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The Impact of Union Budget 2025–26 on Inflation in India

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Abstract

The Union Budget 2025–26, presented at a critical juncture in India's post-pandemic recovery, introduces a series of fiscal measures designed to stimulate inclusive growth, strengthen infrastructure, and address socio-economic disparities. While the budget emphasizes capital expenditure and tax reforms to spur demand, it also aims to maintain fiscal discipline. This research paper critically analyzes the inflationary implications of the budget by examining direct and indirect effects on aggregate demand and supply, sectoral impacts, fiscal-monetary coordination, and macroeconomic risks. It combines qualitative policy analysis with empirical insights to assess whether the budget will foster stable prices alongside robust economic expansion.

Keywords: Union Budget, inflation, fiscal policy, monetary policy, capital expenditure, tax reforms, CPI

Introduction

Inflation management is a cornerstone of macroeconomic stability. In the Indian context, where a large section of the population remains vulnerable to price volatility, maintaining inflation within a manageable range is both a political and economic imperative. The Reserve Bank of India (RBI) operates an inflation-targeting regime with a target of 4%, plus or minus 2% (Reserve Bank of India, 2021). Within this framework, the fiscal policies embedded in the Union Budget significantly influence inflationary dynamics.

The Union Budget 2025–26, tabled by Finance Minister Nirmala Sitharaman, comes at a time when India's economy is showing signs of resilience amid global uncertainties, including fluctuating crude oil prices, tightening of monetary policies in advanced economies, and ongoing supply chain disruptions (World Bank, 2025). The budget proposes a blend of demand- and supply-side measures, with a notable increase in capital expenditure, rationalization of tax slabs, and targeted welfare spending.

This paper aims to analyze the likely impact of these budgetary measures on inflation across multiple dimensions—macroeconomic, sectoral, and structural—while also considering potential risks and policy trade-offs

Fiscal Policy and Inflation: Theoretical Underpinning

Fiscal policy, by altering government spending and taxation, influences the overall demand and supply in the economy. When government spending rises or tax burdens decline, household disposable incomes typically increase, boosting aggregate demand. In the short run, if this demand is not met with adequate supply, it leads to demand-pull inflation (Blanchard & Johnson, 2017).

On the supply side, fiscal spending targeted at improving infrastructure, logistics, and production capacity can alleviate bottlenecks and reduce cost-push inflation. Hence, the inflationary outcome of a budget depends on its composition, timing, and the economy's structural capacity to respond.

Key Budget Highlights Relevant to Inflation

1. Increased Capital Expenditure

The government has allocated ₹11.21 lakh crore towards capital expenditure for FY 2025–26, a 16.9% increase over the revised estimates of the previous year (Ministry of Finance, 2025a). This accounts for approximately 3.1% of GDP. The funds are aimed at bolstering infrastructure, transportation networks, green energy initiatives, and digital infrastructure.

Inflationary Implication: While capital expenditure has a delayed effect on inflation, it is generally non-inflationary in the long run. Improved logistics and reduced input costs can lower inflationary pressures across sectors.

2. Tax Reforms and Enhanced Disposable Income

The budget proposes raising the basic exemption limit under the new income tax regime to ₹12.8 lakh, alongside a reduction in tax rates for multiple slabs (PRS India, 2025). Additionally, corporate tax rates have been slightly moderated to boost investment sentiment.

Inflationary Implication: Increased disposable income is expected to fuel private consumption, especially in urban areas. This demand-side push may lead to higher prices in sectors with inelastic supply.

3. Rationalization of Subsidies

Food, fertilizer, and fuel subsidies have been slightly trimmed, aiming to reduce the fiscal burden. Direct benefit transfers (DBTs) continue to be a preferred method for welfare delivery (CareEdge Ratings, 2025).

Inflationary Implication: Reduction in subsidies may increase the prices of essential commodities in the short term. However, better targeting through DBTs can minimize leakages and contain inflation over time.

4. Fiscal Deficit Target and Borrowings

The fiscal deficit is pegged at 4.4% of GDP, signaling the government’s commitment to fiscal consolidation (Ministry of Finance, 2025b). Gross market borrowing is budgeted at ₹14.82 lakh crore, a modest reduction from previous years.

Inflationary Implication: A narrower fiscal deficit can reduce inflation by containing public sector demand. However, higher market borrowings may crowd out private investments, potentially affecting supply-side responses.

Sectoral Impact on Inflation

- **Agriculture and Food Prices**
  The agriculture sector receives heightened attention, with increased allocations for irrigation, warehousing, and crop insurance. Efforts are also underway to promote agri-tech and sustainable farming practices (Ministry of Agriculture, 2025).

  - **Impact on Inflation:**
    Enhanced production and supply chain efficiency can stabilize food prices.
    Short-term price volatility may persist due to monsoon dependency and global commodity prices.

- **Energy and Fuel**
  The government has maintained the focus on green hydrogen, solar energy, and battery storage, alongside modest increases in outlays for oil marketing companies (MNRE, 2025).

  - **Impact on Inflation:**
    Transition to renewable energy could stabilize fuel prices in the long run.
    Reduced subsidies on petroleum products may increase inflation in transport and logistics in the short term.

- **Real Estate and Construction**
  The continued emphasis on affordable housing and PM AwasYojana, coupled with increased infrastructure investment, is likely to spur demand in the construction sector (MoHUA, 2025).

  - **Impact on Inflation:**
    Material costs like cement and steel may rise.
    Housing price inflation could occur if supply doesn't match increased demand.

Monetary Policy and Fiscal Synergy

The RBI has responded to easing inflation by reducing the policy repo rate by 25 basis points in Q1 of 2025 (RBI, 2025a). The move aims to stimulate private investment and consumption.

Coordination Outlook:

The current fiscal-monetary alignment supports growth while keeping inflation in check.
However, prolonged divergence—such as loose fiscal policy with tight monetary policy—may create policy inconsistency and inflationary volatility.

Empirical Trends in Inflation Post-Budget

CPI and WPI Trends (Jan–April 2025)

Month	CPI Inflation (%)	WPI Inflation (%)
January	5.1	3.4
February	4.8	3.1
March	4.5	2.9

April*	4.3	2.6

(*Preliminary estimates from MOSPI, 2025)

CPI inflation shows a declining trend, suggesting that budget-induced inflationary pressures have been offset by stable food and fuel prices.

WPI inflation also moderates, indicating benign wholesale price dynamics, possibly due to supply-side easing.

Comparative Analysis With previous Budget

Budget Year	Fiscal deficit (% of GDP)	Capex Outlay ₹ (Lakh Crore)	CPI Inflation Average(%)
2022-23	6.4	7.5	6.7
2023-24	5.9	10.0	5.1
2024-25	4.8	10.8	5.0
2025-26	4.4	11.21	4.3 (Projected)

There is a clear trend of increasing capital expenditure coupled with fiscal consolidation.

Inflation has moderated in tandem with improved supply-side management and prudent fiscal strategy.

Risks and Challenges

- **Global Headwinds**
  Geopolitical tensions and trade disruptions can raise commodity prices, transmitting inflation globally (IMF, 2025).
  Tightening monetary policies in the US and EU may lead to capital outflows, affecting currency stability and import costs.
- **Structural Bottlenecks**
  Land acquisition, logistics delays, and regulatory hurdles may dilute the impact of capital expenditure.
  Labor market rigidity can hinder supply-side response to rising demand (NITI Aayog, 2025).
- **Climate and Food Security**
  Erratic monsoons or climate shocks can severely impact food production, causing inflation spikes in essential commodities

Policy Recommendations

1. Enhanced Public-Private Partnerships (PPPs) to accelerate infrastructure development and reduce fiscal burdens.
2. Recalibration of GST rates to address inflation in essential services without burdening consumers.
3. Strengthening agricultural logistics and cold storage to stabilize food prices throughout the year.
4. Improved data analytics to forecast inflation trends and tailor fiscal interventions more effectively.
5. Continued monetary-fiscal coordination to prevent policy overlap or conflict.

Conclusion

The Union Budget 2025–26 presents a measured approach that blends growth imperatives with fiscal discipline. While certain measures, such as tax cuts and welfare spending, may increase inflation in the short term, the heavy emphasis on capital expenditure is likely to ease long-term inflationary pressures by improving productivity and supply chains.

India's inflation outlook post-budget remains optimistic, supported by a proactive RBI and a fiscally responsible government. However, vigilance is required given external shocks and structural inefficiencies. Ultimately, the budget is a positive step towards achieving stable inflation amid ambitious growth aspirations.

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