1 December 2023

Real GDP growth exceeds expectations; investment and industrial sector shine bright keeping growth above 7%

- Real GDP grew by 7.6% YoY in Q2 FY24, slightly down from 7.8% in the preceding quarter. The latest GDP data was much higher than what was predicted by many independent market surveys (the consensus estimate was 6.8%).
- The latest GDP print underscores the robust momentum of domestic economic activity despite sluggish global growth.
- Overall, the real GDP growth for H1 FY24 stood at 7.7% YoY. Higher than expected growth in H1 FY24 will likely prompt an upward revision by the RBI to its GDP projections in its upcoming meeting in December, but we do not expect a change in policy rate or stance.
- Growth in Q2 was primarily led by investment and government consumption as private consumption slowed and the drag from the external sector continued.
- Gross fixed capital formation growth was likely supported by the centre and state government CAPEX as well as a pick-up in the real estate sector. Private consumption growth slowed likely due to softer rural demand. Meanwhile, net exports remained a drag on overall GDP growth.
- On the production side of the economy, GVA growth was buoyed by the very strong performance of the industrial as well as the services sectors. Meanwhile, the agriculture sector's growth slowed significantly.
- Within the industry, manufacturing and construction sub-sectors were the outperformers although all sub-sectors saw double-digit growth. Meanwhile, the service sector's contribution to growth remained impressive even though all the sub-sectors witnessed a slight moderation in growth.
- The economy continues to show signs of strength in the early part of Q3 FY24. That said, growth is expected to moderate owing to a less favourable base effect and fizzling out of festive season related boost to the economy. Additionally, softer demand from the rural sector due to an expected disappointing Kharif season production is likely to inhibit consumption growth.
- Beyond the immediate near term, risks to growth are also posed by slowing global demand in response to the past two years' global monetary policy tightening which could elevate external sector risks from the trade as well as capital flows channels.

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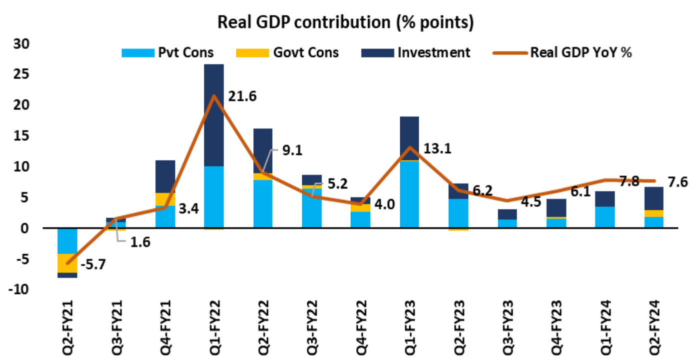
Real GDP growth beats market estimates – grows by 7.6% YoY

Surpassing the market estimates, the real GDP grew by 7.6% YoY in Q2 FY24 only slightly moderating from 7.8% in the previous quarter due to a less favourable base effect. The latest GDP print underscores the robust momentum of domestic economic activity despite sluggish global growth.

Overall, the real GDP growth for H1 FY24 stood at 7.7% YoY. Higher than expected growth in H1 FY24 will likely prompt an upward revision by the RBI to its GDP projections in its upcoming meeting in December, but we do not expect a change in policy rate or stance. A resumption of rate hikes at this juncture seems very unlikely given that tighter monetary policy is starting to temper demand in the most interest-rate sensitive sectors and inflation continues to ease. However, the prospect of a rate cut in the near term also is low given that (1) inflation will still take a while to align to the 4% target and (2) pressures on the current account are elevated. A rate cut at this point could negatively affect capital flows and ultimately exacerbate depreciatory pressure on the rupee.

Meanwhile, the nominal GDP growth was down to 8.6% in H1 FY24 from 10.9% in H2 FY23 due to a slowdown in the deflator growth. Indeed, the WPI inflation was tracking in negative in H1 FY24. With nominal growth tracking lower than the assumed growth of 10.8% in the union budget (based on FY23 actuals), receipts growth could be affected and ultimately lead to some fiscal slippage.

Growth in Q2 led by investment and government consumption



Source: MOSPI

Activity in Q2 was primarily led by investment and government consumption as private consumption slowed and the drag from the external sector continued.

Gross fixed capital formation (GCF) - observed yet another quarter of impressive growth (11.0% YoY) and contributed ~3.8 percentage points (pp) to the real GDP growth print – supported by the centre and state governments as project completions by the private sector slowed in Q2. Indeed, the central and state governments' capital expenditure for Q2 was 26.4% and 44.5% above the previous year's level. The strong growth has also likely been supported by the pick-up in the real estate sector as suggested by various expert reports. For the outlook ahead, we remain optimistic about the growth in the fixed capital formation from continued infrastructure push by the government, however the pace of the same could moderate in coming quarters due to front loading of the capex spending and a potential shift of focus towards welfare spending ahead of general elections. On the other hand, the economy may see some revival in private capex amidst increasing capacity utilisation, improved corporate profitability and rising capital imports. As per the RBI's latest bulletin, there are tentative signs of pick-up in the private sector capex based on the funds raised for capex by the corporates through different channels – being 60% higher in H1 FY24 compared to H2 FY23.

India's real GDP estimates

(Constant Prices)	% YoY					
	FY 2023	Q2-FY23	Q3-FY23	Q4-FY23	Q1-FY24	Q2-FY24
Private Consumption	**7.5**	**8.3**	**2.2**	**2.8**	**6.0**	**3.1**
Government Consumption	**0.1**	**-4.1**	**-0.6**	**2.3**	**-0.7**	**12.4**
Gross Capital Formation	**9.6**	**6.5**	**5.2**	**7.8**	**7.1**	**9.9**
Gross Fixed Capital Formation	11.4	9.6	8.0	8.9	8.0	11.0
Exports	13.6	12.2	11.1	11.9	-7.7	4.3
Less Imports	17.1	23.1	10.7	4.9	10.1	16.7
Discrepancies	-14.8	-51.8	-52.4	2.9	-190.2	-251.5
Real GDP	**7.2**	**6.2**	**4.5**	**6.1**	**7.8**	**7.6**
Real GDP Excluding Govt Exp	**8.1**	**7.3**	**5.0**	**6.5**	**8.9**	**7.2**

Source: MOSPI

Private consumption growth slowed to 3.1% YoY in Q2 from 6.0% in the prior quarter owing to the waning of the favourable base effect. Nonetheless, it contributed ~1.9 pp to the real GDP growth. Growth in this component has likely been supported by the continued strong urban demand while the rural demand was mixed due to the uneven monsoon.

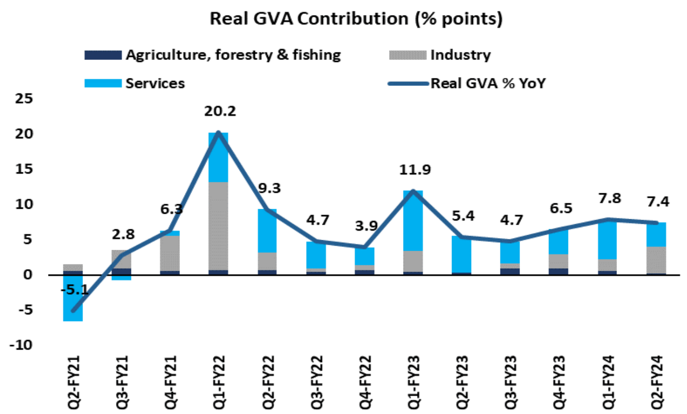
Looking ahead, we expect private consumption to gain momentum due to the festive related demand in Q3. Based on the early estimates of the Diwali sales published by the Confederation of All India Traders (CAIT), the retailers clocked a record high sale of Rs 3.75 lakh crores up until Diwali, which is already ~36% higher than last year's season. While the near-term outlook for consumption is optimistic due to the festive season related boost, there are downside risks emanating from the softer reading of the labour market data including moderation in the hiring activity (Naukri JobSpeak Index) and decline in new EPFO subscribers. Additionally, the El-Nino conditions could continue to impact the agriculture sector even during the Rabi season and remain a dampener for the rural demand. Based on first advanced estimates, the Kharif foodgrain production is pegged at 4.6% below last year, which could hamper rural incomes and consumption.

Government final consumption expenditure accelerated sharply to 12.4% from a contraction of 0.7% in the previous quarter and contributed ~1.1 pp to the real GDP growth. This was primarily led by the unfavourable base effect as on a sequential basis the government expenditure declined by 8.5% QoQ. For the outlook ahead, with an expectation of an increase in welfare spending and subsidies ahead of the elections (April-May), the government's final consumption could observe an uptick.

Lastly, the drag from the net exports on economic growth continued in Q2 as it stripped off ~3.6 pp from the real GDP growth. Even though exports of goods and services turned positive in Q2 (4.3% YoY), it was outpaced by the impressive growth of imports (16.7%) reflecting strong domestic demand. The drag from the external sector is expected to continue in the next quarter with the trade deficit surging to a record high in October due to an increase in gold & silver imports amidst the festive and wedding season. While this is more likely a one-off data point and is expected to normalize going ahead, relatively higher non-oil non-gold & silver imports compared to exports are expected to keep the net exports in the negative.

Discrepancies contributed ~4.6 pp to the overall GDP growth, marking the second consecutive quarter of an outsized contribution. Accordingly, from a data quality perspective, the GVA gives a more reliable picture of growth.

Industrial and services sector lift GVA growth; Agri slows as expected



Source: MOSPI

On the production side of the economy, GVA in Q2 FY24 grew by 7.4% YoY buoyed by a surprisingly strong performance of the industrial sector, particularly manufacturing, which grew by 13.9% YoY. Not only manufacturing, but all sub-sectors of industry grew by double digits in Q2. While the services sector growth slowed significantly to 5.8% YoY from 10.3% previously, its contribution to growth remained sizeable which mainly reflects the robust performance of the financial, real estate and professional services sectors as well as public administration and defence. As expected, agriculture sector growth was affected by a poor and erratic monsoon and as such grew by a dismal 1.2% YoY.

India's real GVA estimates

(Constant Prices)	% YoY					
	FY 2023	Q2-FY23	Q3-FY23	Q4-FY23	Q1-FY24	Q2-FY24
Agriculture, Forestry & Fishing	**4.0**	**2.5**	**4.7**	**5.5**	**3.5**	**1.2**
Industry	**4.4**	**-0.5**	**2.3**	**6.3**	**5.5**	**13.2**
Mining & Quarrying	4.6	-0.1	4.1	4.3	5.8	10.0
Manufacturing	1.3	-3.8	-1.4	4.5	4.7	13.9
Electricity and Other Utility Services	9.0	6.0	8.2	6.9	2.9	10.1
Construction	10.0	5.7	8.3	10.4	7.9	13.3
Services	**9.5**	**9.4**	**6.1**	**6.9**	**10.3**	**5.8**
Trade, Hotels, Transport, Communication etc	14.0	15.6	9.6	9.1	9.2	4.3
Financial, Real Estate & Professional Services	7.1	7.1	5.7	7.1	12.2	6.0
Public Administration, Defence and Other Services	7.2	5.6	2.0	3.1	7.9	7.6
Gross Value Added (at Basic Price)	**7.0**	**5.4**	**4.7**	**6.5**	**7.8**	**7.4**
Core GVA	**7.6**	**5.9**	**5.3**	**7.3**	**8.7**	**8.4**

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

Within industry, manufacturing and construction sub-sectors were the outperformers. Although we had expected manufacturing sector growth to improve in Q2 from the 4.7% growth in Q1, the magnitude of increase was quite outsized. Based on the long-term relationship between IIP and GDP, we expected manufacturing growth to be ~10%. Nevertheless, as we have also mentioned in our previous monthly reports, high-frequency data suggests that manufacturing sector output improved supported by primary goods, infrastructure and construction related goods, and consumer goods. Furthermore, a decline in input cost pressures (compared with last year) also likely supported activity in this sector. The RBI's latest industrial outlook survey for the manufacturing sector remains optimistic on prospects of the sector as the expectations score continued to improve for Q3 on top of Q2's already impressive score. Construction sector growth was equally impressive at 13.3% YoY. Strong CAPEX push by the government and related development of infrastructure has supported growth in the sector in the post-COVID era. A revival in the Indian real estate sector as evidenced by improved housing sales, increase in property prices and housing starts, has also contributed to an improved pace of construction activity. The continued focus of the government on infrastructure development especially in the run up to the general elections, coupled with a positive sentiment in the real estate sector gives confidence that activity in the construction sector is likely to remain robust over the near term.

Within services, the contribution of the financial, real estate and professional services sub-sector remained impressive, even though growth in this sector moderated quite significantly to 6% YoY from 12.2% previously (partly attributed to a less favourable base effect). A higher net interest margin (compared to last year) and improvement in activity in the real estate sector have supported growth in this sub-sector. Public administration, defence and other services also contributed a sizeable sum to overall growth which is reflective of strong government expenditure growth. Growth in the trade, hotels, transportation, and communication etc sub-sector slowed substantially which is probably a result of a combination of a less favourable base effect (due to a shift in the festive calendar) and lower demand from the rural sector as incomes there were affected by poor performance of the agricultural sector. While we remain optimistic about the prospects of the former two sub-sectors (albeit with some degree of moderation expected), momentum in the consumer demand-focused services could remain affected in Q3 given that Kharif agriculture production and incomes are expected to disappoint.

Pace of activity will moderate going ahead

The economy is showing signs of strength in the early part of the third quarter of fiscal year 2024, based on high-frequency indicators for October. Having said that, the overall growth is still expected to moderate in H2 FY24 largely due to the less favourable base effect and fizzling out of the festive season demand in the last quarter. Additionally, we assess the downside risks to the outlook to persist from the weaker agricultural output and slowing global demand in response to the past two years of global monetary policy tightening.

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