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ECONOMY OBSERVER



September 2025

India Banks on GST 2.0 and Trade Diversification to Drive Growth

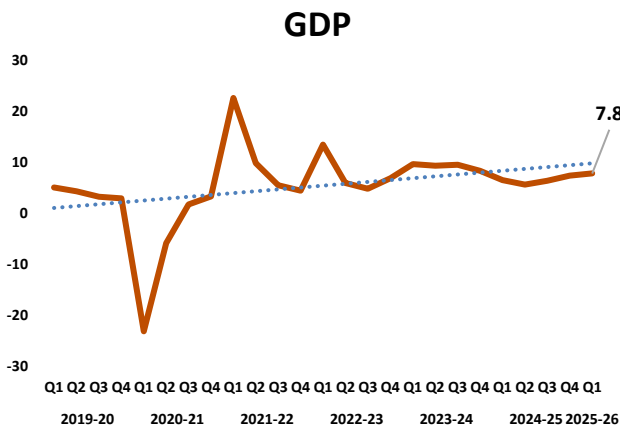
India’s economy grew by **7.8% in Q1 of FY 2025–26**, marking the **fastest expansion in five quarters** and beating market expectations of 6.6%. This surge was driven by strong performance in the services sector (9.3%), robust manufacturing (7.7%), and a rebound in government spending, but beyond the headline numbers, a strategic policy shift is unfolding. The government is now prioritizing demand-side measures, moving focus from supply-side incentives that have yet to meaningfully catalyze private capital expenditure. At the heart of this shift is GST 2.0, unveiled during the 56th GST Council Meeting on September 3, 2025. This reform aims to ease the tax burden on households, stimulate consumption, and correct the regressive tilt of indirect taxation. The government is banking on a demand-led recovery, expected to be achieved by reducing GST on essential goods, while still raising levies on luxury and sin goods in a bid to make the tax system more equitable and consumption-friendly. While GST 2.0 is a critical lever, it must be part of a wider policy mix including targeted fiscal support, employment generation, and rural demand stimulation to ensure that growth is inclusive, resilient, and sustainable. Earlier, the GST tax system was fragmented across multiple slabs—**2%, 12%, 18%, and 28%**—depending on the nature of goods and services. This complexity often led to classification disputes and compliance challenges.

Under the new reforms, a **streamlined dual-slab structure** has been introduced:

- A **lower rate of 5%** is applied to essential goods and services such as food, healthcare, agriculture.
- A **standard rate of 18%** mostly on non-essential goods and services including items such as mobile phones, electronic appliances, restaurant services, and online streaming subscriptions.
- A **higher rate of 40%** is reserved for luxury items, sin goods and services.

This simplified structure aims to enhance transparency, reduce litigation, and promote ease of doing business.

The reform package under GST 2.0 introduces significant rate cuts on essentials such as food, healthcare, and agriculture inputs aiming to boost household consumption, reduce cost pressures, and stimulate grassroots demand. Services like insurance and hospitality (because hotels as well as food items are now at lower brackets) benefit from exemptions or reduced rates, making them more accessible to middle- and lower-income groups. On the compliance front, measures like faster refunds, auto-approvals, and simplified return filings are designed to ease operational burdens, especially for small businesses, improve liquidity and encourage formalization.



Current GDP data for FY26

Pharma	From	To
All Medicine	12%	5%
36 vital lifesaving drugs for conditions like cancer and rare diseases	12%	0%
Medical Equipment	18% or 12%	5%
Individual Health & Life Insurance	18%	0%
Agriculture		
Tractors	12%	5%
Specified Bio - Pesticides, Micro-Nutrients	12%	5%
Tractor Tyres & Parts	18%	5%
Agriculture, Horticulture or Forestry Machines for soil preparation, cultivation, Harvesting & Threshing	12%	5%
Automobiles		
Petrol & Petrol Hybrid, LPG,CNG Cars(Not exceeding - 1200cc &	28%	18%
Diesel & Diesel Hybrid Cars(Not exceeding - 1500cc & 4000mm)	28%	18%
Motor Vehicles for transport of goods	28%	18%
3 wheeled Vehicles	28%	18%
Food		
Butter,Ghee, cheese and dairy Spreads	12%	5%
Pre packaged Namkeens, Bhujia & Mixtures	12%	5%
Roti, Chapati, Paratha, etc	5%	0%

New GST rates

While GST 2.0 may stimulate short-term consumption through streamlined compliance and improved cash flows particularly for MSMEs it also introduces some fiscal challenges. While the revenue loss from rate cuts is estimated at ₹3,700 crore, the net impact is ₹48,000 crore due to broader structural changes and consumption boosts. While direct revenue losses may be offset through increased private expenditure (and thereby higher tax collections), broadening the tax base, enforcing compliance, strategic disinvestment, and curbing discretionary spending, these measures alone may not suffice. Mounting fiscal pressures could force the government into difficult trade-offs—such as curtailing infrastructure investments or raising taxes on higher-income groups—unless mitigated by a well-calibrated fiscal rebalancing strategy. On the compliance front, GST 2.0 brings in measures like faster refunds, auto-approvals for low-risk registrations, and the operationalization of the GST Appellate Tribunal by December 2025, steps aimed at reducing litigation and supporting MSME formalization, especially in labor-intensive sectors. One of the impacts of GST 2.0 implementation is likely to be inflationary, meaning the RBI may face constraints on further rate cuts, making coordinated policy action essential. Ultimately, the success of GST 2.0 hinges on effective implementation, fiscal discipline, and political consensus; without these, the reforms risk becoming a temporary stimulus rather than a sustainable growth strategy.

In parallel, India is also navigating external trade headwinds, particularly the 50% tariff imposed by the USA. To offset the impact of loss in exports, India is actively pursuing export diversification. This includes strengthening trade relationships with the UK, EU, and Middle Eastern countries, while continuing negotiations with the US. These efforts aim to reduce dependency on any single market and enhance India’s global trade resilience. Together, the internal reforms under GST 2.0 and the external pivot in trade strategy paint a positive and proactive image of the Indian economy. If executed with precision, this dual approach could not only cushion short-term shocks but also lay the foundation for long-term, inclusive, and globally competitive growth.

Latest Economy Observer from Dun & Bradstreet highlights broad-based domestic momentum and easing inflation despite rising trade pressures

Dr. Arun Singh, Global Chief Economist, Dun & Bradstreet said, “India’s growth trajectory remains steady, anchored by strong domestic demand and policy reforms, though sustaining momentum hinges on managing external shocks and capitalizing on structural shifts. In Q1 FY26, real GDP outperformed expectations, marking the fastest expansion in five quarters, driven by robust private consumption and investment, which offset trade headwinds as net exports dragged. External trade is likely to stay vulnerable to global dynamics, underscoring the need for diversification and policy support. GST rationalization is expected to lift urban consumption, complementing already resilient rural demand and cushioning the impact of export losses from higher tariffs.”

POSITIVE

- India’s GDP grew 7.8% y/y in Q1 FY26, marking a five-quarter high and signaling strong economic momentum.
- India-EU FTA negotiations entered final stage, aiming to enhance market access and reduce tariff barriers.
- India is proactively targeting new markets (EU, UK, UAE, Japan, Latin America, Africa) to mitigate tariff risks.
- Government unveiled next-generation GST reform with a streamlined two-tier rate structure (5% for essentials and 18% for most goods), along with a special 40% slab for ultra-luxury and sin goods
- CPI inflation eased to 1.6% in July 2025, the lowest in over eight years, improving consumer affordability.
- India’s services exports reached a record \$387.5 billion in FY25, up 13.6% y/y.

NEGATIVE

- US imposed 50% tariff on Indian exports effective August 27, impacting key sectors like textiles and pharma.
- Mining output contracted by 7.2% in July, dragging down industrial performance.
- Ongoing tariff tensions, especially with the US, and volatile commodity prices pose risks to India’s external sector
- Elevated gold imports, driven by festive and investment demand, are worsening India’s trade deficit by increasing non-essential dollar outflows.
- Imports continued to outpace exports, especially from UAE and China, despite diversification efforts.
- Bond market experienced volatility post-RBI policy, with benchmark yields briefly spiking before stabilizing
- India’s merchandise trade deficit widened to \$27.35 billion in July 2025, up from \$18.78 billion in June 2025 marking an eight-month high.

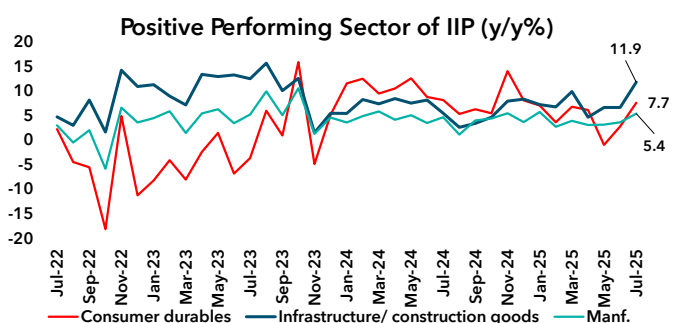
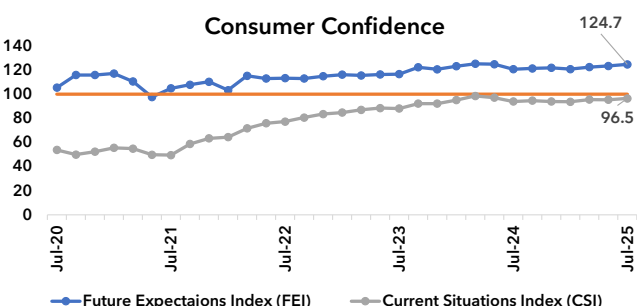
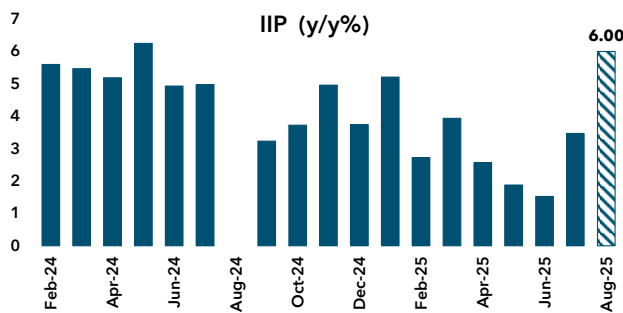
D&B's Economy Observer Forecast			
Variables	Forecast**	Latest Period	Previous period
IIP Growth	6.0% Aug-25	3.5% Jul-25	1.5%June-25
Inflation WPI	(-) 0.2% Aug-25	(-) 0.6% Jul-25	(-) 0.1% June-25
CPI (Combined)	1.6% Aug-25	1.6% Jul-25	2.1% June-25
91-day T-Bills*	5.4% Aug-25	5.4% Jul-25	5.4% June-25
10-year G-Sec Yield*	6.4% Aug-25	6.4% Jul-25	6.3% June-25
Bank Credit	11.2% Aug-25	9.6% Jul-25	9.5% June-25
Exchange Rate (INR/USD) *	87.2 Sep -25	87.4 Aug-25	86.1 Jul-25

*Weekly Average ** Dun and Bradstreet Forecast

Real Economy

- India's GDP grew by 7.8% y/y in Q1 FY26, marking a five-quarter high and surpassing RBI's forecast of 6.5%. Growth was led by services (9.3%), manufacturing (7.7%), and construction (7.6%), supported by strong investment and easing inflation.
- Dun & Bradstreet forecasts the Index of Industrial Production (IIP) to have grown by 6.0% y/y in August 2025, following a 3.5% rise in July. Growth is being driven by robust demand in construction-linked sectors and a favorable base effect. July's IIP was led by manufacturing gains in basic metals (12.7%), electrical equipment (15.9%), and non-metallic mineral products (9.5%).
- The manufacturing sector continues to benefit from resilient domestic demand and policy support, though mining output contracted by 7.2% in July. Infrastructure and consumer durables posted strong growth, indicating sustained momentum in capital formation.
- On the trade front, the US imposed a 50% tariff on Indian exports effective August 27, impacting key sectors such as textiles, gems & jewellery, electronics, and pharmaceuticals. The move is linked to India's continued energy ties with Russia and has prompted exporters to explore alternative markets.
- In response, the Indian government has initiated a phased export diversification strategy. Short-term efforts focus on scaling exports to the EU, UK, UAE, and Japan, while long-term plans target new markets in Latin America, Africa, and East Asia.
- From a governance perspective, the government has introduced reforms (to be effective from 22nd September) simplifying the GST to a two-rate structure of 5% and 18%, eliminating the 12% and 18% slabs, to streamline compliance and reduce consumer prices. At the same time, a new 40% slab has also been introduced on ultra-luxury and sin goods such as tobacco and high-end cars
- GSTV (Goods and Services Tax Verification) was introduced in July 2025 as part of enhanced compliance measures, including hard-locking GSTR-3B and stricter invoice matching, to improve transparency and reduce tax evasion.

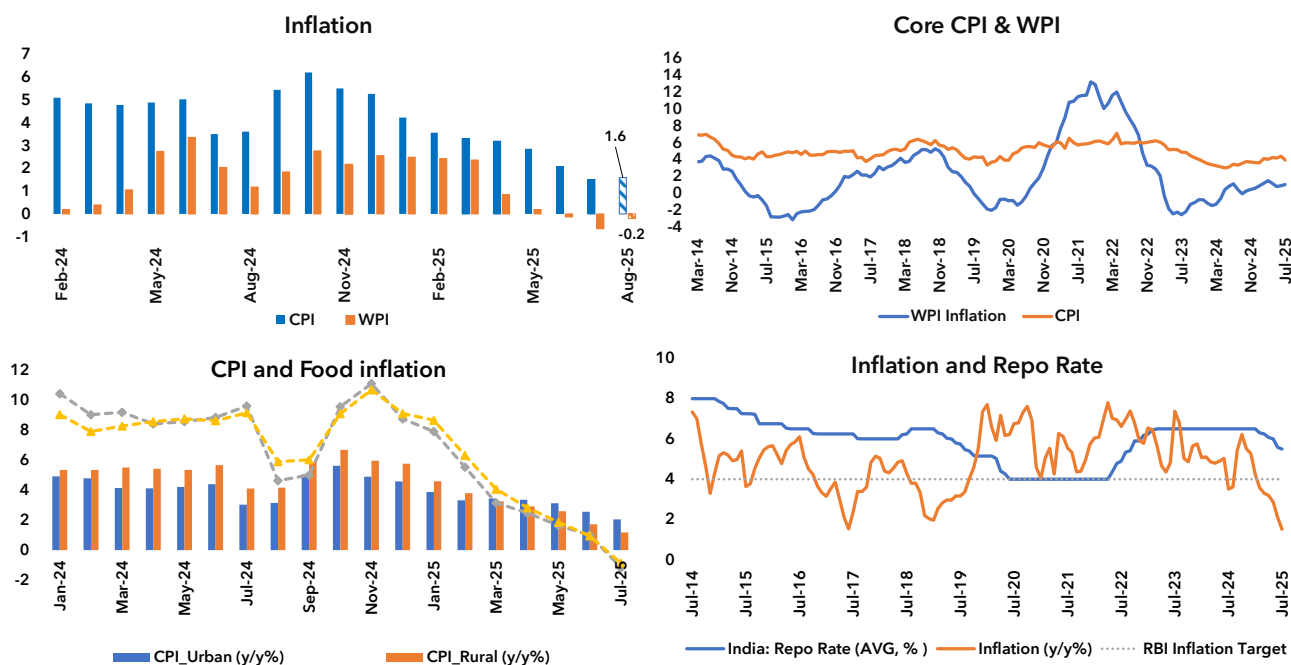
India's near-term industrial outlook remains cautiously optimistic. Despite external shocks and trade headwinds, domestic policy agility, resilient demand, and structural reforms continue to support growth. The convergence of fiscal, trade, and digital reforms reinforces investor confidence and strengthens the foundation for long-term economic resilience.



Price Scenario

- Dun & Bradstreet forecasts CPI inflation to stabilize at 1.6% y/y in August 2025, maintaining the low trajectory observed in July, when inflation eased to 1.6% y/y—the lowest in over eight years. The moderation is driven by a sharp decline in food prices, particularly vegetables, pulses, cereals, and sugar.
- In July 2025, rural inflation dropped to 1.2%, while urban inflation eased further to 2.1%. Food inflation turned negative in both segments, reflecting improved supply conditions and lower retail markups, especially in urban markets.
- The steep fall in food prices vegetables down 20.7%, pulses down 13.8%, cereals down 7.5%, and spices down 3.1% was supported by a favorable monsoon, robust kharif sowing, and stabilized agricultural output expectations. These factors have reinforced the disinflationary trend across food and beverages.
- On the wholesale front, WPI inflation declined by 0.6% y/y in July 2025, marking the first back-to-back monthly contraction since October 2023. Dun & Bradstreet forecasts WPI inflation to remain negative at -0.2% in August 2025, driven by softening input costs and a continued fall in global mineral oil prices.
- The decline in WPI was led by a sharp drop in food prices at the wholesale level, with onions falling 44.4%, potatoes 41.3%, vegetables 28.9%, and fruits 12.45%. Fuel prices also dropped by 2.43%, the steepest decline in five months.

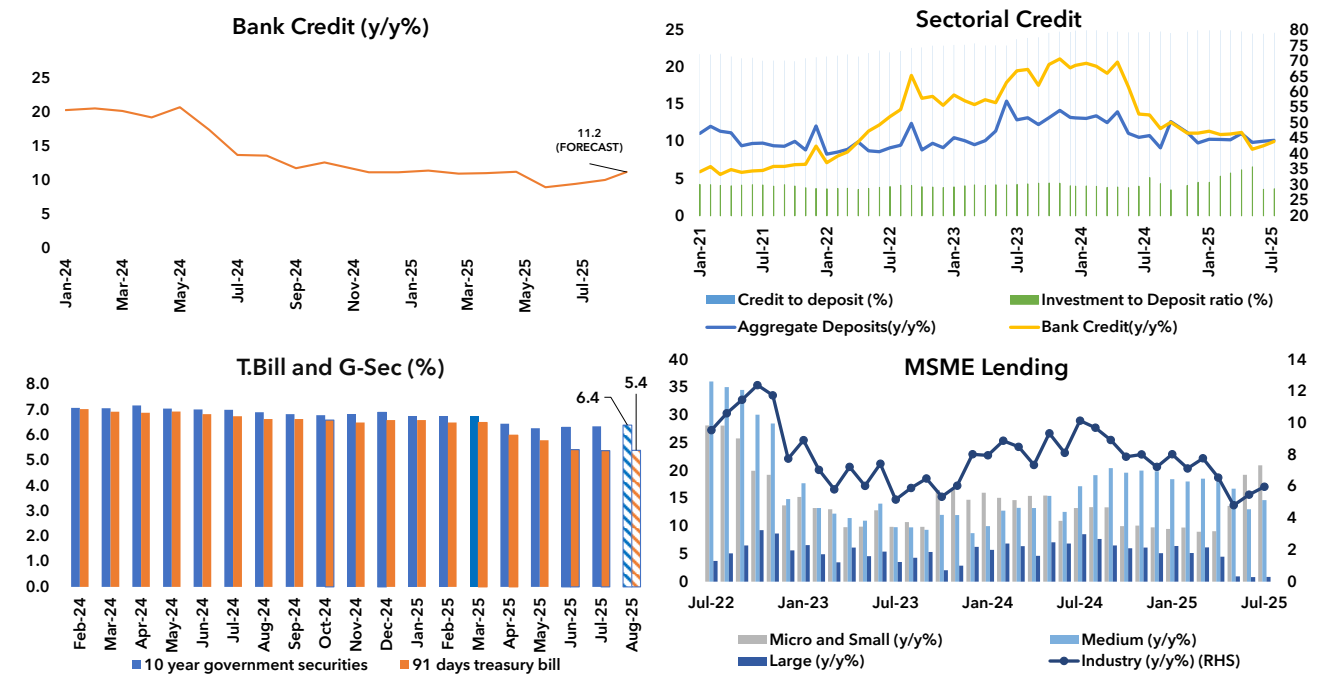
India's inflation trajectory continues to moderate, reinforcing price stability and strengthening the case for continued policy support to growth. Improved agricultural productivity, and robust agri-infrastructure investments have stabilized food prices. Industrial sectors are benefiting from softening input costs, aiding manufacturers, particularly in export-oriented industries. Over the medium term, headline inflation is projected to remain well within the RBI's target range of 4% (with band of +/-2%), offering policymakers strategic flexibility to maintain a supportive policy stance. The RBI's careful calibration of liquidity and interest rates will be crucial in managing inflation expectations amid a still-uncertain global environment.



Money Market

- Indian financial markets in August 2025 reflected cautious investor sentiment amid global trade tensions and sectoral volatility. Dun & Bradstreet forecasts the 10-year G-Sec yield to remain steady at 6.4%, supported by selective investor interest and RBI’s liquidity support. The 91-day T-Bill yield is also expected to hold at 5.4%, reflecting strong demand in RBI’s auction and short-term liquidity comfort.
- Bank credit growth is projected to accelerate to 11.2% in August, up from 9.6% in July, driven by festive season demand, improved credit access, and lower borrowing costs. The RBI maintained its repo rate at 5.50% and a neutral policy stance, signaling a wait-and-watch approach as inflation trends stabilize. Liquidity remained in surplus, with ₹1.79 lakh crore absorbed via the Standing Deposit Facility and reverse repo operations.
- India witnessed a sharp FPI equity outflow of ₹34,993 crore in August, driven by U.S. tariff tensions, rupee depreciation, and weak earnings in IT and financial sectors. This marked the highest monthly sell-off since February, with 15 of 19 trading sessions seeing net withdrawals.
- NPCI’s revised UPI regulations, effective August 1, 2025, introduced caps on balance checks (50/day), transaction status retries (3 per transaction), and auto-pay execution windows (non-peak hours only). These changes aim to reduce system congestion and fraud risk. Additionally, NPCI mandated beneficiary name previews and limited account-linked API calls to 25/day per app.

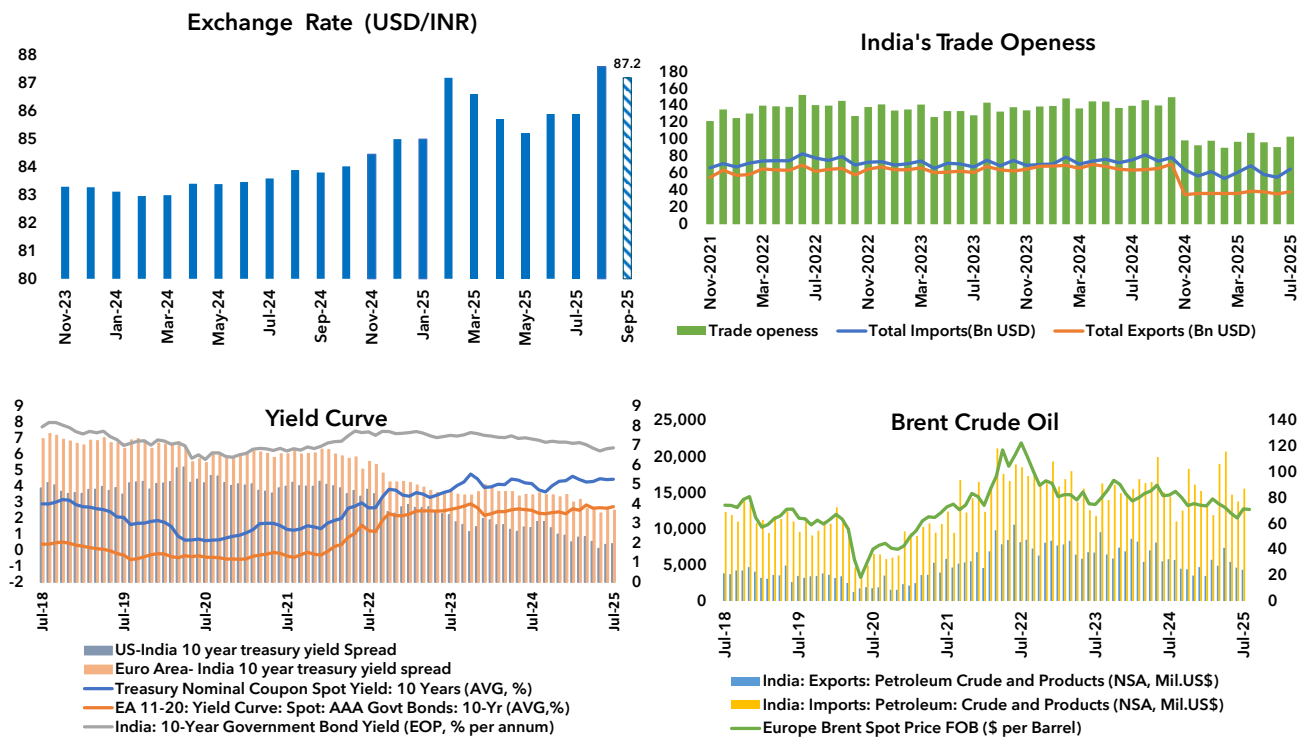
India’s financial markets are poised to maintain cautious stability, underpinned by the RBI’s proactive liquidity management, robust domestic credit expansion, and progressive reforms in digital payments. As the economy navigates tariff-related headwinds, the rollout of enhanced UPI rules are expected to boost transaction efficiency and security, reinforcing investor confidence in the months ahead.



External Scenario

- Dun & Bradstreet anticipates the rupee to average ₹87.2/USD in September, marginally stronger than ₹87.4/USD in August. The rupee remains under moderate pressure amid ongoing US-India tariff tensions and equity outflows. The Reserve Bank of India (RBI) is expected to intervene to curb excessive volatility, while strong services exports offer support.
- Services exports remain a key pillar of resilience, with India's services exports reaching a record \$387.5 billion in FY25, registering a robust 13.6% growth over the previous year. Key contributors include telecommunications, IT, transport, travel, and financial services.
- Meanwhile, the merchandise trade deficit widened to \$27.35 billion in July, up from \$18.78 billion in June, reaching an eight-month high. This was fueled by a surge in imports especially crude oil, gold, electronics, and machinery, while exports grew modestly, weighed down by a sharp decline in petroleum shipments.
- A widening trade deficit and capital outflows together signal macroeconomic pressure, although strong domestic investor activity and IPO participation have helped cushion market volatility.
- In Q3 FY25, exports to FTA countries totaled \$43.19 bn, reflecting a 16% year-on-year increase. Major gains exceeding 50% were experienced in Bhutan (53.4%), Singapore (52.0%), and Australia (50.4%), contributing to the overall growth. However, declines were noted in Mauritius (53.4%) and South Korea (7.2%).
- India-EU Free Trade Agreement (FTA) negotiations have entered the final stage, with the 13th round of talks scheduled for September 8-12. The pact aims to enhance market access and reduce tariff barriers, with a target to conclude by end-2025.

India's external sector continues to navigate a complex global landscape marked by tariff tensions, volatile commodity prices, and shifting trade dynamics. While the services sector and forex reserves offer resilience, a widening merchandise trade deficit remains a key vulnerability. With trade negotiations advancing and policy buffers in place, India is actively recalibrating its external strategy to balance growth ambitions with macroeconomic stability.



Economy Observer is a monthly report that shares an in-depth analysis on key macroeconomic developments in India and provides a monthly forecast of key economic indicators, providing insight into the expected direction of the Indian economy.

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