Macroeconomics | First cut

Rebounding growth

June 2023

Uptick in last quarter lifts GDP growth in fiscal 2023

- India's real gross domestic product (GDP) growth rose sharply to 6.1% on-year in the fourth quarter of fiscal 2023 compared with 4.5% in the third
- The growth surpassed the number factored in the National Statistics Office's (NSO) second advance estimate of February. Annual growth for fiscal 2023 was revised up to 7.2% (provisional estimate) from 7.0% in the second advance estimate
- Fourth-quarter growth was primarily driven by investment and net exports, with the latter less of a drag given rising exports and slowing imports. Fixed investment turned in the strongest growth on the demand side while private consumption growth was more subdued on-quarter . Manufacturing and agriculture growth improved on-quarter on the supply side even as services growth remained strong, albeit slowing a tad relative to the previous quarter
- The provisional estimate of 7.2% comes on top of 9.1% expansion in fiscal 2022. This suggests strong growth momentum, which was propelled by domestic demand through the year, both from investment and private consumption. Investment's share rose to an 11-year high of 34% of GDP, while that of private consumption rose to an 18-year high of 58.5% in fiscal 2023
- However, nominal GDP growth tapered to 10.4% on-year in the fourth quarter compared with 11.4% in the third. This was primarily due to the price-effect, since the GDP deflator slowed to 4.1% from 6.6%. The deflator is significantly influenced by inflation based on wholesale price index (WPI), which halved to 3.3% from 6.6%. The gap between nominal and real growth is likely to reduce further, with inflation expected falling this fiscal

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While the growth momentum was strong in fiscal 2023, the current fiscal will feel the lagged impact of rate hikes of central banks over the past 15 months.

External demand is likely to be a bigger hindrance to growth with western advanced economies staring at a sharp slowdown in the coming quarters, whipping up a headwind for exports. While domestic demand will also weaken, hit by rising lending rates, softening inflation and government capex will offer support. Monsoon and El Nino risks remain a swing factor.

Overall, we expect India's real GDP growth to slow to 6.0% in this fiscal 2024 from 7.2% in the previous fiscal.

Agriculture and manufacturing rev up GDP growth

- On the supply side, gross value added (GVA) grew 6.5% in the fourth quarter compared with 4.7% in the previous quarter
- Agriculture and allied activities surged to 5.5% from 4.7%, the result of a robust rabi output despite unseasonal rains towards the year-end
- Manufacturing growth rose sharply after two quarters of decline (4.5% in the fourth versus -1.4% in the third). Resilient domestic demand, easing commodity prices and supply constraints supported production

- Among industrial components, growth improved for construction (10.4% vs 8.3%), reflecting a pickup in capital expenditure, particularly by states. There was a modest improvement in mining (4.3% vs 4.1%), while growth slowed for utilities[1] (6.9% vs 8.2%). Overall, industrial GVA grew 6.3% versus 2.3% int third quarter
- Services maintained the momentum, growing 6.9% versus 6.1%. Growth remained strong for trade, hotels, transport and communication services (THTC), but slowed a tad to 9.1% in the fourth quarter from 9.6% in the third. It rose sharply for financial, real estate and professional services (7.1% vs 5.7%), and moved up for public administration and other services (3.1% vs 2.0%)
- For fiscal 2023, growth was strongest for THTC services (14% in fiscal 2023 vs 13.8% previous year), followed by construction (10% vs 14.8%), utilities (9% vs 9.9%), public administration and other services (7.2% vs 9.7%), financial, real estate and professional services (7.1% vs 4.7%), agriculture (4% vs 3.5%), and manufacturing (1.3% vs 11.1%)
- The solid THTC growth reflected the pending catchup to pre-pandemic levels, while manufacturing was hit by surging commodity prices and supply constrains post the Russia-Ukraine conflict. Manufacturing remained much above its pre-pandemic level relative to THTC (see chart 1)

Investment and net exports support growth

- Among demand-side segments, the strongest growth was in exports of goods and services (11.9% in fourth quarter versus 11.1% previous quarter). While slowing global trade impacted goods exports, services exports remained strong
- Meanwhile, imports slowed sharply to 4.9% from 10.7%. This meant net exports contributed positively to GDP growth in the fourth quarter (see chart 2)
- Among domestic demand drivers, the strongest growth was in investment (8.9% vs 8.0%). Government capital expenditure remained strong, with states raising capex towards fiscal-end. The increasing investment growth also indicates a gradual pickup in private capex
- While private consumption expenditure improved, it was more subdued than investment (2.8% vs 2.2%). High inflation may have weighed on household consumption, with consumer price index-linked inflation remaining elevated at 6.4% in the fourth quarter; staying put as against the previous quarter
- However, for fiscal 2023, private consumption growth was strong at 7.5%, on top of 11.2% in fiscal 2022. Investment was vigorous at 11.4% compared with 14.6%. Imports increased more sharply than exports in the full year, at 17.1% and 13.6%, respectively, illustrating that net exports were a drag on GDP growth. Government consumption spending had slowed sharply to 0.1% from 6.6%, as pandemic spends ebbed

Outlook

While growth was robust in fiscal 2023, a slowdown is inevitable this fiscal, driven by rising borrowing costs. While central banks aggressively raised policy rates over the past 15 months, their transmission to broader lending rates is taking place with a lag. Rates are expected to peak in the fiscal, hitting both global and domestic demand.

External demand will weaken more with major advanced economies facing the highest interest rates in over a decade. S&P Global expects United States GDP growth to slow to 0.7% in 2023 from 2.1% in 2022; Eurozone will brake to 0.3% from 3.5%. These economies account for 33% of India's goods exports.

Hence, exports will rein in India's growth this fiscal.

While the rise in domestic interest rates is relatively lower than in advanced economies, bank lending rates have reached the pre-pandemic five-year average. This is expected to moderate domestic demand, especially in interest-sensitive segments such as automobiles and housing.

[1] Electricity, gas, water supply and other utility services

However, falling commodity prices and slowing inflation augurs well for domestic demand this fiscal. We expect further support from the government's continuing infrastructure spend.

The key swing factor is monsoon, which has a significant bearing on rural demand. While the India Metrological Department has forecast a normal monsoon, regional and temporal distribution will have a bearing on agricultural output. Downside risks from an expected El Niño remain.

Overall, we expect India's real GDP to grow 6% this fiscal, compared with 7.2% in fiscal 2023. Nominal growth will see a sharper slowdown to 10.6% from 16.1%, with falling inflation (particularly for WPI) narrowing the gap between real and nominal GDP.

Chart 1: Tracking catchup to pre-pandemic level in fiscal 2023

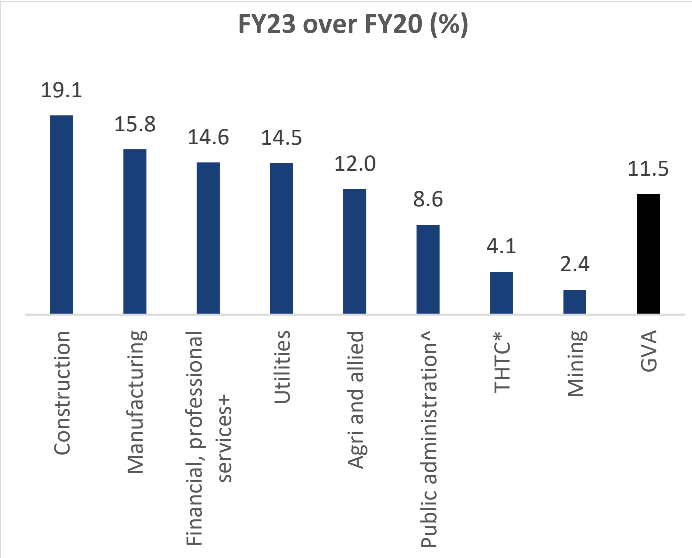
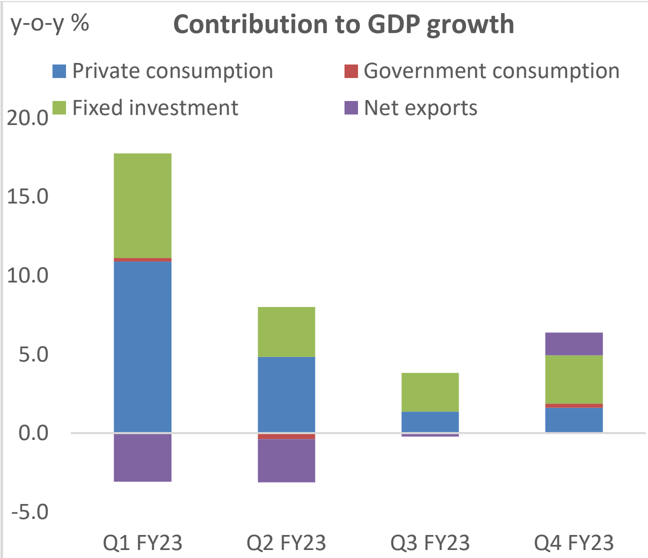


Chart 2: All demand segments supported growth in fourth quarter



*Note: *refers to trade, hotels, transport and communication services; +Financial, real estate and professional services; ^Public administration, defence and other services*

Source: NSO, CEIC, CRISIL MI&A Research

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