ICICI Bank Global Markets

India Q4 FY2021 GDP Preview: Some sequential improvement is possible

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The estimates for Gross Domestic Product (GDP) growth for Q4 FY2021 will be released next week. We expect the Gross Value Added (GVA=GDP+net of subsidies and taxes) to rise by 2.2% YoY in Q4 FY2021, as much of the pickup in growth happened in March, due to the low base of last year. Q4 FY2021 saw a continuing realisation of pent-up demand, robust consumer sentiment and industries operating at full capacity amid the ongoing vaccinations, stellar export growth and demand recovery. However, the rising input cost pressures due to the sky-rocketing commodity prices (steel, copper, crude oil), posed downside risks to the growth momentum and recovery. The Government spending might be a positive contributor to the growth, owing to the large infrastructure push planned in the budget. The net exports are expected to have contributed negatively to the GDP growth in Q4.

On a sectoral basis, agriculture is likely to continue to support growth, with the production of crops of wheat, paddy, pulses and oilseeds, ending higher in a year. Besides, the production of several crops reached an all-time high, across the states. The key sectors of manufacturing and construction are expected to display a robust recovery in Q4 FY2021. **This is validated by the movement seen in the high frequency data reflected in our proprietary Ultra Frequency Index (UFI), which averaged at ~106 in Q4 (highest reading till now) that was above the pre-COVID levels of 100.** A healthy earnings performance of India Inc. on the backdrop of the rise in demand, as well as the continued cost saving, also point towards an improving momentum. The services sector may still show a stagnated growth, due to the rising infections starting from mid-March, though significant sequential improvement is likely across all sub-sectors, given the Government spending and traction in real estate.

Growth momentum remained robust in Q4 FY2021, as all the high frequency indicators, including the peak power demand, vehicle registrations, automobile sales, rail freight traffic, electricity demand and generation, showed stellar performance. However, a slight moderation was witnessed in some indicators after mid-March, owing to the rising second wave of infections. The month of April and May 2021 have seen further deterioration of economic activity, due to the rising lockdown, resulting in restrictions imposed in almost 90% of the states, across the country. **We peg the expected GDP print for FY 2021 at -7.2 % YoY. We have revised our FY 2022 real GDP growth lower to 9.7% -10% YoY, from our earlier expectations of 10.5% YoY growth.**

Lead indicators for the services sector:

- Over the Jan to Mar 2021 period, domestic passenger traffic reached the 15 million mark that is higher than the levels seen in Mar 2020. Impetus to travel remained strong during this period, as the infection rates were lower and states demanded lesser stringent quarantine rules. Railway freight traffic clocked an average growth of ~11 % YoY over Q3, remained robust in Q4, with March witnessing a massive 33% YoY jump, after a small slump in February. The significant jump in March numbers are partly due to the base effect, as well as due to the robust growth in freight traffic for cement and iron and steel.

- **The services PMI remained in the expansionary zone throughout Q4 2021.** The Q4 services PMI averaged at 54.2, as compared to the average of 53.4 in Q3 2021. The steep rise in February was aided by an improved demand and more favourable market conditions. Low COVID-19 cases and lesser stringent movement restrictions allowed high contact services and tourism activities to carry on smoothly. However, rising COVID-19 cases softened the PMI in March, as people voluntarily reduced demand for travel and high contact services. Even though the services PMI remained in the expansionary phase, concerns remained in terms of labour shortages and subdued demand.

- Passenger vehicles sales remained robust, throughout Q4 FY2021. While high levels of unemployment rate and low demand, amid the COVID-19 crisis affected the passenger car segment, the sale of utility vehicles and two wheelers remained robust. The average growth in the utility segment was at 45.7 % YoY, throughout Q4 2021.

- **Credit growth to services sector averaged ~6.4 % over Jan-Mar 2021**, which was significantly slower, as compared to the trend seen over Q3, where it averaged at 9 %. Credit growth in the services sector decelerated to 1.4 % in Mar 2021 from 7.4 % in Mar 2020, mainly due to the slowdown in the credit growth of Non-Banking Financial Companies (NBFCs) and contraction in credit to its professional services. However, credit to trade segment continued to perform well, registering an accelerated growth of 11.8 % in Mar 2021.

(% YoY unless oterwise specified)		Domestic passenger traffic (people in millions)	Railway Freight traffic	Cargo traffic	Passenger Vehicles sales	Passenger car sales	Utility vehicle sales	Two Wheelers sales	Services PMI (value)	Credit to Services
Q2 FY21	Jul-20	4.0	-7.7	-13.2	-49.6	-22.2	6.4	-38.6	34.2	10.1
	Aug-20	5.6	1.4	-10.4	-3.9	6.8	30.6	-15.2	41.8	8.6
	Sep-20	7.8	17.9	-1.9	14.2	50.1	36.4	3.0	49.8	9.1
Q3 FY21	Oct-20	10.3	11.0	-1.2	26.5	43.6	46.9	11.6	54.1	9.5
	Nov-20	12.5	8.4	2.8	14.2	-10.0	9.4	16.9	53.7	8.8
	Dec-20	14.4	13.5	4.4	4.6	-4.8	7.3	13.4	52.3	8.8
Q4 FY21	Jan-21	15.2	11.1	4.0	13.6	13.1	40.9	7.4	52.8	8.4
	Feb-21	15.4	7.8	1.9	11.1	0.1	40.8	6.6	55.3	9.3
	Mar-21	15.3	33.0	16.4	17.9	5.7	55.5	10.2	54.6	1.4

Source: CEIC, ICICI Bank Research

Lead indicators for the industry:

- **The industrial sector relapsed in Q4 FY2021**, with contraction in the overall output of 0.9 % YoY in Jan 2021 and 3.4 % YoY in Feb, on the backdrop of a high base. It however recovered in Mar 2021 amid the low base of the last year and stellar exports growth. The output of eight core infrastructure industries showed a better performance in Q4 (~ 1.4% YoY) after printing a contraction in the previous quarter (-0.3% YoY). Since Aug 2020, the Manufacturing Purchasing Managers' index has been in expansion, indicating a brighter outlook, but current conditions remain fragile and volatile
- **Mining clocked a contraction over Jan-Feb 2021, however, it moved back to the positive territory in Mar 2021, amid a low base and strong natural gas production.** On an average, mining printed a slight negative growth (-0.13% YoY) in Q4 FY2021, as coal output contracted very sharply and crude oil remained in significant contraction, over the quarter, while natural gas output improved substantially on a sequential basis. Mining posted the steepest contraction in FY2021 since FY2012, due to supply bottlenecks, while crude oil and natural gas production remained subdued. due to lack of critical infrastructure and equipment, operational difficulties, lack of demand and labour supply shortages, amidst the pandemic. Mining is expected to add value to the headline Gross Value Added (GVA) over Q4. Going ahead, particularly in Q1 FY2022, the rising second wave infections might impinge on the mining activity in mineral-rich states like Odisha, Jharkhand, etc.
- **Manufacturing activity has seen a stellar growth in Q4 FY2021 (much of the recovery was seen in March) aided by a low base in Mar 2020, given the pent-up demand realisation and a faster pace of vaccination; encouraging production across swathes of sectors.** 16 out of the 23 industry groups posted a year-on-year growth in March, including manufacture of food products and beverages, textiles, chemical products, basic metals, pharmaceutical products, non-metallic mineral products, machinery and equipment and motor vehicles, while manufacture of coke and refined petroleum products remained a drag on the sector. For FY2021 as a whole, manufacturing suffered the worst contraction with all the industry groups remaining in red, except the manufacture of pharmaceutical products. The Production-Linked Incentive (PLI) scheme introduced for bulk drugs and medical devices has been received well by the industry and it is expected to support the domestic pharmaceutical production and medical exports. **Manufacturing is likely to see a healthy growth and positive value addition to the GVA over the concluded quarter, providing a significant recovery impetus to the industry**

- **Manufacturing PMI moderated to an average of 56.9 over Q4 from 57.2 over Q3, despite some loss of growth momentum in March, as firms scaled up production and input buying in line with the upturn in sales.** The slight moderation can be attributed to the rising second wave of infections in the country, starting mid-March. According to the survey, the rate of input cost inflation was among the strongest seen over the past three years in March
- **Electricity production was healthy over Q4,** and plant load factor for thermal electricity averaged at 63.67 over January-March, as compared to 55.16 over October-December. Value addition from this component is likely to be high in Q4, given the robust activity levels amid demand recovery. Going ahead, despite the onset of the summer season, the imposition of stricter lockdowns in major manufacturing states could impact the electricity demand from industrial segments

(% YoY unless otherwise specified)		IIP	Mining	Manufacturing	Electricity	Core Industries	PMI Manufacturing (Value < 50: contraction)
Q4 FY20	Jan-20	2.2	4.4	1.8	3.1	2.2	55.3
	Feb-20	5.2	9.6	3.8	11.5	6.4	54.5
	Mar-20	-18.7	-1.3	-22.8	-8.2	-8.6	51.8
Q3 FY21	Oct-20	4.5	-1.0	4.5	11.2	-0.5	58.9
	Nov-20	-1.6	-5.4	-1.6	3.5	-1.1	56.3
	Dec-20	2.2	-3.0	2.7	5.1	0.4	56.4
Q4 FY21	Jan-21	-0.9	-2.5	-1.3	5.5	0.9	57.7
	Feb-21	-3.4	-4.4	-3.7	0.1	-3.8	57.5
	Mar-21	22.4	6.1	25.8	22.5	6.8	55.4

Source: CEIC, ICICI Bank Research

- **Construction is expected to post a healthy growth in Q4 FY2021. H2 FY2021 has seen a sharp revival supported by favourable interest rates, adequate liquidity and Government measures, including a reduction in the stamp duty and steep discounts to clear the inventory.** Core index for steel registered a substantially higher average growth over Q4, as compared to Q3, amid a demand slowdown due to the rising steel prices, while the index for cement came back to a positive territory, after contracting in the previous quarter. Credit to the construction growth remained muted over Q4, averaging -6.8% as compared to an average growth of 2.2% in the previous quarter. The performance of the IIP infrastructure and construction goods head was healthier over Q4 than over Q3. The impetus to value addition from the construction segment should improve in the quarters ahead, given the infrastructure push planned in the Budget. However, reverse migration of workers, due to the rising infections, needs to be carefully monitored, as more stringent restrictions are imposed to curb the spread of the virus
- **Commercial vehicles segment continues to falter,** as availability of finance, negligible sales of passenger buses, due to the closure of educational institutes and supply side constraints, kept the registrations in deep red. The voluntary vehicle scrappage policy announced in the Union Budget is likely to benefit the sales of commercial vehicles, like buses and trucks through the entire value chain ranging from vehicle makers to auto ancillary makers, including component manufacturers
- **Credit growth to industry remained in red in Q4 FY2021, although it has shown a sequential improvement over the previous quarter, led by an acceleration in credit to Micro, Small and Medium Enterprises (MSMEs).** The credit growth to MSMEs averaged ~5.8% in Q4 as compared to a growth of ~4.6% in the previous quarter. This was supported by the Emergency Credit Line Guarantee Scheme (ECLGS) disbursements of INR 1.81 trillion (as on Feb 28, 2021), which is around 60% of INR 3 trillion. Credit to large industries remained in contraction, however, the pace of contraction has moderated. Going ahead, the downside risks to the credit growth include, lockdown in key states, which may impact the industrial as well as service segments. Another risk includes the ending of the ECLGS scheme in Jun 2021, which had propped up the MSME credit. However, the extension of the On-Tap-Targeted Long-Term Repo Operations (TLTRO) and on lending norms, could support its growth
- **Global Trade momentum remained buoyant aided by vaccination progress and a strong economic recovery, across major trading partners.** Merchandise exports displayed a robust run (19% YoY) in Q4, as global demand improved. Imports remained strong, notching 18% YoY growth in Q4 despite rising infections, as industrial demand remained resilient. Both exports and imports exhibited a stellar growth in March, notching the highest ever level reached in a month. After accounting for service exports, contribution to GDP from net exports is likely to be negative in Q4, as import recovery outperformed exports pick-up. Going ahead, exports rebound will be guided by the global economic recovery, while import momentum could see some near term moderation driven by the second COVID wave

- **The consumer goods, both durables as well as non-durables, showed a significant positive growth in Q4 FY2021, however most of the recovery came in Mar 2021 benefitting from pent-up demand and a low base.** On a sequential basis as well, growth expanded in both the categories. Automobile sales improved sharply in Q4 amid demand recovery, reflecting an increased consumer preference for personal travel. Consumer durables could be under some pressure going ahead due to the restricted mobility and COVID worries translating into lower discretionary spending. Activity disruption in the rural sector, due to the second wave, might also impinge on the consumer non-durables output in the coming months.

(% YoY unless otherwise specified)		Infrastructure & Construction goods	Exports	Non-oil non-gold imports	MSME Credit growth	Credit to industry	Consumer Durables	Consumer Non - durables
Q4 FY20	Jan-20	-0.3	-2.1	-4.8	1.0	2.5	-3.7	-0.6
	Feb-20	2.8	3.3	0.7	0.6	0.7	-6.2	-0.3
	Mar-20	-24.3	-34.3	-29.4	1.1	0.7	-36.8	-22.3
Q3 FY21	Oct-20	10.9	-5.0	-3.7	4.3	-1.7	18.1	7.3
	Nov-20	2.1	-8.5	-0.4	5.0	-0.7	-3.2	-0.7
	Dec-20	3.1	0.4	8.9	4.4	-1.2	6.5	1.9
Q4 FY21	Jan-21	1.8	6.6	7.3	4.9	-1.3	-0.2	-5.4
	Feb-21	-4.0	-0.8	5.9	5.9	-0.2	6.6	-4.5
	Mar-21	31.2	60.3	46.7	6.7	0.4	54.9	27.5

Source: CEIC, ICICI Bank Research

Despite the pandemic, the agriculture sector and its allied activities are likely to continue supporting growth in the last quarter of the year, as has been seen over the fiscal. After a healthy sowing of *rabi* crops that ended at 34.6 million hectare, as compared to 33.6 million hectare last year (~ 2.9% higher on an annual basis in terms of acreage), the farmers and agriculture workers have successfully harvested the rabi crop on schedule. The production of crops of wheat, paddy, pulses and oilseeds ended higher on year, with production of several crops reaching an all-time high, across states. Although, there has been some impact of the rising infections affecting the rural areas and imposition of lockdowns, leading to supply-side disruptions in states, such as Uttar Pradesh, Madhya Pradesh, and Rajasthan, while in states like Punjab and Haryana, where there is high Government procurement, such problems have not persisted. The robust food grain output this year should continue to bolster contribution of agriculture to GVA, over the last year and this year, while the forecast of a normal monsoon by IMD bodes well for the upcoming kharif season. The ongoing wave of infections could have an impact on the overall sector, depending on the trajectory of the pandemic and its rural penetration.

The upshot is that we expect GVA growth to the tune of 2.2 % YoY over Q4 FY2021. Going into FY2022, we peg the GDP growth at ~9.7-10 % YoY in FY2022, assuming that the lockdown restrictions in various states will start easing at the end of June. Economic activity is expected to recover from June onwards, as the second wave is subsiding in a few states owing to the falling new cases, starting from the third week of May. The low base will aid the next fiscal's print, but downside risks to growth remain in the form of a third wave taking place, ingress of the virus in the rural areas, a strained health infrastructure and a tepid bounce-back in consumption, owing to less pent-up demand this time. However, the Reserve Bank of India (RBI)/Monetary Policy Committee (MPC) will continue to support growth through its accommodative policy stance, easy liquidity conditions and clear communication, to provide relief to the debt markets, until growth is on a durably strong footing and uncertainty ebbs. The growth stimuli available from the Union Budget and the additional long term impact measures, including the Production Linked Incentive (PLI), will provide a sturdy growth path over the recovery horizon.

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