

Low deflators lifted real growth in Q1-FY26; policy steps, including latest GST reforms, likely to support growth

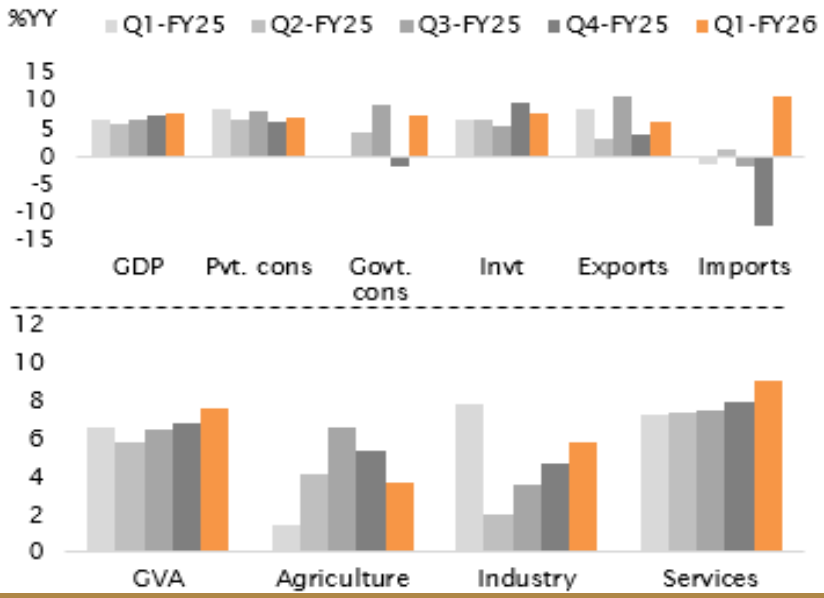
6 September, 2024

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Key takeaways

- Real GDP growth improved to five-quarter high of 7.8%YY in Q1-FY26 from 7.4% growth in the previous quarter. Growth surprised on the upside with most market polls expecting a slowdown (Reuters poll: 6.7%). Real GVA growth also rose to a six-quarter high of 7.6%YY from 6.8% in Q4-FY25. A key feature of Q1-FY26 data was the moderation in nominal growth, so that the buoyancy in real terms was attributable to low deflators.
- Details on GDP showed that consumption, both private and government, and investment clocked in year-on-year growth of above 7% each. Net exports dragged down growth after contributing positively for four straight quarters, as higher year-on-year exports growth was more than offset by double-digit rise in imports.
- On the GVA side, the year-on-year growth in agriculture eased in Q1 from Q4-FY25 to 3.7%YY, while industrial growth improved for the third straight quarter to 5.8%. Services growth reached an eight-quarter high of 9.0%. Compared to Q1-FY25, there was improvement agriculture and services growth, but moderation in industry.
- In July, industrial growth improved to four-month high of 3.5%YY from 1.5% in June. The print surprised on the upside relative to market estimates of sub-3% growth. Production was buoyed by manufacturing amid continued contraction in mining and muted growth in electricity. By product groups, there was improvement in growth across segments, except primary goods that stayed in contraction.
- Signals from other high frequency data on economic activity remained mixed in July amid some green shoots such as nascent signs of revival in credit growth and PMI indicators reaching multi-year high levels.
- Near-term outlook continues to be clouded by high US tariffs and uncertainties around a potential trade deal. Among key developments, the government rationalized GST rates with fiscal implications that are expected to be offset by consumption boost and higher compliance.
- Real GDP growth print for Q1-FY26 exceeded the RBI MPC's estimate of 6.5% and hardly leaves any room to justify further easing at the upcoming decision on 1-Oct. Before considering any changes to its policy, the MPC might wait until H2-FY26 to access the impact of various factors on domestic growth-inflation dynamics, such as: 1) 50% US tariffs on India 2) GST reforms 3) transmission of front-loaded monetary easing announced in June.

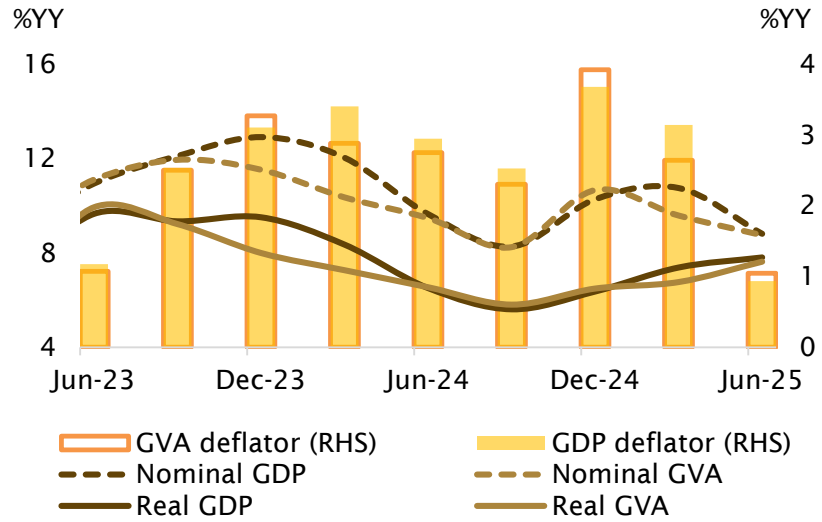
Both real GDP, GVA growth above 7.5%YY in Q1-FY26

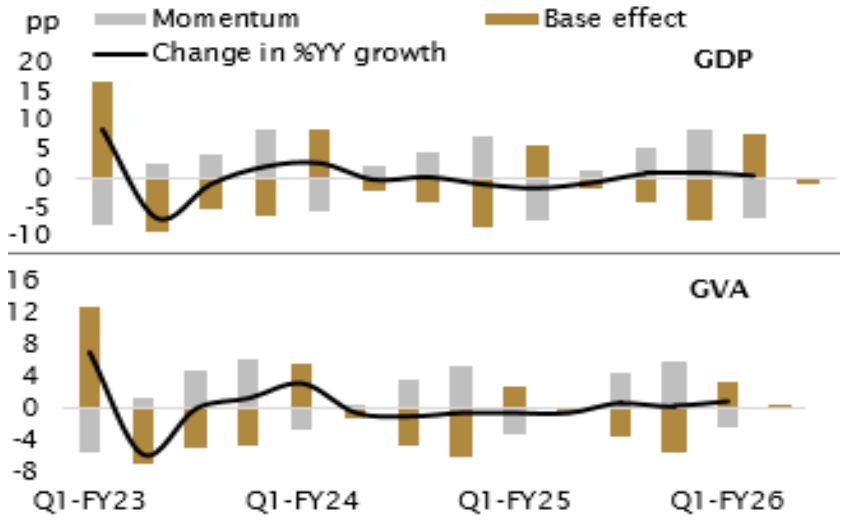


Low deflator, base effects lifted real growth in Q1-FY26 amid moderation in nominal growth and sequential contraction

- Real GDP growth improved to five-quarter high of 7.8%YY in Q1-FY26 from 7.4% growth in the previous quarter and 6.5% in the same quarter of FY25. Growth surprised on the upside with most market polls expecting a slowdown from the previous quarter (Reuters poll: 6.7%). Real GVA growth also marked an improvement to six-quarter high of 7.6%YY from 6.8% in Q4-FY25 and 6.5% in Q1-FY25.
- A key feature of Q1-FY26 data was the moderation in nominal growth, so that the buoyancy in real terms was driven by low deflators. Both nominal GDP and GVA growth moderated to 8.8% each from 10.8% and 9.6%, respectively in the previous quarter and 9.7% and 9.5%, respectively in Q1-FY25. GDP deflator was the lowest in almost six years, while GVA deflator moderated to the weakest in around 10 years.
- The improvement in Q1 year-on-year growth in both real GDP and GVA from the previous quarter was due to favorable base effects as the quarter-on-quarter or sequential momentum was negative, as is typically the case in Q1. Real GDP fell 6.7%QQ versus long-term average (FY13-25, ex-COVID years) drop of 4.5% for the quarter. Real GVA declined 2.5%QQ, compared to the long-term average decrease of 0.6% for Q1.
- The gap between real GDP and GVA growth, which captures net indirect taxes (NIT), stayed positive but narrowed from Q4-FY25, as year-on-year growth in NIT moderated but remained in double digits. But in nominal terms, the slowdown in growth of NIT was notable at 9.5%YY from 22.7% in the previous quarter and 11.4% in Q1-FY25. This was in line with the moderation in nominal growth in Q1-FY26.

Both real GDP and GVA growth improved year-on-year in Q1-FY26, aided by low deflators and favorable base effects

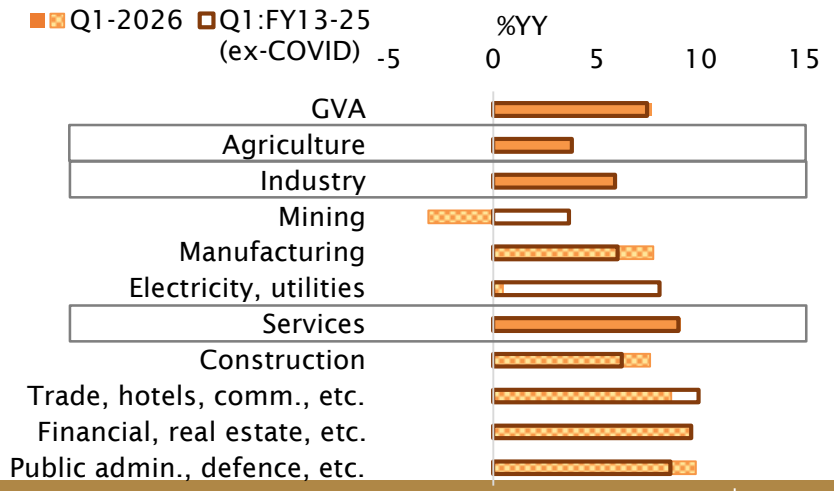


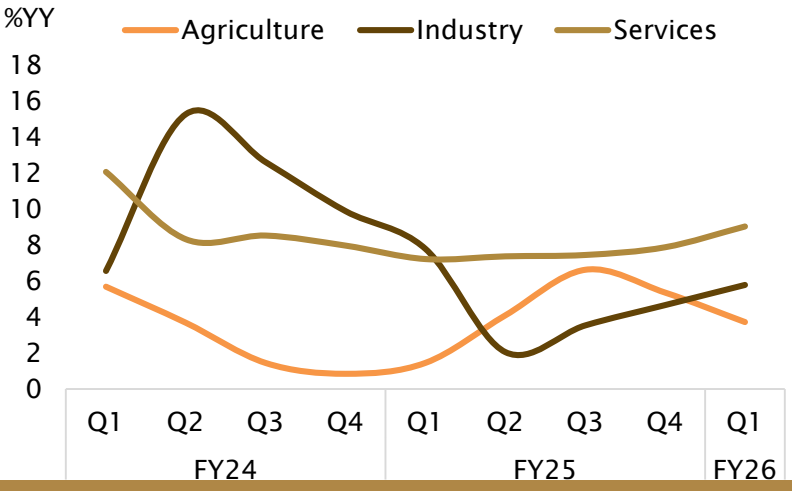


Agriculture growth moderated in Q1 for second straight quarter; industry, services growth continued to improve

- Real GVA grew 7.6%YY in Q1-FY26, mildly above average growth of 7.4% for Q1 (FY13-25, ex-COVID). In Q4-FY25, real GVA had increased 6.8%, and in Q1-FY25 by 6.5%. The easing in nominal growth to 8.8%YY in Q1-FY26 was in line with 8.7% growth in EBITDA, as per RBI data on listed companies' performance.
- Compared to Q4-FY25, agriculture growth eased in Q1 to 3.7%YY, while industrial growth improved for the third straight quarter to 5.8%, and in case of services, reached an eight-quarter high of 9.0%. Compared to Q1-FY25, there was improvement agriculture and services growth, but moderation in industry.
- Manufacturing, with around 80% share in industry GVA, continued to add the most to industrial growth. Mining activity was a drag amid an early onset of monsoon, which also lowered electricity demand and supply. Services, with more than 60% share in total GVA, remained the strongest contributor to year-on-year growth, buoyed by segments such as financial and real estate; trade, hotels, and communication; and public administration and defence. Past data shows that sequential growth in financial segment tends to peak in Q1, but there were concerns that high year-on-year growth in other services sub-sectors was propelled by low deflators, particularly in construction; and trade, hotels, and communication.
- Agriculture growth and its contribution to GVA growth was mildly below historical average for the quarter.
- In terms of sequential change, the contraction in GVA was steeper than historical average for the quarter, reflecting the trends in industry and agriculture, and slower expansion in services. It also underscored the role of base effects in lifting year-on-year growth compared to the previous quarter.

Real GVA growth mildly above trend for Q1; agriculture growth eased amid continued buoyancy in industry, services

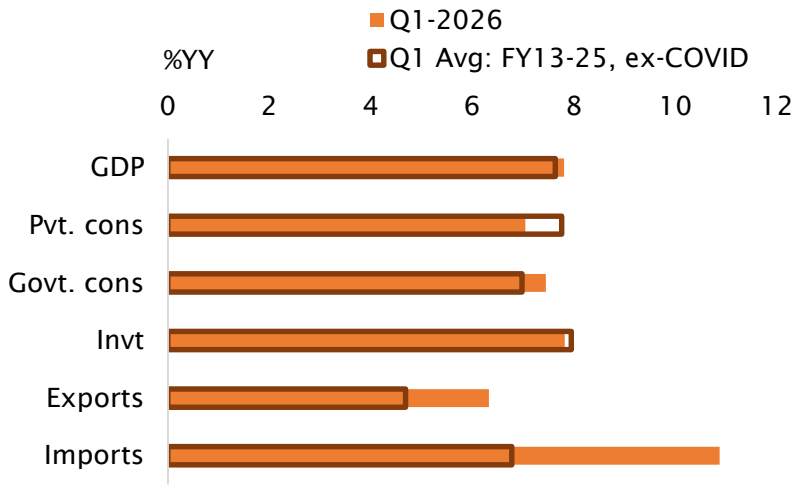




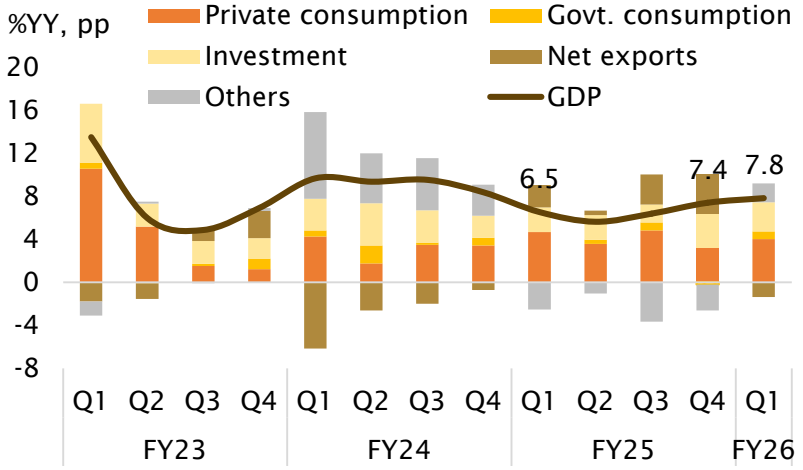
Buoyancy in consumption, investment added to GDP growth in Q1; net exports were a drag after four quarters of contribution

- Real GDP grew 7.8%YY in Q1-FY26, up from 7.4% in Q4-FY25 and 6.5% growth in Q1-FY25. The print was also above average growth of 7.6% for the quarter (FY13-25, ex-COVID years).
- Consumption, both private and government, and investment clocked in year-on-year growth of above 7% each. Net exports dragged down growth after contributing positively for four successive quarters. The improvement in year-on-year exports growth from the previous quarter was more than offset by double-digit rise in imports. There was year-on-year increase in government consumption after contraction in the previous quarter and in Q1-FY25, while private consumption growth improved from the previous quarter. There was moderation in investment growth to 7.8%YY from six-quarter high of over 9% in Q4-FY25.
- With 60% share in nominal GDP, private consumption contributed the most to real GDP growth in Q1, followed by investment and public consumption. The 'others' component, comprising of discrepancies, change in stocks and valuables added 1.8pp to growth after being a drag for four straight quarters.
- Except for private consumption and investment, segments such as public consumption, exports, imports posted higher year-on-year growth compared to long-term averages for Q1 (FY13-25, ex-COVID years).
- In terms of sequential change, the decrease in real GDP growth was sharper than historical trend for the quarter amid steep quarter-on-quarter declines in exports, public consumption, and investment. This reiterates the role of base effects in lifting year-on-year growth in Q1 from the previous quarter.

Consumption, investment grew above 7%YY in Q1



Net exports deducted from GDP growth in Q1-FY26

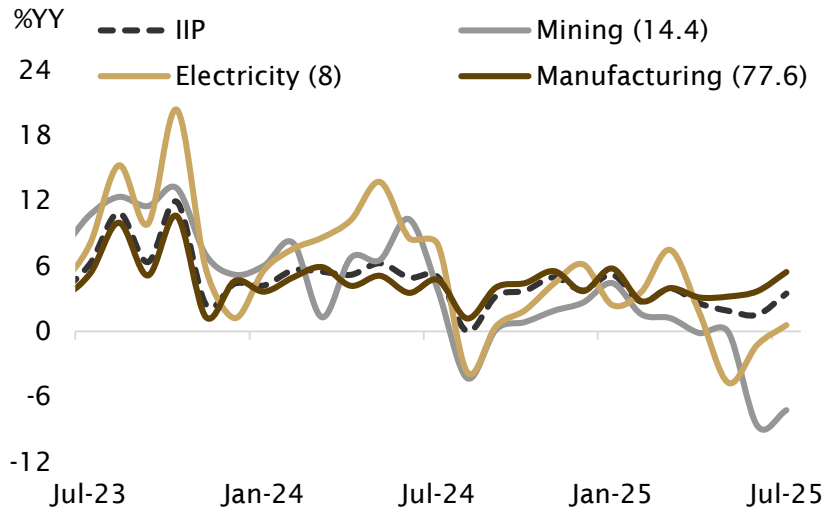


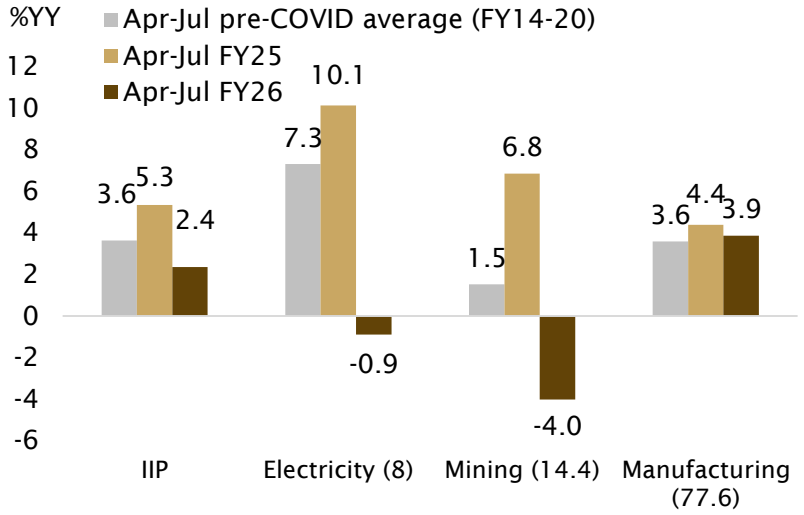
Others include discrepancies, valuables, change in stocks

IIP growth improved in July, led by manufacturing

- In July, industrial production growth improved to four-month high of 3.5%YY from 1.5% in June. The print surprised on the upside relative to market estimates of sub-3% growth. Production was up 1.1% month-on-month, compared to decline of 0.3% (average) – 0.8% (median) for the month (FY13-25, ex-COVID years).
- Base effects were favorable that also lifted year-on-year growth. These are slated to be positive in August as well, which could offset some of the negative momentum typically seen in the month.
- In FYTD terms, output rose 2.4%YY, which was below growth in FYTD-FY25 and in the pre-COVID period.
- **Manufacturing:** Being the index heavyweight, growth trend was in line with headline IIP at six-month high of 5.4%YY versus 3.7% in June. The monthly momentum was above historical trends that offset negative base effect. On FYTD basis, growth was below the same period in FY25 but above the pre-COVID trend.
- **Mining:** The year-on-year growth stayed in contraction for fourth straight month, with the declines turning steeper in June and July amid an early onset of monsoon. In July, output fell (-)7.2%YY versus (-)8.7% drop in June. The monthly change was negative and sharper than prior trends, but partly offset by base effect.
- **Electricity:** The year-on-year growth turned positive at 0.6%YY after declining for two consecutive months. The sequential increase was largely in line with historical average and base effect was mildly favorable. In FYTD terms, growth was negative in both mining and electricity vis-à-vis increases posted in the same period of FY25 and pre-COVID period.

The year-on-year IIP growth improved in July, led by manufacturing, but remained muted in fiscal year-to-date terms

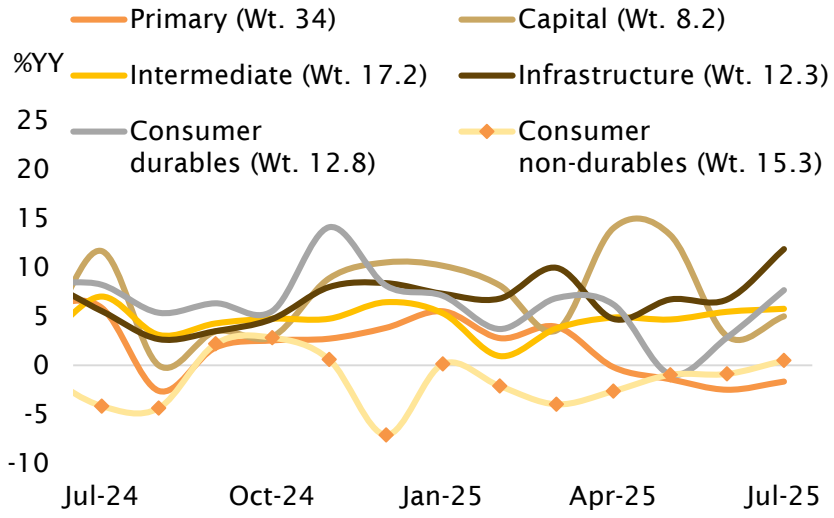


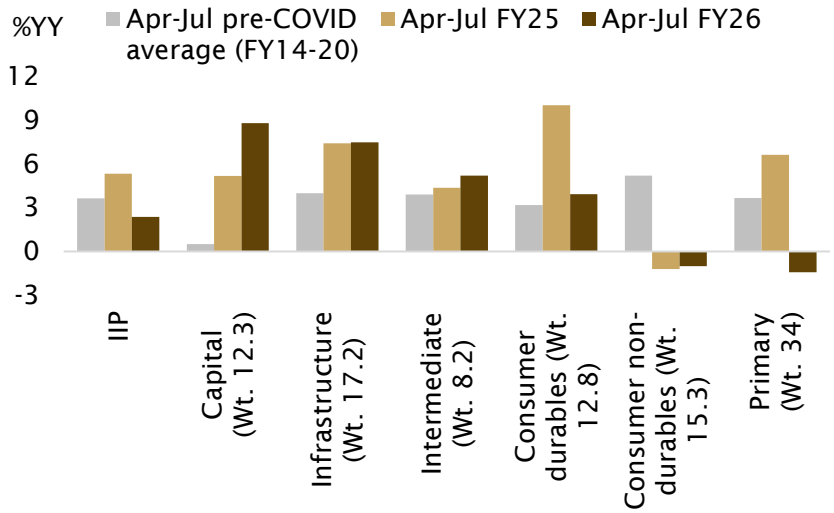


By product types, year-on-year growth improved across segments in July, except primary goods that stayed in contraction

- **Trends in use-based classification:** The year-on-year growth in infrastructure goods swung to double digits for the first time since Oct-2023, and contributed the most to headline IIP growth. There was improvement in growth across segments, except primary goods that stayed in contraction for the fourth straight month, albeit at a shallower rate than in June. Production of consumer non-durables posted slight growth after declining for five successive months. Both consumer durables and intermediate goods added 1pp each to IIP growth, as output growth reached seven-month high.
- **Fiscal year-to-date trends:** In terms of FYTD data, capital and infrastructure goods posted strongest growth, exceeding FYTD-FY25 and pre-pandemic trends. There was similar improvement in growth of intermediate goods relative to previous years' trends. The dichotomy in output of consumer durables versus non-durables continued to persist in FYTD-FY26, even as consumer durables growth eased compared to FYTD-FY25, and the contraction in non-durables was mildly lower year-on-year in Apr-Jul FY26. Primary goods output has been falling year-on-year since the beginning of FY26, contrasting healthy trends in previous years.
- **Monthly momentum and base effects:** Except for primary goods, production of all other segments grew month-on-month in July. This was in line with historical trends in case of primary goods, though output of capital and infrastructure goods also tends to decline in July. Base effects were positive for primary and infrastructure goods, and consumer durables; and negative for other segments.

Capital, infrastructure goods output posted strongest growth in FYTD-FY26; primary goods, consumer non-durables output fell





Signals from high frequency data on domestic economic activity remain mixed amid some green shoots

- **Signals from high frequency indicators:**
  - The year-on-year increase in capital expenditure at the Centre in Apr-Jul FY26 was among main drivers of strong production of 1) capital and infrastructure goods within the IIP, 2) cement and steel within core industries of the IIP. However, railway freight traffic fell year-on-year after expanding for four straight months. Port cargo traffic growth eased to the lowest in four months but stayed positive, partly reflecting the frontloading of exports ahead of the US tariffs implementation. Air cargo traffic growth was firm and marked an improvement from the previous month. However, fuel consumption decreased year-on-year and electricity demand was tepid, though it increased after declining for two successive months.
  - Data from the Retailers Association of India shows that retail sales held firm in July at 8%YY and marked an improvement from 2% growth in Jul-2024. The year-on-year growth in e-way bill generation reached 21-month high in July, indicative of pre-festive season inventory build-up.
  - Among indicators of urban activity, domestic air passenger traffic fell in July due to seasonal factors. Passenger vehicle sales were weak at 1.5%YY after declining in June. The Naukri Jobspeak Index, an gauge of white collar hiring, rose 3.4%YY in August but eased from the recent peak of 10.5% in June.
  - Both tractor and two-wheeler sales posted strong growth in July at 7.1%YY and 8.7%YY, respectively. There was sharp decline in household work demand under MGNREGA due to the onset of Kharif sowing. As on 29-Aug, total Kharif sowing was up 3.1%YY, though it was lower for oilseeds and some cash crops. Total sowing was at 99.7% of normal sown area for the season. As on 27-Aug, southwest monsoon was 5% above average for the season, but the distribution was skewed, with northwest (+23%), central (+9%), and southern regions (+5%) receiving surplus rains amid deficiency in east and northeast regions (-18%).
- **Signals from survey data:**
  - In addition to the continued bright prospects for the rural economy amid solid progress in southwest seasonal rains and Kharif sowing, details on urban consumer confidence from the RBI's latest round of surveys bode well for outlook amid an uptick in current perception and one-year ahead expectation on income and discretionary spending. This was in addition to a broad-based improvement in both rural and urban consumer confidence indices on current situation and future expectations.
  - The RBI's survey on industrial outlook showed that businesses stayed optimistic in Q1 amid slight softening in sentiment. This indicator needs to be watched out for in the backdrop of external sector uncertainties due to ongoing trade tensions with the US.
  - In August, the PMI composite index marked the sharpest pace of expansion in over 17 years at 63.2 from 61.1 in July, lifted by strong services PMI and also manufacturing PMI that hit another new high. The latter was supported by domestic demand that helped cushion some of the tariff-related drag.

GST reforms to support growth; RBI likely to maintain pause, as impact of policy support measures and tariff-related woes unfold

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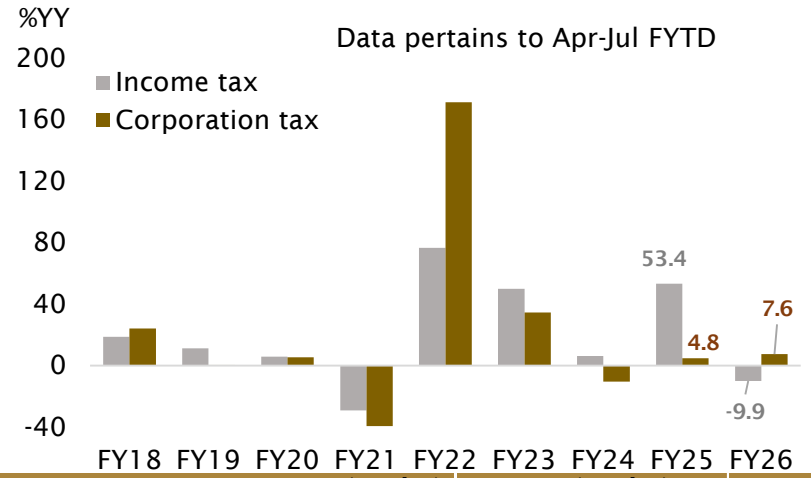
- **Credit growth:** One of the key transmission channels linking monetary policy to economic activity is credit growth. Post the RBI's front-loading of policy stimulus in June, credit growth seems to have bottomed out in May, with nascent signs of pick up in June and July. But a notable trend has emerged in the past couple of months, with larger share of incremental credit to industry accruing to micro and small firms. Large corporates have been turning to market-based instruments such as commercial paper and corporate bonds for funding, so that the flow of resources to overall commercial sector has remained strong, as noted by various studies*.
- **Centre's fiscal accounts:** In Apr-Jul FY26, the Centre's fiscal deficit stood at 30% of FY26BE, compared to 18% of FY25RE in the same period of FY25. The pace of deficit quickened amid lower receipts and higher spending as percent of budget estimates in FYTD-FY26. The income tax relief announced in the Union Budget for FY26 has kept the pace of revenues low and down year-on-year, even as corporate tax and GST collections have stayed firm. On the expenditure side, both revenue and capital spending have accelerated at faster rates. Increased capital spend aided industrial output growth in FYTD-FY26, in addition to external demand from frontloading of exports ahead of the US tariffs imposition.
- **GST reforms:** The government has simplified the GST tax structure from four slabs (5%,12%,18% and 28%) to two (5% merit rate, 18% standard rate). The compensation cess levy will be discontinued and there will be a special 40% rate on few sin and super-luxury goods. The revised rates would be effective 22-Sep, with the exception of some tobacco related items, on which existing GST rates and compensation cess would continue till loan and interest payment dues under the compensation cess account are discharged.
- In addition to lower tax rates on items of mass consumption, and middle-class aspirational goods, the changes are expected to benefit labor-intensive (textiles, leather, handicrafts) and other sectors such as farm, insurance, automobiles, renewable energy, cement, among others. The changes include process reforms to simplify registration, filing of returns and refunds. The rate revisions also address issues pertaining to inverted duty structure (particularly for man-made textiles and fertilizer sectors) and classification of items.
- In the post-GST meeting press conference, government officials cited the estimated net revenue impact of rate rationalization at (-)Rs.480bn (0.2% of GDP), with FY24 as consumption base. But it is expected that increased consumption and tax compliance will more than offset this fiscal implication and boost domestic growth.
- **Policy implication:** The real GDP growth of 7.8%YY in Q1-FY26 exceeded the RBI MPC's estimate of 6.5% by a wide margin and hardly leaves any room for the MPC to justify further easing at its upcoming decision on 1-Oct. Before considering any changes to its current policy rate and stance, the committee might wait until H2-FY26 to access the impact of various factors on domestic growth-inflation dynamics, such as: 1) 50% US tariffs on India 2) GST reforms and 3) transmission of front-loaded monetary easing announced in June.

* Monthly Economic Review, Ministry of Finance, State of the Economy, RBI Bulletin, August 2025

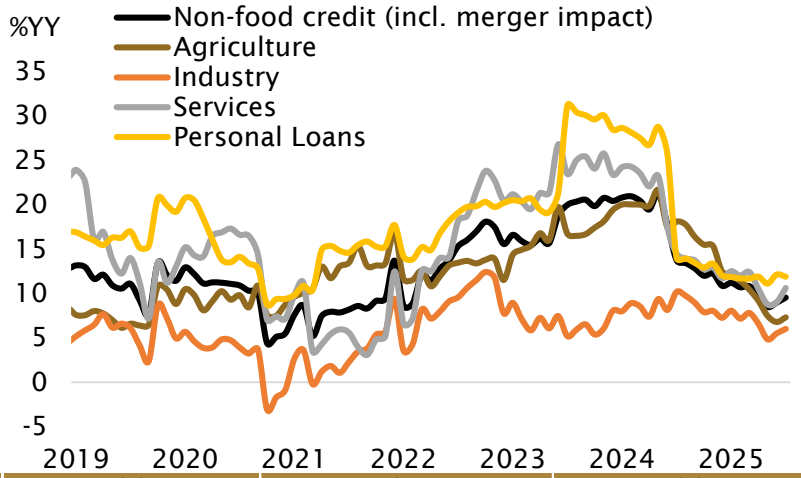
Weak income tax revenues could pose risks to Centre's fiscal balance; revival in credit growth could lift economic activity

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Income tax revenues down year-on-year in Apr-Jul FY26



Nascent signs of revival in non-food credit growth



	(Rs. bn)	FYTD (Rs. bn)		FYTD (%YY)		FY26BE		FY25RE		FY26BE	
	Jul-25	Jul-25	Jul-24	Jul-25	Jul-24	Rs. bn	(% of BE)	Rs. bn	(% of RE)	Current run rate	Required run rate
Revenue receipts	1,520	10,654	10,170	5	34	34,204	31	30,880	33	2,664	2,944
Gross tax revenue	2,239	10,929	10,842	1	21	42,702	26	38,535	28	2,732	3,972
Net tax revenue	1,215	6,618	7,152	(7)	23	28,374	23	25,570	28	1,655	2,719
Direct taxes	1,006	5,736	5,984	(4)	36	25,250	23	22,420	27	1,434	2,439
Indirect taxes	1,229	5,182	4,849	7	7	17,401	30	16,070	30	1,295	1,527
Assignment to states	1,016	4,285	3,666	17	18	14,224	30	12,869	28	1,071	1,242
Non-tax revenues	305	4,036	3,018	34	69	5,830	69	5,310	57	1,009	224
Non-debt capital receipts	18	298	64	366	(53)	760	39	590	11	74	58
Recovery of loans	17	71	64	12	(23)	290	25	260	25	18	27
Disinvestment	0.3	227	0.1			470	48	330	0	57	30
Total receipts	1,538	10,952	10,234	7	32	34,964	31	31,470	33	2,738	3,002
Total expenditure	3,415	15,636	13,004	20	(6)	50,653	31	47,165	28	3,909	4,377
Revenue expenditure	2,697	12,167	10,391	17	(2)	39,443	31	36,981	28	3,042	3,409
Capital expenditure	718	3,469	2,613	33	(18)	11,211	31	10,184	26	867	968
Fiscal deficit	1,877	4,684	2,769	69	(54)	15,689	30	15,695	18	1,171	1,376
Primary deficit	1,270	217	(509)	(143)	(117)	2,926	7	4,316	(12)	54	339
Revenue deficit	1,177	1,513	221	585	(93)	5,238	29	6,101	4	378	466

Select high frequency indicators

Colour codes based on minimum and maximum Z-score values since April 2023 for respective variables; green shows improvement, red indicates weakening. (Reversed for MGNREGA data where a fall implies improved farm activity)

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(%YY, unless mentioned otherwise)		Jan-25	Feb-25	Mar-25	Apr-25	May-25	Jun-25	Jul-25	Aug-25
Agriculture and rural sector	Tractor sales	11.1	30.9	21.6	7.0	8.4	10.2	7.1	
	Tractor registrations	5.2	-14.5	-5.7	7.6	2.8	8.7	11.0	
	Two wheeler sales	2.1	-9.0	11.4	-16.8	2.2	-3.4	8.7	
	Two-wheeler registrations	4.2	-6.3	-1.8	2.3	7.3	4.7	-6.5	
	Three-wheeler registrations	6.9	-1.9	-5.7	24.5	6.3	6.7	0.8	
	Household work demand under MGNREGA	14.4	2.8	2.2	-6.5	4.4	4.4	-12.3	-26.0
Industry, construction and urban sector	Industrial production	5.0	2.9	3.0	2.7	1.2	1.5	3.5	
	Core sector output	4.6	2.9	3.8	0.5	0.7	1.7	2.0	
	Cement production	14.3	10.7	12.2	6.3	9.7	8.2	11.7	
	Natural gas production	-2.3	-6.7	-4.8	-1.7	-4.1			
	Electricity requirement	1.3	2.0	5.7	2.8	-4.8	-2.3	2.6	
	Steel consumption	10.9	10.9	13.6	6.0	8.1	9.3	7.3	
	Fuel consumption	3.0	-5.2	-3.1	0.2	0.7	1.4	-4.0	
	Passenger vehicle sales	12.9	3.7	3.7	5.5	0.8	-6.3	1.5	
	Passenger vehicle registrations	15.5	-10.3	6.3	1.6	-3.1	2.5	-0.8	
	Naukri JobSpeak Index	3.9	4.0	-1.5	8.9	0.3	10.5	6.8	3.4
Services	Commercial vehicle registrations	8.2	-8.6	2.7	-6.9	-3.7	6.6	0.2	
	Railway freight traffic	1.7	-2.4	2.9	4.5	3.1	1.2	-0.1	
	Port cargo traffic	7.6	3.6	13.3	7.0	4.4	5.6	4.0	
	Toll collection (volume)	14.8	18.7	11.9	16.6	16.4	15.5	14.8	
	Domestic air cargo traffic	6.9	-2.5	4.9	16.6	2.3	2.6	4.8	
	International air cargo traffic	7.1	-6.3	3.3	8.6	6.8	-1.2	4.2	
	Domestic air passenger traffic	14.0	12.1	9.9	9.7	2.6	3.7	-2.5	
	International air passenger traffic	11.0	7.7	6.7	12.9	5.0	3.4	5.4	
	Tourist arrivals	-0.2	-8.6	-13.7	-3.8				
	GST e-way bills (total)	23.1	14.7	20.2	23.4	18.9	19.3	25.8	
	GST revenue collection	13.6	9.1	10.2	12.7	16.4	6.2	7.5	
PMI (Index)	PMI Manufacturing	57.7	56.3	58.1	58.2	57.6	58.4	59.1	59.3
	PMI Services	56.5	59.0	58.5	58.7	58.8	60.4	60.5	62.9

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