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Economic growth in line with expectation in FY22; the FY23 outlook clouded by spillover from global developments

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- Real GDP growth for Q4 FY22 came at 4.1% YoY compared to our estimate of ~4.0%, driven by investment, exports, and private consumption.
- Growth slowed compared to the previous quarter in line with continued normalization of the base effect and the possible impact of several factors, including disruptions related to the third COVID wave, supply chain issues, and a sharp rise in global commodity prices.
- From the supply side, real GVA growth noted an expansion of 3.9% YoY in Q4 FY22, slowing from 4.7% YoY in Q3 FY22, given the waning of a favourable base effect and spillover from global developments.
- In terms of contribution to real GVA growth in Q4, the services sector led the overall growth, followed by agriculture. The industrial sector noted sluggish growth.
- In fiscal year terms, real GDP grew by 8.7% YoY in FY22, precisely in line with our projection, following a contraction of 6.6% YoY in FY21. The level of real GDP in FY22 reached 101.5% of the pre-COVID level (i.e., FY20).
- All major sub-components of aggregate demand crossed their respective pre-COVID levels. However, private consumption (at 101.4% of its pre-COVID level) continues to lag other demand indicators.
- Among GVA sub-sectors, all major sub-components crossed their respective pre-COVID levels, led by industry and agriculture, while the services sector recovery lagged, indicating incomplete recovery for contact-intensive services.
- Going ahead, a contained COVID situation, higher vaccination coverage, and continued broadening of the economic recovery are expected to support economic activity in FY23.
- However, global growth slowdown, high commodity prices, rising domestic inflation, and expected monetary policy tightening by the RBI will weigh on India's economic recovery. Accounting for these factors, we expect economic growth to be around 7% YoY in FY23, with downside risks.
- In terms of policy implications, the latest GDP data doesn't alter our expectations about monetary policy normalization in FY23.
- In line with our expectation of front loading of rate hikes and the urgency shown by the RBI to tame inflation, we expect the RBI to hike the repo rate by an additional 110 bps in FY23 (with 25-40 bps expected to be announced in the June meeting) after 40 bps already announced in May.

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The Q4 FY22 real GDP growth came in line with expectations

Real GDP growth for Q4 FY22 came at 4.1% YoY compared to our estimate of ~4.0%. In terms of pre-COVID levels, real GDP in Q4 FY22 reached 106.7% of the corresponding quarter in FY20. Growth slowed compared to the previous quarter in line with continued normalization of the base effect. Several other factors, including disruptions related to the third COVID wave, heightened geopolitical tensions, supply chain issues, a sharp rise in global commodity prices, and rising domestic inflation likely to have also weighed on the economic recovery momentum. In terms of contribution to real GDP, economic growth in the March quarter was led by investment, exports, and private consumption. Government consumption spending contribution to overall real GDP growth rose compared to the previous quarter as the government stepped up expenditure to meet budget targets. Meanwhile, exports supported the aggregate demand, helping curtail the drag from the net exports.

Private consumption expenditure, the mainstay of aggregate demand in India, noted a sluggish growth of 1.8% YoY in Q4 FY22 compared to 7.4% YoY in Q3 FY22. With the rising inflationary pressures and the uneven labour market recovery weighing on consumer demand, private consumption noted a sequential contraction of 2.9% QoQ from 14.7% QoQ expansion in Q3 FY22. With a sequential deterioration, private consumption expenditure was steady at ~108% of the pre-COVID level (i.e., Q4FY20) even as other demand indicators built a lead on their respective pre-COVID levels. The labour market showed signs of deterioration in Q4 FY22 with a shrinking labour force and a decline in the employment rate. While we see tentative signs of recovery in consumer sentiment (as per the last RBI survey), the private consumption outlook remains dependent on the labour market conditions. As per the CMIE data, the greater unemployment rate increased from 11.1% in March to 11.8% in April, but this was due to the labour-force participation rate rising to a four-month high outpacing the jobs gains of ~7mn in the month. Further, the Naukri JobSpeak Index improved to 125% of pre-COVID (CY19) levels in April from 123% the prior month. Going ahead, high economic uncertainty, global developments, elevated inflation, and expected monetary tightening could weigh on the pace of labour market recovery and households' purchasing power.

On the other hand, the government consumption expenditure noted improvement with a growth of 4.8% YoY in Q4 FY22 compared to 3.0% YoY in the prior quarter. This was despite the unfavourable base effect from the last year. With the government accelerating its expenditure in the final quarter of FY22, government consumption noted a massive increase of 30.3% QoQ in Q4 FY22 compared to 1.1% in Q3 FY22, pushing its level to 135.1% of Q4 FY20 level. In FY23, other demand indicators will have to pick up pace as economic recovery reliance on government consumption spending will have to go down in view of the modest revenue growth budgeted and risk of expenditure rationalization (to accommodate increased subsidy burden).

GDP estimates at constant prices

(Constant Prices)	% YoY						
	FY 2020	FY 2021	FY 2022	Q1-FY22	Q2-FY22	Q3-FY22	Q4-FY22
Private Consumption	**5.2**	**-6.0**	**7.9**	**14.4**	**10.5**	**7.4**	**1.8**
Government Consumption	**3.4**	**3.6**	**2.6**	**-4.8**	**8.9**	**3.0**	**4.8**
Gross Capital Formation	**-2.2**	**-11.4**	**21.7**	**72.3**	**26.8**	**8.4**	**5.2**
Gross Fixed Capital Formation	1.6	-10.4	15.8	62.5	14.6	2.1	5.1
Exports	-3.4	-9.2	24.3	40.8	20.7	23.1	16.9
Less Imports	-0.8	-13.8	35.5	61.1	41.0	33.6	18.0
Real GDP	**3.7**	**-6.6**	**8.7**	**20.1**	**8.4**	**5.4**	**4.1**
Real GDP Excluding Govt Exp	**3.8**	**-7.8**	**9.5**	**24.8**	**8.4**	**5.6**	**4.0**

Source: CMIE

Meanwhile, the investment demand - gross capital formation (GCF)- noted a robust growth of 5.2% YoY, though slowing from 8.4% in the prior quarter in line with the waning of the base effect. With the acceleration in the pace of the capital expenditure by the central government, the investment demand noted a solid sequential growth of 15.6% QoQ (v/s 8.1% QoQ contraction in Q3). Accordingly, its level in Q4 reached 117.7% of its pre-pandemic levels from 106.4% in Q3 FY22. The central government posted a sharp jump of ~73% YoY in CAPEX in Q4 FY22, up from 13.4% in the prior quarter, which supported the overall investment growth. The government will continue to take the lead in driving investment in FY23, as reflected in the high CAPEX outlays budgeted for the current financial year. Meanwhile, corporates' improved credit profile and rising capacity utilization bode well for the private investment revival in FY23. Further, the total new projects announced also increased, reflecting the signs of revival. As per CMIE data, new investment projects announced increased by 45% QoQ to Rs 5 lakh crore in Q4 FY22, higher than the pre-pandemic quarterly (in CY2019) average of Rs 4.4 lakh crores. However, high economic uncertainty and elevated input costs may lead to companies adopting a wait and watch strategy, delaying the broader pick-up in private investment.

The strong export performance continued to support aggregate demand, with exports growing by 16.9% YoY in Q4 FY22. This helped lower the drag from net exports (exports minus imports) to one percentage point (pp) in Q4 FY22 compared to 3 pp in the previous quarter. With dark clouds over the global economic outlook, India's exports are likely to face a challenging operating environment compared to last year.

Catch-up in the services sector drove real GVA growth in Q4 FY22

From the supply side, real GVA growth noted an expansion of 3.9% YoY in Q4 FY22, slowing from 4.7% YoY in Q3 FY22, given the waning of favorable base effect and spillover from global developments. With the global disruptions, including the Russia-Ukraine war, supply chain issues, and high commodity prices hampering the pace of the economic recovery in the final quarter of the last year, the sequential momentum in real GVA growth slowed to 5.2% QoQ in Q4 FY22 from 6.2% QoQ in Q3 and 8.7% QoQ in Q2. Nonetheless, the real GVA in Q4 FY22 was above the pre-pandemic levels at ~110% (compared to the corresponding quarter of FY20) as all the major sub-sectors fared above their respective pre-pandemic levels. In terms of contribution to overall GVA growth in Q4, the services sector led the overall growth, followed by agriculture.

The agriculture sector noted a growth of 4.1% YoY in Q4 FY22 from 2.5% YoY in Q3 FY22, supported by the favorable base effect from the last year. On a sequential basis, it noted a sequential contraction of 14.2% QoQ, as crop yields were impacted due to adverse weather conditions. As per the third advance estimate, wheat production has been revised downwards by 4%, reflecting the impact of the scorching heatwave across the country. In FY23, the projection of a normal monsoon, adequate reservoir levels, and expected higher MSP prices continue to underpin a positive outlook for the sector. High fertilizer prices could impinge on agriculture activity even though the government is expected to cushion part of this impact by raising subsidies and minimum support prices. The agri-export potential is likely to be curtailed due to the government's steps, such as a temporary ban on wheat exports, given concerns over domestic food security and rising food prices.

The industrial sector remained a laggard as it noted a modest growth of 1.3% YoY in Q4 FY22, slightly above the 0.3% YoY in Q3 FY22, dragged down by an unfavorable base effect. Despite the global headwinds impeding the industrial activity, the sector managed to post an impressive sequential expansion of 17.6% QoQ in Q4 FY22 from a contraction of 0.4% QoQ in the preceding quarter. Among the major sub-sectors, the increase in momentum of the industrial growth was driven by mining, electricity, gas & other utilities, and construction. As the electricity demand got a boost from the revival of the economic activity and heatwave, electricity and other utilities and mining noted a sequential expansion. Meanwhile, the construction activity noted a growth of 2.0% YoY compared to a contraction of 2.8% YoY in Q3 FY22. On a sequential basis, the construction industry registered a double-digit expansion of 26.7% QoQ, up from 9.9% QoQ in the prior quarter, potentially reflecting the thrust of the central government on the capital infrastructure to support the growth in the economy. Within the industrial sector, the manufacturing sector remained a drag as it noted a contraction of 0.2% YoY compared to a mere growth of 0.3% in Q3 FY22, possibly reflecting the impact of the rising global commodity prices and the input cost pressures on the margins, and the global semiconductor chip shortages. Going ahead, the outlook for industrial activity is mixed. Potential disruption to electricity supply due to low coal stocks at power plants remains a risk for electricity generation and wider industrial activity in the short term. On a positive note, manufacturing PMI remained in the expansionary zone for the tenth consecutive month, rising from 54.0 in March to 54.7 in April. However, high global commodity prices and supply chain disruptions (stemming from the Russia-Ukraine war and COVID induced lockdown in China) are likely to continue to tamper with the industrial outlook.

GVA estimates at constant prices

(Constant Prices)	% YoY						
	FY 2020	FY 2021	FY 2022	Q1-FY22	Q2-FY22	Q3-FY22	Q4-FY22
Agriculture, Forestry & Fishing	**5.5**	**3.3**	**3.0**	**2.2**	**3.2**	**2.5**	**4.1**
Industry	**-1.4**	**-3.3**	**10.3**	**46.6**	**7.0**	**0.3**	**1.3**
Mining & Quarrying	-1.5	-8.6	11.6	18.0	14.5	9.2	6.7
Manufacturing	-2.9	-0.6	9.9	49.0	5.6	0.3	-0.2
Electricity and Other Utility Services	2.2	-3.6	7.5	13.8	8.5	3.7	4.5
Construction	1.2	-7.3	11.5	71.3	8.1	-2.8	2.0
Services	**6.3**	**-7.8**	**8.4**	**10.5**	**10.2**	**8.1**	**5.5**
Trade, Hotels, Transport, Communication etc	5.9	-20.2	11.1	34.3	9.6	6.3	5.3
Financial, Real Estate & Professional Services	6.7	2.2	4.2	2.3	6.1	4.2	4.3
Public Administration, Defence and Other Services	6.3	-5.5	12.6	6.2	19.4	16.7	7.7
Gross Value Added (at Basic Price)	**3.8**	**-4.8**	**8.1**	**18.1**	**8.3**	**4.7**	**3.9**
Core GVA	**3.0**	**-6.4**	**8.5**	**24.6**	**7.3**	**3.0**	**3.2**

Source: CMIE

The services sector led the real GVA momentum in the final quarter of the last year, with 5.5% YoY expansion v/s 8.1% YoY in the prior quarter. With the broadening of the economic recovery as we return to normalcy, the services sector noted a sequential pick of 5.4% QoQ (v/s -2.5% QoQ in Q3 FY22). Among the major sub-sectors, the growth in the services sector was led by public administration and other services, though its contribution eased in line with a fall in growth to 7.7% YoY in Q4 FY22 (v/s 16.7% YoY in Q3 FY22) and a sequential contraction of 2.8% QoQ (v/s 8.7% QoQ in Q3 FY22). Its slower growth potentially reflects the weak performance of other services activities (such as education, health, etc) within the segment. The public administration segment is likely to have done well in line with robust sequential growth in the central government revenue expenditure. Encouragingly, the contact-intensive sectors like tourism, hotels, transport, communication, etc. posted a sharp sequential acceleration of 17.4% QoQ in Q4 FY22; however, due to the unfavorable base effect, it only posted a growth of 5.3% YoY. Financial services, on the other hand, noted an expansion of 4.3% YoY in Q4 FY22, buoyed by the favorable base effect as it remained somewhat flat on a sequential basis.

Given the contained COVID situation and higher vaccination coverage, the outlook for the services sector is improving; however, partly hampered by rising inflation. High-frequency indicators suggest a pick-up in the activity, especially for contact-intensive services. The services PMI noted a sharp acceleration from 53.6 in March to 57.9 in April. Contact intensive sectors like tourism, hotels & restaurants have seen a recovery in credit growth over the past few months, suggesting a broadening of the economic recovery. As demand for services improves, the pass-through of built-up input costs may accelerate, which could weigh on the services sector momentum.

The FY22 real GDP reaches 101.5% of its pre-COVID level; economic growth is projected at 7% YoY in FY23

In fiscal year terms, real GDP grew by 8.7% YoY in FY22, precisely in line with our projection, following a contraction of 6.6% YoY in FY21. The level of real GDP in FY22 reached 101.5% of the pre-COVID level (i.e., FY20). All major sub-components of aggregate demand crossed their respective pre-COVID levels. However, private consumption (at 101.4% of its pre-COVID level) continues to lag other demand indicators. From the production side, real GVA grew by 8.1% YoY in FY22, following a 4.8% contraction in FY21. Real GVA reached almost 103% of its pre-COVID level (v/s FY20) in FY22. All major sub-sectors crossed their respective pre-COVID levels, led by industry and agriculture, while services sector recovery lagged with the trade, hotels, transport, and communication segment remaining ~11% below its pre-COVID level, indicating incomplete recovery for contact-intensive services. In nominal terms, GDP grew by 19.5% in FY22 thanks to a high GDP deflator of 10.8%, which reflects elevated wholesale price inflation of 13% in FY22.

Overall, economic growth was broadly in line with our expectations in Q4 FY22. Going ahead, a contained COVID situation, higher vaccination coverage, and continued broadening of the economic recovery are expected to support economic activity in FY23. However, global growth slowdown, high commodity prices, rising domestic inflation, and expected monetary policy tightening by the RBI will weigh on India's economic recovery. Accounting for these factors, we expect economic growth to be around 7% YoY in FY23, with downside risks.

In terms of policy implications, the latest GDP data doesn’t alter our expectations about monetary policy normalization in FY23. We expect CPI inflation to average 6.3% YoY (with upside risks) in FY23. The RBI is expected to revise its FY23 inflation projection of 5.7% YoY upward in the June meeting. In line with our expectation of front loading of rate hikes and the urgency shown by the RBI to tame inflation, we expect the RBI to hike the repo rate by an additional 110 bps in FY23 (with 25-40 bps expected to be announced in the June meeting) after 40 bps already announced in May. It is also likely to continue with measures such as additional CRR hikes, to withdraw surplus liquidity. We also expect additional supply-side measures from the government after the recent cut in petrol and diesel excise duty.

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