Research

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Sinking deeper

Lockdowns and restrictions have hit harder than expected

June 1, 2020

Covid-19 strikes bigger blow to services

That the fourth-quarter (Q4) gross domestic product (GDP) growth would plunge more than previously expected was a given. Hard data on industrial production, exports, auto sales and freight transport, among others, had hinted the hit from global slowdown and just a week of domestic lockdown in March had caused much pain.

The fourth quarter and full-year provisional estimates for fiscal 2020 brought more clarity on the extent of this pain. GDP in the fourth quarter grew 3.1% compared with 4.1% in the third quarter. The fiscal 2020 growth estimate is now 4.2% compared with 6.1% in fiscal 2019.

CRISIL sees the Indian economy contracting 5% in fiscal 2021. While we expect non-agricultural GDP to de-grow 6%, agriculture could cushion the blow by growing at 2.5%. ***This is premised on the following: an extension of restrictions and lockdown, especially in states where Covid-19 cases are still rising; a normal monsoon that supports the kharif crop and agriculture incomes; softer crude oil prices; and, limited fiscal support to prop up an immediate growth revival. Overall, risks remain tilted to the downside and hinge on further extension in containment measures, slipping of global growth and a sub-normal monsoon.*** Our recent report, *Minus five*, details these assumptions and risks.

The latest GDP release by the National Statistical Office (NSO) highlights three key trends:

- ***Services suffering more than industry.*** For Q4 of fiscal 2020, services sector growth slipped to 4.4% from 5.7% in the third quarter (Q3). The hardest hit were trade, hotels, transport, communication and storage – sectors that would have come to a near standstill due to the lockdown. These sectors are set to sink deeper in the first quarter (Q1) of fiscal 2021.

  The industrial sector contracted for the second consecutive quarter led by a sharp fall in manufacturing activity. The impact was, however, cushioned somewhat by the strong performance of electricity and mining. The bigger blow to manufacturing in Q4 is possibly because of the dip in merchandise exports. A rough classification using IIP manufacturing data as proxy for the quarter, suggests a sharper fall in output of labour-intensive sectors relative to capital-intensive sectors suggesting. This raises worry on the job front.

- ***Farm to the rescue***. Robust agriculture growth played a huge role is cushioning growth in Q4. The sector – which is also expected to do well in fiscal 2021 – grew 5.9% which is the highest growth in eight quarters. If not for the outperformance of this sector, overall gross value added (GVA) growth would have plunged deeper. **GVA grew 3% in Q4 compared with 3.5% in Q3. Excluding agriculture, GVA growth is down to 2.5% from 3.4% in Q3**.

- ***Bigger role for government***. The heft of the government in driving growth was seen in Q4 data as well. Government consumption spending saw a double-digit growth for the third consecutive quarter. We believe this will continue in fiscal 2021 as fiscal spending on stimulus measures gathers speed. The role of private sector in supporting growth will stay weak. In Q4, private consumption growth at 2.7% was the slowed in 21 quarters while fixed investments contracted for the third consecutive quarter.

Highlights

- On the demand side, **fixed investment growth** fell sharply by 6.5% in Q4, from -5.2% in Q3 and -3.9% in Q2. A sharp slowdown in government capex spending in addition to a weaker private capex appetite has likely caused this drop. For fiscal 2020, fixed investment growth fell 2.8% after growing 9.8% in fiscal 2019.
- **Private consumption growth** at 2.7% is the lowest in 21 quarters, having plunged from 6.6% in Q3. A sharp slowdown in incomes has dented consumer sentiment and kept private consumption growth weak. For fiscal 2020, private consumption growth was at 5.3%, compared to 7.2% in fiscal 2019.
- What supported growth for the third quarter in a row was higher **government consumption** (13.6% growth in Q4). Exports, at -8.5%, fell sharper than imports at -7% in Q4.

  Meanwhile, for the full year, a sharper fall in imports (-6.8% in fiscal 2020) relative to exports (-3.6%), brought about a 30% reduction in the trade deficit from a year ago
- **On the supply side**, GVA growth slowed to 3% in Q4 from 3.5% in Q3. Much of this slowdown came from services, although the industry sector continued to post a contraction for the second quarter in a row. Agriculture growth at 5.9% outperformed in Q4 led by healthy progress in the rabi crop.

Early indicators suggest more pain for the first quarter

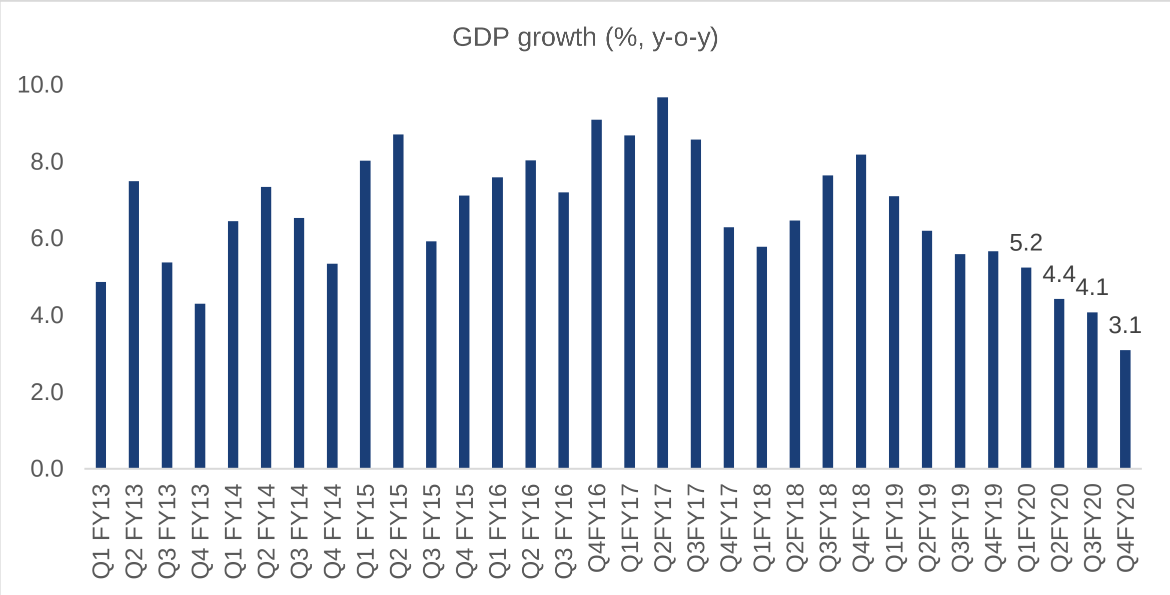
The government extended the lockdown five times to deal with the rising number of cases, curtailing economic activity severely. Despite easing of restrictions, the first quarter of this fiscal will be the worst affected. June is unlikely to see major relaxations despite the Covid-19 affliction curve yet to flatten. Not only will the first quarter be a washout for the non-agricultural economy, services such as education, and travel and tourism among others, could continue to see a big hit in the quarters to come. Jobs and incomes will see extended losses as these sectors are large employers. CRISIL also foresees economic activity in states with high Covid-19 cases to suffer prolonged disruption as restrictions could continue longer.

Additionally, the economic costs now beginning to show up in the hard numbers are far worse than our initial expectations. The purchasing managers indices (PMIs; released by IHS Markit) for the manufacturing and services sectors were at 27.4 and 5.4, respectively, in April, implying extraordinary contraction. That compares with 51.8 and 49.3, respectively, in March. Exports contracted 60.3% in April, core sector output contracted 38%, there were no sales in the auto segment and new telecom subscribers declined 35%, while railway freight movement plunged 35% on-year.

We believe successive lockdowns have a non-linear and multiplicative effect on the economy – a two-month lockdown will be more than twice as debilitating as a one-month imposition, as buffers keep eroding. Partial relaxations continue to be a hindrance to supply chains, transportation and logistics. Hence, unless the entire supply chain is unlocked, the impact of improved economic activity will be subdued.

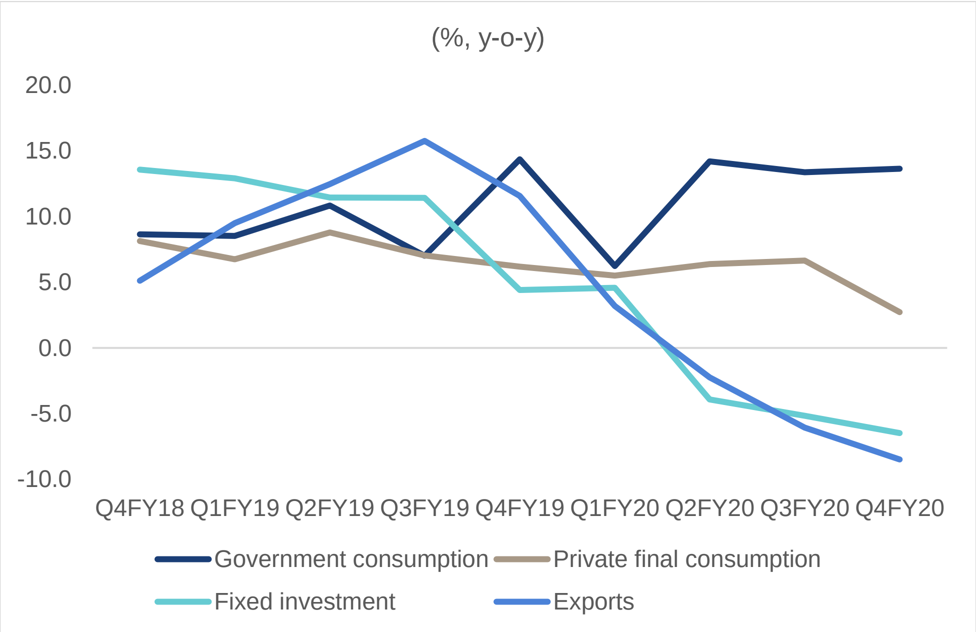
Therefore, despite the stringency of lockdown easing in the third, fourth and fifth phases, their negative impact on GDP is expected to massively outweigh the benefits from mild fiscal support and low crude oil prices, especially in the April-June quarter. Consequently, we expect the current quarter's GDP to shrink 25% on-year.

Chart 1: Exports slowdown and domestic lockdown causes growth to plunge



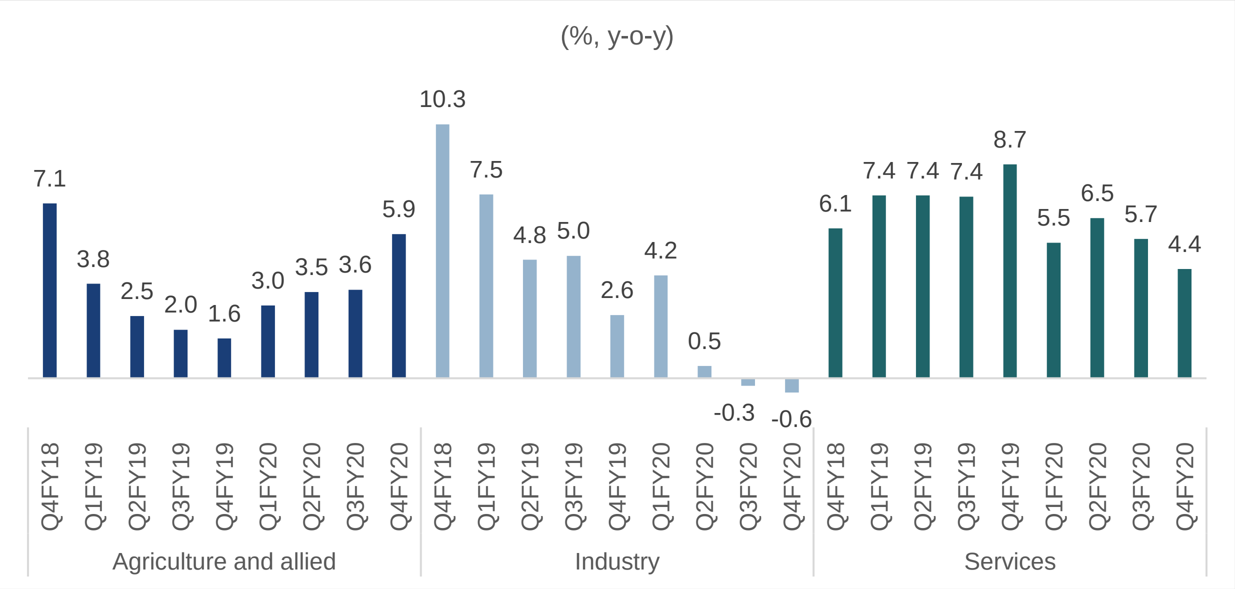
Source: National Statistics Office, CEIC, *CRISIL*

Chart 2: Growth drivers and laggards (demand-side)



Source: National Statistics Office, CEIC, CRISIL

Chart 3: Growth drivers and laggards (supply-side)



Source: National Statistics Office, CEIC, CRISIL

Analytical contacts

Dharmakirti Joshi
Chief Economist, CRISIL Ltd.
dharmakirti.joshi@crisil.com

Dipti Deshpande
Senior Economist, CRISIL Ltd.
dipti.deshpande@crisil.com

Media contacts

Saman Khan

Media Relations
CRISIL Limited
D: +91 22 3342 3895
M: +91 95940 60612
B: +91 22 3342 3000
saman.khan@crisil.com

Hiral Jani Vasani

Media Relations
CRISIL Limited
D: +91 22 3342 5916
M: +91 982003 9681
B: +91 22 3342 3000
hiral.vasani@crisil.com

Parmeshwari Bhumkar

Media Relations
CRISIL Limited
D: +91 22 3342 1812
M: +91 841184 3388
B: +91 22 3342 3000
parmeshwari.bhumkar@crisil.com

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CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India

Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited /lifeatcrisil

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