Macroeconomics | First cut

Hitting a peak for now

September 1, 2023

Domestic demand buoys GDP more in the first quarter

- India's real gross domestic product (GDP) growth rose to 7.8% on-year in the first quarter of fiscal 2024, compared with 6.1% previous quarter. This was the second consecutive quarter of rising growth

- Higher growth was domestically driven, as private consumption accelerated, while investment growth remained high. Easing inflation in first quarter added to the purchasing power of consumers. Meanwhile, government's focus on capital spending (capex) maintained the investment momentum. However, external demand was a drag that led to declining export growth

- Rising consumption seems to have benefited services the most, which saw highest growth among supply-side sectors. Manufacturing growth rose to a lesser extent, somewhat contratary to what the strong PMI and healthy corporate profits in the first quarter were indicating. Agriculture growth slowed a bit, reflecting delayed sowing due to deficient rains in June

Growth is likely to have peaked in the first quarter, and is expected to face headwinds in the coming quarters. Monsoon is the biggest risk for domestic demand, as it turned deficient in August under the pressure of El Niño. Further weakness in September could mean hit to rural incomes and rising inflationary pressures.

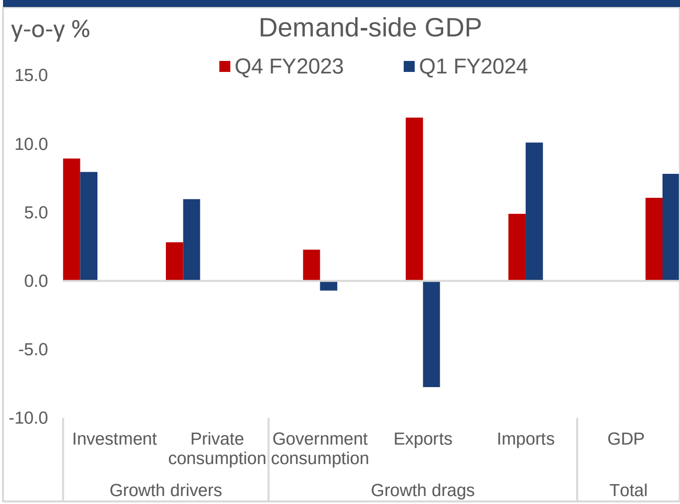
External demand will remain a drag on growth as western advanced economies undergo a more protracted slowdown under their interest rates staying higher for longer.

Also, the lagged impact of 250 basis points rate hike since April 2022 will weigh on demand.

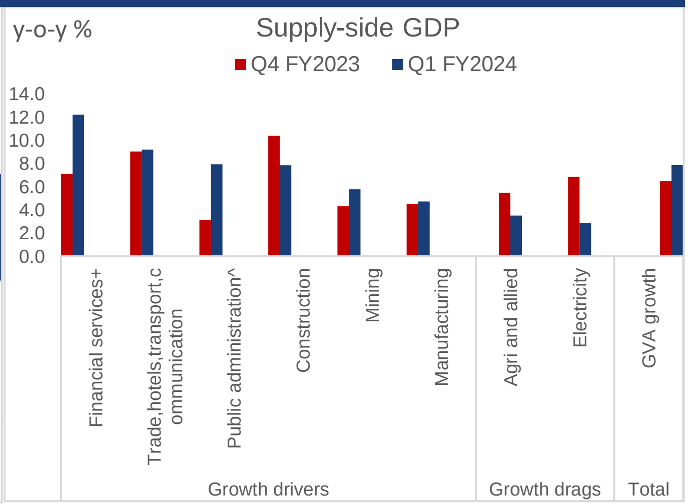
However, robust Indian government capex is expected to cushion growth to some extent.

Taking these factors into account, we maintain our forecast for real GDP growth at 6.0% for this fiscal.

Domestic demand segments drive GDP growth



Services growth rises the most, manufacturing growth dampened by weak external demand



Note: Financial services+ refers to financial real estate and professional services, public administration+ refers to public administration, defence and other services
Source: National Statistics Office, CEIC, CRISIL

Investment and private consumption drive growth

- All demand-side segments showed healthy growth with the exception of government final consumption expenditure and exports
- Fixed investment once again had a good outing (8.0% in first quarter of fiscal 2024 vs 8.9% previous quarter). The government frontloading its capex at the start of the fiscal, along with reviving private capex maintained the investment momentum. Investment's share in GDP remains at close to decadal highs at ~35% of GDP.
- Private consumption recorded a sharp uptick (6.0% vs 2.8%). A sharp fall in retail inflation (4.6% consumer price index-linked (CPI) inflation in first quarter vs 6.2% previous quarter) added to consumers' purchasing power. This particularly helped the rural economy catch up with strong urban demand. Support also came from bank credit, which has sustained double digit growth despite elevated interest rates
- Meanwhile, exports fell into the red, recording a growth of -7.7% from 11.9%, as a result of a slowdown in the world's major economies as well as drop in prices compared with last year
- Imports remained strong on the back of resilient domestic demand. Imports of goods and services recorded the highest growth 10.1% in the first quarter vs 4.9% in fourth quarter. This, coupled with falling exports led to a bigger external drag on growth in the first quarter
- Support remained weak from government final consumption expenditure, which plunged to -0.7% compared with a growth of 2.3% in the previous quarter

Services benefit the most from domestic demand

- On the supply side, gross value added (GVA) grew 7.8% in the first quarter compared with 6.5% in the previous quarter
- Services saw the sharpest rise in growth (10.3% on-year in first quarter versus 6.9% previous quarter). Services remained robust despite the slowdown in global trade which impacted the goods demand more than services
- Within services, growth was the highest in financial, real estate and professional services (12.2% vs 7.1%). Other services segments also saw rising growth, namely trade, hotels, transport and communication services (THTC) (9.2 vs 9.1%), and public administration, defence and other services (7.9% vs 3.1%)
- Manufacturing grew a tad from 4.5% in the previous quarter to 4.7% this quarter. Easing commodity prices and supply constraints, along with resilient domestic demand supported production. However, declining goods exports dampened industrial prospects
- Agriculture, construction, electricity and other utility services showed slower growth in the first quarter compared to previous quarter
- Agriculture and allied activities slowed to 3.5% from 5.5%. Sowing started with a delay, in response to delayed onset of monsoon in June
- Construction growth moderated (7.9% vs 10.4%), as a result of a decline in residential housing activity. But it grew faster than GDP over a high base and was positive for employment generation as construction is a labour intensive activity. There was a modest improvement in mining (5.8% vs 4.3%), while growth fell sharply for utilities (2.9% vs 6.9%). Overall, industrial GVA grew 5.5% versus 6.3% in the fourth quarter

Falling inflation reduces the wedge between nominal and real GDP

In contrast to rising real GDP, nominal GDP growth slowed to 8.0% in first quarter from 10.4% previous quarter. This was primarily due to the price effect, since the GDP deflator slowed to 0.2% from 4.1%. The deflator is significantly influenced by inflation based on wholesale price index (WPI), which turned negative at -2.8% in first quarter from 3.4% previous quarter.

Outlook

Growth is likely to have peaked in the first quarter of this fiscal. Several headwinds are likely to slow growth in the following quarters:

1. **Weakening monsoon:** All-India rainfall has turned deficient at 10% below long period average (LPA) as on August 31. It was the driest August in a century. While the Indian Meteorological Department (IMD) expects some revival in rains in September, overall monsoon is expected to remain below normal, under pressure from El Nino. This could hit kharif crop yields and production. Rabi crop could also be hit if groundwater levels are not replenished adequately. IMD's projection of rains picking up in September generates some hope
2. **Inflation pressures**: After easing in first quarter, retail inflation has resurged in the second quarter, which is likely to soften consumption demand particularly in the second quarter. Food is the biggest risk to inflation, given weak monsoon. Rural demand will particularly face the brunt from hit to incomes from weak crop production and high inflation
3. **External drag on growth:** Global growth is likely to slow this year under elevated interest rates. Central banks in United States and Europe have not put an end to rate hikes yet, and rate cuts are not expected before next year. S&P Global expects a shallow, but a more protracted slowdown with borrowing costs staying at decadal highs
4. **Impact of elevated interest rates:** While strong bank credit growth has supported domestic demand so far, impact of elevated interest rates could still play out in the coming quarters. The rise in domestic interest rates is relatively lower than in advanced economies, but the bank lending rates have reached the pre-pandemic five-year average

Government capex is expected to ramain a key support to the investment cycle this year. Private capex is showing signs of pick-up, with rising capacity utilisation but will take time to get broad based and take the investment baton from the government.

Overall, we expect India's real GDP to grow 6% this fiscal, compared with 7.2% in fiscal 2023.

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