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Pinned down to 5.1%

As the slowdown deepens, we revise our GDP growth forecast

December 2, 2019

Slowdown has intensified half-way through this fiscal

- We're cutting our GDP growth call for fiscal 2020 to 5.1% from 6.3%
- In the second half this fiscal, we expect growth to recover mildly to 5.5% from 4.8% in the first half, with support from monetary policy, agriculture, a mild pick-up in government spending, and a weak-base effect.
- Monetary policy is expected to remain growth supportive in the near term, we expect RBI to cut repo rate by 25 basis points (bps) in its December policy

At 4.5%, GDP growth in the second quarter (Q2) of this fiscal is the lowest since the fourth quarter (Q4) of fiscal 2013, and a full 50 bps below Q1. This is in line with our expectations, and GDP growth in the first half of fiscal 2020 tots up to 4.8%.

Key short-term indicators such as industrial production, merchandise exports, bank credit, tax collections, freight movement, electricity production, and credit, had all pointed to weakening growth momentum (*chart 1*).

On the demand side, a dip in fixed investment and weak private consumption growth were the drags. Government consumption supported growth in first half, but capex spending on infrastructure - roads and highways, shipping, power and affordable housing was slower till August. However, from September, there has been some pick-up that, if sustained, should have mildly positive spillovers.

Private consumption growth, benefiting from a weak base, printed higher in Q2 but its growth rate nearly halved on-year and versus first half of last fiscal as consumer sentiment stayed muted.

Lower external trade (exports–imports) gap also helped growth.

On the supply side, weakness in manufacturing is worrisome with gross value added (GVA) by the sector contracting in Q2. The construction sector, too, posted weak numbers, while overall industry GVA was stagnant. Within services, the trade, hotels, transport and communications segment was the weakest. Here too, government spending saved the blushes.

A major worry is the sharp fall in nominal growth to 6.1% in Q2 – the lowest in the new GDP series. We expect nominal GDP this fiscal to average 8.9% as against the budget estimate of 12%. This will impact tax collection and fiscal ratios.

Our view

The weakness in the financial sector is aggravating the demand-led slowdown. Decelerating global growth, falling trade intensity, and uncertainties stemming from US-China trade war are hurting, too.

There is also an atypical brake at work – the clean-up of the financial sector happening after almost 20 years. That can stretch the slowdown, particularly because policy space for counter-cyclical action is limited with tax revenue way behind target. Recent data shows that government has decided to speed up spending to support the economy. It now becomes important to fast-track non-tax revenue generation through divestments and asset monetisation to keep the fiscal deficit under check.

Monetary policy transmission has also been weak, and financial sector stress and risk aversion have adversely impacted credit flow *(See box, Anatomy of a slowdown).*

We revise down our growth forecast for fiscal 2020 to 5.1%, from 6.3% estimated earlier. Weak growth in the first half of this fiscal and just a mild recovery in the second half will drag down our GDP forecast significantly. We believe the second half will see mild pick-up in growth led by adequate monsoon and the support to the rural

economy, some delayed impact of repo rate cuts, and spillover of recent pick-up in government spending. Low-base effect (GDP growth was 6.2% in the second half of fiscal 2019) will also help.

Highlights

GDP growth plunged to a 26-quarter low of 4.5% in Q2 from 5% in Q1, which means growth in the first half was 4.8%, significantly below the 7.5% seen in the same period of fiscal 2019.

- From the demand-side, **fixed investment growth** fell sharply to 1% from 4% in Q1. Growth in the first half stood at 2.5%, well below the 12.5% seen last fiscal. Government consumption growth of 15.6% salvaged otherwise dismal numbers
- Monthly data show overall government capex between April and August rose 6.5% on-year, compared with 16.4% in the corresponding previous period. Spending on roads and highways, shipping, power and affordable housing hard-braked, which had a negative rub-off on sectors such as cement and steel

  Pradhan Mantri Gram Sadak Yojana data suggests rural road construction in the first half declined to ~35 km per day, well below the 56 km per day in the same period last fiscal. And Pradhan Mantri Aawas Yojana-Gramin data as per the website show affordable houses built in rural areas nosedived to 31,000 per month from 8 lakh in the same period last fiscal
- **Private consumption growth** at 5.1%, was slightly higher in Q1 compared with Q2 as it benefited from a weak base. But growth nearly halved when compared with last year's Q2 as consumer sentiments stayed muted. Growth in H1 was at 4.1%, down from 8.5% in H1 of last fiscal. Several short term indicators such as sales of auto, consumer durables and core imports had already pointed towards continued sluggishness in domestic demand

  Domestic sentiments – both at the household and corporate level – remain subdued despite monetary policy turning supportive. RBI's Consumer confidence index was at a 30-quarter low in Q2, while the industrial outlook survey shows sentiments at a 42 quarter low. As per CRISIL's analysis, aggregate preliminary results[1] (excluding BFSI and oil companies) show 2.1% on-year revenue decline for corporate India in Q2 on account of muted private consumption demand
- What supported growth was higher **government consumption** (15.6% growth in Q2 and 12.3% in H1) and a reduction in the **external trade** gap. Government revenue spending was higher in the first half, on transfer to states, defence expenditure and interest payments

  Meanwhile a sharp 6.9% fall in imports in Q2 (-1.6% in the first half) relative to exports, which fell 0.4% (but had risen 2.6% in the first half) reduced the trade deficit by over 30% in Q2 (18% in H1) compared to a year ago - implying that imports are subtracting less from growth
- On the supply side, growth in GVA slowed 60 basis points to 4.3% over Q1 as industry growth slackened (0.5% compared with 2.7% in Q1). Much of this was due to manufacturing, which contracted 1% over an already low 0.6% in Q1. Low domestic and global demand has been hurting. Construction growth suffered (down 240 bps to 3.3% over Q1) because of extended and heavy monsoon, and slack government capex spending. The services sector held up (6.8% growth versus 6.9% in Q1) supported by government revenue spending on public administration and defence. Within services, trade, hotels, transport and communications saw a sharp fall in growth

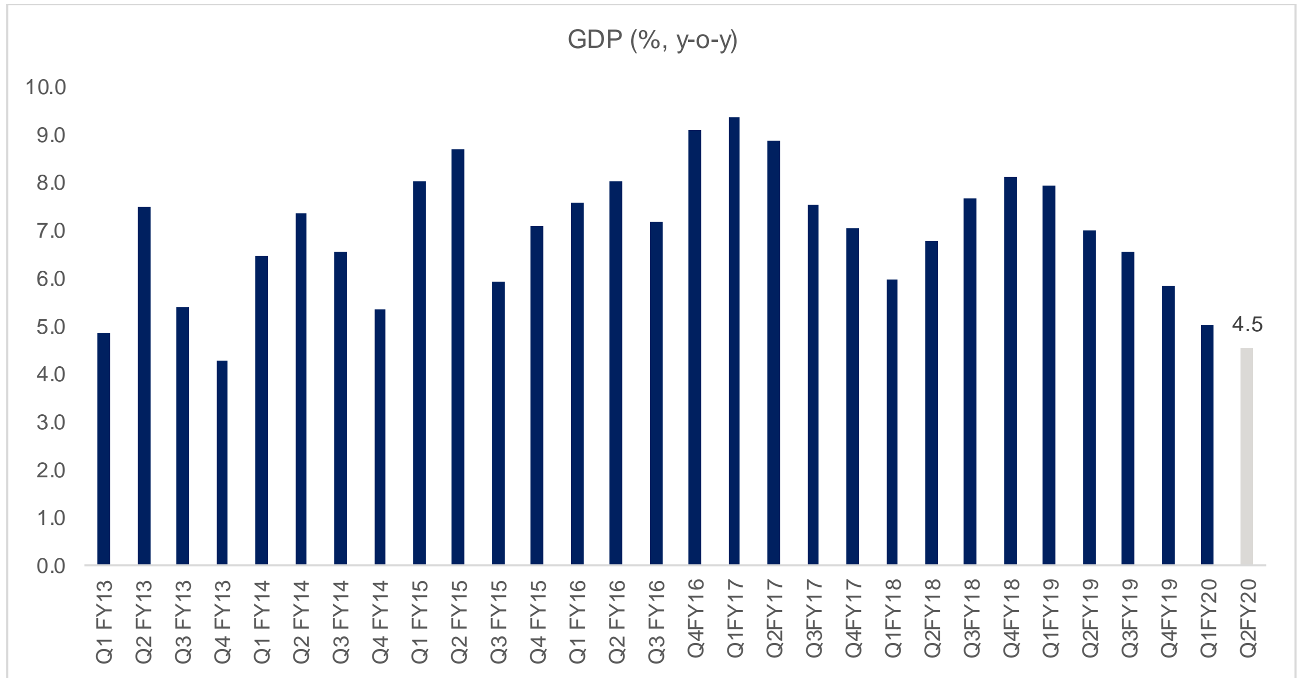
[1] Preliminary analysis by CRISIL Research using results data from 295 companies comprising ~60% of the National Stock Exchange's market capitalization (excluding financial services and oil companies)

- Agriculture growth at 2% was weak for two reasons: a strong-base effect, and delayed start to monsoon along with heavy and unseasonal rains hurting kharif production. But the coming quarters could see growth rebounding as healthy groundwater and reservoir levels prop the rabi crop
- Early indicators show the growth picture for Q3 is hazy, but there could be some signs of improvement. For example, auto sales remain negative, but the pace of decline is slowing. Similarly, government spending on infrastructure is ticking up, which should benefit related sectors (*chart 4*)

Anatomy of a slowdown

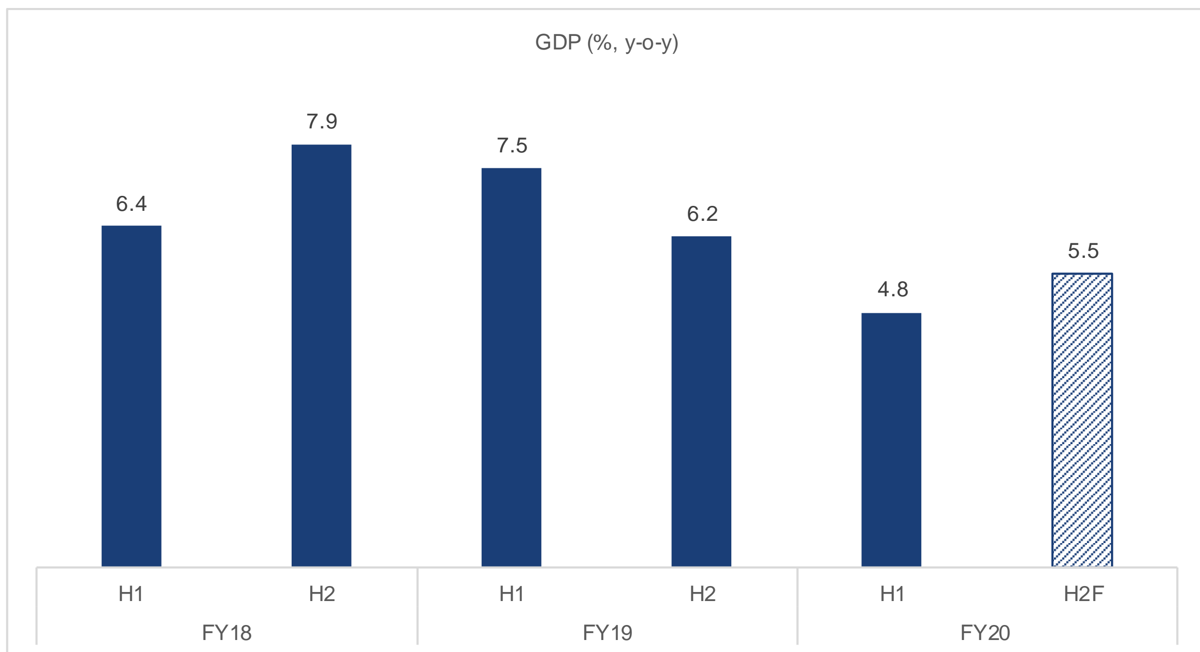
- **It runs deep:** The Indian economy is going through a deeper than anticipated slowdown, as weakness in the real sector and stress in the financial sector feed into each other. Additionally, slowing global economic growth, falling trade intensity, and uncertainty over the US-China trade conflict are posing obstacles. The slowdown is also atypical as it is accompanied by the first clean-up of the financial sector in nearly two decades. With government wherewithal also limited, the slowdown can stretch
- **Large reforms in recent years:** Reforms measures such as inflation targeting by the Reserve Bank of India (RBI), implementation of the Insolvency and Bankruptcy Code (IBC) and the Real Estate (Regulatory and Development) Act are positives over the long term, but they are drags in the short term. The implementation of the Goods and Services Tax (GST) in 2017 created more headwinds and hit government's tax collection. The payoff from these reforms are getting delayed because of the adjustment process is taking time
- **Big regulatory actions:** A number of sectors have borne the brunt of regulatory changes in recent years. The ensuing period of adjustment has weighed down business performance. Several sectors were already facing the heat from both, the domestic and global economic slowdown. Moreover, large regulatory changes occurred in the automobiles sector in 2017, while banking and non-banking sectors are going through a clean-up. Government did announce some measures to address these issues which should bear fruit over the medium term
- **Downturn is sharper and can be prolonged**: That's because the financial system – which plumbs the economy– is clogged. While demand for credit is weak, its supply is also constrained. Risk aversion has meant caution on lending. Transmission of monetary policy is also restrained because of the stress. Consequently, green shoots of growth will take time to show up

Chart 1: Growth at a 26-quarter low



Source: National Statistics Office (NSO), CRISIL

Chart 2: Second half of fiscal 2020 to see a mild pick-up in growth



Source: NSO, CRISIL

Chart 3: Growth in the sub-components of GDP

	Q2FY19	Q1FY20	Q2FY20	H1FY19	H2FY20
Private consumption	9.8	3.1	5.1	8.5	4.1
Government consumption	10.9	8.8	15.6	8.7	12.3
Investment	11.8	4.0	1.0	12.5	2.5
Exports	12.7	5.7	-0.4	11.4	2.6
Imports	22.9	4.2	-6.9	16.9	-1.6
GDP	**7.0**	**5.0**	**4.5**	**7.5**	**4.8**

	Q2FY19	Q1FY20	Q2FY20	H1FY19	H2FY20
Agriculture	4.9	2.0	2.1	5.0	2.1
Industry	6.7	2.7	0.5	8.2	1.6
Manufacturing	6.9	0.6	-1.0	9.4	-0.2
Mining	-2.2	2.7	0.1	-0.7	1.6
Construction	8.5	5.7	3.3	9.1	4.6
Electricity, gas, water supply	8.7	8.6	3.6	7.7	6.1
Services	7.3	6.9	6.8	7.2	6.8
Trade, hotels, transport, communication	6.9	7.1	4.8	7.4	6.0
Financial, real estate, professional services	7.0	5.9	5.8	6.8	5.9
Public administration, defence	8.6	8.5	11.6	8.1	10.1
GVA	**6.9**	**4.9**	**4.3**	**7.3**	**4.6**

Source: NSO, CRISIL

Chart 4: Indicators on the ground suggested a weaker Q2, signals about Q3 hazy

High frequency indicators (%, y-o-y)		Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Oct-19
Consumers	Rural terms of trade	1.0	1.0	1.0	1.0	1.0	1.0	0.9	0.9	0.9	1.0	1.0
	Consumer durables IIP	-1.2	-0.7	-1.2	7.1	8.1	8.3	6.2	0.0	-2.6	-7.2	n/a
	Consumer non-durables IIP	7.8	7.2	16.3	10.7	2.0	6.1	4.9	3.4	7.0	3.7	n/a
	Two wheeler sales	7.8	12.5	20.8	25.2	16.2	5.1	7.4	-8.9	-11.6	-20.4	-14.4
	Car sales	3.7	9.1	-0.3	1.0	19.6	-2.3	-0.8	-4.6	-23.3	-36.8	-6.3
	Retail credit	14.1	15.9	17.4	19.4	18.5	16.7	17.0	16.6	16.4	16.4	n/a
	Consumer-oriented core imports	41.9	26.2	20.6	8.4	-5.8	6.3	-4.7	-5.4	-6.7	-5.6	-7.8
	Consumer-oriented IIP manufacturing	3.1	2.7	7.9	6.9	4.1	6.2	2.9	1.3	1.0	-2.0	n/a
Business (Industry)	Cement production (IIP)	-3.3	0.6	11.1	18.7	16.4	12.5	13.0	11.6	1.1	0.3	n/a
	Steel consumption	6.7	6.1	7.4	8.0	9.7	10.6	9.3	9.2	3.2	5.8	0.2
	Manufacturing IIP	1.6	2.5	7.0	7.6	5.1	5.7	3.5	1.3	2.4	-0.3	
	PMI Manufacturing	51.7	50.1	52.5	51.8	52.0	52.1	53.4	53.6	52.2	51.8	50.6
	Industrial credit	-1.5	-0.3	1.0	0.9	1.1	1.5	4.0	5.9	6.6	4.2	
	Commercial paper (o/s)	12.1	-2.2	19.8	11.9	23.5	69.7	20.1	19.9	14.0	-19.7	-21.3
	External commercial borrowings (o/s)	1.1	2.2	2.8	2.5	2.6	2.9	2.4	5.8	4.0	4.4	n/a
	Capital goods IIP	-4.2	4.9	7.4	8.6	8.6	6.5	5.7	-7.4	-3.5	-16.4	n/a
	Tractor sales	9.6	32.7	13.7	41.8	22.9	2.9	17.7	-6.3	-14.4	-11.5	-5.0
	Commercial vehicle sales	-9.3	20.8	36.6	31.9	53.7	27.8	7.5	0.7	-9.4	-34.5	-23.3
	Railway freight cargo	3.8	6.4	4.2	4.8	6.4	4.4	6.0	4.6	2.7	-3.7	-8.1
	Export growth	8.8	12.1	14.9	6.2	14.7	10.8	5.1	6.4	-1.3	-3.7	-1.1
	Investment oriented IIP manufacturing	-0.8	2.1	5.6	8.8	6.9	4.7	4.5	1.3	4.8	2.6	n/a
Business (Services)	PMI-Services	51.8	48.0	50.4	49.9	51.2	52.2	53.0	52.2	50.3	51.6	49.2
	Services credit	4.3	5.6	12.7	13.7	22.0	24.6	26.2	21.8	14.9	11.9	n/a
	Domestic airline passenger traffic	17.4	14.7	17.9	22.8	19.6	18.8	11.9	3.9	-0.7	1.5	n/a
	Number of telecom subscribers	13.8	13.8	5.9	0.1	-4.0	-1.9	0.2	0.9	2.4	0.5	n/a
	Services export	0.1	1.7	13.1	19.8	27.5	24.4	13.1	6.9	9.4	8.7	n/a
Central government finances	Gross tax revenue **(ytd)**	6.4	19.5	21.1	-2.8	14.1	8.6	4.2	10.7	2.7	-4.8	-0.7
	Capex **(ytd)**	n/a	n/a	n/a	n/a	19.3	13.9	-3.7	16.1	-18.5	17.6	16.7
	Roads and highways **(ytd)**	n/a	n/a	n/a	n/a	49.0	14.4	-12.2	33.3	-97.7	1.7	1.5
	Shipping **(ytd)**	n/a	n/a	n/a	n/a	-14.0	1.8	2.6	-15.4	-35.8	34.2	34.7
	Housing **(ytd)**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	67.2	30.5	16.2
	Rural development (ytd)	n/a	n/a	n/a	n/a	27.3	11.0	4.2	3.0	-22.0	-2.3	1.5

Note: Red denotes worsening, green improvement, and yellow shows little to no change
Source: CRISIL

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