

INDIA REACT: GDP Jumps in 2Q, But Masks Sequential Slowdown (1)

By Abhishek Gupta (Economist)

(Bloomberg Economics) --

OUR TAKE: India's GDP growth vaulted higher in the second quarter, primarily aided by a low base as the second virus wave cratered output in the year-ago period. The data, however, masks a sequential slowdown. Quarter-on-quarter output contracted at a larger pace than the typical seasonal drop, while year-on-year growth was sharply lower than the Reserve Bank of India's forecast, suggesting the central bank might be nearing the end of rate hikes.

- GDP growth jumped to 13.5% year on year in 2Q 2022, up from 4.1% in 1Q. That was lower than both the Bloomberg Economics forecast of 14.0% and consensus estimate of 15.3%.
- Growth in gross value added -- which strips out tax and subsidy transfer payments -- came in even lower at 12.7% year on year, below both our forecast of 13.3% and the consensus estimate of 14.0%.
- On a sequential basis, GDP growth contracted by 9.6% -- that's a much larger contraction than the typical 2Q seasonal drop of 7%. This likely reflects the impact of headwinds ranging from a slowing global economy, rising domestic and global interest rates, and inflationary pressures hurting both consumers and firms.
- GDP growth came in sharply below the RBI's estimate of 16.2%. This confirms our view that the central bank is nearing the terminal policy rate. We expect the RBI to raise the repo rate -- currently at 5.4% -- to a terminal level of 6% by December.
- Looking ahead, we see the pace of recovery slowing further in the near term. The RBI's rapid pace of rate hikes since April has resulted in a sharp rise in borrowing costs, while the slowing global economy is likely to hamper demand for domestic goods and services.
- We expect GDP growth to slow to 6.7% year on year in 3Q and 5.1% in 4Q. For the full fiscal year through 1Q 2023, we expect GDP growth to slip to 7.2%, down from 8.7% in fiscal 2022.

Growth Jumps, But Pace of Recovery Slows

Source: Bloomberg Economics, MoSPI

While near term headwinds remain, we are optimistic for India's recovery prospects over the medium term. On a sequential basis, we expect the growth slowdown to hit a trough at year-end and the economy to experience a rapid recovery starting early-2023.

- Fiscally expansive steps to curb inflation have helped counter some of the global headwinds. This also means the central bank is unlikely to raise interest rates into restrictive territory. That should allow a more sustained recovery going forward.
- On a realized basis, we expect the real policy rate to remain negative until February 2023 and below 1% at least until the end of 2023.

- The country has inked new free trade agreements with Australia and the UAE this year and another with the UK is expected soon. This is likely to open new export opportunities for India's manufacturers and provide a cushion against the global slowdown.
- The cumulative rewards of all the structural reforms initiated by the government since 2015 -- unification of indirect taxes, corporate tax cuts, banking sector clean up, capacity building in renewable energy, cash subsidies to boost manufacturing, privatization of public assets -- should finally start to kick in as the economy recovers from the shadows of the pandemic.

GDP Growth By Sector

Source: MoSPI