GDP growth as expected, but watchful eye on potential downside

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India's economic momentum continued in the 1st quarter this fiscal where latest GDP data released for April-June showed India continuing to lead the world as fastest growing economy & also outpacing China's growth rate of 6.3%.

Remaining resilient Indian economy exhibited substantial growth driven by strong domestic demand. The government's capital expenditure and a recovery led by the services sector have served as protective factors, buffering the nation against the challenges of tighter monetary policies and a fragile global economic environment.

The Data

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The RBI had projected April-June quarter GDP growth at 8%, taking the growth for 2023-24 to 6.5%.

Most economists project this year's GDP growth to be lower than central bank's projection at 6.0%.

Though the April-June GDP growth by itself looks impressive, it is just 13.6% higher than the pre-pandemic level--an average annual growth rate of 3.4% per year.

The GVA growth for the June quarter rose to 7.8% from 6.5% in the previous quarter.

The GDP growth in April-June quarter was primarily driven by robust growth in the services sector, which sped to 10.3% from 6.9% in the previous quarter. Within the services sector, financial services, real estate, and professional services led to the rise.

Industrial growth slowed to 5.5% from 6.3% in January-March and the farm sector growth eased to 3.5% from 5.5%. Slower growth in utility services, electricity, gas brought down the pace of growth in industry.

Private final consumption expenditure growth rose 6.0% in April-June up from 2.8% in January-March, but the government's consumption expenditure fell to (-)0.7% from 2.3%. Though growth in gross fixed capital formation moderated, it still grew at a healthy 8.0%.

Gross fixed capital formation, which reflects investments in the economy, accounted for 34.7% of the GDP, higher than the pre-pandemic level of around 32%.

Downside Risks

Although the growth story marks a high point, it's important to acknowledge that the data also highlights certain challenges to India's growth trajectory

These include:

- Due to negative WPI, GDP deflator fell sharply. This meant, the nominal GDP growth was at only 8.0%, down from 10.4% in the previous quarter.
  The government has assumed a nominal GDP growth of 10.8% for 2023-24. Lower nominal growth will have implications for tax collections and fiscal deficit and market borrowing.
- Export growth sharply fell -7.7% on year in April-June in line with global slump in exports, import growth grew 10.1%, up from 4.9% in the previous quarter. Consequently, the drag from net exports was larger. It remains to be seen if the trend in imports will persist. If it does, the downward risks to GDP growth will only grow.
- Manufacturing growth at 4.7% was subdued, despite lower commodity prices. It is likely that the slowdown in exports contributed to slower pace of manufacturing growth. Construction also slowed down despite the rise in centre and state capital expenditure.
- Possibly, the biggest risk to GDP going forward could be from the monsoon. The southwest monsoon has been 10% below normal in the first three months of the year. If the rains continue to be wayward it can reduce agricultural growth and, in turn, impact rural demand. A lower agricultural production will have serious implications for monetary policy going forward.

With Inflation speeding well past the upper bound of the target range in July to 7.44% can lead to some moderation on the consumption demand. Concerns over the prospects for growth in the face of weak exports & weak monsoons since August also pose risk to the growth estimates. However, we would remain one of the fastest growing economies in the world despite uncertainties.

The RBI will continue to target liquidity to keep inflation under check. It may take appropriate call on rates based on incoming data & might keep it higher for longer.

The article has been authored by Ajay Manglunia, MD & Head, Investment Grade Group, JM Financial. All views expressed are personal.