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Indian economy extends recovery in Q4 FY21; second COVID wave to weigh on Q1 FY22 numbers

- India's economic recovery gathered pace in Q4 FY21, registering real Gross Domestic Product (GDP) growth of 1.6% YoY, better than our estimate of 0.9% YoY for the quarter and compared to 0.5% YoY in Q3.
- Economic recovery was broad-based in Q4; however, the reliance on government spending increased. Real GDP excluding government spending contracted by 1.1% YoY compared to an expansion by 0.6% YoY in the previous quarter.
- Real Gross Value Add (GVA) grew by a solid 3.7% YoY in Q4 FY21 compared to 1% YoY expansion in Q3. A rise in subsidy outlays led to a widening gap between GVA and GDP numbers in Q4 and FY21.
- Economic recovery was broad-based from the supply side as well, driven by the manufacturing and construction sectors while the agriculture sector maintained a good pace of growth. Contact intensive services remain the worst affected.
- For FY21, the real GDP print for FY21 came at -7.3% YoY, close to our projection of -7.5% YoY. This is the second yearly economic contraction since FY1980 and the severest at least since FY1952.
- However, implicit in the annual contraction numbers is the underlying economic recovery that came to light H2 FY21 onwards. Compared to a contraction of 15.9% in H1 FY21, the real GDP grew by 1.1% YoY in H2 FY21, buoyed by normalization of economic activity, pent-up demand, and policy support.
- The second COVID wave is expected to weigh on economic recovery in Q1 FY22. However, the prospects of a quick rebound are strengthening with a continued downward trend in daily COVID cases and expected pick-up in vaccination pace.
- We expect economic growth to be around 9.9% YoY in FY22, after incorporating the likely impact of the second COVID wave on sequential recovery in Q1, followed by a resumption of recovery in the subsequent quarters.

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.

Indian economy grows for the second consecutive quarter

The Indian economy expanded by 1.6% in Q4 FY21, (better than our projection of +0.9% YoY) and offered a positive surprise to the Central Statistics Office's (CSO) second advance estimate (-1.1% YoY in Q4 FY21) – driven primarily by government spending and investment demand. This marked the second consecutive quarter of growth, outlining the steady recovery that began from H2 FY21.

Economic recovery was broad-based in Q4, however, the reliance on government spending increased. Private consumption - the primary driver of the Indian economy (with ~59% share in nominal GDP), returned to the growth path with a 2.7% YoY rise in Q4 FY21 after three consecutive quarters of contraction. However, the pace of expansion was slower than expected. This probably reflects the early impact of the second COVID wave as was evident in the deteriorating labour market conditions in March 2021. Meanwhile, investment demand - gross fixed capital formation (GFCF) noted a double-digit growth of 10.9% YoY in Q4 FY21. Although better momentum was captured in the IIP investment index (weighted average of IIP construction and capital goods), which increased by 7.7% YoY in Q4 FY21, the actual release positively surpassed our expectations. This resonates well with the infrastructure and manufacturing push undertaken by the government and also aligns with the positive surprise on construction activity as noted in GVA.

India GDP estimates at constant prices

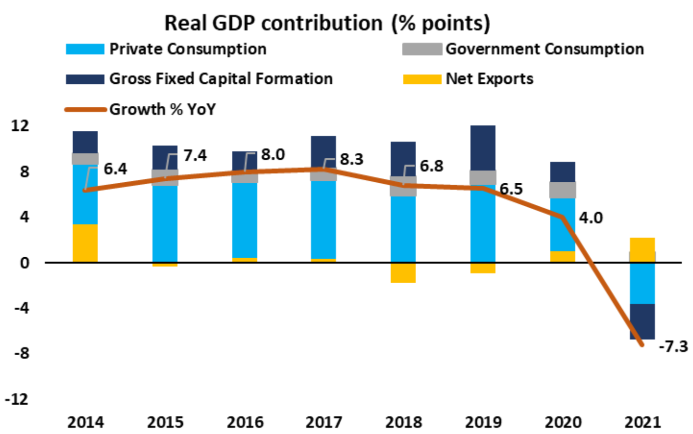
%YoY (constant prices)	FY 2019	FY 2020	FY 2021	Q1-FY21	Q2-FY21	Q3-FY21	Q4-FY21
Private Consumption	**7.6**	**5.5**	**-9.1**	**-26.2**	**-11.2**	**-2.8**	**2.7**
Government Consumption	**6.3**	**7.9**	**2.9**	**12.7**	**-23.5**	**-1.0**	**28.3**
Gross Capital Formation	**9.7**	**2.3**	**-10.1**	**-47.7**	**-8.0**	**3.0**	**13.8**
Gross Fixed Capital Formation	9.9	5.4	-10.8	-46.6	-8.6	2.6	10.9
Exports	12.3	-3.3	-4.7	-21.8	-2.0	-3.5	8.8
Less Imports	8.6	-0.8	-13.6	-40.9	-17.9	-5.0	12.3
Real GDP	**6.5**	**4.0**	**-7.3**	**-24.4**	**-7.4**	**0.5**	**1.6**
Real GDP excluding govt exp	**6.6**	**3.6**	**-8.5**	**-29.0**	**-5.2**	**0.6**	**-1.1**

Source: MOSPI

Government consumption expenditure also noted a robust increase of 28.3% YoY in the fourth quarter, driving overall economic growth. Real GDP excluding government spending contracted by 1.1% YoY compared to an expansion by 0.6% YoY in the previous quarter. This did not come as a surprise as the ramp-up in government expenditure was broadly on expected lines from the revised budget estimates. Central government expenditure increased by 113% YoY in Q4 FY21 (revenue and capital expenditure increased by 125% YoY and 42.6% YoY respectively), which is likely to have been partly offset by relatively slower expenditure growth of state governments. Meanwhile, net exports shaved off ~1% from the Q4 FY21 growth number as imports noted a much robust increase (12.3% YoY) in Q4 FY21 compared to exports (8.8% YoY).

On an annual basis, the provisional estimates for real GDP noted a contraction of 7.3% YoY in FY21, closer to our estimate of -7.5% YoY. This is better than the contraction of 8% YoY according to the CSO's second advance estimate released in February'21. Economic contraction in FY21 is the second yearly economic contraction since FY1980 and the severest, at least since FY1952. Embedded in the annual numbers were the effects of the nationwide lockdown and the complete standstill in economic activity during Q1 FY21 that extended to subsequent quarters and impaired domestic activity. As a result, private consumption demand contracted by 9.1% YoY - its first-ever contraction in over four decades. The disruption to consumption demand was more pronounced in urban demand compared to rural demand that remained resilient due to a less severe impact from the virus and strong government support. This was evident in the disparity between consumer durables (proxy for urban demand) and consumer non-durables (proxy for rural demand) that contracted by 15.2% YoY and 2.3% YoY respectively in FY21. Investment demand also contracted by 10.8% YoY as business confidence waned and the uncertainty around the pandemic put a halt to investment activity. Meanwhile, government consumption expenditure offered support as it noted a growth of 2.9% YoY. Net exports also offered a cushion with imports declining more sharply than exports and contributed positively to annual GDP by 2.2 percentage points.

Government spending and external demand offer support to the economy in FY21



Source: MOSPI

Implicit in the annual contraction numbers is the underlying economic recovery that came to light H2 FY21 onwards.

Compared to a contraction of 15.9% in H1 FY21, the real GDP grew by 1.1% YoY, confirming a sustained economic recovery buoyed by normalization of economic activity, pent-up demand, and government and RBI support.

Manufacturing and construction sectors led to real GVA growth acceleration in Q4

Real Gross Value Add (GVA) grew by a solid 3.7% YoY in Q4 FY21 compared to 1% YoY expansion in Q3. Economic recovery was broad-based, led by the industry while the agriculture sector maintained a good pace of growth and the services sector posted a relatively smaller contraction compared to the previous quarter. The agriculture sector grew by 3.1% YoY despite an unfavourable base (given 6.8% YoY growth in Q4 FY20). For FY21, the sector emerged as the bright star, being the only major sector posting expansion in all four quarters of FY21 and managing a robust 3.6% YoY growth in FY21. Favourable monsoon conditions, for a third consecutive year in FY21, government policy measures and relatively lower impact of lockdowns on agriculture and allied activities supported this remarkable performance. Given the projected normal monsoon in the current year, the sector is expected to continue to grow at a healthy pace, though it could be partly disrupted by the spread of the second COVID wave to rural areas.

India GVA estimates at constant prices

%YoY (constant prices)	FY 2019	FY 2020	FY 2021	Q1-FY21	Q2-FY21	Q3-FY21	Q4-FY21
Agriculture, forestry & fishing	**2.6**	**4.3**	**3.6**	**3.5**	**3.0**	**4.5**	**3.1**
Industry	**5.3**	**-1.2**	**-8.2**	**-35.8**	**-3.0**	**2.9**	**7.9**
Mining & quarrying	0.3	-2.5	-8.5	-17.2	-6.5	-4.4	-5.7
Manufacturing	5.3	-2.4	-7.2	-36.0	-1.5	1.7	6.9
Electricity and other utility services	8.0	2.1	1.9	-9.9	2.3	7.3	9.1
Construction	6.3	1.0	-8.6	-49.5	-7.2	6.5	14.5
Services	**7.2**	**7.2**	**-8.1**	**-21.5**	**-11.4**	**-1.2**	**1.5**
Trade, hotels, transport, communication etc	7.1	6.4	-18.2	-48.1	-16.1	-7.9	-2.3
Financial, real estate & professional services	7.2	7.3	-1.5	-5.0	-9.1	6.7	5.4
Public administration, defence and other services	7.4	8.3	-4.6	-10.2	-9.2	-2.2	2.3
Gross Value Added (at basic price)	**5.9**	**4.1**	**-6.2**	**-22.4**	**-7.3**	**1.0**	**3.7**
Core GVA	**6.3**	**3.4**	**-8.8**	**-29.1**	**-8.6**	**0.7**	**2.9**

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

Industry led the real GVA momentum in the final quarter of the last year, with 7.9% YoY expansion accelerating from 2.9% YoY in the previous quarter. This acceleration was driven by the manufacturing and construction sectors. Manufacturing sector growth jumped from 1.7% YoY in Q3 to a strong 6.9% YoY in Q4. This is broadly in line with a sharp pick-up in IIP-Manufacturing output to 5.8% YoY in Q4, up from 1.7% in Q3, and strong quarterly financials reported by listed manufacturing companies. The sector, however, contracted for the second consecutive year in FY21, by 7.2% YoY (v/s -2.4% in FY20), due to a steep fall in the first half of the fiscal year. With state governments providing lockdown exemptions to manufacturing activities during the second wave, the impact on the sector's activity is likely to be relatively less in FY22 than last year.

Within industrial activities, the construction sector also showed a jump in growth from 6.5% YoY in Q3 to a double-digit rise to 14.5% YoY in Q4. It was boosted by spending on physical infrastructure expansion as reflected in new records being created (13,000 kilometers in 2020-21) in the construction of national highways. In FY21, the sector still saw a steep 8.6% YoY contraction, reflecting a slump in activity in the first half of the year. Meanwhile, electricity and other utility services maintained an upward trend, with a 9.1% YoY rise in Q4 after registering a 7.3% YoY growth in Q3. This helped the sector post growth in FY21 at a level closer to FY20. In comparison, the mining sector remained the sore thumb within the industrial sector, with a wider contraction in the final quarter compared to the previous one, leading to a steep 8.5% YoY fall in the full year. The sector has been facing supply bottlenecks and logistical issues, which are unlikely to be resolved in the near term.

Meanwhile, the services sector managed to come out of three consecutive quarters of contraction and posted an expansion by 1.5% YoY in Q4. The sector remains hamstrung by laggard recovery of contact intensive industries such as trade, hotel, transport, and communication, etc., which remained in the contraction zone, even though it narrowed compared to the previous quarter. Among all major sub-heads, this segment registered the worst contraction last year. With the second wave striking in Q1 FY22, these contact intensive services are likely to remain a drag on overall economic growth, and their recovery is expected to be delayed to the second half of FY22 when the vaccination pace is likely to pick up. Among other major services sub-heads, public administration and other services came out of three consecutive quarters of contraction to post a 2.3% YoY growth in Q4. A sharp rise in central government spending in the final quarter has possibly offset the likely weak performance of other services activities within this segment. Financial services, on the other hand, maintained above 5% growth pace, though it slowed slightly from the previous quarter. Overall real GVA contracted by 6.2% YoY last year compared to an already low growth pace of 4.1% in FY20. In nominal terms, the contraction was less steep, with a relatively moderate fall of 3% in real GVA versus the expansion of 7.6% in FY20.

In terms of the outlook for FY22, we expect the second COVID wave to weigh on the recovery of contact intensive services and delay their recovery to the second half of FY22. However, construction, manufacturing, electricity, and public administration activities should show resilience and are expected to resume recovery relatively quickly, assuming the ongoing downward trend in COVID cases continues and the pace of vaccination picks up in the coming weeks, allowing states to gradually lift relaxations. According to the Ministry of Health, ~12 crore vaccine doses will be made available in June 2021, which is over 50% higher than the capacity available in May 2021 and could support around 4 million vaccine doses per day. This should help with lockdown relaxations and economic activity normalization. We expect economic growth to be around 9.9% YoY in FY22, after incorporating the likely impact of the second COVID wave on sequential recovery in Q1, followed by a resumption of recovery in the subsequent quarters.

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