Macroeconomics | First cut

Trumping expectations

December 1, 2023

Second-quarter GDP growth at 7.6% beats expectations

India's real gross domestic product (GDP) continued in strong expansionary mode, growing 7.6% in the second quarter of this fiscal (July-September 2023), vs 7.8% in the previous quarter. The print was considerably stronger on-year (6.2% in the same period last fiscal). With this, growth has trended above the pre-pandemic five-year average quarterly growth of 6.7%.

Growth surpassed forecasts in the second quarter, driven by strong government spending and a sharp rise in manufacturing and construction growth. Globally, too, growth beat expectations in major economies such United States (US) and China, contributing to better export earnings for India. However, private consumption was tepid, possibly reflecting hit to agriculture and rural demand.

However, we expect growth to slow in the second half of this fiscal, driven by the impact of (1) tightening financial conditions on global growth and exports, (2) weak rains and reservoir levels on domestic agriculture and (3) transmission of the Reserve Bank of India's (RBI) rate hikes to bank lending rates.

We have revised up GDP growth forecast by 40 basis points to 6.4% for fiscal 2024, compared with 7.2% last year.

Highlights

- GDP grew 7.6% on-year in the second quarter compared with 7.8% in the previous quarter
- Gross value added (GVA) grew 7.4% compared with 7.8% the previous quarter. Growth was the strongest for industry (13.2%), followed by services (5.8%) and agriculture and allied (1.2%)
- Within industry, growth improved across segments, with strongest growth in manufacturing (13.9%) and construction (13.3%)
- Within services, growth was highest for public administration, defence and other services (7.6%), followed by financial, real estate and professional services (6.0%), and trade, hotels, transport and communication (THTC; 4.3%)
- Within domestic demand, growth was strongest for government consumption expenditure (12.4%), followed by fixed investment (11.0%). Exports took a positive turn (4.3%). However, private consumption saw the slowest growth (3.1%)
- Nominal GDP grew 9.1% compared with 8% the previous quarter

Manufacturing and construction lead growth

- Among major producing sectors, manufacturing saw the highest growth at 13.9% on-year in the second quarter, a major push from 4.7% in the previous quarter. Resilient domestic demand supported growth, while goods exports were less of a drag relative to the previous quarter. Industrial goods (metals, machinery, infrastructure and construction goods) along with some consumer goods (automobiles and pharmaceuticals) saw highest growth this quarter[1]. Lower input costs on-year (non-food wholesale price index-based inflation averaged -3% in the second quarter) also supported manufacturing GVA.

- Construction GVA grew (13.3% vs 7.9%) was supported by government capital expenditure (capex) in infrastructure
- Services growth slowed (5.8% vs 10.3%) on a high base of the second quarter last year (9.4%)
    - Growth in THTC slowed (4.3% in Q2 versus 9.2% in Q1) as the sector caught up with pre-pandemic levels
    - Financial, real estate and professional services slowed to 6% from 12.2%. Financial services performed well with strong credit demand. However, services exports growth moderated 4.6%, on average, in the second quarter, compared with 6.0% the previous quarter
    - Public administration, defence and other services grew 7.6% vs 7.9%
- Agriculture and allied GVA slowed (1.2% vs 3.5%), reflecting monsoon's hit to agricultural output. Kharif output is estimated to be 4.6% lower than last year, based on the government's first advance estimates.

Strong government spending keeps domestic demand resilient

- **Strong government support for consumption and investment**: Government final consumption expenditure (GFCE) rose sharply to 12.4% in the second quarter compared with -0.7% in the previous quarter.
  Fixed investment, measured by gross fixed capital formation (GFCF), improved (11.0% vs 8.0%). Its share in GDP rose to a fresh decadal high of 35.3%. Government remains the primary driver of GFCF growth this year. Centre's capex grew 26.4% on-year in the second quarter, while states, which contribute more to government spending, grew stronger at 39.4%. Faster growth could also indicate pickup in private sector investment.

- **Easing external headwinds**: Export growth improved to 4.3% in the second quarter from -7.7%. Improving global growth, especially in the US and China alleviated export distress. However, import growth remained strong at 16.7%, following 10.1% growth in the previous quarter, reflecting stronger domestic demand.
  Net exports (exports-imports) continued to drag India's GDP growth, but lesser in the second quarter relative to the previous quarter.

- **Tepid private consumption**: Private final consumption expenditure (PFCE) slowed to 3.1% on-year compared with 6% the previous quarter. Rural demand seems to be weaker, based on rising demand for work under National Rural Employment Guarantee Act (NREGA), and lower growth in sales of tractors, two-wheelers and FMCG goods production in the second quarter relative to the previous quarter. Uneven monsoon and stubbornly high food inflation may have hit sentiment in rural areas. Delayed festive season may have also postponed consumption.

  However, urban demand may have stayed robust, going by improvement seen in passenger vehicle sales, consumer durables and air passenger traffic. Healthy services sector activity augurs well for urban demand, as it accounts for 61.5% of urban employment[2]. Consumer confidence is on an uptrend, based on the RBI's survey. Retail credit growth remained strong at 18.3%, reflecting modest impact of rate hikes so far.

Outlook

India, like the US and China, has outperformed growth expectations in July-September 2023. S&P Global revised up its global GDP growth forecast by 20 basis points to 3.3% for 2023 (calendar year), driven by India and China. Expectations of a slowdown due to rising interest rates have been pushed further.

[1] Based on Index of Industrial Production data
[2] Based on quarterly PLFS data for urban areas

However, downside risks remain on account of the following factors:

Signs of global slowdown: Despite growth being strong in the US so far, S&P has begun to see signs of moderation ahead and a tightening of financial conditions. Growth has already stalled in the eurozone. China continues to face challenges from weak consumer confidence and struggling property sector. Overall, S&P Global expects global growth to slow to 2.8% in 2024. This will weigh on India's export demand in the remainder of this fiscal.

Transmission of the RBI's rate hikes: As the RBI noted in its October monetary policy, bank lending and deposit rates have not increased to the same extent as the repo rate in the current rate hike cycle. It has taken measures to speed up transmission of rate hikes, such as open market sales to reduce excess liquidity, and regulatory measures to temper credit growth (increasing risk weights for unsecured consumer credit and non-bank financial companies). Bank lending rates are already above average seen in the 5 years preceding the pandemic, and further rise in borrowing costs could moderate domestic demand.

Vulnerable rural demand: Rural demand remains vulnerable to weak agricultural output, erratic weather and El Niño this year. While an uneven monsoon hit kharif output, the upcoming rabi crop faces risks from lower groundwater levels. As on November 30, the reservoirs were at only 80% of last year's level. The impact of other rural activities (work demand under NREGA, livestock and fishing) will also have a bearing on rural demand.

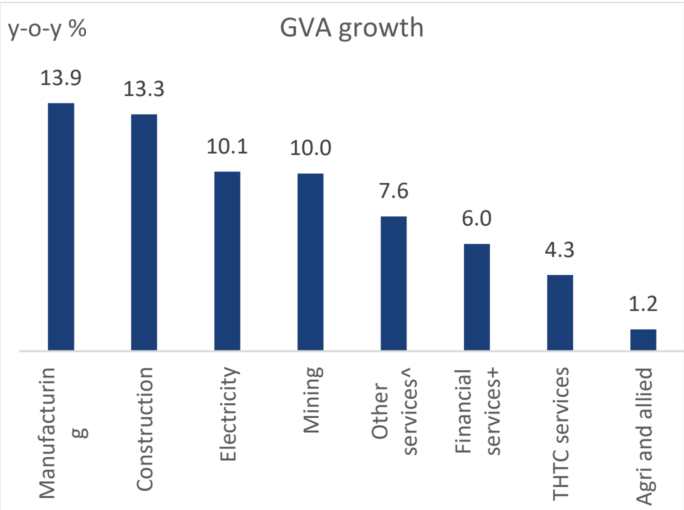
Geopolitical risks: Escalation in geopolitical tensions can impact India through spike in crude prices. We expect crude prices to range $80-85 per barrel this fiscal.

Government capex is expected to remain a key support to the investment cycle this year. Private investment is also showing signs of pick-up, with rising capacity utilisation in manufacturing.

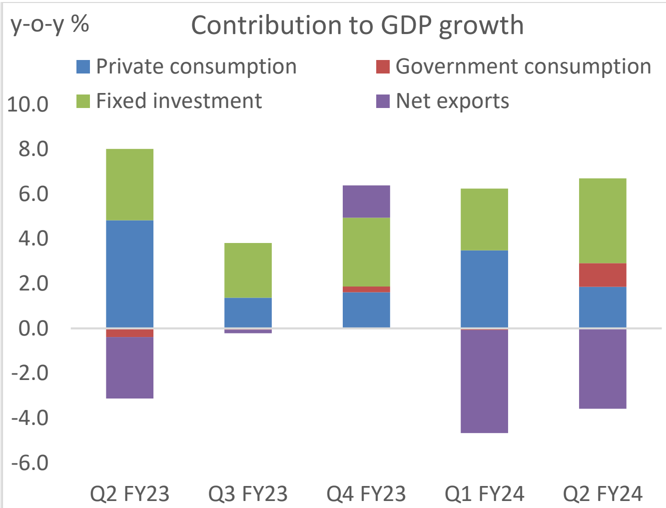
Downside risks are expected to moderate GDP growth in the second half. Despite this, India will end up outperforming other large economies this fiscal.

Overall, we expect India's real GDP to grow 6.4% this fiscal, compared with 7.2% last year.

Industrial segments see strongest growth



All demand segments improve, except consumption



Note: ^Refers to public administration, defence, and other services; +financial, real estate and professional services
Source: NSO, CEIC, CRISIL

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