

# PrepAlpine

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## GS Paper III: Economics

### 1. Understanding GDP Growth, Inflation and Structural Economic Challenges

#### a. Introduction

In macroeconomics, a Goldilocks economy refers to an ideal situation in which growth remains strong, inflation stays moderate, unemployment is low and the economy avoids both overheating and stagnation. It represents a condition where policymakers do not face sharp trade-offs between growth and price stability.

In recent discussions, India was described as being in a possible Goldilocks phase because it continued to remain among the fastest-growing major economies while inflation appeared manageable. However, this narrative has increasingly come under scrutiny due to slowing growth momentum, renewed inflationary pressures, rupee depreciation and global geopolitical risks.

The debate is important because it shifts attention from short-term growth numbers to deeper structural questions, such as the strength of private investment, employment generation, dependence on energy imports, manufacturing competitiveness and the need for long-term economic reforms.

Thus, the issue is not merely whether India is growing, but whether the growth is durable, inclusive and structurally strong.

#### b. Understanding Gross Domestic Product

Gross Domestic Product, commonly known as GDP, refers to the total monetary value of all final goods and services produced within a country during a specific period. It is the most widely used indicator for measuring the size and growth performance of an economy.

GDP helps assess:

- Overall size of the economy
- Pace of economic growth
- Level of national income
- Broad direction of economic activity

However, GDP must be interpreted carefully because high growth in a particular year may not always indicate strong underlying economic health.

This makes it important to distinguish between nominal GDP and real GDP.

#### c. Nominal GDP and Real GDP

GDP is usually measured in two ways: nominal GDP and real GDP.

Type of GDP	Meaning
Nominal GDP	GDP measured at current market prices
Real GDP	GDP adjusted for inflation

Nominal GDP includes the effect of price rise. Therefore, it may increase even when actual production has not risen significantly. Real GDP, on the other hand, removes the effect of inflation and shows the actual increase in production and economic activity.

For analysing true growth, real GDP is considered more reliable.

Accurate measurement of real GDP also depends on the base year used for calculation.

#### **d. Base Year Revision in GDP**

India periodically revises the base year used for GDP calculation. The base year provides a reference point for comparing prices and measuring real growth accurately.

A base year revision becomes necessary because the structure of the economy changes over time. Consumption patterns evolve, new industries emerge, technology changes production systems and services acquire greater importance.

The recent shift in the GDP base year from 2011–12 to 2022–23 indicated that earlier estimates may have overstated the size and growth of the economy. This means that India's economy may have been smaller than previously estimated.

Such revisions underline the importance of data transparency and careful interpretation of growth figures.

Along with GDP levels, economists also use long-term growth rates to understand the economy's direction.

#### **e. Meaning of Compound Annual Growth Rate**

Compound Annual Growth Rate, or CAGR, measures the average annual growth rate over a period of time. It smoothens short-term fluctuations and provides a clearer picture of long-term growth trends.

For example, a country may grow rapidly in one year and slowly in another. CAGR helps understand the average pace of growth across the entire period.

Therefore, CAGR is useful for identifying whether an economy is accelerating, slowing down or maintaining stable momentum.

#### **f. India's Growth Trend**

India's nominal GDP growth has gradually moderated over time.

<b>Period</b>	<b>Nominal GDP CAGR</b>
Last 22 years	Around 12.3 percent
Last 12 years	Around 10 percent
Last 7 years	Around 9.5 percent

A similar deceleration is visible in real GDP growth.

<b>Period</b>	<b>Real GDP CAGR</b>
Last 22 years	Relatively higher
Last 12 years	Around 6.2 percent
Last 7 years	Below 5.5 percent

The broad conclusion is that India's growth rate has been gradually decelerating over time. This suggests weakening economic momentum and the presence of deeper structural challenges.

This is why short-term high growth figures must be interpreted cautiously.

### g. Why Short-Term High Growth Can Be Misleading

After the Covid-19 contraction, India recorded high growth rates in some years. However, part of this growth was due to the base effect.

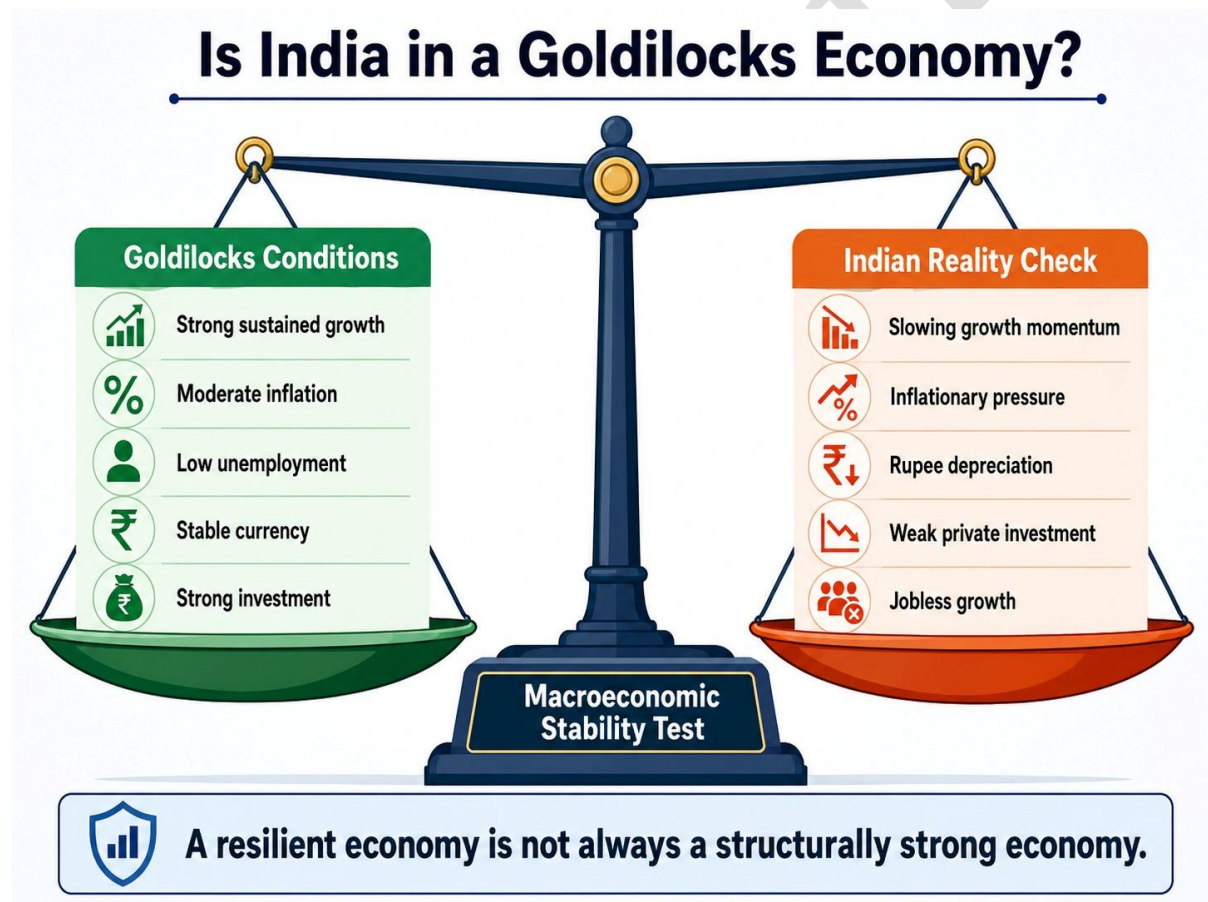
The base effect occurs when growth is calculated from an unusually low previous level. If GDP falls sharply in one year, even a moderate recovery in the following year appears very high in percentage terms.

#### Why Base Effect Matters

- It can exaggerate recovery after a contraction
- It may hide weak underlying demand
- It can create misleading optimism
- It does not necessarily indicate structural strength

Therefore, short-term high growth figures after a contraction may not necessarily indicate strong long-term economic health. For a realistic assessment, policymakers must examine multi-year trends rather than isolated annual numbers.

This distinction is central to the debate over whether India is truly experiencing a Goldilocks economy.



### h. Why the Goldilocks Narrative Is Being Questioned

A true Goldilocks economy requires sustained growth, low inflation, currency stability, strong investment and healthy employment generation.

India's present situation appears more complex.

<b>Goldilocks Condition</b>	<b>Emerging Indian Reality</b>
Strong sustained growth	Growth momentum has slowed
Low inflation	Inflationary pressures remain a concern
Stable currency	Rupee has faced depreciation pressure
Strong investment	Private investment remains weak
Healthy employment	Quality job creation remains inadequate

This is why many economists argue that India may not have been experiencing a genuine Goldilocks phase. The economy has shown resilience, but resilience should not be confused with structural strength.

External shocks, especially geopolitical tensions and energy price volatility, further complicate this macroeconomic picture.

### **i. Impact of Global Geopolitical Tensions**

Global geopolitical tensions, especially conflict involving the United States, Iran and Israel, create serious risks for India because of its dependence on imported energy.

The Strait of Hormuz is particularly important for India, as a large share of crude oil and liquefied natural gas supplies move through this route. Any disruption in this region can raise energy prices and increase uncertainty in global trade.

For India, such disruptions can lead to:

- Higher oil import bills
- Rising inflation
- Pressure on the current account deficit
- Weakening of the rupee
- Slower economic growth

Thus, geopolitical shocks can quickly translate into domestic macroeconomic stress.

Among these external risks, oil price volatility remains especially important for India.

### **j. Why Rising Oil Prices Matter for India**

India is heavily dependent on imported crude oil. When oil prices rise, the impact is transmitted across the economy.

Higher oil prices:

- Increase the import bill
- Raise transport and production costs
- Fuel inflation
- Put pressure on government finances
- Increase demand for foreign currency
- Weaken the rupee

Therefore, oil price volatility remains one of India's most important external vulnerabilities.

This vulnerability is closely linked with movements in the value of the rupee.

## k. Rupee Depreciation and Its Causes

Rupee depreciation means that the Indian rupee loses value against the United States dollar. This makes imports costlier and can increase inflation.

The rupee may depreciate due to several reasons.

### Foreign Capital Outflows

- Foreign investors may withdraw funds when growth slows
- Global uncertainty may reduce risk appetite
- Emerging-market currencies may face pressure

### High Import Dependence

- Crude oil imports increase dollar demand
- Fertiliser and technology imports add pressure
- A large import bill weakens currency stability

### Global Dollar Strength

- During uncertainty, investors move toward the United States dollar
- The dollar strengthens against emerging-market currencies
- The rupee faces additional depreciation pressure

Rupee depreciation has both positive and negative consequences, but for an import-dependent economy the risks are often significant.

## 1. Effects of Rupee Depreciation

### Positive Effects

May improve export competitiveness

Benefits some IT and service exporters

May support tourism earnings

### Negative Effects

Makes imports costlier

Raises imported inflation

Increases pressure on fuel prices

For an import-dependent country like India, the negative effects of sharp depreciation can be significant, especially when oil prices are high.

Currency weakness, inflation and external shocks together make growth slowdown a serious policy concern.

## m. Why Growth Slowdown Is a Serious Concern

India aims to become a developed economy by 2047. To achieve this goal, it requires sustained high real growth, generally estimated around 7 to 8 percent over a long period.

However, if long-term growth trends remain below this level, India may face difficulty in achieving its developmental aspirations.

The concern is not merely about GDP numbers. The larger concern is whether growth is generating adequate employment, improving productivity, expanding manufacturing and raising incomes across regions and social groups.

Therefore, the slowdown must be examined through deeper structural challenges within the economy.

## n. Structural Challenges in the Indian Economy

### **Weak Private Investment**

Private investment remains crucial for long-term growth. Businesses invest when they expect strong demand, stable policy conditions and profitable returns.

When demand is weak or uncertainty is high, private investment slows. This reduces future productive capacity and employment generation.

### **Jobless Growth**

India has often experienced growth without adequate creation of high-quality formal jobs. This weakens the link between GDP growth and social welfare.

A growth model that does not create sufficient employment cannot be considered fully inclusive.

### **Import Dependence**

India remains dependent on imports for several critical sectors, including:

- Energy
- Electronics
- Fertilisers
- Defence equipment

This makes the economy vulnerable to global price shocks, supply disruptions and currency pressures.

Reducing strategic import dependence is therefore essential for long-term economic resilience.

### **Manufacturing Weakness**

The share of manufacturing in India's GDP remains relatively low compared to the requirements of mass employment and export competitiveness.

A stronger manufacturing base is necessary for:

- Job creation
- Export expansion
- Technological upgrading
- Industrial competitiveness

### **Uneven Consumption Growth**

India's consumption pattern is uneven. Urban and premium consumption may grow, while rural demand often remains weak or inconsistent.

Such unevenness indicates that income growth is not equally distributed across the economy.

These structural issues show why short-term macroeconomic resilience must be supported by long-term reforms.

## **o. Need for Structural Economic Reforms**

The slowdown in long-term growth points toward the need for deeper structural reforms. Short-term stimulus may provide temporary support, but sustained growth requires improvements in productivity, investment, human capital and institutional efficiency.

Structural reforms are necessary because they expand the economy's productive capacity rather than merely boosting demand temporarily.

The key areas of reform must therefore focus on manufacturing, human capital, finance, exports and governance.

## **p. Key Areas for Reform**

### **Manufacturing Expansion**

India must strengthen labour-intensive manufacturing sectors, improve logistics, reduce regulatory friction and integrate domestic firms into global value chains.

This is essential for employment generation and export competitiveness.

### **Human Capital Development**

Education, health and skill development are essential for productivity growth.

Without a skilled and healthy workforce, high growth cannot be sustained.

### **Ease of Doing Business**

Simpler compliance systems, faster approvals, better contract enforcement and regulatory predictability can improve investor confidence.

A predictable business environment encourages long-term private investment.

### **Financial Sector Reforms**

A strong financial system is necessary for credit flow, investment, innovation and entrepreneurship.

Banking reforms, capital market deepening and better risk assessment can support growth.

### **Export Competitiveness**

India must improve export infrastructure, reduce logistics costs and integrate more deeply with global production networks.

Export growth is essential for sustaining high growth without creating external imbalances.

However, reform must proceed alongside macroeconomic stability, especially in relation to inflation.

## **q. Inflation-Growth Trade-Off**

One of the most important challenges in macroeconomic policy is balancing growth and inflation.

If inflation rises sharply, the Reserve Bank of India may raise interest rates. Higher interest rates make borrowing costlier, which can slow investment and consumption. However, if growth slows too much, employment and incomes suffer.

### **Nature of the Trade-Off**

- High inflation hurts purchasing power
- High interest rates can weaken investment
- Low growth affects jobs and income
- Excessive stimulus may create price pressures

Therefore, policymakers must maintain macroeconomic stability while supporting productive growth.

This makes the role of the Reserve Bank of India especially important.

## **r. Role of the Reserve Bank of India**

The Reserve Bank of India plays a central role in managing inflation, liquidity, interest rates, financial stability and currency movements.

Its key objectives include:

- Maintaining price stability

- Supporting financial stability
- Managing liquidity
- Supporting growth within the framework of macroeconomic stability

The challenge for the Reserve Bank is to control inflation without excessively weakening growth.

Macroeconomic management also requires ethical governance, credible data and realistic public communication.

## **s. Way Forward**

### **Focus on Long-Term Growth Trends**

India should avoid excessive reliance on short-term statistical spikes and instead evaluate growth through long-term productivity, investment and employment trends.

### **Undertake Deep Structural Reforms**

Reforms are needed in:

- Manufacturing
- Agriculture
- Labour markets
- Education
- Finance
- Trade competitiveness

These reforms must aim to increase productivity and generate durable employment.

### **Strengthen Domestic Demand**

Employment generation, rural income growth and support for micro, small and medium enterprises are essential for broad-based consumption growth.

### **Reduce Energy Dependence**

India must expand:

- Renewable energy
- Green hydrogen
- Domestic exploration
- Energy storage

This will reduce vulnerability to imported fossil fuels.

### **Preserve Macroeconomic Stability**

Policy must balance growth, inflation, fiscal discipline and external stability. Macroeconomic stability is necessary for investor confidence and long-term development.

The way forward must therefore combine growth acceleration with stability, inclusion and resilience.

## **Conclusion**

The debate over India's so-called Goldilocks economy highlights the need to look beyond short-term growth numbers. India continues to remain one of the world's fastest-growing major economies, but long-term trends suggest slowing growth momentum, structural weaknesses and vulnerability to global shocks.

Sustainable development requires more than high GDP growth. It requires productive investment, quality employment, stable inflation, external resilience and inclusive income growth.

For India to achieve its aspiration of becoming a developed economy by 2047, policy must move beyond temporary statistical optimism and focus on durable, broad-based and structurally sound growth.

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## Reader's Note — About This Current Affairs Compilation

Dear Aspirant,

This document is part of the PrepAlpine Current Affairs Series — designed to bring clarity, structure, and precision to your daily UPSC learning.

While every effort has been made to balance depth with brevity, please keep the following in mind:

### 1. Orientation & Purpose

This compilation is curated primarily from the UPSC Mains perspective — with emphasis on conceptual clarity, analytical depth, and interlinkages across GS papers.

However, the PrepAlpine team is simultaneously developing a dedicated Prelims-focused Current Affairs Series, designed for:

- factual coverage
- data recall
- Prelims-style MCQs
- objective pattern analysis

This Prelims Edition will be released separately as a standalone publication.

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Some sections may feel shorter or longer depending on topic relevance and news density. To fit your personal preference, you may freely resize or summarize sections using any LLM tool (ChatGPT, Gemini, Claude, etc.) at your convenience.

### 3. Format Flexibility

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- lists
- tables
- visual cues

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