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Higher taxes lift GDP growth but at 6.5%, GVA growth suggests continued resilience; outlook remains positive with some near-term moderation

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- Real GDP grew by 8.4% YoY in Q3 FY24, accelerating from an upwardly revised Q2 growth of 8.1%. The latest GDP growth was much higher than what was predicted by many independent market surveys (the consensus estimate was 6.6%).
- The GVA growth has interestingly come in at expectations, standing at 6.5%. The divergence between the GDP and GVA is attributed to the higher pace of tax collection.
- The continued rapid pace of growth underscores India's generally favourable macro fundamentals and strengthens the case for RBI's patience in considering any potential adjustments to its monetary policy stance.
- GDP growth in Q3 was supported by strong investment activity and a slight improvement in private consumption growth, while government consumption and net exports exerted a drag.
- Looking ahead, we expect investment to remain a major driver of GDP growth in FY25 even though growth in this component is almost certainly likely to moderate. Consumption growth is expected to recover further in FY25 as we expect the push from rural demand to return with better prospects for the Rabi crop season.
- Risks to consumption growth will be posed by uneven recovery of the labour market. Furthermore, government consumption and net exports are unlikely to be major drivers of growth.
- On the production side of the economy, GVA growth was buoyed by an acceleration in the services sector and surprisingly strong performance of the industrial sector. Meanwhile, the agriculture sector GVA contracted.
- The momentum in the services sector was boosted by improvement in trade, hotels, transportation etc. while the real estate and insurance sectors provided support. In Industry, the manufacturing and construction sectors were the outperformers while mining and utilities slowed.
- High frequency data for January so far generally leans towards improvement in economic activity. Forward-looking surveys by the RBI also suggest the outlook is optimistic for both manufacturing and services. Overall, the economy is expected to sustain momentum in Q4 with the pace of expansion being more moderate.

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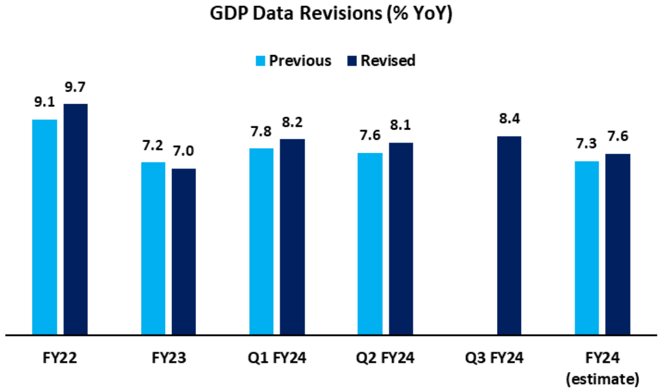
Real GDP growth beat market expectations; GVA was closer

Real GDP growth in Q3 FY24 zoomed past market expectations growing by 8.4% YoY accelerating from an upwardly revised Q2 growth of 8.1%. The continued rapid pace of growth underscores India's generally favourable macro fundamentals and strengthens the case for RBI's patience in considering any potential adjustments to its monetary policy stance.

The market consensus for growth in Q3 was 6.6%. GVA growth has interestingly come in at expectations, standing at 6.5%. The divergence between the two is attributed to the higher pace of tax collection. Indeed, the latest national accounts data shows that adjusted for prices, net taxes (less subsidies) grew by 32% YoY in Q3 compared with ~13% growth in Q2. Furthermore, national accounts data for the first three quarters of years going back to FY22 have been revised, details of which are available in the chart below.

FY23 growth was adjusted lower; FY24 growth has been nudged up



Source: MOSPI, CMIE

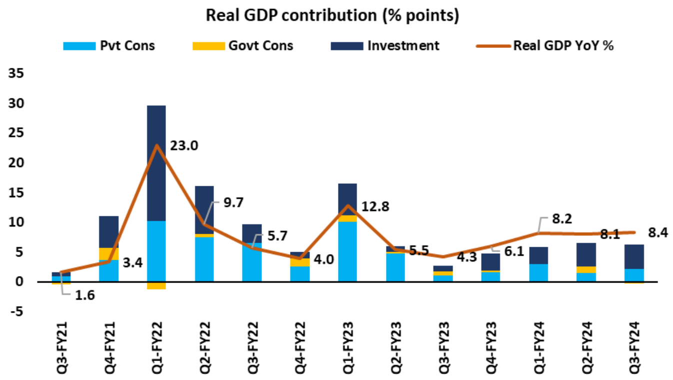
According to the GDP data, growth was supported by strong investment activity and a slight improvement in private consumption growth, while government consumption and net exports exerted a drag.

Government CAPEX sustained investment growth

In Q3 FY24, gross capital formation (GCF) grew in double digits for the second consecutive quarter. GCF clocked an impressive growth of 12.2% YoY, out of which 9.9pp were contributed by fixed investment. The momentum in this component is mainly sustained by public sector capital expenditure which grew by ~24% at the central government and ~17% at the state governments' level in Q3. Meanwhile, investment by the private sector in Q3 remained disappointing. Indeed, investment projects completed by the private sector fell by 30% YoY in the quarter ended in December 2023. Households, on the other hand, have likely contributed to fixed investment growth given that residential sales have picked up[1].

Additionally, the contribution of valuables to GCF growth was sizeable at 2.1pp which is indicative of heavy buying of gold and other precious metals and stones by Indian households (further boosted by the festive season). Indeed, India's imports of gold and silver during Q3 grew by 71% YoY. Looking ahead, we expect investment to remain a major driver of GDP growth in FY25. However, given the slower budgeted growth in government CAPEX for FY25 and absent signs of private investment revival and an unfavourable base effect, growth in this component is almost certainly likely to moderate.

Investment and consumption drove growth in Q3 FY24



Source: MOSPI, CMIE

Consumption growth improves; likely to gather momentum in FY25

Private consumption growth improved slightly to 3.5% YoY in Q3 from 2.4% in Q2. The improvement is likely attributed to sustained urban demand, while a weaker agriculture sector and resultant tepid rural demand dragged overall consumption growth. Improvement in private consumption growth was expected given indications from high frequency indicators like two-wheeler sales and IIP consumer durables. Moderation of inflation (especially food) is also partly a reason for the improvement in consumption growth.

Looking ahead, we believe that growth in the consumption sector will recover further in FY25 as we expect the push from rural demand to return with better prospects for the Rabi crop season. The continued easing of inflationary pressures will be a support to consumption growth as well. However, risk to consumption growth will be posed by uneven recovery of the labour market. Survey-based indicators from CMIE

[1] According to industry experts like Knight Frank & JLL, residential sales improved in H2 2023 compared with H1.

and Naukri suggest a weakening in the labour market which could exert a drag on consumption in a lagged manner.

India's real GDP estimates

(Constant Prices)	% YoY					
	FY 2023	Q3-FY23	Q4-FY23	Q1-FY24	Q2-FY24	Q3-FY24
Private Consumption	**7.5**	**1.8**	**2.8**	**5.3**	**2.4**	**3.5**
Government Consumption	**0.1**	**7.1**	**2.3**	**-0.1**	**13.8**	**-3.2**
Gross Capital Formation	**9.6**	**2.8**	**7.8**	**7.5**	**10.6**	**12.2**
Gross Fixed Capital Formation	11.4	5.0	8.9	8.5	11.6	10.6
Exports	13.6	10.9	11.9	-6.5	5.3	3.4
Less Imports	17.1	4.1	4.9	15.3	11.9	8.3
Discrepancies	-14.8	-3.9	2.9	-183.0	-122.6	-105.2
Real GDP	**7.2**	**4.3**	**6.1**	**8.2**	**8.1**	**8.4**
Real GDP Excluding Govt Exp	**8.1**	**4.0**	**6.5**	**9.3**	**7.5**	**9.5**

Source: MOSPI, CMIE

Government consumption and net exports dragged headline growth

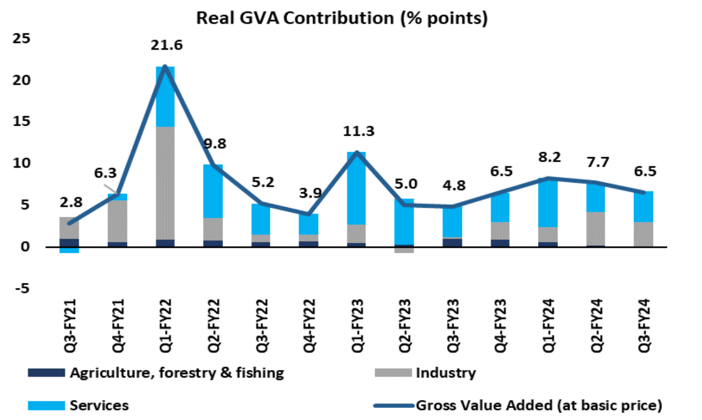
Meanwhile, government consumption contracted significantly in line with the drop in government revenue expenditure. This is reflective of the government's efforts to reduce its recurrent expenditure to remain committed to its fiscal consolidation path while keeping focus on CAPEX to support the economy. Central government revenue expenditure (net of interest payments and subsidies) in Q3 fell by 7.5% YoY compared with a growth of ~35% in Q2. Given that growth in this component is budgeted to further slow in FY25 to 0.6% from an estimated 3.9% in FY24, it's unlikely to be a major driver of growth.

Unsurprisingly, net exports continued to remain a drag on GDP growth, although the magnitude of the drag was slightly lower. In Q3 the combined goods and services trade deficit stood at ~US$ 25 billion compared with US$ 33 billion a year ago (nominal value). However, given that world commodity prices have eased by ~17% in Q3 FY24 vs Q3 FY23, in volume terms, the deficit on net exports continues to swell.

Discrepancies contributed an outsized 3.5pp to GDP growth, highlighting potential data quality issues. As such, we believe that GVA provides a more accurate representation of the pace of economic activity on the ground.

GVA Growth Supported by Industrial and Services Sectors; Agricultural Sector Contracts

From the supply side of the economy, GVA grew by 6.5% in Q3 FY24, slowing from 7.7% in the previous quarter but continued to remain robust. This was achieved despite an upward revision in previous years. Had the base remained unchanged, the growth would have printed at 7.1%. The growth in Q3 was buoyed by the acceleration in the services sector on the back of a pick-up in growth of Trade, Hotels & Transportation etc. and the surprisingly strong performance of the industrial sector, particularly manufacturing, which sustained its double-digit growth for the second consecutive quarter. Meanwhile, the agriculture sector contracted for the first time in over four years due to sub-par monsoon which affected the Kharif sowing. The outlook, however, looks better with Rabi sowing having reached the previous year's level.



Source: MOSPI, CMIE

India's real GVA estimates

(Constant Prices)	% YoY					
	FY 2023	Q3-FY23	Q4-FY23	Q1-FY24	Q2-FY24	Q3-FY24
Agriculture, Forestry & Fishing	**4.0**	**5.2**	**5.5**	**3.5**	**1.6**	**-0.8**
Industry	**4.4**	**0.6**	**6.3**	**6.0**	**13.6**	**10.4**
Mining & Quarrying	4.6	1.4	4.3	7.1	11.1	7.5
Manufacturing	1.3	-4.8	4.5	5.0	14.4	11.6
Electricity and Other Utility Services	9.0	8.7	6.9	3.2	10.5	9.0
Construction	10.0	9.5	10.4	8.5	13.5	9.5
Services	**9.5**	**7.2**	**6.9**	**10.7**	**6.0**	**7.0**
Trade, Hotels, Transport, Communica	14.0	9.2	9.1	9.7	4.5	6.7
Financial, Real Estate & Professional	7.1	7.7	7.1	12.6	6.2	7.0
Public Administration, Defence and C	7.2	3.5	3.1	8.2	7.7	7.5
Gross Value Added (at Basic Price)	**7.0**	**4.8**	**6.5**	**8.2**	**7.7**	**6.5**
Core GVA	**7.6**	**5.0**	**7.3**	**9.1**	**8.7**	**8.4**

Source: MOSPI, CMIE; Note – Core GVA is GVA excluding agriculture, forestry & fishing and public administration, defence, and other services

The services sector continues to lead economic growth as it grew by 7.0% in Q3 and contributed 3.7 pp to the GVA growth. This was supported by the pickup in growth momentum of trade, hotels, & transportation etc. which grew by 6.7% in Q3 up from 4.5% in Q2. The improvement was seen in listed companies' profit growth, freight movement, and hotel occupancy rates amidst the Men's Cricket World Cup in Q3. Despite a moderation in banks' profit margins, financial, real estate and professional services noted a pick-up likely due to continued momentum in real estate and an improvement in insurance premiums. Given that the government revenue expenditure (ex. interest payments and subsidies) contracted in nominal terms in Q3, robust growth in public administration, defence and other services growth likely reflects strong growth in other services such as health, education etc.

Within the industrial sector, the manufacturing and construction sectors continued to outshine and support the economic activity. Even though growth in the manufacturing sector moderated slightly from the previous quarter, it remained in double digits at 11.6% and contributed 1.8pp to the real GVA growth. Some slowing in manufacturing growth from the previous quarter could be a result of the waning of favourable support from the reducing input cost prices thereby affecting the profit margins of companies. This is also reflected in the WPI for manufactured products (proxy for input prices), which increased from -2.1% in Q2 to -0.8% in Q3. A continued thrust on capital spending by the government and sustained momentum in the real estate sector supported growth in the construction sector. Meanwhile, growth slowed in electricity and mining from the previous quarter, but the contribution remained somewhat unchanged.

High frequency data for Q4 so far suggest momentum continues

High frequency data for January so far generally leans towards positive with an improvement observed in freight services, expansionary PMI, cement output etc. Core output on the other hand showed some weakening attributed to fertilisers, refinery products, etc. Forward-looking surveys by the RBI also suggest the outlook is optimistic for both manufacturing and services, with optimism for Q4 FY24 being a shade lower for the manufacturing sector. Based on the second advance estimate, the growth for real GVA is imputed at 5.3%. Overall, the economy is expected to sustain momentum in Q4 with the pace of expansion being more moderate.

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