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Indian economy back on a growth path in Q3 FY21, progressing towards V-shaped recovery.

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- Indian economy returned to growth in the third quarter of FY21, emerging out of two consecutive quarters of contraction.

- Real Gross Domestic Product (GDP) grew by 0.4% YoY in Q3 FY21 compared to a contraction of 7.3% YoY in the preceding quarter, reflecting a robust V-shaped recovery from a steep contraction in the previous two quarters.

- The economy's return to growth was in line with our expectations even though the real GDP growth number was slightly lower than our projection of 0.7% YoY and consensus of 0.5% YoY.

- Nonetheless, economic recovery was relatively broad-based. The difference in headline GDP and GDP excluding government expenditure narrowed in Q3, reflecting a pickup in private sector activity.

- On the supply side, the real Gross Value Added (GVA) also returned to growth, with a print of 1% YoY versus a contraction of 7.3% YoY in the previous quarter.

- A two-paced recovery, observed in the last quarter, was also evident in the third quarter. However, there are some tentative signs of recovery becoming relatively broad-based as more sub-sectors, including manufacturing, construction, and financial services, returned to growth.

- The National Statistical Office (NSO) also released the second advance estimate for Gross Value Added (GVA) and GDP FY21, revising the real GVA to -6.5% YoY from the earlier estimate of -7.0% YoY and real GDP number to -8.0% YoY from the previous estimate of -7.7%.

- The divergence in the direction of revisions in estimated real GVA and real GDP numbers for FY21 could be due to higher subsidies accounted for in the final quarter, bringing down the GDP number.

- In addition to a relatively favourable base in Q4 and broadening economic recovery, we believe there is a possibility of higher-than-anticipated government expenditure and recovery in taxes, which should partly offset higher subsidies.

- We presently believe that real GDP contraction is likely to be below 7% YoY in FY21. We project a real GDP contraction of around -6.7% YoY in FY21 and an expansion of 12.4% YoY in FY22.

Pramod Chowdhary
Chief Economist
pramod.chowdhary@dmifinance.in

Ashray Ohri
Economist
ashray.ohri@dmifinance.in

www.dmifinance.in

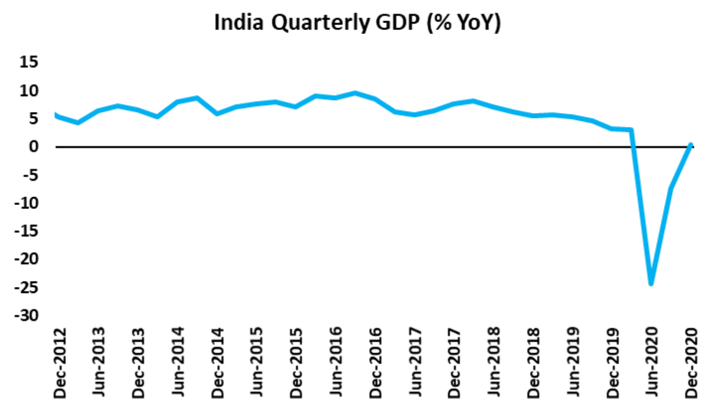
+91 11 4120 4444

DMI Finance Pvt Ltd.
Express Building, 9-10, 3rd Floor, Bahadur Shah Zafar Marg, New Delhi, Delhi 110002

Robust V-shaped recovery continues in Q3 FY21, with signs of broadening of the base

Indian economy returned to growth in the third quarter of FY21, exiting two consecutive quarters of contraction. Real GDP grew by 0.4% YoY in Q3 FY21 compared to a contraction of 7.3% YoY in the preceding quarter, reflecting a robust V-shaped recovery from a steep contraction in the previous two quarters. The economy's return to growth was in line with our expectation even though the real GDP growth number was slightly lower than our projection of 0.7% YoY and consensus of 0.5% YoY. Nonetheless, economic recovery was relatively broad-based. The difference in headline GDP and GDP excluding government expenditure narrowed in Q3, reflecting a pickup in private sector activity.

India on a path to V-shaped recovery



Source: MOSPI

Economic recovery in Q3 was led by investment demand, which grew by 2.6% YoY, buoyed by the government's aggressive capital expenditure push. This was reflected in the pickup in demand for capital and infrastructure/construction goods in Q3 FY21, as indicated by the Index of Industrial Production (IIP) investment index that increased by 2.4% YoY in the third quarter. This bodes well for the investment health of the economy that has been contracting since December 2020 and lends optimism to the capital drive of the government that aims to build a more sustained model of supply-led growth.

Consumption demand also recovered sharply on a sequential basis, with the resumption of economic activity. However, both government and private demand noted modest contraction in Q3 FY21. Private consumption contracted by 2.4% YoY in Q3 FY21 despite festival demand. The recovery in consumer non-durables was relatively subdued, while consumer durables witnessed better recovery. Evidence of K-shaped recovery raises concerns about the sustainability of recovery over the medium-term, given that labour market conditions continue to remain fragile. Meanwhile, government consumption also contracted by 1.1% YoY in Q3 FY21, despite an 18.9% YoY increase in revenue expenditure by the Centre, indicating curtailment by state governments. However, second advance estimates imply a 29.2% YoY increase in Q4 FY21 in government spending, indicating stronger fiscal support going ahead [Centres' revenue spending has space to increase by 75% after adjusting for the Food Corporation of India (FCI) bill in Q4 FY21].

On the external front, the current account turned back into a deficit in Q3 FY21, after a surplus in the previous quarter, for the first time in more than two decades. However, this was driven by a sharp correction in imports (-4.6% YoY in Q3 FY21 v/s -18.2% YoY in Q2 FY21) and augurs well for domestic demand recovery. Exports, meanwhile, witnessed a contraction of 4.6% YoY in Q3 FY21 v/s a contraction of 2.1% YoY in the previous quarter as foreign demand was impacted by the resurgence of COVID cases and some restrictions across major export markets for India.

Quarterly estimates for GDP (at 2011-12 prices)

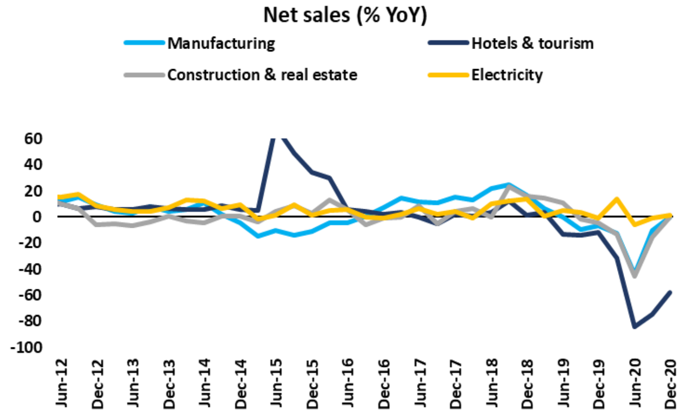
% YoY	Q2-FY20	Q3-FY20	Q2-FY21	Q3-FY21
Private Consumption	6.5	6.4	-11.3	-2.4
Government Consumption	9.6	8.9	-24.0	-1.1
Gross Fixed Capital Formation	3.9	2.4	-6.8	2.6
Changes in Stocks	-40.0	-40.0	3.7	7.0
Valuables	-12.3	-16.4	-45.6	-16.1
Exports	-1.3	-5.4	-2.1	-4.6
Less Imports	-1.7	-7.5	-18.2	-4.6
Real GDP	**4.6**	**3.3**	**-7.3**	**0.4**

Source: MOSPI

On the supply side, real GVA also returned to growth, with a print of 1% YoY reflecting a robust V-shaped recovery from a steep contraction in the previous two quarters. A two-paced recovery that was observed in the last quarter was also evident in the third quarter. However, there are some tentative signs of recovery becoming relatively broad-based as more sub-sectors returned to growth. As in Q2 FY21, agriculture and industry sectors led economic recovery while the services sector, albeit improving, still lagged behind. The agriculture sector continued its good run in the third quarter, with growth picking up to 3.9% YoY from 3% in the previous quarter. Rabi crop sowing is progressing well with a 2.6% YoY rise in acreage sown till the end of January 2021, which bodes well for agriculture growth in the final quarter.

The industry segment bounced back to a growth of 2.7% YoY in Q3 FY21 compared to a 3% YoY contraction in Q2 and a trough of -35.9% YoY in Q1. It is heartening to see three sub-sectors, viz manufacturing, construction and electricity, gas, water supply, & other utilities posting growth in Q3. This is compared to the previous quarter when only electricity & the other utilities segment registered growth. In line with our expectations, the manufacturing sector's real GVA registered growth in Q3 FY21, growing by 1.6% YoY, after being in contraction for the past five quarters, including a COVID-driven steep fall in the first half of the current financial year. This was already indicated by IIP manufacturing sector numbers, which showed 1.2% YoY growth in Q3 FY21 from a fall of 1.1% YoY in the preceding quarter. The corporate sector, for the manufacturing segment, also announced a good set of sales numbers in the December quarter aided by festive demand and restocking. As electricity demand picked up on the back of the unlocking of the economy and the festive season, the electricity, gas, water supply & other utilities sectors' real GVA accelerated in Q3 FY21. Based on high-frequency data, this sector continues to do well in the final quarter of the financial year even though there seems to be some moderation after the effect of festive demand tapered off. The construction sector surprised with a faster-than-anticipated turnaround, and real GVA for the sector appears to be returning to growth. This possibly reflects the spillover of higher government CAPEX during the quarter. Within the industry, mining sector recovery continues to languish on the back of excess supply and relatively tepid demand, even though contraction in the sector also eased in the third quarter compared to the previous quarter.

Corporate sector posts good sales numbers for Q3, though contact-intensive services remain under pressure



Source: CMIE

Dragging down the overall GVA number, the services sector shows a laggard recovery in Q3 as well, which is understandable given that contact-intensive industries remain the hardest hit. However, there is a recovery in all major sub-heads in Q3, with narrower contraction registered for three out of four while one, the financial, real estate & professional services segment, returned to growth. Contact-intensive services viz trade, hotels, transport & communication segments continue to be the hardest hit, with another deep contraction in the third quarter though they have shown decent recovery to -7.7% YoY from -15.3% YoY in the previous quarter thanks to unlocking of the economy amidst a controlled COVID situation in the country. Public administration & defence and the other services segment registered less-than-expected recovery. Given a surge in central government expenditure in Q3 FY21 compared to a contraction in the previous quarter, we expected this segment to return to growth in the third quarter. However, real GVA for public administration & defence and other services registered a contraction of 1.5% YoY in Q3 FY21, though there is still a significant recovery from the 9.3% YoY fall in the preceding quarter. Slower-than-anticipated recovery is possibly due to expenditure restraints at the state level and continued pressures on other services (such as education, entertainment, medical, community services, etc.). We continue to expect public administration & defence and other services segment to post growth in the final quarter on the back of government's higher expenditure as well as improvement in other services with the relaxation of restrictions on places such as cinema halls, swimming pools, exhibitions halls, etc. that are allowed to operate at a higher capacity. However, this will be tampered with by local restrictions in some states like Maharashtra amidst concerns of a second wave.

Quarterly estimates for Gross Value Added (at 2011-12 prices)

% YoY	Q2-FY20	Q3-FY20	Q2-FY21	Q3-FY21
Agriculture, forestry & fishing	3.5	3.4	3.0	3.9
Industry	-1.8	-2.6	-3.0	2.7
Mining & quarrying	-5.2	-3.5	-7.6	-5.9
Manufacturing	-3.0	-2.9	-1.5	1.6
Electricity and other utility services	1.7	-3.1	2.3	7.3
Construction	1.0	-1.3	-7.2	6.2
Services	8.2	7.0	-11.3	-1.0
Trade, hotels, transport, communication etc	6.8	7.0	-15.3	-7.7
Financial, real estate & professional services	8.9	5.5	-9.5	6.6
Public administration, defence and other services	8.8	8.9	-9.3	-1.5
Gross Value Added (at basic price)	**4.6**	**3.4**	**-7.3**	**1.0**
Core GVA*	**4.0**	**2.3**	**-8.5**	**0.7**

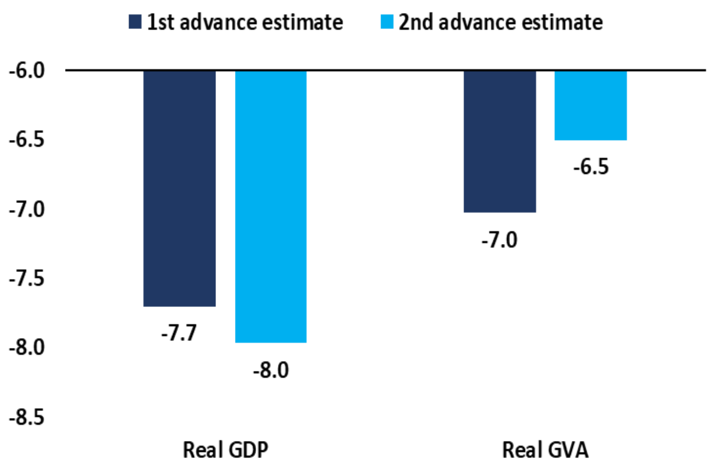
Source: MOSPI. *GVA excluding Agriculture and Public Admin.

The curious case of revision in estimated annual numbers for FY21

The National Statistical Office (NSO) also released the second advance estimate for real GVA and real GDP FY21, incorporating revisions to previous quarter numbers and its implied estimate for the final quarter. As per the second advance estimate, the NSO projects a narrower contraction in real GVA of 6.5% YoY compared to the first advance estimate of -7.0% YoY. There were modest revisions made to Q1 and Q2 numbers, with Q1 FY21 real GVA number revised to -22.4% YoY from the earlier estimate of -22.8% YoY, while Q2 FY21 number was revised to -7.3% YoY compared to the previous estimate of -7.0% YoY. Based on its revised annual number, the implied growth in real GVA in Q4 FY21 comes to 2.5% YoY, which aligns with our expectations

In contrast to the revision in the annual estimate of real GVA, the NSO revised the real GDP FY21 estimate to -8% YoY compared to its earlier estimate of -7.7% YoY. It also revised real GDP numbers for Q1 and Q2; with Q1 FY21 updated to 24.4% YoY v/s the earlier estimate of 23.9% YoY, whereas the second-quarter contraction was revised to 7.3% YoY from 7.5% YoY previously. The divergence in the direction of revisions in real GVA and real GDP for FY21 could be due to higher subsidies accounted for in the final quarter, bringing down the GDP number. Based on the revised annual estimate number, implied real GDP in Q4 FY21 is calculated to contract by 1.1% YoY. We believe there is a possibility of higher-than-anticipated government expenditure, which should partly offset higher subsidies. The ongoing broadening of economic recovery should also help the economy gain traction. We presently believe that real GDP contraction is likely to be below 7% YoY in FY21. We project a real GDP contraction of around -6.7% YoY in FY21 and an expansion of 12.4% YoY in FY22.

NSO's revised annual estimate for FY21



Source: MOSPI

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