Macroeconomics | First cut

Signs of moderation

November 29, 2024

Manufacturing and investments hit the brakes

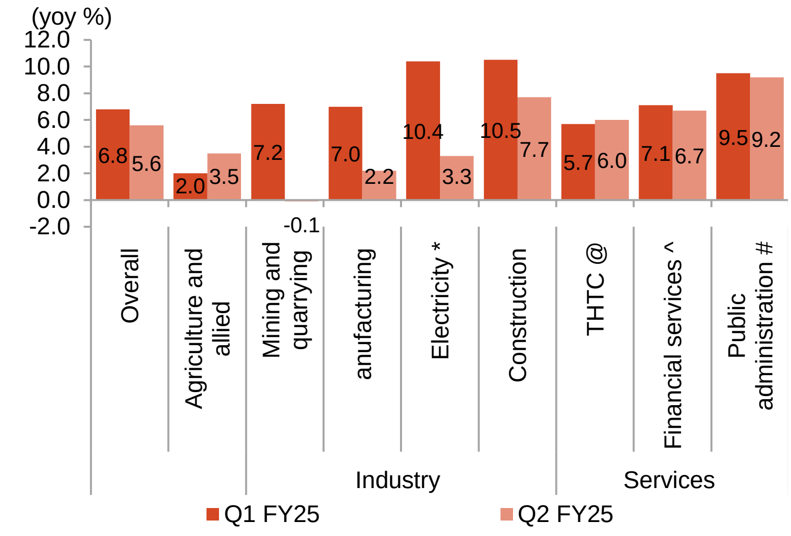
Key takeaways from the second-quarter GDP data

- **Gross domestic product (GDP) growth slowed sharper than expected**: GDP grew 5.4% on-year in the second quarter of this fiscal, a sharp deceleration from the 6.7% in the first quarter of fiscal 2024. This comes over high growth in the second quarter of fiscal 2024, in which the economy had grown 8.1%
- Gross value-add (GVA) moderated to 5.6% in the second quarter versus 6.8% in the previous quarter
- **Nominal GDP moderated as well, to 8.0% from 9.7%** in the first quarter of this fiscal; it was also lower than the 9.6% recorded in the year-ago quarter

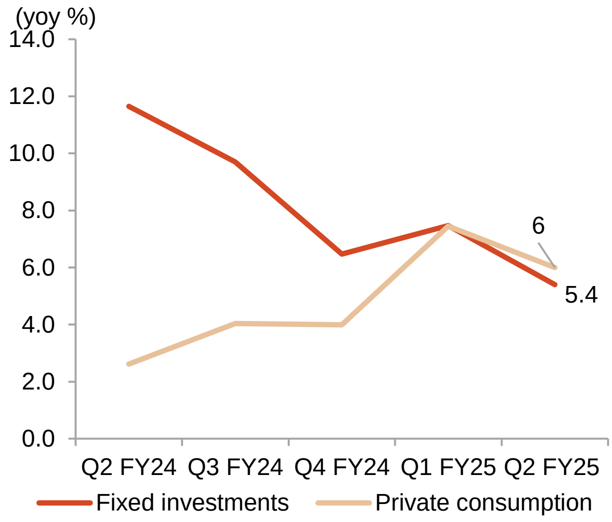
Factors contributing to the slowdown

- **On the demand side, moderation in consumption and investment growth** were a drag on GDP growth. The slowdown was sharper in investment, which was weighed down by continuing weakness in government capex. At the same time, consumption moderated with elevated borrowing costs and inflation eating into household budgets. However, improving agriculture and government consumption spending likely supported consumption
- From the supply side, **manufacturing growth slowed sharply** compared to the first quarter of fiscal 2025, weighed down by weaker domestic demand and worsening export performance. **Services in comparison maintained its momentum of over 7% growth**. That said, **agricultural growth picked up**, supported by healthy kharif sowing on the back of an above-normal monsoon
- The base effect also played a role in slowing growth in fixed investments and industry

Industry crawled; agriculture picked up in Q2



Investments slowed more than consumption



Note: THTC: Trade, hotels, transport and communication. # Electricity, gas, water supply and other utility services. @ Trade, hotels, transport, communication and services related to broadcasting, ^ Financial, real estate, and professional servicesC. # Public administration, defence, and other services

Source: National Statistical Office (NSO), CEIC, CRISIL

The fine print

Improving agriculture, slowing industry

- **GVA growth marginally higher than GDP growth:** On the supply side, the 5.6% GVA growth was marginally higher than the 5.4% GDP growth since growth in net taxes slowed (2.7% vs 4.1%)

- GVA growth for agriculture picked up further (3.5% vs 2.0% in the previous quarter). Higher growth in agriculture and allied activities was driven by healthy kharif sowing (up 1.9% on-year and 1.7% with respect to the normal sown area[1]) on account of the above-normal monsoon. Growth in the first half of this fiscal thus remains broadly in line with the corresponding period last year (2.7% vs 2.8%)

  Industry growth slowed significantly (3.6% from 8.3% in the previous quarter) on the back of stuttering domestic demand and merchandise exports. Within industry, manufacturing growth fell sharply, to 2.2% in the quarter from 7.0% in the previous quarter. Subsector-wise, Index of Industrial Production (IIP) data indicated slowing growth in the output of primary goods, infrastructure and construction goods as well as consumer durables in the second quarter, while consumer non-durables output contracted further. Industrial growth slowed substantially in the first half of this fiscal compared with the previous fiscal (6.1% vs 9.7%).

  Construction GVA moderated but remained healthy (7.7% vs 10.5%).

  Heavy rains also led to a contraction in mining output (-0.1% vs 7.2%) and significant slowdown in electricity output (3.3% vs 10.4%)

[1] Average sown area as of the corresponding date in the previous five years (2019-2023)

- Services growth stayed steady (7.1% vs 7.2%)
  - THTC[2] growth picked up slightly, to 6.0% from 5.7% in the previous quarter
  - Growth in financial, real estate and professional services moderated slightly to 6.7% from 7.1%
  - Public administration, defence and other services decreased slightly as well, to 9.2% vs 9.5% in the previous quarter

However, growth in the services sector slowed substantially in the first half of the fiscal compared with the same period last year (7.1% vs 8.3%).

Consumption and investment moderate

- **Private consumption lags:** Private final consumption expenditure (PFCE) moderated to 6.0% in the second quarter from 7.4% in the previous quarter. High frequency indicators suggest weaker urban demand is likely to have led the slowdown.

  Elevated food inflation has been exerting a substantial strain on the finances of lower-income households in rural and urban areas. It has led to lower sales growth of discretionary items such as fast-moving consumer goods (FMCG)..

  The urban economy faced a double whammy of high inflation and slowing credit growth. The latest Reserve Bank of India's (RBI) survey released in October indicated consumer confidence in urban areas moderated on average in the second quarter versus the previous one, with price levels being one reason. PLFS (Periodic Labour Force Survey) data shows urban wage growth was becoming sluggish over fiscal 2024, particularly for non-salaried workers. Bank retail credit growth, which has a higher footprint in the urban economy, moderated in second quarter following a rise in lending rates.

  In contrast, rural wage growth stayed healthy this quarter. This, along with declining job demand under the National Rural Employment Guarantee Act (MGNREGA), indicate improvement in rural conditions in the second quarter. The better monsoon has have augured well for agricultural activity. Indeed, commentary from key FMCG companies indicates demand in the second quarter was better from the rural economy compared with the urban.

  That said, consumption grew faster in the first half of this fiscal against the corresponding period in the previous year (6.7% vs 4.0%). It also grew faster than the headline GDP number this quarter.

- **Fixed investment**, as measured by gross fixed capital formation (GFCF), moderated in the second quarter (5.4% vs 7.5%), with government capex growth weighed down by a 1.7% contraction in state capex even as central capex revived (10.3% growth in the quarter). This kept GFCF growth in the first half of this fiscal at a substantially lower clip than the corresponding period last year (6.4% vs 10.1%).

- **Exports slow sharply while imports contract:** Exports of goods and services fell sharply to 2.8% on-year in the second quarter vs 8.7% in the preceding one. This was led by a broadbased slowdown across merchandise exports of oil, gems and jewellery, organic and inorganic chemicals, and petroleum products. Meanwhile, import growth of goods and services fell as well (-2.9% vs 4.4% in the previous quarter).

- **Government** consumption spending, as measured by government final consumption expenditure (GFCE), rebounded in the second quarter after contracting in the previous quarter (4.4% vs -0.2%). This is likely to have supported private consumption to some extent. However, growth in the first half of this fiscal was significantly lower than the same period last fiscal (2.0% vs 6.2%).

[2] Trade, hotels, transport, communication and services related to broadcasting

Outlook

We expect GDP growth to slow to 6.8% this fiscal after a high growth of 8.2% last year, weighed down by high interest rates and low fiscal impulse. Risks are tilted toward the downside given the lacklustre second quarter growth number. However, certain high frequency indicators from October such as automobile sales and export growth are showing encouraging signs of a revival in the third quarter, indicating the slowdown in the second quarter could be transitory.

Agricultural growth has risen and is likely to increase further due to expectations of a healthy kharif harvest on account of the monsoon being 8% above the Long Period Average at the season's end. Higher reservoir levels also bode well for rabi output. All this should provide a fillip to agricultural incomes and rural consumption.

Additionally, increased kharif arrivals into the market are likely to ease the pressure on food inflation, which has been elevated for several months, eroding the purchasing power of both rural and urban households. Easing inflation, along with the onset of the festive and wedding season, is likely to buoy consumption growth in the second half of this fiscal. While elevated borrowing costs continue to hobble consumption in urban areas (retail credit growth has been visibly slowing in recent months), the pickup in rural consumption is expected to more than offset any slowdown on the consumption side.
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While government capex has rebounded in the second quarter and is likely to pick up further as state capital expenditure revives, investment prospects largely hinge on a sustained pickup in private capex which, in turn, depends on the extent of increase in domestic demand.

Exports will have to navigate increased uncertainties arising from Donald Trump's re-election and the possibility of the United States (US) imposing tariffs on China and global exports. At present, S&P expects US growth to slow to 2% in 2025 (calendar year) compared with 2.7% in 2024 and China to 4.1% from 4.8%. While US growth remains above the trend, China will be below. It should be noted that the US is a bigger export market for India than China.

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