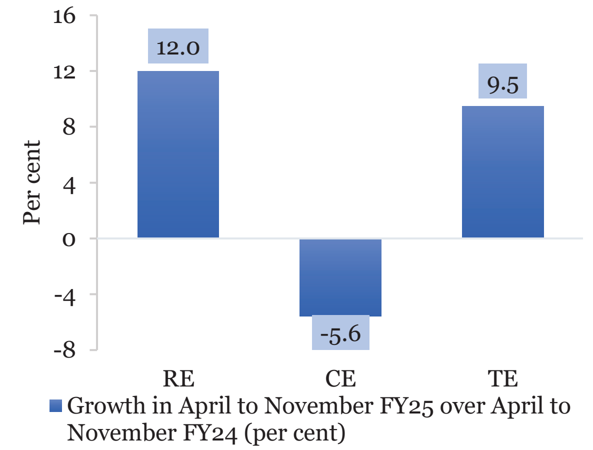
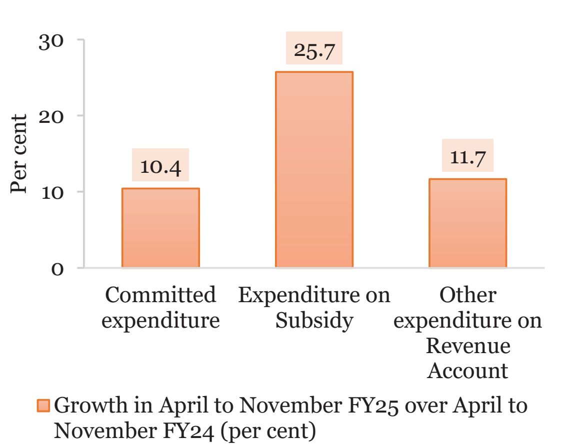
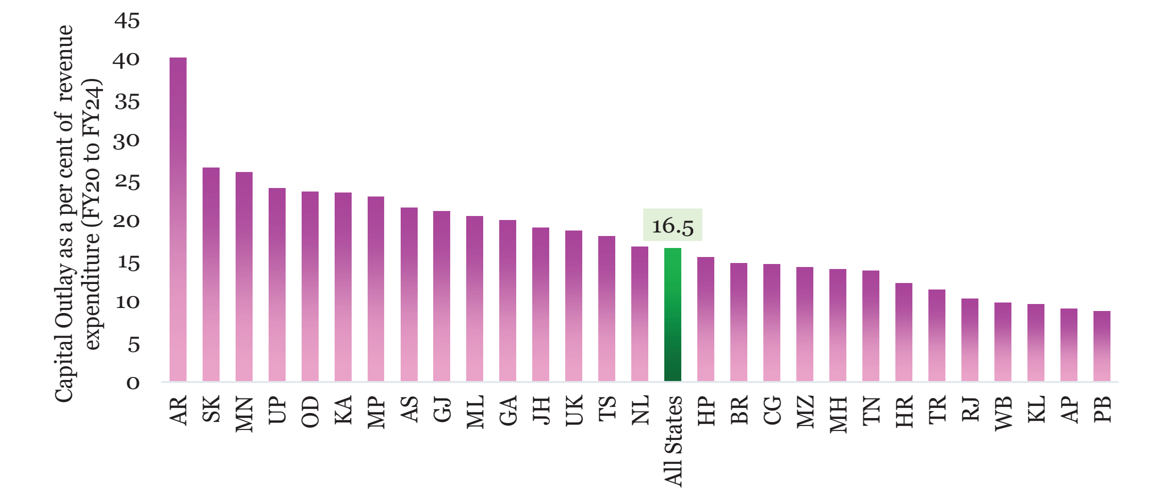


Chart I.43: Allocative efficiency considerations need attention



Source: CAG monthly provisional accounts.
RE-revenue expenditure; CE-expenditure on capital account; TE-total expenditure.

Chart I.44: Varying degree of capital outlay as a per cent of revenue expenditure



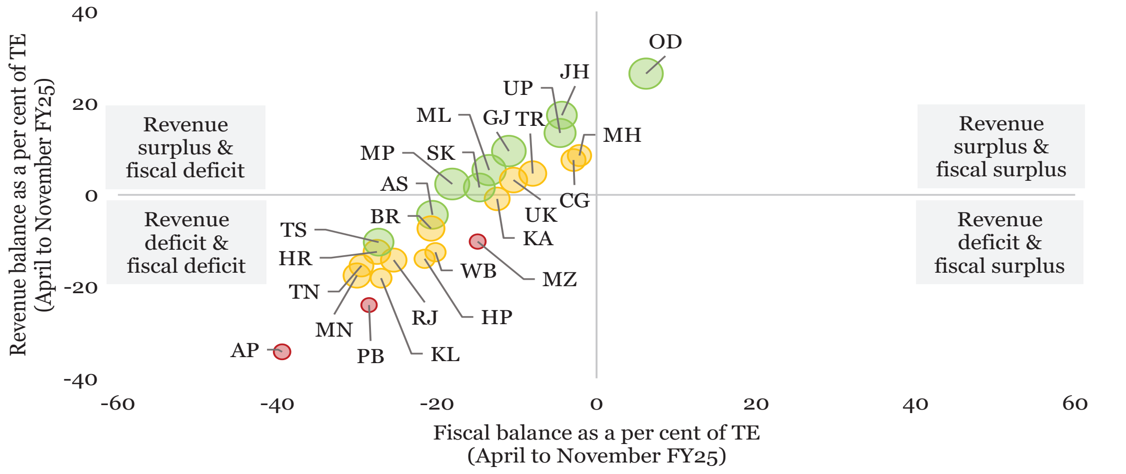
Source: RBI e-STATES database. Revised estimates for FY24.

30 Interest payments, salary and pension. For Mizoram and Sikkim, expenditure on pension and subsidy; for Karnataka and Tamil Nadu, expenditure on salaries & wages and subsidies; and for Arunachal Pradesh, expenditure on subsidies included in 'other expenditure on revenue account'.

31 28 states.

1.51 In April-November 2024, 11 States maintained revenue surplus (Chart I.45).The chart shows that revenue surplus (or lower revenue deficit) is corrleated with higher capital expenditure.

Chart I.45: Strong correlation between capex and fiscal space



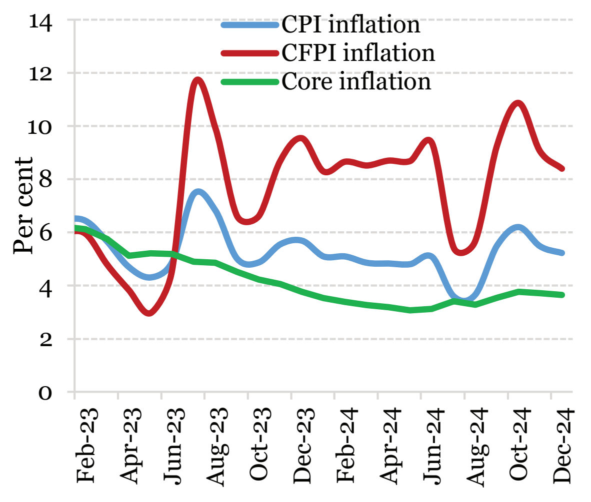
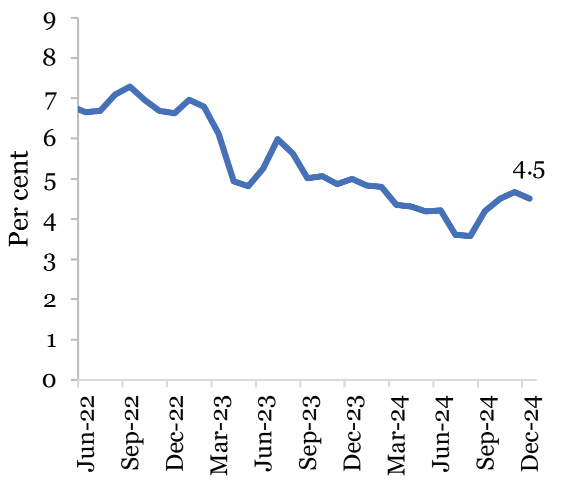
Source: CAG monthly provisional accounts. Excludes Arunachal Pradesh and Nagaland.

Note: The size and colour of the bubble represents capital expenditure as a per cent of total expenditure (TE) - red for less than 7 per cent, yellow for 7 to 14 per cent and green for 14 to 21 per cent.

Inflation – a combination of low and stable core inflation with volatile food prices

1.52 Retail headline inflation, as measured by the change in the Consumer Price Index (CPI), has softened from 5.4 per cent in FY24 to 4.9 per cent in April – December 2024. The decline is attributed to a 0.9 percentage point reduction in core (non-food, non-fuel) inflation between FY24 and April – December 2024. While the average inflation in FY25 has trended downward, monthly volatility in food prices and a select few commodities have been responsible for CPI inflation printing towards the upper side of the tolerance band of 4 (+/-) 2 per cent.

1.53 Pressures in food prices have been driven by factors such as supply chain disruptions and vagaries in weather conditions. Food inflation, measured by the Consumer Food Price Index (CFPI), has increased from 7.5 per cent in FY24 to 8.4 per cent in FY25 (April-December), primarily driven by a few food items such as vegetables and pulses. Chart I.47 plots headline retail inflation excluding the following commodities – tomato, onion and potato, (TOP). These commodities together constitute 2.2 per cent of the CPI basket.

Chart I.46: Food price pressures driving retail inflation	Chart I.47: CPI inflation excluding TOP commodities significantly lower[32]
	

Source: Consumer Price Indices released by Central Statistical Office (CSO), MoSPI

External sector stability safeguarded by services trade and record remittances

1.54 India's external sector displayed mixed trends, primarily due to volatile global conditions. A decline in commodity prices affected India's merchandise exports through the petroleum goods channel. Data on merchandise trade shows that India's merchandise exports grew by 1.6 per cent YoY in April – December 2024.[33] However, non-petroleum exports (on the same comparison basis) were up by 7.1 per cent. Non-petroleum and non-gems and jewellery exports rose by 9.1 per cent. Merchandise imports rose by 5.2 per cent. This growth was primarily driven by an increase in non-oil, non-gold imports. Gold imports also grew, influenced by higher global prices, early purchases ahead of festive spending, and demand for safe-haven assets.

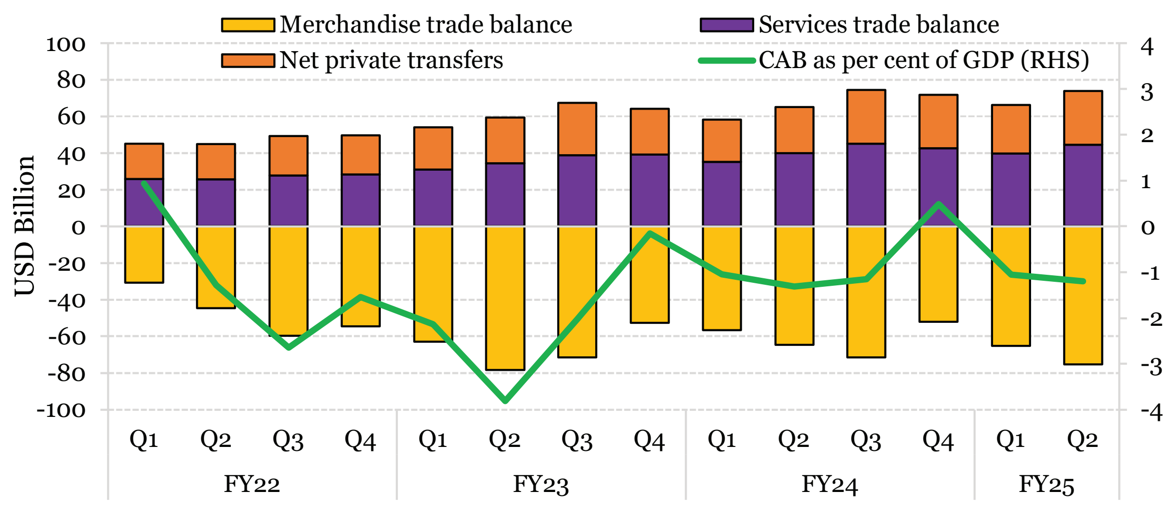
1.55 While the outpacing of merchandise imports over merchandise exports widened India's merchandise trade deficit, India's services trade surplus has lent balance to the overall trade deficit. India's robust services exports have propelled the country to secure the seventh-largest share in global services exports, underscoring its competitiveness

32 Further, if gold and silver are also excluded, CPI inflation excluding these five commodities (which constitute 3.4 per cent of the CPI basket) is even lower.

33 https://www.commerce.gov.in/wp-content/uploads/2025/01/PIB-Release_15012025-final.pdf.

in this critical sector. In addition to the services trade surplus, remittances from abroad led to a healthy net inflow of private transfers. As per the World Bank, India was the top recipient of remittances in the world, driven by an uptick in job creation in OECD economies.[34] These two factors combined to ensure that India's current account deficit (CAD) remains relatively contained at 1.2 per cent of GDP in Q2 FY25.

Chart I.48: Services trade surplus and private transfers lending balance to the external sector



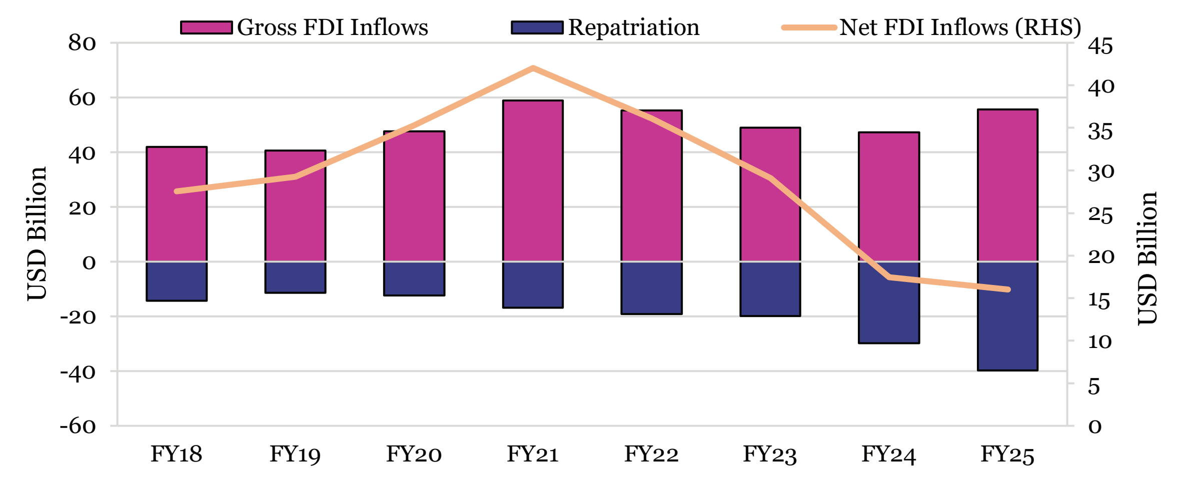
Source: Tables 196 and 197, RBI Handbook of Statistics on the Indian Economy
Note: CAB – Current Account Balance

1.56 Comfortable financing of the CAD by the capital account has ensured external sector stability. Within capital flows, gross foreign direct investment (FDI) inflows increased 17.9 per cent YoY in April – November 2024. Gross FDI inflows during April – November in FY25 are higher than the levels witnessed in the corresponding period of any previous years except FY21. Net FDI inflow declined over this period, primarily on account of the uptick in repatriation, which is higher by 33.2 per cent YoY after a growth of 51.5 per cent in FY24. The rise in repatriation through the channels of secondary sales and Initial Public Offerings (IPOs) by multinational companies amid strong stock market performance points to investor confidence in profitable exits for direct investors.[35]

34 World Bank. (2024, June 26). In 2024, remittance flows to low- and middle-income countries are expected to reach $685 billion, larger than FDI and ODA combined. https://tinyurl.com/38esxhzr.

35 "Behind India's growth over last 10 yrs—increase in repatriations, steady FDI inflows". https://tinyurl.com/2tt3pxsf.

Chart I.49: Rise in repatriation even as gross FDI inflows remain robust



Source: Calculations based on FDI figures from RBI Bulletin Table no. 34

1.57 On the other hand, foreign portfolio investment (FPI) flows have been volatile in the second half of 2024, primarily on account of global geopolitical and monetary policy developments. Net FPI inflows slowed to USD 10.6 billion in April – December 2024 from USD 31.7 billion during the same period the previous year. The inclusion of India's sovereign government securities (G-secs) of certain tenors in the JP Morgan EM Bond Index induced heightened activity within the debt segment of the FPIs. Further elucidation of the impact of the inclusion of Indian G-secs in global bond indices can be seen in Chapter 3.

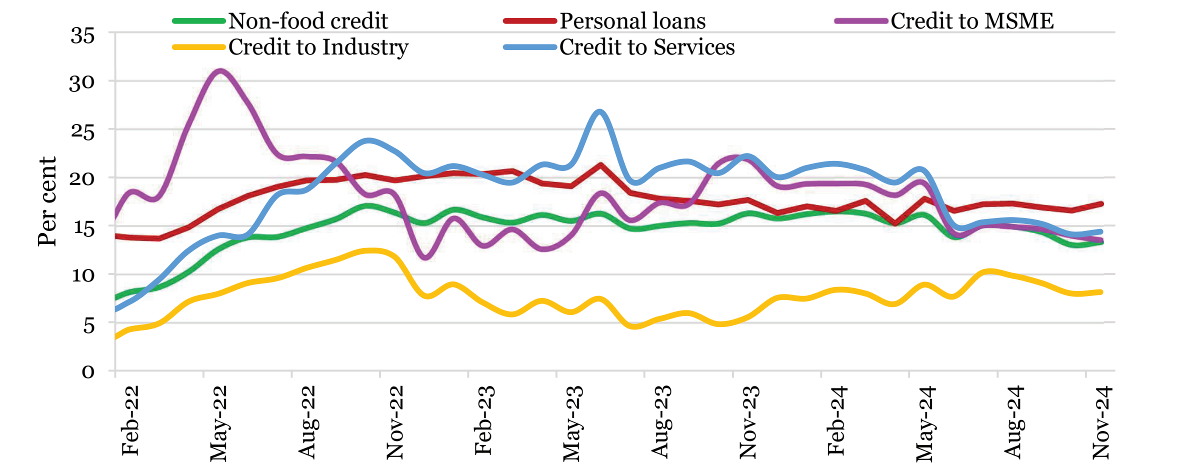
1.58 As a result of stable capital flows, India's foreign exchange reserves increased from USD 616.7 billion at the end of January 2024 to USD 704.9 billion in September 2024 before moderating to USD 634.6 billion as on 3 January 2025. India's forex reserves are sufficient to cover 90 per cent of external debt and provide an import cover of more than ten months, thereby safeguarding against external vulnerabilities.

1.59 Looking ahead, global policy changes could influence India's external trade. The evolving trade stance of a few major economies could affect key Indian export sectors such as chemicals, machinery, textiles, and electronics. In the short term, diversifying export markets is essential, while medium-term efforts should focus on increasing market share. Over the long term, India must position itself as a strategic partner in high-value sectors like biotechnology and semiconductors. Strategic technology partnerships provide opportunities for enhanced cooperation in key areas like space, semiconductors, quantum technologies and advanced telecommunications.

Financial sector prospects amid a moderation of growth in credit disbursal

1.60 The banking and financial sector remains stable and well-capitalised, and is catering to the financing needs of the economy. While credit disbursal by scheduled commercial banks (SCBs) is growing in double-digits, there has been a moderation in the growth in recent months. This is on the back of a high base and also due to regulatory tightening in sectors where high growth was observed. In view of high growth in certain components of consumer credit, the RBI had, on 16th November 2023[36], raised the risk weights on unsecured retail loans by 25 basis points. However, expansion in the segment continues to be broad-based, with housing loans as the major contributor. Apart from personal loans, credit to the services sector is the other major driver of expansion in gross bank credit. Industrial credit growth is picking up but remains below growth rates in other major sectors.

Chart I.50: Moderation in growth of bank credit to different sectors



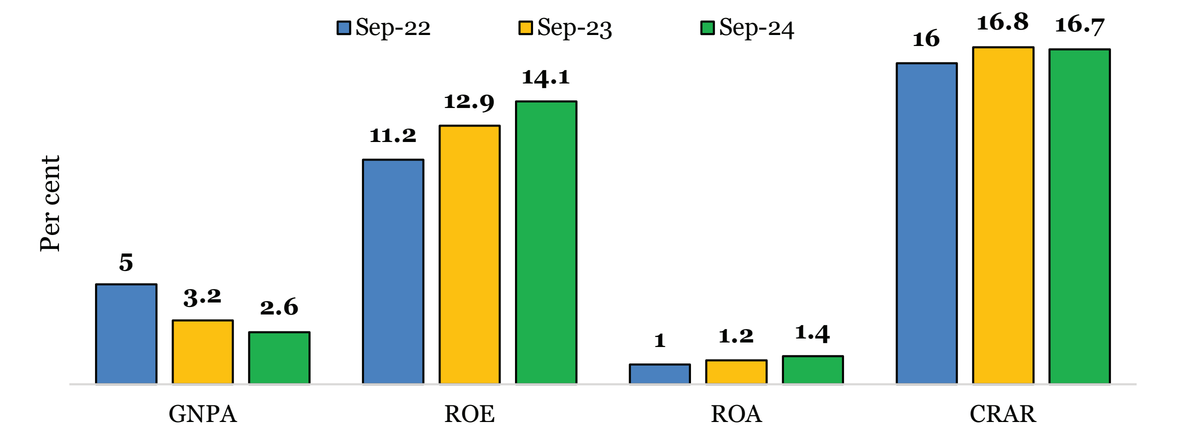
Source: Calculations based on credit figures in Table no. 170 - Deployment of Gross Bank Credit by Major Sectors, Handbook of Statistics on the Indian Economy.

1.61 Stability in the banking sector is underscored by declining asset impairments, robust capital buffers, and strong operational performance. As per the RBI's Financial Stability Report (FSR), December 2024[37], the gross non-performing assets (NPAs) in the banking system have declined to a 12-year low of 2.6 per cent of gross loans and advances. The capital-to-risk-weighted assets ratio (CRAR) for SCBs stands at 16.7 per cent as of September 2024, well above the norm. The profitability of SCBs improved during H1 FY25, with profit after tax (PAT) surging by 22.2 per cent YoY, while the Return on Equity (RoE) and Return on Assets (RoA) have improved on a YoY basis. Macro stress tests suggest that banks' overall capital levels would stay above the regulatory minimum even in adverse scenarios.

36 https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12567&Mode=0.

37 Reserve Bank of India. (2024, December). Financial Stability Report. https://tinyurl.com/zv662e5d.

Chart I.51: Stable banking system indicators



Source: Various editions of RBI Financial Stability Report

1.62 While the long-term stability of the banking system is safeguarded, there was scrutiny over the short-term dynamics emerging from the mismatch of credit and deposit growth rates. The RBI FSR's (June 2024)[38] analysis of previous episodes where credit growth outpaced deposit growth shows that the average duration of such cycles where credit growth exceeds deposit growth is 41 months. The merger of a bank with a non-bank has elongated the cycle in this episode. The analysis reveals that credit growth precedes deposit growth and that convergence is usually achieved through a fall in credit growth.

1.63 Another area of concern within the banking system is the stress on unsecured credit, i.e., personal loans and credit cards. As of September 2024, 51.9 per cent of the fresh addition to the stock of NPAs in the retail loan portfolio emanated from the slippages in the unsecured loan book.[39] The RBI FSR (December 2024) notes that nearly half of borrowers with credit card and personal loans also have another active retail loan, often substantial, such as a housing or vehicle loan. When a borrower defaults on any loan category, financial institutions classify all loans of that borrower as non-performing. Hence, their larger, secured loans face delinquency risks due to defaults in smaller personal loans.

1.64 Apart from active monitoring of the banking system, there is a need to be cautious regarding developments in the Indian and global stock markets. While the Indian financial sector shows resilience, international market conditions may have some influence on India. Any correction in the US stock market could have implications for global markets (See Box II.2 of the Survey for an analysis pertaining to the Indian market).

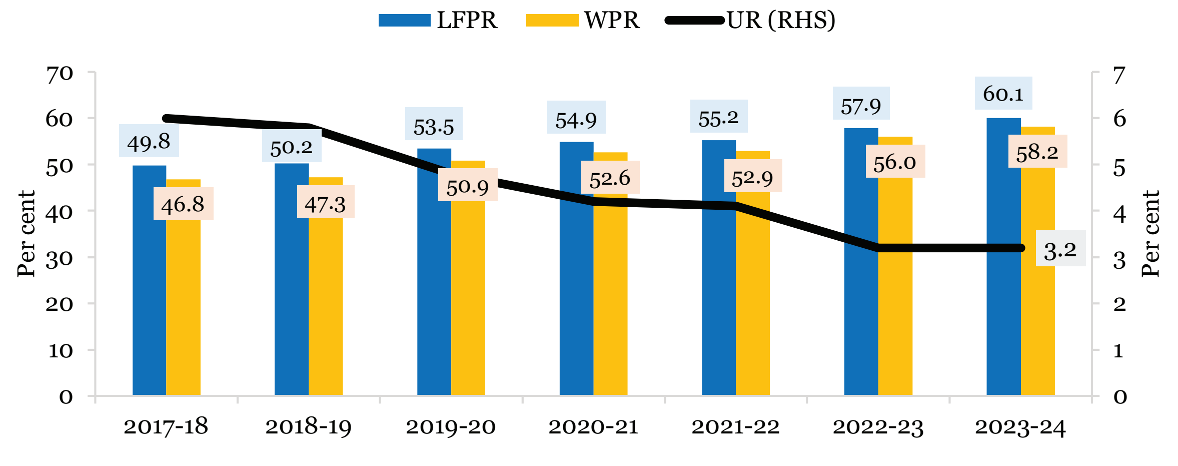
38 Reserve Bank of India. (2024, June). Financial Stability Report. https://tinyurl.com/3ba9x6vr.

39 Reserve Bank of India. (2024, December). Financial Stability Report. https://tinyurl.com/4wtz3c6u.

Employment trends

1.65 India's labour market growth in recent years has been supported by post-pandemic recovery and increased formalisation. As per the 2023-24 annual Periodic Labour Force Survey (PLFS) report, the unemployment rate for individuals aged 15 years and above has steadily declined from 6 per cent in 2017-18 to 3.2 per cent in 2023-24. The labour force participation rate (LFPR) and the worker-to-population ratio (WPR) have also increased (Chart I.52). In Q2 FY25, the urban unemployment rate for people aged 15 years and above improved slightly to 6.4 per cent compared to 6.6 per cent in Q2 FY24. Both LFPR and WPR also increased during this period.

Chart I.52: Improvement in employment indicators



Source: Annual PLFS report 2023-24, MoSPI

Note: i) **LFPR** - labour force participation rate, **WPR** - worker-to-population ratio, **UR**- unemployment rate
ii)Statistics presented are by Usual status for persons aged 15 years and above

1.66 The formal sector in India has seen significant growth, with net Employees' Provident Fund Organisation (EPFO) subscriptions more than doubling from 61 lakh in FY19 to 131 lakh in FY24. In April -November 2024, net additions reached 95.6 lakh, driven largely by youth. Workers aged 18-25 years contributed to 47 per cent of the net payroll additions. This indicates a growing trend towards formal employment, which enhances workers' access to social security and stability. Government initiatives are playing a key role in enhancing the formalisation of the job market.

1.67 Technological developments over recent years have generated much discussion on the impact of Artificial Intelligence (AI) on India's labour market. The integration of AI into India's labour market presents an opportunity to enhance productivity, elevate workforce quality and create employment, provided, systemic challenges are effectively addressed through robust institutional frameworks. For India, a services-driven economy with a youthful and adaptable workforce, the adoption of AI offers the potential to support economic growth and improve labour market outcomes. Prioritising education and skill development will be crucial to equipping workers with the competencies needed to thrive in an AI-augmented landscape. By capitalising on the global infancy of AI, India has the opportunity to prepare its labour force for a future defined by collaboration between human and machine intelligence. An elucidation of these dynamics can be found in Chapter 13.

OUTLOOK AND WAY FORWARD

1.68 A steady growth trajectory shapes the global economic outlook for 2024, though regional patterns vary. The near-term global growth is expected to be a shade lower than the trend level. The services sector continues to drive global expansion, with notable resilience in India. Meanwhile, manufacturing is struggling in Europe, where structural weaknesses persist. Trade outlook also remains clouded in the next year.

1.69 Inflationary pressures have been easing globally, though risks of synchronised price pressures linger due to potential geopolitical disruptions, such as tensions in the Middle East and the ongoing Russia-Ukraine conflict. Central banks have adopted more accommodative monetary policies. However, the pace of rate cuts varies across regions depending on the growth imperatives and the pace of disinflation, creating potential divergences in economic recovery.

1.70 On the domestic front, rebounding rural demand augurs well for consumption. Investment activity is expected to pick up, supported by higher public capex and improving business expectations. Capacity utilisation in manufacturing remains above the long-term average, and private sector order books have shown steady growth, alongside a rise in investment intentions. However, these gains could be tempered by the global excess capacities in sectors such as steel, leading to aggressive trade policies in search of demand.

1.71 Going forward, food inflation is likely to soften in Q4 FY25 with the seasonal easing of vegetable prices and Kharif harvest arrivals. Good Rabi production is likely to contain food prices in the first half of FY26. Adverse weather events and rise in international agricultural commodity prices, however, pose risks to food inflation. Global energy and commodity prices have softened in the recent past, making the core inflation outlook benign. However, risks remain on account of significant global political and economic uncertainties.

1.72 In brief, there are many upsides to domestic investment, output growth and disinflation in FY26. There are equally strong, prominently extraneous, downsides too.

Nonetheless, the fundamentals of the domestic economy remain robust, with a strong external account, calibrated fiscal consolidation and stable private consumption. On balance of these considerations, we expect that the growth in FY26 would be between 6.3 and 6.8 per cent.

1.73 Navigating global headwinds will require strategic and prudent policy management and reinforcing the domestic fundamentals. The Budget 2024-25 laid out a multi-sectoral policy agenda for sustained growth push. In this context, Chapter 5 elaborates on the need for deregulation and reforms at the grassroots level to improve the overall competitiveness of the economy and to lift trend growth rates, supporting higher levels of economic activity.

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