Insights

India Boosts Manufacturing and Infrastructure Spending in Union Budget 2026-27

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February 2026

Key takeaways

- Indian Finance Minister Nirmala Sitharaman presented the Union Budget for Financial Year (FY) 2026–27, on February 1, announcing record infrastructure spending and new measures to support manufacturing and other strategic sectors.
- The economy is expected to close the current fiscal year at 7.4% growth, according to the annual Economic Survey, released on January 30, but economic expansion is forecast to slow slightly next year, to between 6.8-7.2%, though a U.S.-India trade deal could rewrite those estimates.
- The budget balances fiscal consolidation and new spending. The budget deficit is forecast to fall to 4.3% of GDP next year from an estimated 4.4% in the current fiscal year. Similarly, the debt-to-GDP ratio is projected to decline to 55.6%, from 56.1%. Anticipated inflation of 4% would fall comfortably within the Reserve Bank of India's 2-6% target range.
- The budget includes no new tax cuts or changes to effective tax rates, but confirms the rollout of the Income Tax Act, 2025, effective April 1, 2026, to ease compliance burdens.
- Capital expenditure for roads, ports, and high-speed railways will increase 9% to a record USD 133.1 billion. Capital expenditure on defense will increase by 18%.
- Sector-specific highlights include a new USD 1.1 billion biopharma manufacturing initiative; the introduction of seven high-speed rail corridors and 20 new national waterways; a USD 1.1 billion dedicated small and medium enterprises growth fund; significant new spending for carbon capture and lithium-ion battery manufacturing; and full duty exemptions on the import of 17 cancer drugs and other lifesaving medications.
- The budget also maintains a strong focus on AI initiatives, including a tax holiday for new data centers through 2047 and the launch of the India Semiconductor Mission 2.0 (ISM 2.0), to boost exports and reduce dependencies.
- Companies that seek to expand local manufacturing and jobs, integrate their India production into export-oriented supply chains, support infrastructure development, and invest in strategic sectors and technologies will be best positioned to benefit from regulatory facilitation, incentives, and stronger government support and cooperation.

Modest fiscal consolidation enables greater capital expenditure

The government forecasts that real GDP growth will close out the current fiscal year at 7.4% (slightly above IMF estimates of 7.3%), reaffirming India's position as the fastest-growing major economy in the world. The 2026-27 budget will continue to prioritize public investment, with capital expenditure allocation growing by 8.8% to USD 133.1 billion, or 4.4% of GDP. The increase in Indian public sector investment stands in sharp contrast to many advanced economies, which are cutting back public investments due to high debt and tight monetary policy.

The government has reinforced its commitment to fiscal consolidation, albeit at a slower pace, forecasting a budget deficit of 4.3% of GDP, down from 4.4% in revised FY 2025-26 estimates. For FY 2026-27, the budget projects an 8% increase in gross tax revenue, lower than the 10.8% growth budgeted in the previous year, signaling that last year's bump in consumer spending will flatten now that FY 2025-26 income tax cuts and Goods and Services Tax (GST) reforms have been implemented and absorbed. The new budget also targets a debt-to-GDP ratio of 55.6%, down from 56.1% this financial year. With inflation expected to remain within the RBI's target range of 2-6% (trending closer to the 4% medium-term target), macroeconomic conditions provide room for cautious monetary easing that supports growth while preserving financial stability.

A pragmatic approach with few fireworks

The budget aims to strengthen manufacturing capabilities across a mix of technology-intensive and traditional industrial sectors. Priority industries include semiconductors, electronics and data centers, rare earths, and biopharmaceuticals, alongside traditional sectors such as textiles and capital goods — an effort to balance expansion in emerging, high-growth sectors with more traditional, employment-intensive manufacturing. Amid heightened tensions with Pakistan that culminated in a brief conflict last year, the budget also commits to spending USD 86 billion on defense, a value that sits at 15% above last year's spending. That includes an 18% increase in defense capital expenditure, to USD 23.9 billion, for modernization. The budget also proposes new mega textile parks to strengthen export competitiveness in the labor-intensive garments sector, which was hit hard by U.S. tariffs, but is expected to gain from improved market access following the recently concluded India–EU free trade agreement.

The budget also introduces a set of targeted tax and customs measures intended to support manufacturing and export competitiveness, including duty exemptions on selected inputs, deferred duty payment facilities, and tax relief for non-residents supplying capital goods to bonded manufacturing zones. Trade facilitation should be enhanced by trusted importer recognition and flexibility for Special Economic Zone units to access the domestic market.

Electronics and semiconductor manufacturing

The 2026-27 budget launches ISM 2.0, with an outlay of USD 436 million. India is also proposing a tax holiday extending through 2047 for foreign cloud companies making data center investments in the country and providing cloud services globally, a measure introduced as U.S. technology companies like Google and AWS announce multi-billion dollar data center investments in India. ISM 2.0's focus is on building domestic capabilities beyond fabrication to include equipment and materials, full-stack Indian intellectual property, and more resilient domestic supply chains, complemented by industry-led research and training centers to address skills gaps.

An initiative for rare earth permanent magnets is being scaled up through the creation of dedicated Rare Earth Corridors in mineral-rich states to strengthen domestic mining, processing, and manufacturing capabilities critical to electronics and clean energy supply chains. Separately, customs duty exemptions have been allowed for inputs used to manufacture lithium-ion batteries.

Additional measures seek to attract overseas talent through global income tax exemptions for specialized experts and support exploration of critical minerals via enhanced deductibility of certain expenses.

Biopharmaceutical manufacturing

India's drive to become a global biopharmaceutical manufacturing hub includes a proposed Biopharma SHAKTI program with an outlay of USD 1.1 billion over five years. The initiative seeks to facilitate an end-to-end domestic biopharma ecosystem for biologics and biosimilars, including an overhauled drug regulator to align approvals with global standards and timelines.

Growing infrastructure ambitions

The government plans to invest a record USD 133.1 billion on infrastructure in the coming fiscal year. The budget outlines an expansive infrastructure and connectivity agenda across railways, waterways, urban development, and logistics, anchored by seven high-speed rail corridors, new dedicated freight corridors linking eastern and western industrial hubs, and 20 new national waterways over the next five years. These initiatives are complemented by efforts to scale asset monetization through Infrastructure Investment Trusts and Real Estate Investment Trusts. The breadth of announcements underscores ambition in logistics integration, coastal shipping, and the development of City Economic Regions. The sustained investment in infrastructure is presented as a core strategy to enhance national productivity and competitiveness. In areas such as this one, this budget relies heavily on execution and implementation.

Modest financial sector reforms

The budget introduces several measures to deepen debt markets, including a market-making framework for corporate bonds and the introduction of total return swaps to allow investors to gain exposure without transferring ownership. Foreign investment facilitation features prominently, with a proposed review of foreign investment regulations to create a more contemporary and user-friendly framework. The deadline for filing revised returns has been extended from December 31 to March 31.

The budget proposes the establishment of a high-level committee to review banking, non-banking financial companies (NBFCs), and foreign investment rules. The goal is to align the sector with India's next phase of growth while preserving financial stability and inclusion. The emphasis is on scale and efficiency, including the proposed restructuring of key public sector lenders such as Power Finance Corporation and Rural Electrification Corporation — steps that may improve capital allocation.

Collectively, these measures point to incremental progress in financial market access and depth. But meaningful impact will depend on greater regulatory clarity, consistency in implementation, and procedural easing that translates into faster execution. Managing longstanding execution risks remains important to unlocking access to long-term capital investments.

Prioritizing growth in services

The budget reaffirms the services sector as a core growth driver through a broad set of interventions across health, education, tourism, digital services, and the creative economy.

Investments seek to position India as a global services leader, targeting a 10% share of the global services trade by 2047. Proposals include the establishment of a high-powered standing committee on services, expansion of allied health professional training, multi-skilling of caregivers, and capacity building across medical tourism and the care ecosystem. The budget also offers a business-friendly safe harbor transfer pricing regime by increasing the threshold for safe harbor and joining IT services under a single category with a safe harbor margin of 15.5.

The range of service sector initiatives — a sector that delivers the largest share of India's GDP but a proportionately smaller share of employment — are explicitly oriented toward job creation and labor market absorption across diverse sectors. However, while ambitious, the Indian services landscape remains fragmented across multiple subsectors, with outcomes likely to hinge upon effective coordination and execution to translate into scale and productivity gains.

Girding India for an uncertain global landscape

This year's budget was presented at a moment of cautious optimism for the country. India's Economic Survey 2025-26, released on January 30, describes an economy propelled by resilient domestic demand, steady investment, and sustained momentum in services and manufacturing, even amid rising global uncertainty. Still, some observers remain less confident about the strength of domestic demand and are waiting for "animal spirits" to materialize in business investment. India's underlying economic strength has persisted despite U.S. tariffs, geopolitical shocks, and volatile capital flows — unpredictability that only reinforces for Indian policymakers the importance of building deeper economic buffers and greater resilience. Soon to become the world's fourth-largest economy, India has emerged as an anchor of stability amid global turbulence, steadied by investor confidence, a stable inflation outlook, easing supply side pressures, and coordinated fiscal discipline across levels of government. The FY 2026-27 budget's emphasis on fiscal stability, manufacturing competitiveness, infrastructure investment, defense spending, and modest sectoral reforms should enable India's continued steady growth while preparing it for a more complex and risk-prone global order.

Business implications

This year's budget offers a solid economic and fiscal blueprint but refrains from bold economic reforms. Though it generally steers clear of populist temptations and policies that are likely to chill private investment, it is also unlikely to stoke "animal spirits" and meaningfully boost investment. India's ongoing focus on domestic infrastructure development and manufacturing should continue to improve its business climate and reduce operational costs. Over time, these kinds of steps should also strengthen domestic demand, especially if they can accelerate job creation.

India's FY 2026–27 budget environment unsurprisingly favors companies that can contribute to domestic manufacturing, technology adoption, and export-linked growth. Businesses that will receive the most attention from government and have a better chance at harnessing government collaboration are the ones that expand local production; integrate into emerging industrial supply chains and logistics corridors; support India's infrastructure ambitions and invest in strategic sectors such as semiconductors, AI, biopharma, clean energy, and critical minerals.

India's ability to execute on its budget, at speed, is a critical determinant of the blueprint's commercial impact. That is the case every year, but it is especially so this time around given the budget's announced programs and initiatives to expand manufacturing and infrastructure.

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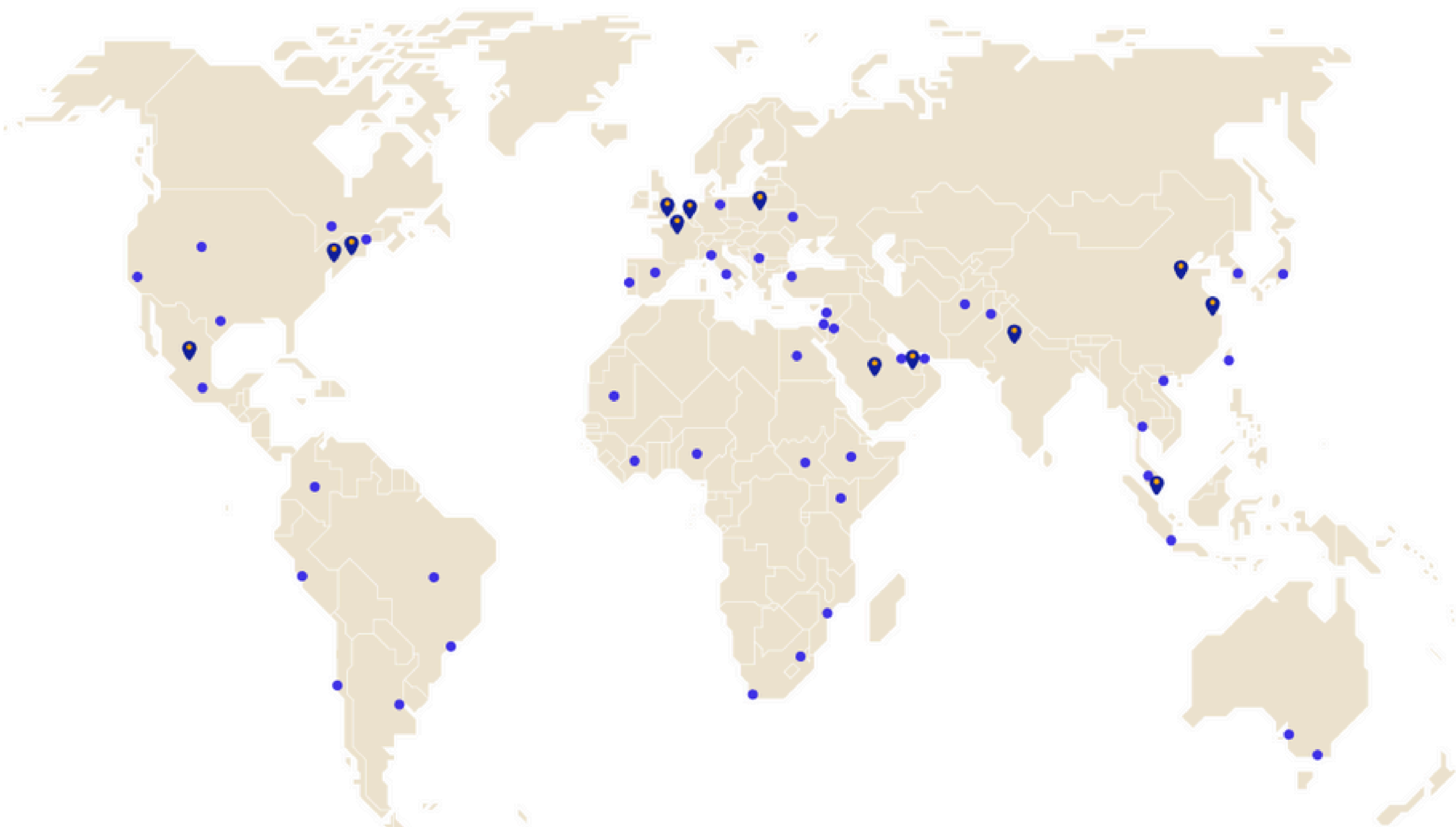

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