Economics

# DBS Flash

## India's soft growth underscores need for easy policy

**Economics/Growth/Fiscal/Rates/India**

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- *4Q19 GDP eased to 4.7% yoy, with notable revisions to past data*
- *Sectoral deflators continue to diverge*
- *Unfavourable global and domestic catalysts cloud the FY21 outlook*
- ***Implications for forecasts**: We anticipate a gradual stabilisation, albeit at modest levels*
- ***Implication for markets:** Policy support is likely to continue.*
- *Short to belly of the yield curve has room to correct*

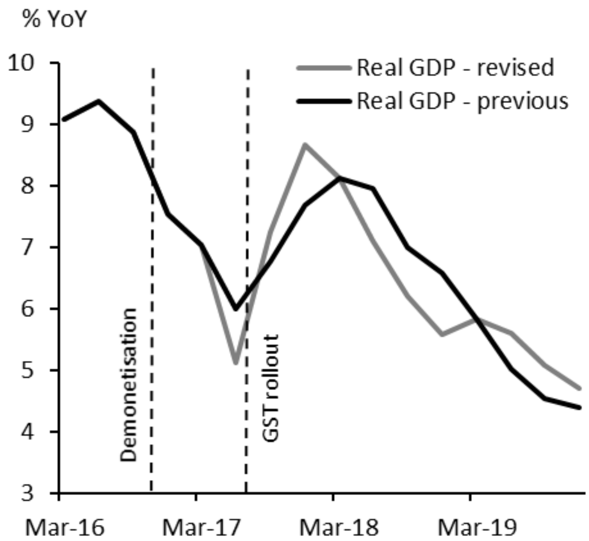
**India's GDP growth rose 4.7% yoy in 4Q19 (third quarter of FY) from a revised 5.1% the quarter before.** Even as the actual release was in line with consensus, upward revisions to the past data kept the downward sloping trend in line with our expectations. Gross value added (GVA) growth eased to 4.5% vs 3Q's 4.8%. This comes despite a sharp cut in the repo rate, loose liquidity and a supportive fiscal stance.

**FY20 GDP was maintained at 5%, implying growth in 1Q20 (final quarter of FY20) at 4.6%.**

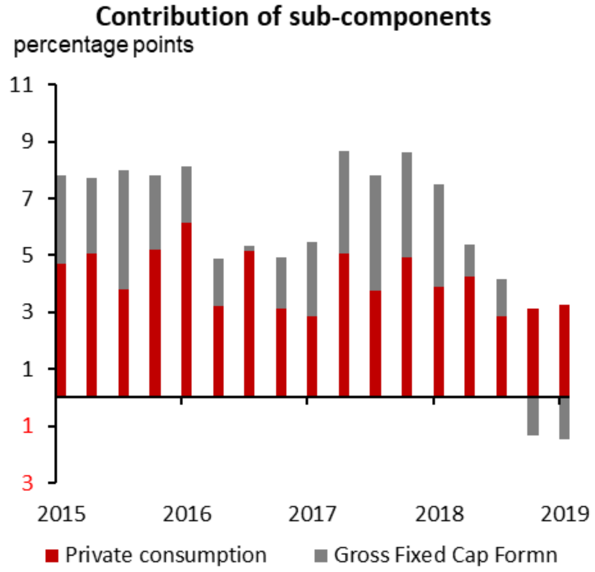
### Five takeaways from the growth numbers

1. Upward revisions to the back-data points to a steeper fall after demonetisation and sharper recovery after the GST-rollout. Despite that FY18 and FY19 marked a slowdown from FY17's 8%. Underlying drivers of consumption and investment fared poorly in the first but appears to have been impacted to a smaller extent in FY19 despite the stress in the non-bank sector. Into FY20, pace of deceleration hastened in 1Q-2Q on broad-based slowdown.

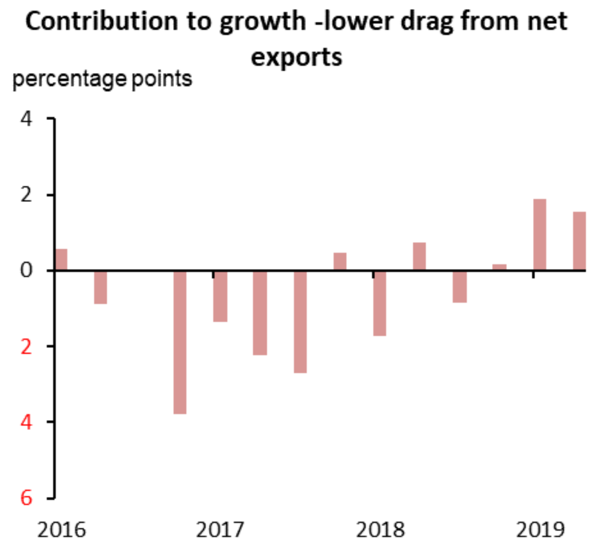
**Real GDP: Notable revisions in back data**




2. Demand-side data revealed resilient consumption, along with support from government spending (contributed 1.2ppt vs 1.6ppt prev quarter). There was a **notable deceleration in capex activity**, as investment growth shaved 1.5ppt in 4Q19 growth (see first chart below). This also reflected in the weak core import growth (non-oil, non-gold) helping to shore the net trade balance.

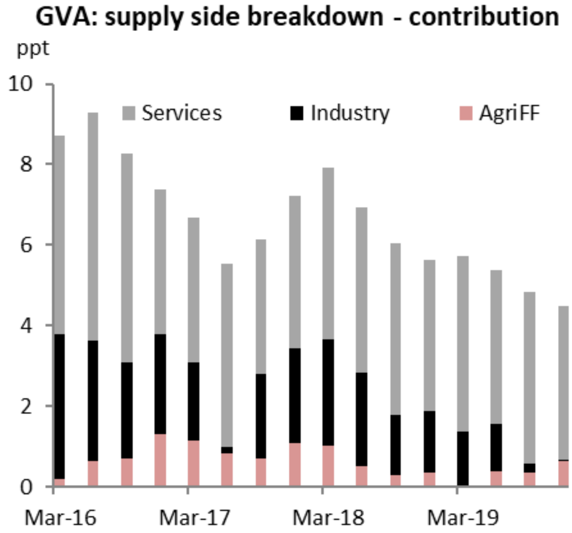


Source: CEIC, DBS



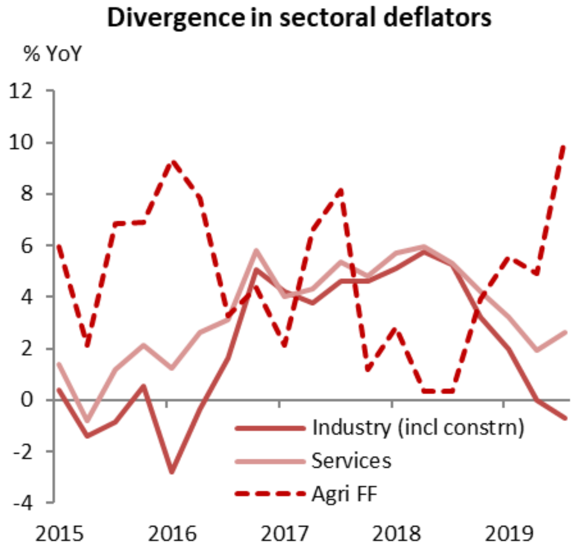
Source: CEIC, calculations are by DBS

3. **Supply-side data** reinforced concerns that the industrial sector, as manufacturing stays weak. This was even before COVID 19 and worries over global growth surfaced. These factors pose an additional headwind for the sector in 1Q20. Core GVA slumped to 3.7% yoy vs 4.2% in 2Q and slowest since mid-2012. **Better farm output offset the fall in contribution from services and industry.**



Source: CEIC, DBS

4. Higher inflation in 4Q also showed up as higher deflators, lifting nominal GDP growth to 7.7% yoy from previous quarter's 6.4%. **Sectoral deflators** continue to diverge, with nominal agricultural growth accelerating to 13.7% yoy, while real growth lagged at 3.5%. Services deflators looked up a tad, but industry's continues to slip, pointing to weak pricing power for the sector.



SOurce: CEIC, DBS

## Outlook

**Unfavourable global and domestic catalysts cloud the FY21 outlook.** Data for January points to bottoming out in few sectors, but on aggregate signs are of stabilisation at modest levels rather than a pick-up. As the festive demand passed in late 2019, strength in some sectors (e.g. auto sales) has petered out. High inflation also likely hurt real purchasing power. January export underperformance belies hope for a hand from external trade. **Providing a decent counterbalance is on track government spending (particularly if the non-tax revenues targets is brought to fruition) and public capex**, **with also services lending some optimism** on better passenger traffic and commercial vehicle sales. Stress on the multiple balance sheets – corporates, government and financial sector – is a risk for a swift recovery.

A challenging global demand backdrop (we have cut China's 2020 GDP by ~50bps post the COVID19 outbreak), asset markets volatility and supply chain disruptions across multiple industry silos, is an additional headwind for manufacturing demand. **Impact of COVID 19 depends on duration, intensity and spread of the infections, as governments put containment policies in place, affecting tourism and trade capabilities.** From a likely 5% in FY20, we expect a gradual drift up in FY21 to 5.6%, helped also be low base effects.

## Policy support to continue

As we noted in PDF, HTML, sub-par growth numbers are likely to raise pressure on policymakers to act. With fiscal policy facing limited space, monetary policy will continue to heavy lift. The RBI has adopted a stealth easing approach, leaving the benchmark repo rate steady and targeting borrowing costs directly by yield control using a combination of operation twist, strong surplus liquidity and introduction of the long-term repo operations. **Cheap financing options could be made more sector-specific if banks' lending activity does not improve to the extent of correction in markets-based funding costs.** A dovish policy approach bodes well for the INR bond markets. Short to belly of the yield curve has room to correct further (Top-10 macro investment strategies for 1H2020 PDF, HTML).

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**Sources**: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)