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Indian economy rebounds on a low base; catch-up to pre-COVID levels yet to take place

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- The Indian economy registered its highest-ever growth rate in Q1 FY22 since the inception of the quarterly series data (starting in 1996) on the back of a highly favorable statistical base.
- Real Gross Domestic Product (GDP) growth came in at 20.1% YoY, close to our projection of 19.8% YoY, compared to the sharp 24.4% contraction in the same period last year.
- Sequentially, real GDP noted a 16.9% QoQ contraction which was much lesser than -29.7% QoQ during Q1 FY21, reflecting a less stringent lockdown during the second wave versus during the first wave.
- On the demand side, the sharp rebound in the June quarter was led by government-driven investment spending, consumption demand, and export growth.
- On the supply side, the real gross value added (GVA) grew by 18.8% YoY, benefitting from a favorable base. The manufacturing and construction sectors led the rebound, while the second wave dented the services sector's recovery.
- Despite high growth prints on an annualized base, real GDP and real GVA in Q1 FY22 were 9.2% and 7.8% below their respective pre-pandemic level of Q1 FY20, reflecting continued slack in the economy.
- On a positive note, high-frequency data indicates a continuation of swift economic recovery from the impact of the second COVID wave.
- We expect recovery to gain momentum, aided by a pick up in vaccination pace, strong exports growth, likely pick up in fiscal spending, and continued accommodative monetary policy stance.

Pramod Chowdhary
Chief Economist
pramod.chowdhary@dmifinance.in

Ashray Ohri
Economist
ashray.ohri@dmifinance.in

Bhawna Sachdeva
Economist
bhawna.sachdeva@dmifinance.in

www.dmifinance.in

+91 11 4120 4444

DMI Finance Private Limited
Express Building, 9-10, 3rd Floor,
Bahadur Shah Zafar Marg,
Delhi – 110002.

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Indian economy posts record growth in Q1 FY22 on the back of a favorable base

The Indian economy expanded by double digits, 20.1% YoY, in Q1 FY22 (close to our projection of 19.8% YoY) and noted its highest-ever growth rate since the inception of the quarterly series data (starting in 1996). The record growth print came on the back of a highly favorable statistical base and reflected a bounce back from the record contraction of 24.4% YoY witnessed in the same period last year. Despite this high growth print, the real GDP in Q1 FY22 was below its pre-COVID levels by 9.2% (v/s Q1 FY20), painting a clearer picture of the current situation and reflecting the impact from the second COVID wave. This was also captured in the sequential contraction of 16.9% QoQ in Q1 FY22 that was half of last year's decline (-29.7% QoQ in Q1 FY21) but remained large compared to the historical seasonal trend of ~3% contraction noted in the first quarter of each fiscal year (5-year average before COVID).

India GDP estimates at constant prices

%YoY (Constant prices)	Q1-FY21	Q2-FY21	Q3-FY21	Q4-FY21	Q1 FY22 v/s Q1 FY21	Q1 FY22 v/s Q1 FY20
Private Consumption	**-26.2**	**-11.2**	**-2.8**	**3**	**19.3**	**-11.9**
Government Consumption	**12.7**	**-23.5**	**-1.0**	**28**	**-4.8**	**7.4**
Gross Capital Formation	**-47.7**	**-8.0**	**3.0**	**14**	**56.7**	**-18.1**
Gross Fixed Capital Formation	-46.6	-8.6	2.6	11	55.3	-17.1
Exports	-21.8	-2.0	-3.5	9	39.1	8.7
Less Imports	-40.9	-17.9	-5.0	12	60.2	-5.3
Discrepancies	917.9	89.4	-42.9	-130	-53.3	375.7
Real GDP	**-24.4**	**-7.4**	**0.5**	**2**	**20.1**	**-9.2**
Real GDP excluding govt exp	**-29.0**	**-5.2**	**0.6**	**-1**	**25.0**	**-11.3**

Source: MOSPI

On an annualized basis, the sharp rebound in the June quarter was led by government-driven capital spending, consumption demand, and exports that contributed ~14.5 percentage points (pp), 10.7 pp, and 8 pp respectively to the real GDP growth print. Government consumption support was subdued this quarter compared to last year, as the government focused more on CAPEX in the current year. Accordingly, Gross Fixed Capital Formation (GFCF) increased by 55.3% YoY, also aided by 46.6% YoY contraction in Q1 FY21. A robust capital outlay from both the central (the Centre's capital expenditure increased by 26.3% YoY) and the 19 state governments (120% YoY) drove investment demand. Meanwhile, private investment is likely to have remained modest given the continued uncertainty from the impact of the second COVID wave. Capacity utilization levels and fresh investments by private players remain muted so far, curtailing overall investment growth. GFCF remains 17.1% below its pre-COVID levels. However, a more broad-based recovery in investment demand can be expected ahead over a one-year horizon, with private players joining the government via crowding in investments, contingent on congenial COVID developments and vaccine advancements.

Private consumption demand grew by 19.3% YoY on a base of 26.2% YoY contraction witnessed in Q1 FY21. The rebound reflected a lower economic impact on households compared to the nationwide lockdown during the same period last year, as lockdowns during the second COVID wave remained less stringent. However, private consumption demand remained ~12% below its pre-COVID levels, reflecting the strain among households. Sequentially, private consumption also contracted by 17.4% QoQ (v/s its past 5-year trend of -3.2% QoQ in the June quarters), reflecting the hit from the second wave. Nevertheless, based on evolving high-frequency indicators, labor market conditions, and mobility trends, we expect consumption demand to recover going ahead. A continued recovery in job creation coupled with improvement in the quality of jobs is critical for sustained demand growth.

Government consumption expenditure contracted by 4.8% YoY, coming in as a slight surprise and reversing its strong support of 28.3% YoY noted in the previous quarter. While expenditure from the central government was expected to be muted (compared to last year), as noted in the revenue expenditure that contracted by 2.4% YoY in Q1 FY22, state governments were expected to keep consumption spending afloat with their revenue expenditure increasing by 10.4% YoY (data based on the availability of 19 states). Nevertheless, there has been a shift in the quality of government spending with an increased focus on capital expenditure that is driving investment demand, as noted above. Moreover, we can expect overall government expenditure to pick up in the coming months in line with fiscal space and revenue growth. The central government's fiscal deficit stood at just 21.3% of its budget estimate (in the first four months of the year until July 2021) and is much below the previous years' trends of spending, allowing it to step up spending in the rest of FY22.

On the external front – exports stood out in their performance, increasing by 39.1% YoY given strong momentum in external trade and partly due to the base effect. Except for government spending (that witnessed low spends in its pre-COVID year due to general elections in 2019), exports are the only component to have surpassed their pre-COVID levels as they stood at 8.7% above Q1 FY20. A combination of strong external demand (particularly among key trading partners) compared to domestic demand and government support measures have pushed exports to record levels in Q1 FY22. Meanwhile, imports rebounded by 60.2% YoY of a more favourable base (-40.9% YoY in Q1 FY21) as domestic demand recovered sizably compared to the same period last year. As such, the windfall gains from a positive current account reversed this year, with net exports shaving off 3.6 pp from overall growth compared to a positive contribution of 5.7 pp in Q1 FY21. Going forward, we expect exports to do well in FY22, supported by a revival in world trade and better vaccination levels among key trading partner nations.

Besides a favourable base, manufacturing and construction sectors led Gross Value Added (GVA) rebound

Real GVA rebounded by 18.8% YoY in Q1 FY22, aided by a favorable base effect given a steep 22.4% YoY nationwide lockdown-induced contraction in the June quarter last year. Catch-up to the pre-pandemic level remains incomplete, with real GVA in Q1 FY22 still 7.8% lower than the pre-COVID Q1 FY20 level. In Q1 FY22, the industry and agriculture sectors led growth as they were relatively less impacted by the second COVID wave. The agriculture sector, which has been a consistent performer over last year, carried forward its resilient momentum into FY22, growing by a solid 4.5% YoY and up 8.2% compared to Q1 FY20. Even sequentially, when we typically see a contraction in Q1, the agriculture sector contraction of 10.7% QoQ was broadly in line with the pre-COVID 5-year average of -10.4% QoQ in the June quarters, indicating limited impact from the second wave. Part of this is because the Q1 agriculture output number takes into account Rabi/Winter Crop production. Still, the impact of the second wave is likely to be limited when it is reported in national accounts in subsequent quarters.

India GVA estimates at constant prices

%YoY (Constant prices)	Q1-FY21	Q2-FY21	Q3-FY21	Q4-FY21	Q1 FY22 v/s Q1 FY21	Q1 FY22 v/s Q1 FY20
Agriculture, Forestry & Fishing	**3.5**	**3.0**	**4.5**	**3.1**	**4.5**	**8.2**
Industry	**-35.8**	**-3.0**	**2.9**	**7.9**	**46.1**	**-6.2**
Mining & Quarrying	-17.2	-6.5	-4.4	-5.7	18.6	-1.8
Manufacturing	-36.0	-1.5	1.7	6.9	49.6	-4.2
Electricity and Other Utility Services	-9.9	2.3	7.3	9.1	14.3	3.0
Construction	-49.5	-7.2	6.5	14.5	68.3	-14.9
Services	**-21.5**	**-11.4**	**-1.2**	**1.5**	**11.4**	**-12.5**
Trade, Hotels, Transport, Communication, etc	-48.1	-16.1	-7.9	-2.3	34.3	-30.2
Financial, Real Estate & Professional Services	-5.0	-9.1	6.7	5.4	3.7	-1.5
Public Administration, Defence and Other Services	-10.2	-9.2	-2.2	2.3	5.8	-5.0
Gross Value Added (at Basic Prices)	**-22.4**	**-7.3**	**1.0**	**3.7**	**18.8**	**-7.8**
Core GVA	**-29.1**	**-8.6**	**0.7**	**4.1**	**25.2**	**-11.2**

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

The industry sector registered a significantly high growth print of 46.1% YoY in Q1 FY22, inflated by a substantial favorable base effect (-35.8% YoY in Q1 FY21). All sub-segments posted double-digit growth, thanks to the base effect. The manufacturing and construction sectors led the rebound in the industrial sector, with 49.6% YoY and 68.3% YoY expansion in Q1, respectively. These two sectors had seen a sharp contraction last year in the June quarter. Compared to FY20, the industry sector output is still 6.2% lower, reflecting incomplete recovery to pre-pandemic levels. Manufacturing and construction GVA also remained 4.2% and 14.9% below Q1 FY20 levels, respectively. Electricity GVA on the other hand, is now 3% above the pre-COVID Q1 FY20 level, having seen an expansion since Q2 FY21. Mining is also inching closer to pre-COVID levels, with its GVA just 1.8% below the Q1 FY20 level, thanks to 18.6% YoY growth in Q1 FY22 and lesser impact from the second wave (-10.8% QoQ in Q1 FY22 v/s -8.1% QoQ 5-year average in the June quarter before COVID).

Overall, industrial activity was relatively less impacted by the April-May COVID wave, given the allowed exemptions for the sector and business adaptability. Accordingly, industrial output declined on a sequential basis by 17.1% QoQ in Q1 FY22, more than the 5-year pre-pandemic average of -2.1% QoQ but far less than 38.8% QoQ fall in Q1 FY21. Mining, manufacturing, and construction also registered a sequential decline in Q1 FY22, which were lower than the levels last year while electricity continued to grow. Robust growth in industry-related high-frequency indicators viz electricity, E-way bills, and GST collections suggest swift recovery after a temporary impact due to the second wave. A rebound in the manufacturing Purchase Managers' Index (PMI) rising from 48.1 in June to 55.3 in July also indicates an improving outlook.

The second COVID wave, more significantly, impacted the services sector. The sector, especially contact-intensive services, has been seeing delayed recovery compared to the other sectors due to the social distancing norms and mobility restrictions. The second wave dented even this hesitant and uneven recovery of the sector. Services GVA grew by a relatively smaller magnitude of 11.4% YoY despite a favourable base (-21.5%YoY in Q1 FY21). The statistical base effect was most pronounced for the trade, hotel, transport, and communication sectors. Accordingly, it grew by 34.3% on a yearly basis. However, its GVA is still 30.2% below Q1 FY20, the largest gap among all sub-sectors. Even on a sequential basis, it posted the highest contraction of 35.3% QoQ in Q1 FY22 compared to -5.1% (pre-pandemic 5-year average in the June quarter) and -

53% QoQ in Q1 last financial year. Despite increased government spending, growth of public administration, defence, and other services GVA was low – in single digits (5.8% YoY) in Q1 FY22 as possibly the other services segment were more impacted by the second wave. This is reflected in a sequential drop for the segment by a sharp 19.3% QoQ fall closer to the contraction seen last year in the June quarter. In comparison, financial, real estate, and professional services managed to grow by 3.7% YoY/18.8% QoQ compared to -5%YoY/+20.7% QoQ in Q1 FY21, indicating relatively resilient growth. Going forward, we expect the services sector to resume its recovery, aided by the controlled COVID situation and acceleration in vaccination pace. Early data for July-August for rail freight and air transport shows robust recovery.

Overall, the second wave weighed on economic recovery, but the impact was less than last year. High-frequency data indicate a continuation of swift economic recovery from the impact of the second COVID wave. We expect this recovery to gain momentum aided by a pick up in vaccination pace, strong exports growth, likely pick up in the fiscal spending and continued accommodative monetary policy stance. This may put upward pressure on our FY22 growth projection of 9.9% YoY, which we will revisit soon.

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