India Q3 FY2021 GDP Preview: Fledgling recovery on the cards

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Estimates for GDP growth for Q3 FY2021 (October-December 2020) will be released at the end of this month. We expect GDP to have risen by ~0.5-0.7% YoY in October-December 2020. The festive quarter saw consumption impetus for goods and available services return in a large measure, continuing the realization of pent-up demand incipient since September, along with festive demand. Government spending also stepped up sharply with a focus on capex, adding acceleration to growth over Q3. Net exports are expected to have contributed positively to GDP growth in Q3, though to a much lesser extent than that seen in Q2, as a recovery in imports occurred across segments. Investment saw anecdotal green shoots in areas of cement, aluminium, realty, among others, which was a welcome takeoff after a long hiatus, though sustainability needs to be monitored.

On a sectoral basis, agriculture is likely to continue to support growth amid robust *rabi* sowing. The key sectors of manufacturing and construction are expected to display continued recovery in Q3 FY2021. The improvement is validated by the movement seen in high frequency data reflecting in our proprietary UFI index, which averaged close to pre-COVID levels in Q3 FY2021, and a healthy earnings performance of India Inc. on the back of rise in demand, as well as continued cost saving. **Consequently, the first industrial value addition for this fiscal can be expected in Q3.** The services sector could still show a marginal contraction, though significant sequential improvement is likely across all sub-sectors, given festive demand, Government spending and traction in real estate.

On the basis of the high frequency data for Q3 and Q4 available so far, the improving economic scenario could well mean an overshoot of the modest recovery pegged by the Government's Advance Estimates. **Thus, we continue to peg the expected GDP print for FY2021 at -6.7% YoY. We have revised our FY2022 growth projection higher from 9.5% YoY seen at the beginning of January, and expect growth to rebound to ~10.5% YoY in FY2022.** We take a look below at how some of the lead indicators for growth panned out in October-December 2020.

Lead indicators for services sector:

- **The month of December saw domestic passenger traffic by airlines going back to the levels seen in March 2020,** as some impetus to travel returned after prolonged confinements. A lowering in the rates of infection, as well as less stringent state quarantine rules inspired travels, aiding a stressed aviation sector, which notched up passenger load factors in the range of 65-80%. **Railway freight traffic clocked an average growth of ~11% YoY over Q3, with robust growth in freight traffic for cement and iron & steel,** as growing industrial traction favoured demand for these. **Cargo traffic had remained unimpressive even after improvement in other transportation methods, but the same finally improved over November-December.**
- **The Government's spending momentum revived materially over October-December 2020 as compared to the previous quarter.** Excluding interest payments, revenue expenditure rose by 23% YoY in Q3 as compared to a contraction of 14% YoY in Q2 FY2021. Similarly, capital expenditure (excluding loans disbursed) rose by 24% YoY in Q3 as compared to a 36% contraction in Q2. **Thus, the Government spending components of GDP and GVA are likely to be sharply growth supportive for the October-December quarter.**
- **Services PMI averaged ~53.4 over Q3 FY2021, as compared to ~41.9 over Q2, with all three months showing a reading above 50.** This was even better than the ~51.7 average seen over Q3 of FY2020. The outlook for the service sector looks brighter now, with output and new business rising. However, concerns remain as hiring has slowed due to liquidity concerns, labour shortages and subdued demand. Additionally, pace of recovery across service sectors is highly uneven, with tourism and hospitality still quite strained.

- **Credit growth to services sector averaged ~9% over October-December 2020, which was marginally slower as compared to the trend seen over Q2.** Segments which saw credit growth pick up sequentially included transport operators and wholesale and retail trade, reflective of festive season impetus in demand. The tourism, hotels and restaurants sector saw a significant rise in credit allocation over November, as restaurant dining resumed in many states, and travel and hotel occupancy increased amid the festive season. Credit growth for professional services moderated very sharply over Q3, and may affect the concomitant GVA segment adversely. Real estate has been a sector which has developed traction post Q1. Anecdotally, there was a surge in apartment sales over Q3 FY2021, after a modest improvement over Q2, which has led to hopes of a recovery in the real estate sector taking off sooner than expected. First-time home buyers and resale flat buyers are now lured by a buyer-centric market, which is also attracting renewed interest of NRIs.
- **Automobile sales recovered significantly over Q3.** According to data from Ministry of Road Transport & Highways, growth in registrations for motor vehicles rose to 12% YoY in November, and further to 33% YoY in December from 5% YoY in October. Registrations for two wheelers also clocked a positive double-digit growth in December after a negative run since April. Steep festive discounts as well as anticipation of a rise in prices due to higher input costs from January 2021 stimulated pre-buying over that quarter.

(% YoY unless otherwise specified)		Domestic passenger traffic (people in millions)	Railway Freight traffic	Cargo traffic	Registered Light Motor Vehicles	Registered Two wheelers	Services PMI (value)	Revex less interest payments	Capex less loans disbursed	Credit to Services
Q3 FY20	Oct-19	23.88	-11.1	-5.4	10.9	6.2	49.2	32.0	5.9	6.5
	Nov-19	25.15	-2.8	0.0	5.0	4.8	52.7	16.5	-9.4	4.8
	Dec-19	25.29	-0.2	5.8	-6.7	-15.8	53.3	31.8	93.8	6.2
Q2 FY21	Jul-20	4.04	-7.7	-13.2	-6.7	-36.4	34.2	26.9	-46.2	10.1
	Aug-20	5.58	1.4	-10.4	7.5	-27.2	41.8	-19.6	-17.7	8.6
	Sep-20	7.79	17.9	-1.9	32.0	-11.0	49.8	-37.0	-37.3	9.1
Q3 FY21	Oct-20	10.32	11.0	-1.2	5.2	-25.3	54.1	-8.2	76.3	9.5
	Nov-20	12.52	8.4	2.8	12.3	-19.6	53.7	50.6	94.0	8.8
	Dec-20	14.44	13.5	4.4	32.9	12.5	52.3	31.3	-16.4	8.8

Source: CEIC, ICICI Bank Research

Lead indicators for industry:

- **Mining clocked a contraction in each of the three months of Q3 FY2021**, as growth in coal output moderated very sharply, and natural gas still remained in significant contraction. Crude oil output improved in annual terms, but was still modest. **Mining is expected to continue to subtract value from headline GVA over Q3.**
- **Manufacturing activity has seen robust fillip over October-December 2020, given demand recovery encouraging production across swathes of sectors**. If we measure the average performance of the Q3 index as % of the January 2020 index for the manufacturing industries within the IIP basket, complete normalization (>100%) has been achieved over Q3 by industries like electrical equipment, other transport equipment (barring motor vehicles & trailers) rubber & plastics, pharmaceuticals, wood & products, chemicals & products, and basic metals. Substantial normalization (>90% but <100%) has been achieved by other industries including motor vehicles & trailers, machinery & equipment, fabricated metal products, coke & refined petroleum products, and textiles. Other industries like food & tobacco products, leather & products, computer, electronic & optical products are on their way to recovery, though the path is much slower. **Manufacturing is likely to see a significantly high growth (3-5% YoY) and positive value addition to GVA over the concluded quarter, providing a significant recovery impetus to industry.**
- **Manufacturing PMI averaged 57.2 over Q3, improving sharply from 51.6 over Q2.** The recovery was broad-based, with marked expansions in both sales and output. According to the survey, by December, input buying by manufacturing firms increased at the fastest pace in nearly a decade to rebuild pre-production inventory, while the rise in new work led to a sharp decline in finished goods.
- **Electricity production was healthy over Q3,** and plant load factor for thermal electricity averaged 55.16 over October-December as compared to 52.56 over July-September. **Value addition from this component is likely to be high in Q3, given robust activity levels amid festivities.**

- **Construction is likely to continue its improving run into Q3 FY2021.** Core index for steel registered a mildly higher average growth over Q3 as compared to Q2, while the contraction in the index for cement narrowed substantially over the same period. A fall in the price of coking coal in the last few months after China banned imports from Australia has helped Indian steel makers show better profitability due to lower production costs. While cement demand in the north and eastern parts of the country is above pre-COVID levels, demand in the south is still low, while demand in the western parts of the country is improving, according to news reports. Growth in credit to construction averaged ~2.2% YoY in Q3 FY2021, as compared to ~6.7% YoY in Q2, on account of a high base. The performance of the IIP infrastructure and construction goods head was healthier over Q3 than over Q2. The impetus to value addition from the construction segment should improve in the quarters ahead, given the infrastructure push planned in the Budget.
- **Commercial vehicle registrations were still in the de-growth region, but the contraction narrowed sharply in December from previous months.** The improvement will continue with more activity in the coming months. The voluntary vehicle scrappage policy announced in the Union Budget is likely to benefit the sales of commercial vehicles like buses and trucks via the entire value chain ranging from vehicle makers to auto ancillary makers including component manufacturers. Moreover, given our expectation of revival in infrastructure, demand for CVs will likely improve going ahead.

(% YoY unless otherwise specified)		IIP	Mining	Manufacturing	Manufacturing PMI (value; <50: contraction)	Electricity	Core Industries
Q3 FY20	Oct-19	-6.6	-8.0	-5.7	50.6	-12.2	-5.5
	Nov-19	2.1	1.9	3.0	51.2	-5.0	0.7
	Dec-19	0.4	5.7	-0.3	52.7	-0.1	3.1
Q2 FY21	Jul-20	-10.5	-12.7	-11.4	46.0	-2.5	-7.6
	Aug-20	-7.1	-8.7	-7.6	52.0	-1.8	-6.9
	Sep-20	1.0	1.4	0.4	56.8	4.9	0.6
Q3 FY21	Oct-20	4.2	-1.3	4.1	58.9	11.2	-0.9
	Nov-20	-2.1	-6.7	-2.0	56.3	3.5	-1.4
	Dec-20	1.0	-4.8	1.6	56.4	5.1	-1.3

Source: CEIC, ICICI Bank Research

- **Credit growth to MSMEs accelerated over October-December 2020 from lower levels in Q2**. The Government's Emergency Credit Line Guarantee Scheme (ECLGS) was amended to focus on entities in 26 stressed sectors including power, construction, iron and steel manufacturing, roads, real estate, textiles, among others. Of the INR 3 tn available under the ECLGS, loans worth INR 2.14 tn were sanctioned till the end of Q3 (January 8, 2021). With relatively quick loan clearance and disbursement, the MSME segment is likely to continue seeing comparative relief over H2 FY2021, while better global trade momentum could help the export-focused ones.
- **Net exports are expected to contribute positively to GDP growth in the just-concluded quarter, but the contribution will likely be smaller than that seen over Q2,** as the contraction in merchandise imports (-5.6% YoY) was only slightly more than that seen in exports (-4.3% YoY). Renewed outbreak of infections across major trading partners caused some slowdown in exports over October-November, but momentum returned in December. Imports rose sequentially over Q3, as industrial traction continued to improve. Non-oil non-gold imports totaled USD 78 bn over Q3 as compared to USD 63 bn over Q2. Service exports saw a more tepid contraction (-6% YoY) as compared to service imports (-11% YoY) over Q3.
- **Performance of consumer durables had started recovering since September,** and despite a contraction registered in the IIP print for the same in November, on-ground demand for white goods, automobiles, etc. has been very strong over Q3, both due to festive impetus, as well as in anticipation of price increases in future months due to input costs rising. Production of non-durables has remained strong, especially surging in December, notwithstanding volatility in the growth rate.

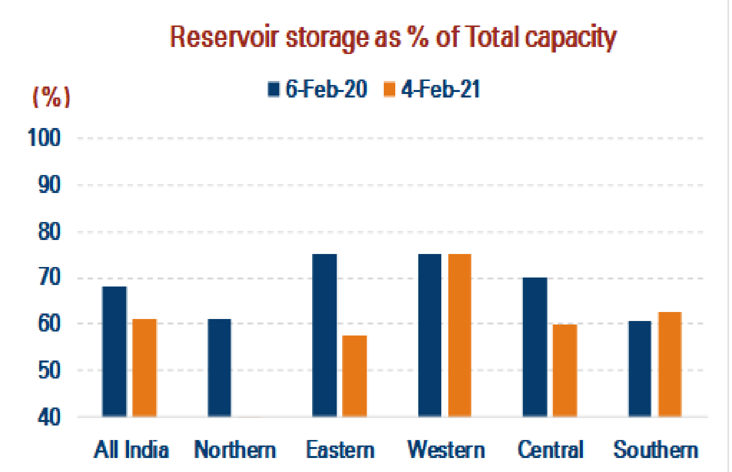
(% YoY unless otherwise specified)		Credit to Industry	MSME credit growth	Exports	Non-oil non-gold imports	Consumer Durables	Consumer Non-durables
Q3 FY20	Oct-19	3.4	-0.8	-1.7	-8.3	-18.9	-3.3
	Nov-19	2.4	-0.6	-1.3	-10.5	-1.4	1.1
	Dec-19	1.6	0.6	-2.7	-8.9	-5.6	-3.2
Q2 FY21	Jul-20	0.8	-2.2	-9.5	-30.4	-23.7	1.8
	Aug-20	0.5	-0.3	-12.2	-29.7	-10.2	-3.0
	Sep-20	0.0	3.2	6.0	-12.6	5.3	2.4
Q3 FY21	Oct-20	-1.7	4.3	-4.7	-4.9	18.0	7.1
	Nov-20	-0.7	5.0	-8.6	-1.7	-3.4	-1.3
	Dec-20	-1.2	4.4	0.1	8.0	4.9	2.0

Source: CEIC, ICICI Bank Research

Healthy sowing and promise of a bountiful harvest kept agriculture as a prop for growth

Area Sown under Rabi crop

Million hectare	31-Jan-20	29-Jan-21	% YoY
Wheat	33.64	34.64	*2.95*
Rice	3.02	3.52	*16.66*
Pulses	16.29	16.74	*2.77*
Coarse Cereals	5.61	5.17	*-7.88*
Oilseeds	8.00	8.40	*4.96*
Total	66.56	68.46	*2.86*



Source: Ministry of Agriculture, Central Water Commission, ICICI Bank Research

The agriculture sector and its allied activities are likely to continue supporting growth in the just-concluded quarter, as has been seen over this fiscal. *Rabi* sowing was a healthy 2.9% higher on an annual basis in terms of acreage, raising the possibility of a bumper harvest, following the bountiful *kharif* crop production earlier last year. The area under key *rabi* crops were higher on year as munificent monsoon rainfall replenished reservoirs and added to soil moisture, which are key to the *rabi* crop. Sowing of wheat, *rabi* paddy, pulses and *rabi* oilseeds (especially mustard and rapeseed) ended higher on year, with sowing of several crops reaching all-time highs, while that of coarse cereals was lower. Increase in wheat sowing area in the states of Madhya Pradesh and Maharashtra made up for less area under wheat in Punjab, Rajasthan, UP, Bihar and Gujarat. Robust food grain output this year should continue to bolster contribution of agriculture to GVA over October-December 2020.

Given the above trends, GDP growth to the tune of 0.5-0.7% YoY is expected over Q3 FY2021. Going into FY2022, we expect GDP growth to recover to ~10.5% YoY in FY2022. While a low base will aid the next fiscal's print, on-ground recovery is also visible in different sectors at varied speeds. The growth stimuli available from the Union Budget and the additional long term impact measures including the PLI will provide a sturdy growth path over the recovery horizon.

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