India Q3 GDP: Emerging from the shadow of the virus

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March 1, 2021

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- **GDP growth re-entered positive territory in October-December 2020, as most segments improved sharply sequentially. Positive value addition from industry, complemented by robust agriculture growth aided GVA**
- **Continued targeted Government support, easy policy environment, faster dissemination of vaccine, and the recovery in urban sentiment will all aid growth over the coming quarters, in addition to base effect**
- **We peg our FY2022 GDP forecast at 10.5% YoY. The incipient rise in infections seen recently have been managed well, but will need to be monitored closely, as will fuel prices, as both are risks to growth**

Gross Domestic Product (GDP) slightly undershot our expectations, printing at +0.4% YoY in Q3 FY2021 (October-December 2020), (ICICI Bank expectation: +0.5 to +0.7% YoY). A major sequential improvement came about in Q3 as compared to Q2 in consumption and Government spending, while investment growth was positive after a gap of three quarters. These trends were all in line with the available monthly data and anecdotal evidence.

Gross Value Added (GVA) came in at +1.0% YoY for Q3 FY2021. A strong showing from agriculture was complemented by the first industrial value addition for this fiscal, just as we had mentioned in our GDP preview report *(India GDP: Fledgling recovery on the cards)*. Also echoing our expectation, the services sector showed a marginal contraction, though significant sequential improvement was seen across all sub-sectors, given festive demand, Government spending and traction in real estate.

The Second Advance Estimates of GDP for FY2021 were also released, and the Government has revised its estimate for GDP contraction in FY2021 to -8.0% YoY from the erstwhile -7.7% YoY. While Government spending growth was revised to a lower positive, to reflect actual trends over the year, nearly all other heads of GDP were revised higher, though still remaining in contraction. Additionally, GDP prints for Q1 (to -24.4% from -23.9%) and Q2 (to -7.3% from -7.5%) were also revised.

<u>Key highlights:</u>

- **At 3.9% YoY in Q3, agriculture showed its best performance in this fiscal yet,** and GVA growth ex-agriculture would have been a much more muted 0.3%. *Rabi* sowing was a healthy 2.9% higher on an annual basis in terms of acreage, raising the possibility of a bumper harvest. The area under key *rabi* crops were higher on year as munificent monsoon rainfall replenished reservoirs and added to soil moisture. 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.
- **Industry regained its sheen, with a +2.7% YoY value addition over Q3, as construction and manufacturing continued to show notable traction.** The sequential pickup was also indicated 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 a rise in demand, as well as continued cost saving.
- **Construction sector made a stellar recovery in Q3, outperforming all other industrial sub-sectors**. 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. 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 continue to improve in the quarters ahead, given the infrastructure push planned in the Budget.**

- **Mining clocked an expected contraction over Q3.** The mining index in IIP had 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. **The electricity head showed continued improvement over Q3 as compared to Q2.** 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, given robust activity levels amid the festive season.

- **Services sector remained the only major sector which displayed a minor contraction in Q3 FY2021, as this sector has taken the most pain from the COVID onslaught. Nonetheless, there was across-the-board improvement seen in all segments of services.**

- **The financial, real estate and professional services segment saw the first positive growth after two quarters of deep contraction.** While this sector is difficult to gauge in terms of indicators, increased traction in real estate would have played a major role. 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.

- **The trade, hotels, transport and communication segment improved sharply amid festive sentiment inciting activity on this head.** 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 also finally improved over November-December. Segments in services which saw credit growth pick up sequentially in Q3 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. **However, the sustenance in demand for services needs to be monitored, especially in light of the incipient pickup in infections.**

GVA growth

Growth estimates (% YoY)		Q1-FY2021	Q2-FY2021	Q3-FY2021	FY2021 (2nd AE)
Agriculture		3.3	3.0	3.9	3.0
Industry		-35.9	-3.0	2.7	-8.2
of which:					
	Mining & quarrying	*-18.0*	*-7.6*	*-5.9*	*-9.2*
	Manufacturing	*-35.9*	*-1.5*	*1.6*	*-8.4*
	Electricity, gas,water supply & other utility services	*-9.9*	*2.3*	*7.3*	*1.8*
	Construction	*-49.4*	*-7.2*	*6.2*	*-10.3*
Services		-21.4	-11.3	-1.0	-8.1
of which:					
	Trade, hotels, transport & communication	*-47.6*	*-15.3*	*-7.7*	*-18.0*
	Financial, real estate & professional services	*-5.4*	*-9.5*	*6.6*	*-1.4*
	Public administration, defence and Other Services	*-9.7*	*-9.3*	*-1.5*	*-4.1*
GVA at basic prices		-22.4	-7.3	1.0	-6.5

Source: CSO, ICICI Bank Research

- **On the expenditure side, private consumption continued to improve sharply sequentially,** while still remaining contractionary. 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. 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, low borrowing costs, 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.

- **Contraction in Government spending also eased tremendously in Q3, as 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.

- **Gross fixed capital formation, or the impulse to invest, turned positive in Q3, displaying a welcome sharp revival, not just for immediate GDP improvement, but for generating employment and long-term growth.** The focus of the Government in this segment has been considerable, and a sustainable return in demand may stimulate private sector plans in the coming quarters as well, some of which is already visible in certain sectors.

- **Net exports was a marginal positive contributor (0.1 percentage points) to GDP in October-December 2020**, as compared to the previous two quarters, just as we had expected. The contraction in exports exactly matched the contraction in imports over Q3. 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.

GDP growth

GDP (% YoY)	Q1-FY2021	Q2-FY2021	Q3-FY2021	FY2021 (2nd AE)
PFCE	-26.3	-11.3	-2.4	-9.0
GFCE	12.8	-24.0	-1.1	2.9
GFCF	-46.4	-6.8	2.6	-12.4
Change in Stocks	-32.5	3.7	7.0	-3.5
Valuables	-71.2	-45.6	-16.1	-38.0
Exports	-22.0	-2.1	-4.6	-8.1
Less Imports	-41.1	-18.2	-4.6	-17.6
GDP	-24.4	-7.3	0.4	-8.0

PFCE: Private final consumption expenditure, GFCE: Government final consumption expenditure, GFCF: Gross fixed capital formation

Source: CSO, ICICI Bank Research

The print confirms our view that the worst of the pandemic fallout was felt in the first two quarters of FY2021, and the second half of the fiscal will witness an improved growth prospect. For the ongoing quarter, while some flat-lining has been seen in a few lead indicators, the overall performance is still promising, and all sectors are expected to do well. Risks remain in the form of high commodity (especially fuel) prices eating into the consumption budget, as well as the incipient second wave of infections, which has so far been handled well, but bears watching.

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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