Macroeconomics | First cut

The catch-up continues

September 2022

Key highlights

- According to the National Statistical Office estimates released on August 31, 2022, India's real gross domestic product (GDP) grew 13.5% on-year in the first quarter (Apr-Jun) of fiscal 2023, a tad lower than our expectation of 15.2% and the Reserve Bank of India (RBI) estimate of 16.2% and 20.1% in the first quarter of fiscal 2022

- We note that the economy was first hit by the pandemic during the first quarter of fiscal 2021 and again affected in the second wave by the delta variant in the first quarter of fiscal 2022. In contrast, there was no pandemic-led disruption in the first quarter of this fiscal. Hence, first quarter data of this 2023 continues to be statistically boosted by the favourable base effect. Despite headwinds due to the Russia-Ukraine conflict, the growth momentum (in seasonally adjusted terms) improved sequentially during the quarter

- On the demand side, private final consumption expenditure (PFCE) registered strong growth of 25.9% on-year in the first quarter of fiscal 2023. Healthy growth was partly driven by a low base. PFCE rose to Rs 22.08 trillion in the first quarter of this fiscal from the corresponding pre-pandemic level of Rs. 20.09 trillion in the first quarter of fiscal 2020. The share of PFCE in GDP (in real terms) rose sharply to 59.9% in the first quarter of fiscal 2023 from 54.0% in the same quarter the previous year. The spurt in PFCE growth (see Chart 3) reflects pent up demand, especially for contact-based services, thanks to ebbing of the pandemic impact amid rising vaccination coverage. Further, goods demand also seems to be on the rise as reflected in high real import growth in the first quarter of this fiscal

  Had it not been for high inflation (CPI inflation of 7.3% in the first quarter of this fiscal the highest since the onset of the pandemic) and subdued rural demand due to negative real rural wage growth, private consumption would have grown faster.

- Investments also continued to recover. Real gross fixed capital formation (GFCF) – a proxy for fresh investments – grew 20.1% on-year in the first quarter of fiscal 2023, with its share in GDP further improving to 34.7% from 33.6% in the previous quarter and 32.8% in the first quarter of fiscal 2022. The improvement was largely led by central government capex (which rose 57% on-year during Apr-Jun) and private investments in infrastructure-linked sectors such as steel and cement. Rise in housing sales – which gets reflected as household investment in the national accounts - during the quarter also likely supported overall investments. State government capex,[1] which declined 6.1% during the first quarter of fiscal 2023, however, limited the upside to investment growth

- The government's final expenditure, which grew just 1.3% on-year in the first quarter of fiscal 2023, remained weak. It covers general (centre and states combined) government revenue expenditure including wages, interest payment, and subsidies. Slower growth of this head reflects the government's stretched fiscal position and increased focus on capex than revenue expenditure

- Net exports too created a drag on growth in the first quarter of fiscal 2023. While exports grew 14.7% on-year, import growth was more than double at 37.2% during the quarter

[1] For 16 major states

- On the supply side, gross value added (GVA) grew 12.7% in the first quarter of fiscal 2023, up from 3.9% in the previous quarter, again largely a reflection of low base effect. That said, several sub-sectors performed well, registering better sequential momentum
- Agriculture and allied sector rose 4.5% on-year in the first quarter of fiscal 2023 from 4.1% in the previous quarter and 2.2% in the year ago quarter, suggesting broader production (including horticulture) has not been impacted much even though there have been some losses in crop production due to the impact of heat waves and uneven southwest monsoon. The overall sector also seems to be getting support from the healthy performance of livestock sector, another important constituent of agriculture and allied services
- Within the industry, manufacturing activity remained subdued. The sector grew just 4.8% on-year despite a favourable base effect suggesting that it remained afflicted by supply issues and a part of the local demand was met through imports. Despite strong top line growth for manufacturing firms, weak GVA growth in manufacturing reflects the hit to margins from high input costs. On the other hand, industrial sector *electricity, gas, water supply and other utility services* did phenomenally well; it grew 14.7% on-year over a high base essentially reflecting high electricity demand due to the heatwave and a weak monsoon start
- The services sector largely continued to do well, thanks to the rebound (see Chart 2) in contact-intensive services such as hotel and airlines, etc[2] (25.7% growth on-year in the first quarter of fiscal 2023) and a continued good performance in *Financial, Real Estate and Professional Services,* which grew 9.2% on-year in the first quarter of fiscal 2023 over a very high base and reflects improved credit and deposit growth in the banking system, key parameters that go into estimation of this sector
- While real GDP growth in the first quarter of fiscal 2023 was at 13.5%, nominal growth reached a high of 26.7%, thanks to GDP deflator reaching its highest level (since the first quarter of fiscal 2021, when the pandemic hit) of 11.6% in the first quarter of fiscal 2023. To be sure, Consumer Price Index- and Wholesale Price Index-based inflation were at 7.3% and 15.5%, respectively, in the first quarter of fiscal 2023. High inflation acts as a hinderance for growth recovery and complicates policy management by the government.

Outlook

While the economic recovery continues to gather pace, it faces multiple risks. Global growth is projected to slow, as central banks in major economies withdraw easy monetary policies to tackle high inflation. This would imply lower demand for our exports. Together with high commodity prices, especially oil[3], this translates into a negative in terms of a trade shock for India. High commodity prices, along with depreciating rupee, indicate higher imported inflation.

While most of the international commodity prices have come off their peaks and a weaker global demand could imply the downward trajectory in prices would continue, they would continue to be high on-year. Moreover, firms would continue to pass on high input costs to end consumers domestically as pass through to the retail end remains incomplete.

Uncertainty due to the Russia-Ukraine conflict could put some of the private capex plans on the back burner which could curtail overall investment growth.

At the same time, uneven monsoon progress has impacted kharif sowing in key crops such as rice.

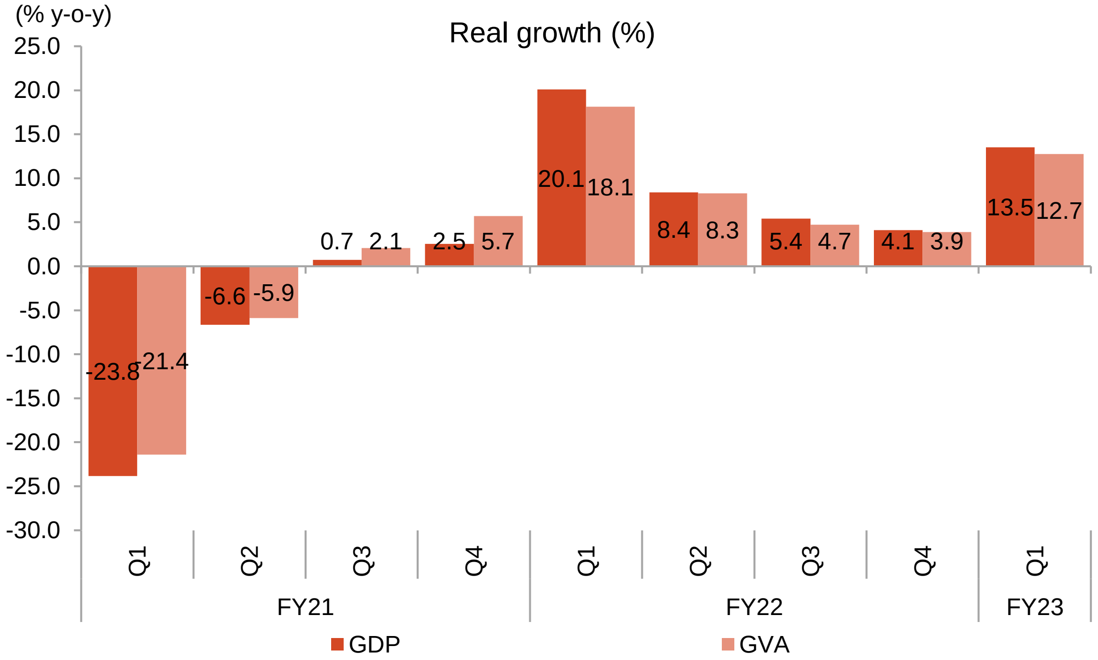
That said, there is a silver lining as well. Recent RBI surveys indicate improving consumer sentiments which bode well for consumption demand and the first quarter GDP print does corroborate that. Rise in capacity utilisation rates

[2] A large part of contact-intensive services is also covered under the head *public admin and others*, for which disaggregated data becomes available with a lag. But high overall growth of this head suggests an improvement in contact-intensive services

[3] CRISIL Research's current projection for Brent crude for fiscal 2023 is at $105-110 per barrel

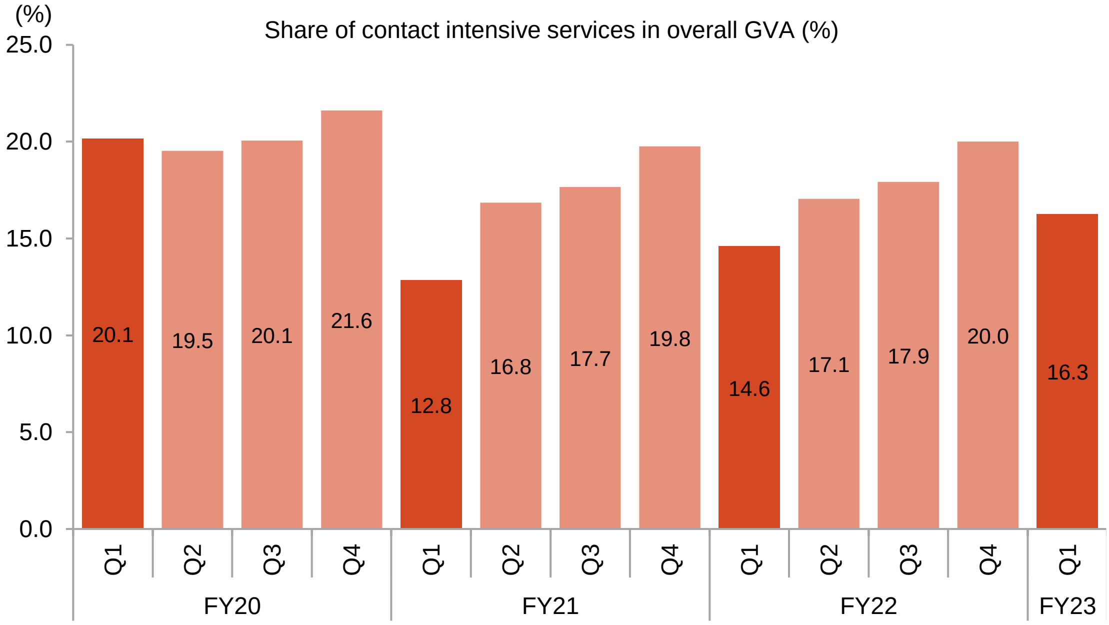
in the manufacturing sector is favourable for private capex in pockets. This is especially true in case of infrastructure-linked sectors such as steel and cement and some Production Linked Incentive scheme-linked sectors. We also expect the growing momentum in contact-intensive services to be broad based and support growth. That said, slower-than-expected growth in the first quarter has increased the downward bias to our real GDP growth projection of 7.3% for fiscal 2023.

Chart 1: The economy's path from the pre-pandemic era to the present



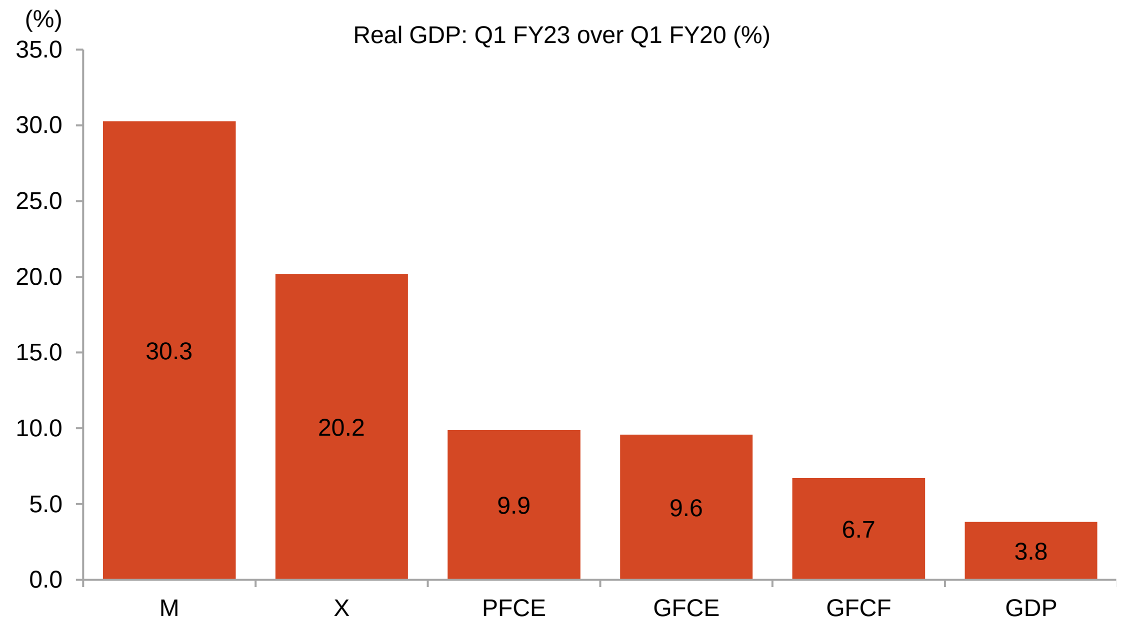
Source: NSO, CRISIL

Chart 2: The catch up in contact-intensive services



PS: Contact intensive services here denote 'Trade, Hotels, Transport, Communication and Services Related to Broadcasting' services
Source: NSO, CRISIL

Chart 3: Private consumption gathering pace



Note: PFCE – Private final consumption expenditure; GFCE – Government final consumption expenditure; GFCF – Gross fixed capital formation; X – Exports; M - Imports
Source: NSO, CRISIL

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