Research

GDP re-stocked

Crisil First Cut | November 2017

The Central Statistical Office (CSO) on Thursday released GDP estimates for the second quarter (Q2) of this fiscal. After declining to a three-year low of 5.7% in Q1 – the fifth straight quarterly decline – GDP nosed up to 6.3% in Q2 on improvement in industrial growth.

The pick-up signals fading impact of demonetisation and destocking that preluded the implementation of the Goods and Services Tax (GST). We expect the growth to pick up to 7.6% in the second half of this fiscal, helped by low-base effect of the second half of fiscal 2017. However, GST implementation glitches, on-going changes in the GST structure, and a possible cut in capex due to rising fiscal stress may limit upside in the subsequent quarters.

Data readings

- Gross value-added (GVA) growth, which measures the economy from the producer or supply side – and is supposed to be a better measure of economy activity – improved to 6.1% in Q2 from 5.6% in Q1, largely on account of revival in industrial activity. Industrial growth improved to 5.8% from 1.6% backed by sharp rebound in manufacturing and mining sector growth, suggesting reduction in GST-related hiccups. A broad-based improvement in the Index of Industrial Production (IIP) by 3.1% in Q2 versus 1.6% in Q1 had hinted at this trend. Services growth, however, slowed to 7.1% compared with 8.7%. Slowdown in 'public administration, defence and other services', or government services growth (to 6% from 9.5%) coupled with a moderation in 'finance, insurance, real estate and professional services growth' (to 5.7% from 6.4%) brought down the services sector growth. Agriculture growth, too, was subdued at 1.7% on account of last year's high base and some moderation in kharif production this season
- On the demand side, private consumption growth moderated to 6.5% from 6.7%, suggesting the improvement in the manufacturing growth was largely the result of a re-stocking exercise. Exports growth remained flat at 1.2%. While imports growth slowed to 7.5% from 13.4%, net exports which remained negative weighed on growth.
- Investments continue to remain subdued, declining to 28.9% of GDP compared with 29.8%. Along with low capacity utilisation and the twin balance sheet problem (high leverage of corporates and large non-performing assets in the banking system), GST-related uncertainties have deferred recovery in the investment cycle. On the other hand, the government's Rs 2.11 lakh crore recapitalisation plan would improve banks' ability to lend, which is an incipient positive for the investment cycle.

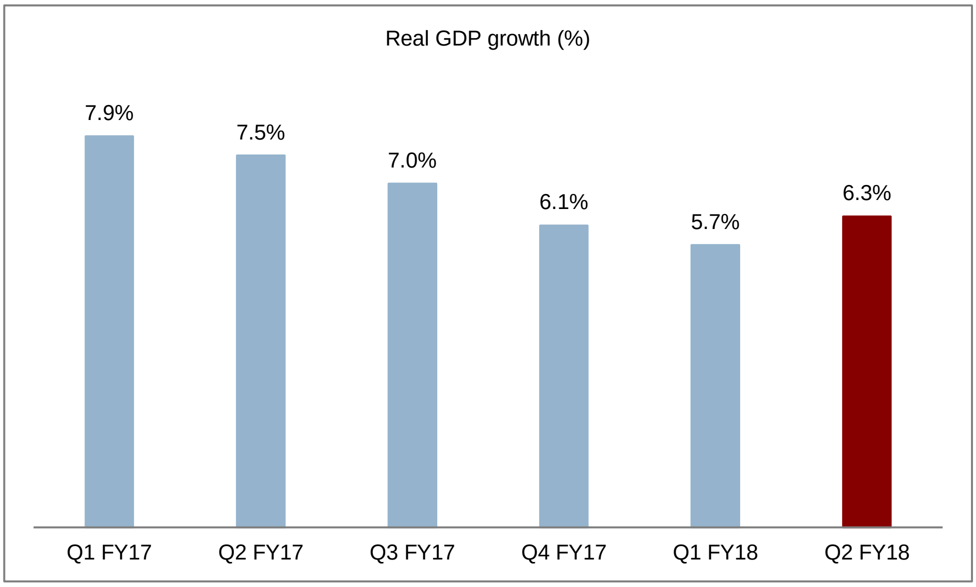
Outlook

Administrative issues related to tax refunds under GST and repeated changes being made to the structure/tax rates continue to lead to uncertainty for businesses and may weigh on growth in the road ahead, particularly for small scale units. That would have negative implications for employment.

In our recent report on India's trade titled *Labour pain*, we showed how India's labour-intensive exports have been hurt the most. With commodity prices showing sustained rise, there would be additional pressure on the bottomline in certain sectors, which may add downside pressure to growth this fiscal.

Given these factors, we revise down our GDP growth forecast for fiscal 2018 to 6.8% (with a downside bias) from 7% earlier. That said, growth will continue to be consumption-led in the second half of fiscal 2018 backed by near-normal monsoon, softer interest rates and inflation, and implementation of seventh pay commission by states. There will also be a mild push to consumption in the forthcoming fiscals from the bank recapitalisation plan, provided the resultant credit growth occurs in growth-inducing sectors.

Bottoming out?



Source: CSO

Nuances of GDP growth

At basic prices	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18
Agriculture & allied	4.1	6.9	5.2	2.3	1.7
Industry	5.9	6.2	3.1	1.6	5.8
o/w Manufacturing	7.7	8.2	5.3	1.2	7.0
Mining	-1.3	1.9	6.4	-0.7	5.5
Services	7.8	6.9	7.2	8.7	7.1
GVA	6.8	6.7	5.6	5.6	6.1

At market prices	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18
Pvt. Consumption	7.9	11.1	7.3	6.7	6.5
Govt. Consumption	16.5	21.0	31.9	17.2	4.1
Fixed Investment	3.0	1.7	-2.1	1.6	4.7
Exports	1.5	4.0	10.3	1.2	1.2
Imports	-3.8	2.1	11.9	13.4	7.5
GDP	7.5	7.0	6.1	5.7	6.3

Source: CSO

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