Assessing India's GDP growth trajectory

- **Q4 growth estimated at 3.5% compared with 5.4% in Q3 with muted manufacturing and contact intensive services**
- **FY23 growth revised lower to 7% from 7.4% earlier on the back of global slowdown, persistent and broad-based inflation, supply disruptions and monetary tightening**
- **Discretionary consumption to moderate since high inflation impacts discretionary consumption more than essentials**
- **FDI inflows to continue given India remains an attractive market despite pull-back in equity markets**
- **Global slowdown will impact India's exports-both manufacturing and services. Outlook for agriculture and services is bright**

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Q4 growth assessment

The beginning of the quarter was marked with advent of Omicron variant and decline in economic activity. However, towards the end of the quarter, activity normalized. ICICI Bank's weekly high Frequency index had dipped to ~108 during the peak of the third wave but had again picked up towards the end of the quarter (at 126). Notably, it had dipped to 69 during second wave. Exports remained a growth driver in Q4 as well. Even contact intensive services started to see recovery towards the end of the quarter. Real estate also continued to see momentum. Credit growth has seen a pick-up. Even so, we expect GDP growth in Q4 at 3.5% on the back of impact of the Omicron variant during the quarter as well as rising oil prices due to Russia-Ukraine war. Our research shows that an increase of USD 10/bbl in oil prices leads to a reduction of 20bps in GDP growth.

Sectors which saw moderation in growth in Q4

- **Mining, industry and contact intensive services sectors continued to see moderation in growth during the quarter.** Within mining, coal output fell to 4.5% during Q4 from 9% in Q3. With natural gas also showing deceleration and crude oil output contracting at a faster pace, overall mining index increased at a slower pace in Q4.

- **Manufacturing output too increased at a softer pace of 0.9% in Q4 from 1.4% during Q3.** While manufacturing PMIs were expanding, the pace of expansion on an average was at a lower level of 54.6 during the quarter compared with 56.3 during Q3. Even manufacturing exports showed a deceleration at 23.8% during the quarter compared with 41% in Q3. However, auto production contracted by 17.8% during the quarter compared with 21.1% in Q3. Overall gross margin pressure on the manufacturing sector continued with rising input costs. EBITDA margins have been stable in Q4 compared with Q3.

- **Contact intensive services sector too will continue to see moderation in growth. Air passenger growth decelerated to 13.5% in Q4 from 67.8% in Q3.** Deceleration in growth was also seen in GST collections, E-way Bills and air and passenger-cargo traffic. Notwithstanding, some of it is also because of higher base since GST collections have seen a fairly robust growth of 15.9% during the quarter.

Sectors that have seen an acceleration during the quarter

- **Financial services and public admin and defense have seen an acceleration in growth during the quarter.** Credit growth has been inching up led by agri, personal loans, MSME segment and services. Even life and non-life insurance has seen a pick-up in Q4. At the same time, real estate activity has seen some moderation in Q4 with stamp duty collections increasing by 16% in Q4 compared with 21.2% in Q3.
- **Electricity output on the other hand has seen an acceleration and so is the case with construction activity as measured by infrastructure and construction and goods index.** However, margin pressure in the sector will be visible as seen in dip in gross margins of iron and steel sector.
- Public admin and defense should also see an accelerated growth in the quarter led by government spending which seems to have increased by 19.2% compared with 8.4% during Q3.
- While consumption as visible in non-oil-non-gold imports continues to remain buoyant with a growth of 33.7% during Q4, output of durables and non-durables as seen in index of industrial production contracted during Q4 at -5.1% and -2.9% respectively. On a YoY basis, diesel consumption during the quarter was flat, though better than contraction seen in Q3. Petrol consumption too was better than what we saw in Q3. Even unemployment rate is lower in Q4 than what it was in Q3.

Based on the overall assessment of different indicators, we expect overall GVA and GDP growth at 3.7% and 3.5% respectively in Q4. (refer heat map in appendix)

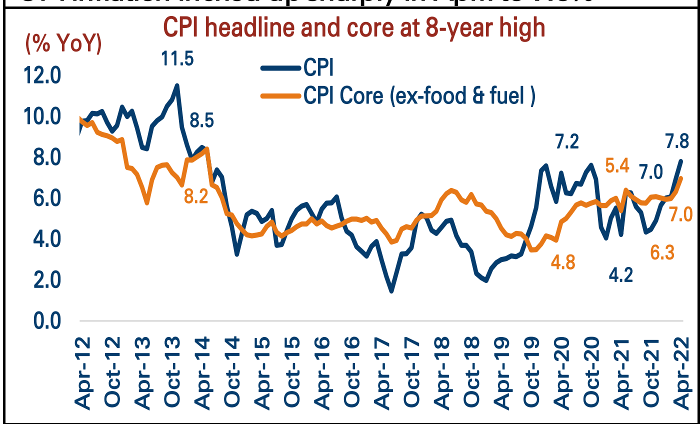
Assessing growth prospects over 2023-24

Divergence between nominal and real consumption

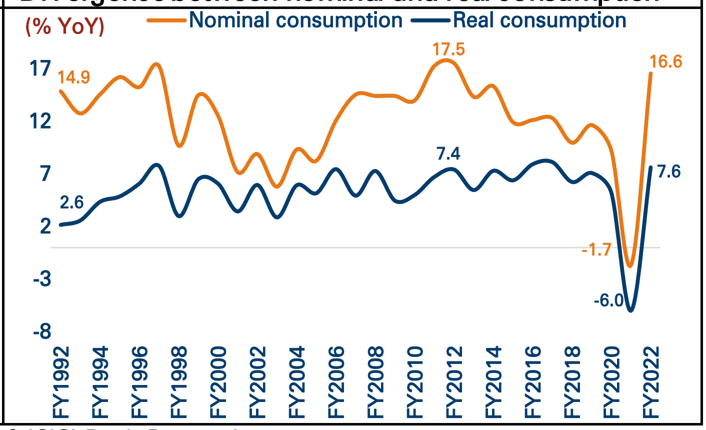
India's inflation picture has turned on the back of higher global commodity prices. Even more worrisome is persistence and the broad-based nature of increase (our note: Persistent and broad-based inflation, RBI to front-load rate hikes). Imported inflation is visible in both WPI and CPI. In WPI, imported inflation is led by mineral oils and manufactured products. While fuel and power inflation is at 39%, manufactured products is at 11%. In the last few months, it has become more generalized with food prices also increasing. CPI food inflation went up by 8% and core by 7%.

This is now reflecting in nominal versus real consumption. While the former is estimated to increase by 16.6% in FY22, the latter by 7.6% only. Similar divergence has been seen in 2012 and early 1990s. One can see the impact of inflation on motor vehicle sales where higher vehicle prices along with higher cost of ownership (petrol or diesel) and supply constraints have led to a drag on volumes. Consumer durable firms are preparing for a reduction in output (ET headline: Mobile, fridge, TV makers slash output targets till July)

CPI inflation inched up sharply in April to 7.8%

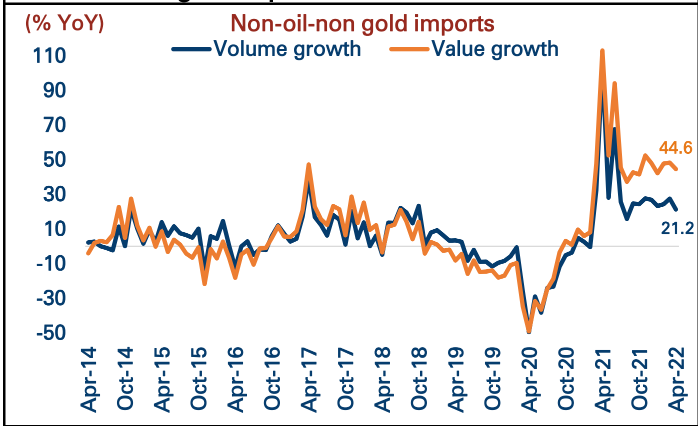


Divergence between nominal and real consumption

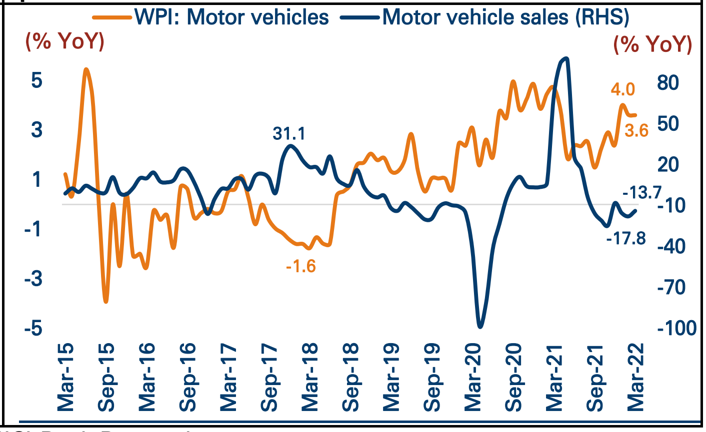


Source: MOSPI, CEIC & ICICI Bank Research

Divergence between volume and value growth of non-oil-non-gold imports



Motor vehicle sales fell sharply on the back of rising prices



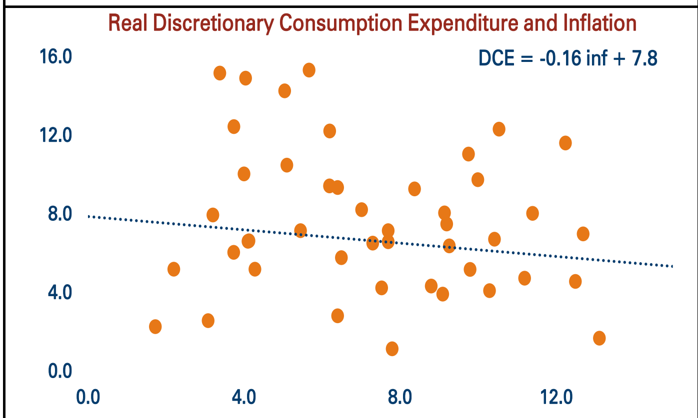
Source: CEIC & ICICI Bank Research

Does higher inflation impact consumption?

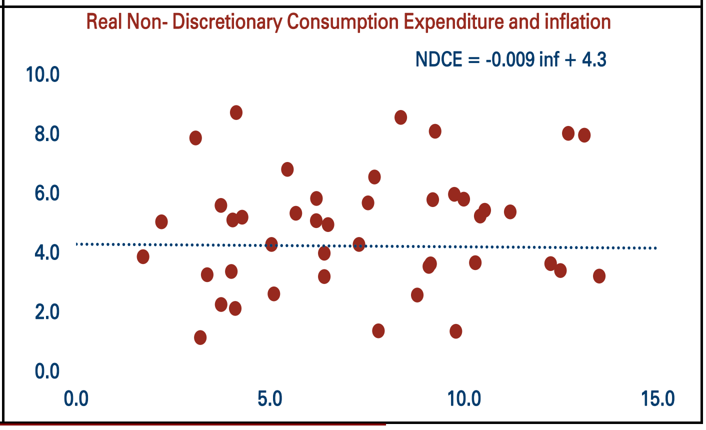
Yes. Our research shows that higher inflation has a negative impact on real discretionary consumer spending (expenditure on clothing and footwear, recreation, furniture, etc.) while real non-discretionary or essential items such as food products, alcoholic beverages and expenditure on health, education and transportation is not impacted to that extent. Real discretionary spending fluctuates more (standard deviation of 3.8) compared to non-discretionary spending (standard deviation of 1.8). Whenever there is a shock to consumption (higher inflation or lower income), discretionary spending gets impacted more. Over the last twenty years (2000-2020), real non-discretionary spending has grown at a stable rate of 5%. However, real discretionary has seen a high of 15% and a low of 2.6%. Nonetheless, as incomes grow it also has seen a faster pace of growth.

The scatterplot below shows that real discretionary spending has a much stronger negative relation with inflation than real essential spending. Thus with inflation inching up, we believe that expenditure on discretionary products will come down (~24% of overall consumption expenditure of the households). Hence, consumption growth will be dragged lower by higher inflation. Nonetheless, IT sector, start-ups and government and private sector investments will create jobs. However, inflation will eat away some of the volumes which would have otherwise been visible.

Discretionary spending has a negative relation with inflation



Spending on essential items do not get impacted due to inflation

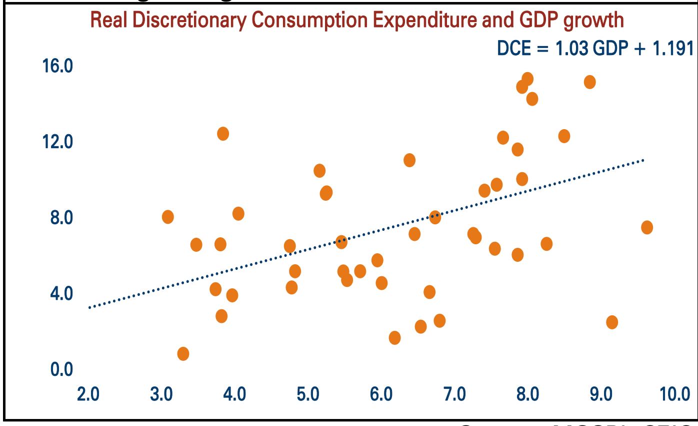
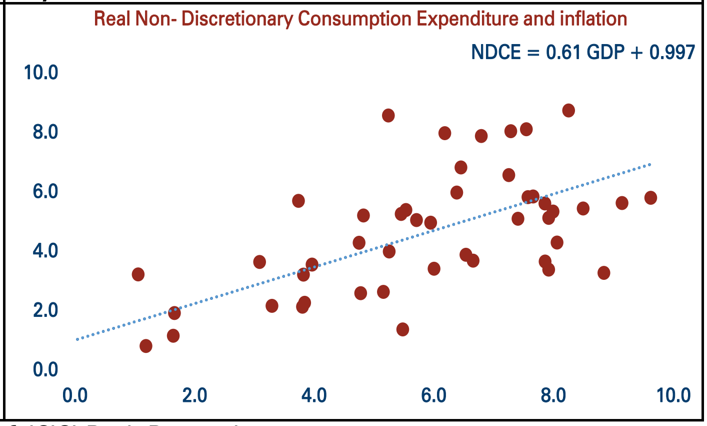


Descriptive Statistics

	Dicretionary expenditure	Non-discretionary expenditure
Mean	9.6	5.2
Median	9.4	5.2
SD	3.8	1.8
Max	15.3	8.7
Min	2.6	2.1

Source: MOSPI, CEIC & ICICI Bank Research
Note: SD stands for Standard Deviation

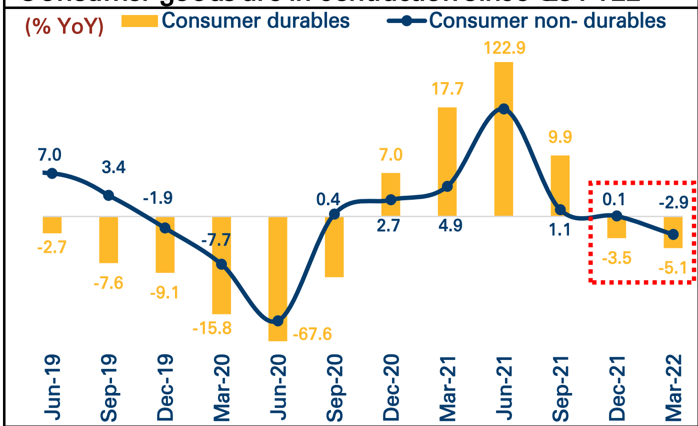
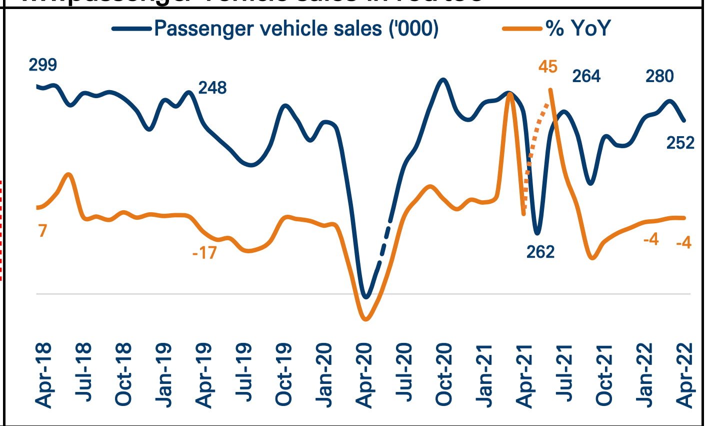
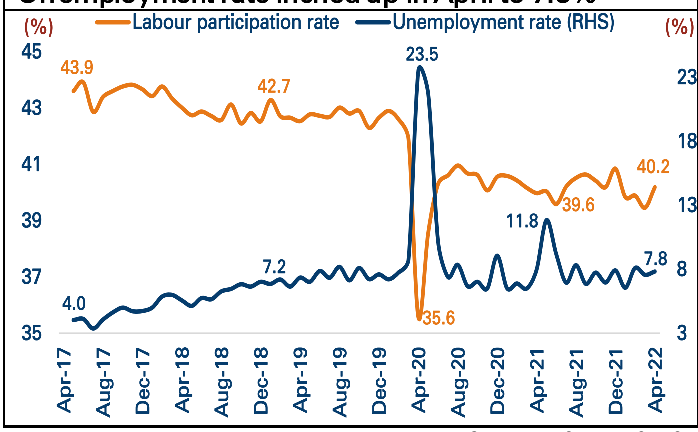
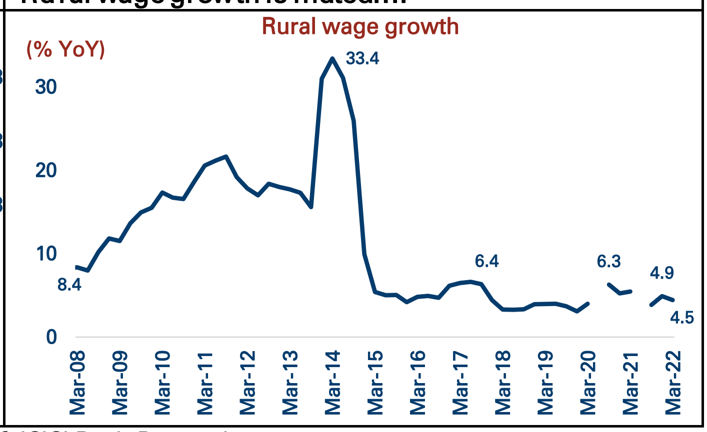
Growth induces much higher discretionary consumption. The scatterplots below show that real consumption is positively related with GDP growth. Here, real discretionary spending has a much stronger relationship with GDP compared with non-discretionary spending.

Discretionary spending increases sharply with increasing GDP growth	Non-discretionary spending inches up too, although by a smaller amount
	

Source: MOSPI, CEIC & ICICI Bank Research

What may work for consumption is the gradual normalization of contact intensive services and thus reduction in unemployment rate. As labour force participation rate improves, we are also likely to see uptick in rural wage growth. Notably, real rural wage growth is negative which we believe will impact entry level and price/ income sensitive product segments the most.

Consumption growth is weak. This is visible in the following high frequency indicators.

Consumer goods are in contraction since Q3 FY22	.....passenger vehicle sales in red too
	
Unemployment rate inched up in April to 7.8%	**Rural wage growth is muted....**
	

Source: CMIE, CEIC & ICICI Bank Research

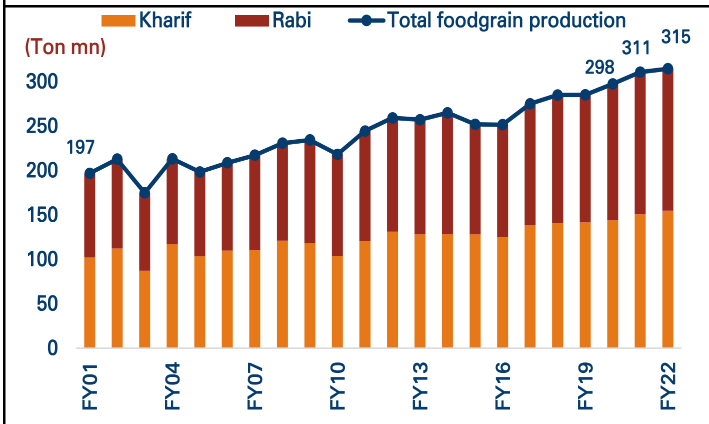
Farm incomes are likely to support rural consumption though. This is on the back of better realization for farmers as producer prices have seen an uptick. Agriculture exports have been buoyant and added to farm incomes. It is only now that export restrictions have been imposed. Even so, higher international prices and a normal monsoon implies outlook for farming sector is buoyant in the next crop season as well. Our next section covers this.

Agriculture to remain resilient on the back of normal monsoon forecast and robust food production

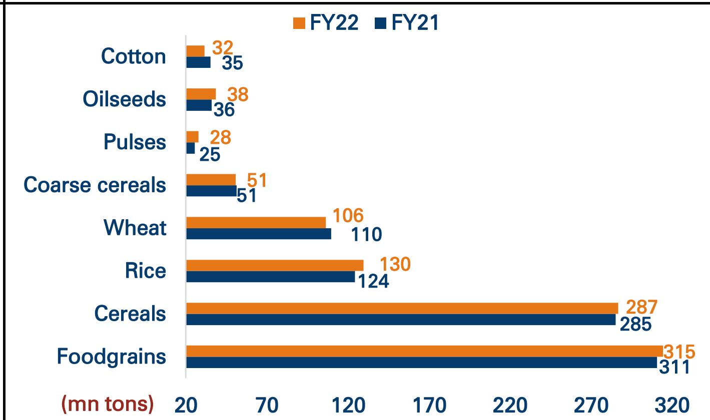
Agriculture is expected to stay strong on the back of higher food-grain production estimates and normal monsoon. Third advance estimates peg food-grain production at 314.5mn tons in FY22 vs. 311mn tons in FY21 (higher by 1.2% YoY). Within this, cotton and wheat production are expected to fall by 10.5% YoY and 2.9% YoY respectively while pulses and oilseeds production are expected to increase by 9% YoY and 7.1% YoY respectively. For cotton and wheat, price rise will more than offset any dip in production. Prices are up by 27% and 51% CYTD22. Exports have added to domestic incomes.

As per IMD's first forecast for 2022, monsoon is normal (98% of LPA), thought slightly lower than the last year. Also water storage capacity in reservoirs is higher than the 10 year average or last year's average. **Agriculture sector will grow at a steady rate of ~3% in FY23. This will further boost rural demand and incomes.**

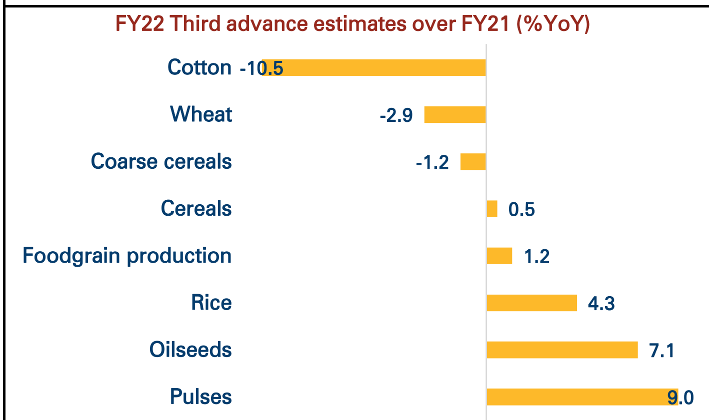
Third advance estimates peg food-grain production at 314.5 mn tons



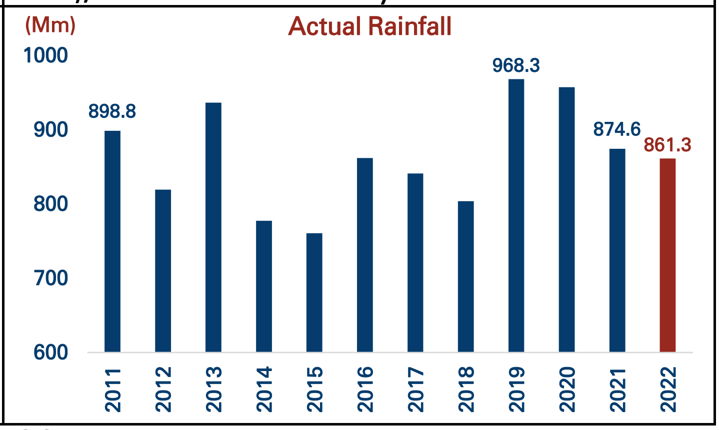
Food-grain production expected to grow by ~1.2% YoY in FY22



Production of cotton expected to fall sharply by 10.5% YoY in FY22

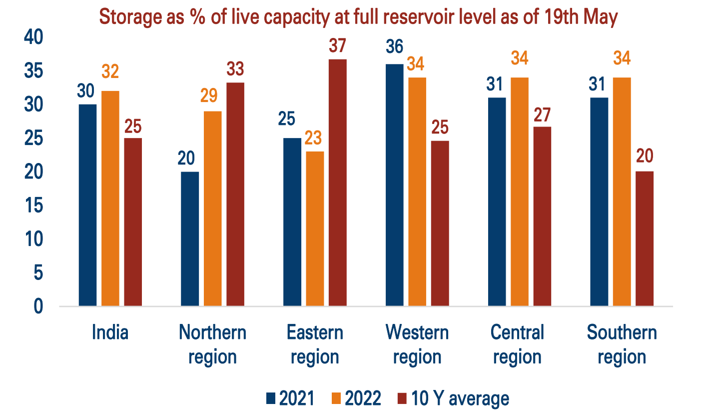


IMD forecasts monsoon to be normal in FY22 (98% of LPA), however less than last year

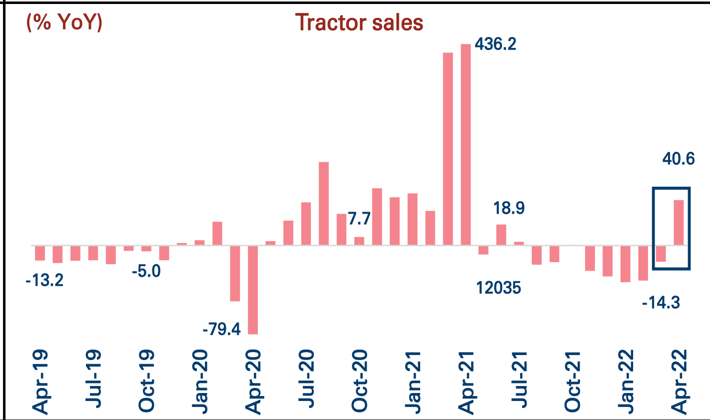


Source: IMD, CEIC & ICICI Bank Research

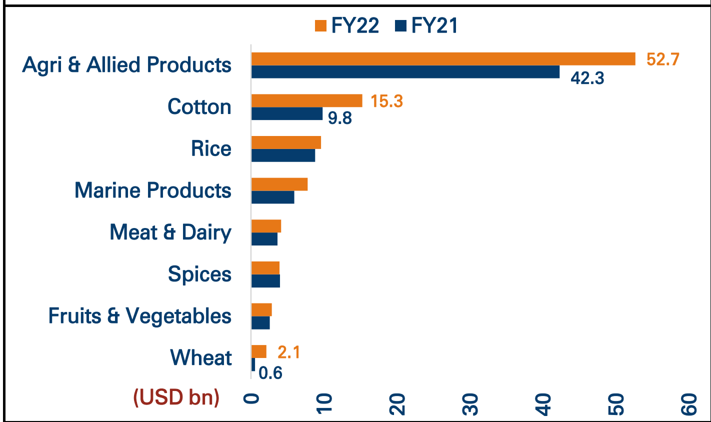
Water storage capacity in reservoirs is higher than the 10 year average as well as last year



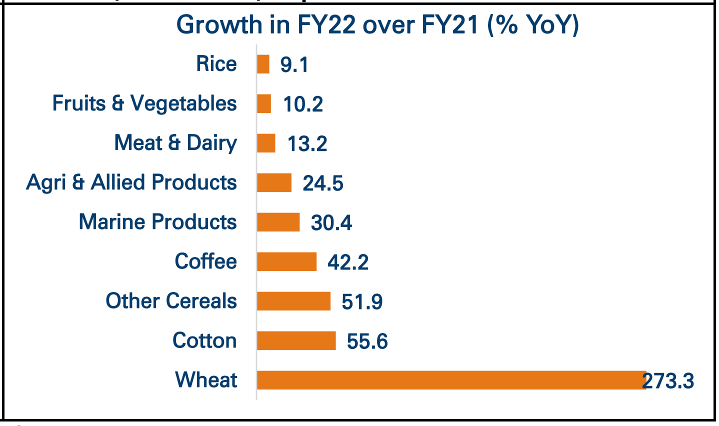
Tractor sales picked up in April 2022, growing by 40.6% YoY



Agri exports remained robust in FY22



……led by sharp growth in wheat (273.1% YoY) and cotton (55.6% YoY) exports



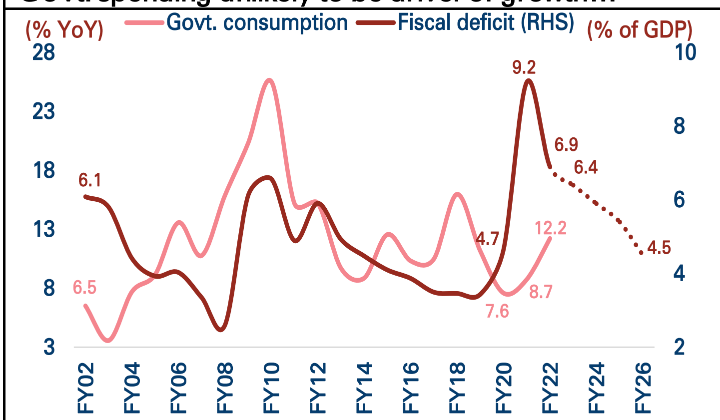
Source: CEIC & ICICI Bank Research

On path of fiscal consolidation

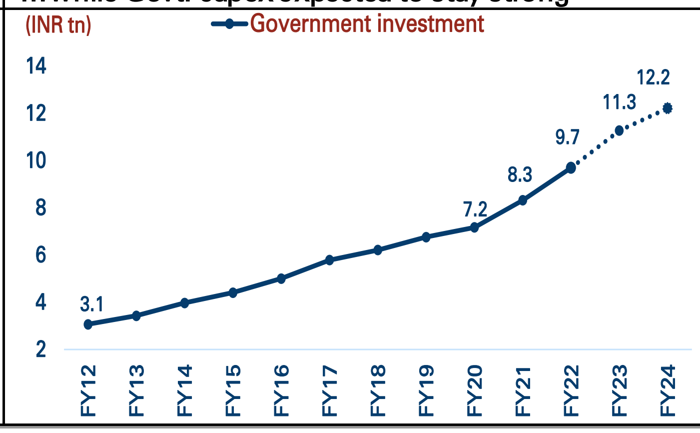
Government spending has been a big driver of growth. India's counter-cyclical fiscal policy was visible with fiscal deficit expanding to 9.2% of GDP in FY21. Fiscal consolidation kick-started in FY22 with fiscal deficit being reduced to 6.9% of GDP. This is estimated to fall to 6.4% of GDP in FY23 and eventually to 4.5% of GDP in FY26. Government expenditure on subsidies—food and fertilizer—are estimated to increase by INR 1.8tn over and above what was Budgeted. At the same time, steps taken to reduce inflation—cut in excise duty—will have a direct bearing on indirect tax collections (estimated impact of INR 1tn). At the same time, higher GST collections will negate some of this impact. Dividend from RBI has seen a dip from last year's level of INR 991bn and is lower than Budget estimate as well.

At the same time, government has been a key driver of crowding-in private sector investments. Government's investment spending is estimated to increase by 25% in FY23 to INR 7.5tn. **We believe Centre is likely to continue to push infra spending given the multiplier impact of the same on the economy. However, fiscal consolidation will ensure that government spending is not the key driver of growth.**

Govt. spending unlikely to be driver of growth…



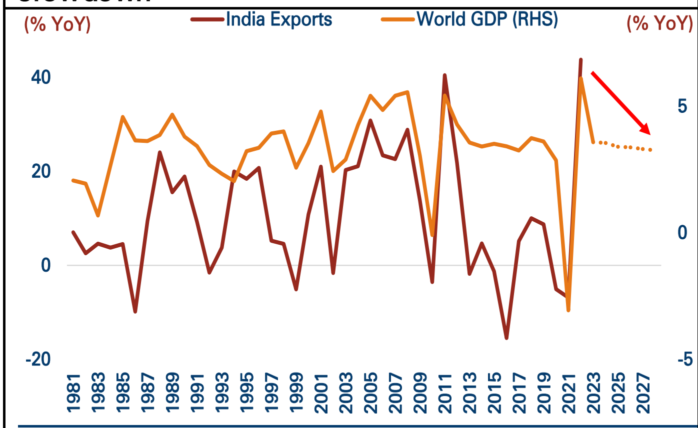
…while Govt. capex expected to stay strong



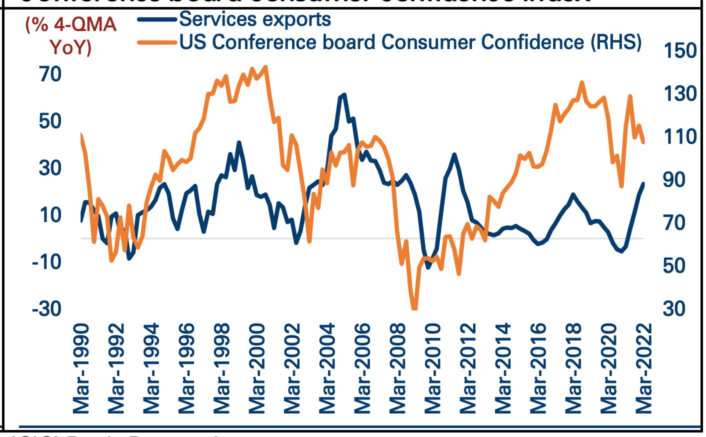
Exports a bright spot, but some deceleration is in the offing

India's exports have increased sharply in FY22 to USD 420bn, led by engineering and petroleum products. However, global growth slowdown due to monetary tightening in advanced economies, Russia-Ukraine war and lockdowns in China will pose a risk to exports. India's exports move in line with the world GDP growth (see chart below). IMF has reduced its global growth forecast for 2022 to 3.6% from 6.1% earlier. Growth slowdown in US will pose a risk to India's software services exports as well which have been increasing. Our research shows that US conference board consumer confidence index and software services exports (4-QMA) move hand-in-hand. Moreover, US consumer confidence is on the retreat on the back of sky high inflation and financial tightening being unveiled by US Fed to curtail it. India's exports—merchandise and services—should also see a deceleration.

India's exports might be at risk due to global growth slowdown



Relation between India's services exports and US conference board consumer confidence index



Source: CEIC, IMF & ICICI Bank Research

Industry is showing a mixed picture

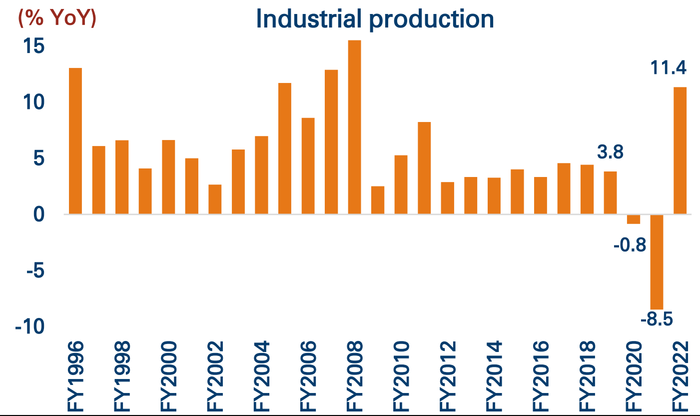
India's industrial output has rebounded in FY22 on a low base. However, it is a tale of two parts. During H1FY22, average IIP growth was 34% which then fell to 1.8% in H2. Gross margin for manufacturing companies remained stable in Q4 from Q3 levels. However, gross margins are lower than pre-Covid. This goes to show that manufacturing firms are yet to pass-on the entire extent of margin impact visible. However, stable gross margins between Q4 and Q3 imply input costs are being incrementally passed-on.

Margin pressure is particularly visible in sectors such as textiles, electronic goods, iron and steel and rubber. However, revenue growth for metals, iron and steel, textiles and electronics remains buoyant. Essential sectors such as FMCG and pharma are witnessing revenue growth of 11% but is largely a result of price increase. Same is the case with sectors such as iron and steel, metals and textiles.

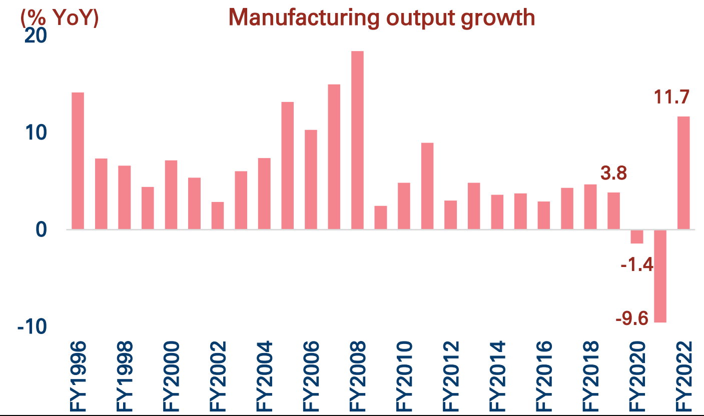
Volume driven growth is visible in coal and electricity production as economic activity has normalized. In case of coal output, it is driven by substitution of imports for domestic output since global coal prices have seen a very large jump.

The underlying margin pressure and necessity to increase prices for margins to revert to mean, domestic and global monetary tightening and resultant impact on demand along with supply side constraints continuing into most of 2022 on the back of lockdowns in China imply industrial activity is likely to increase by 4.7% and 5.6% in FY23 and FY24 respectively. Within this, construction will continue to get a boost from government spending and buoyancy in real estate activity.

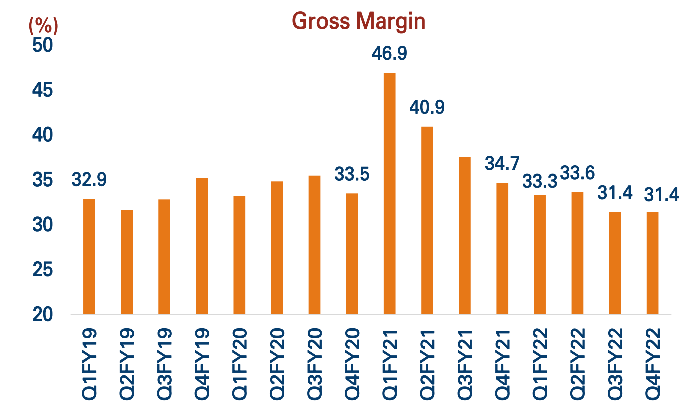
IIP grew by 11.4% YoY in FY22 due to low base….



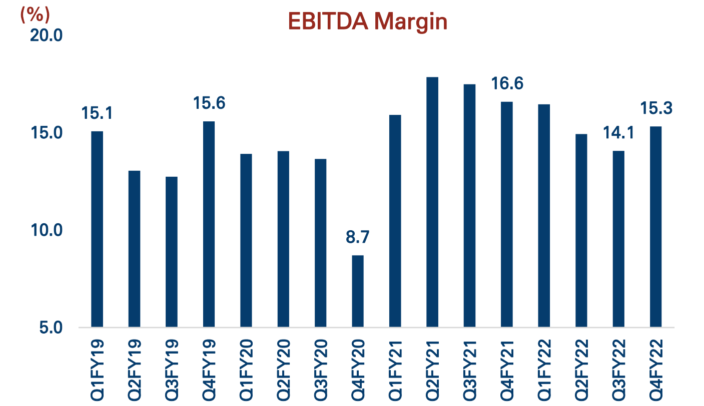
While manufacturing output grew by 11.7%



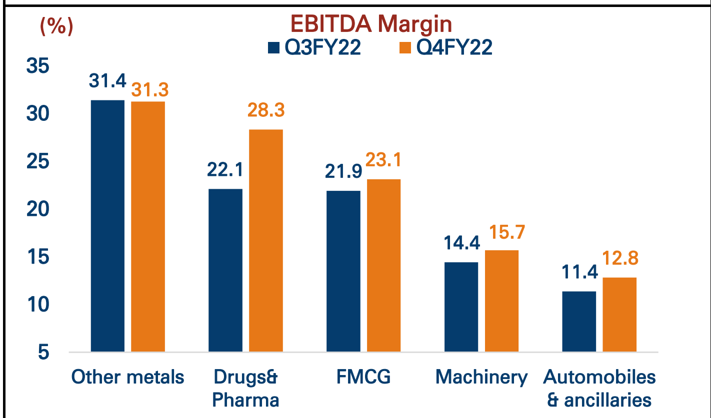
Gross margins remained stable in Q4FY22 as compared to Q3



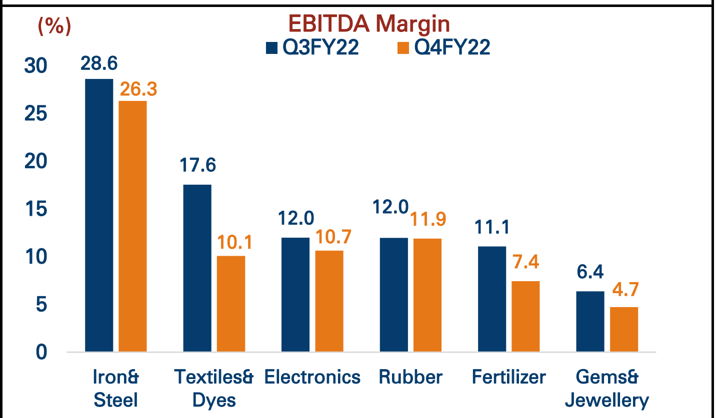
…. While EBITDA margin of mfg. firms inched up



Mfg sectors that saw a rise in EBITDA margin in Q4FY22

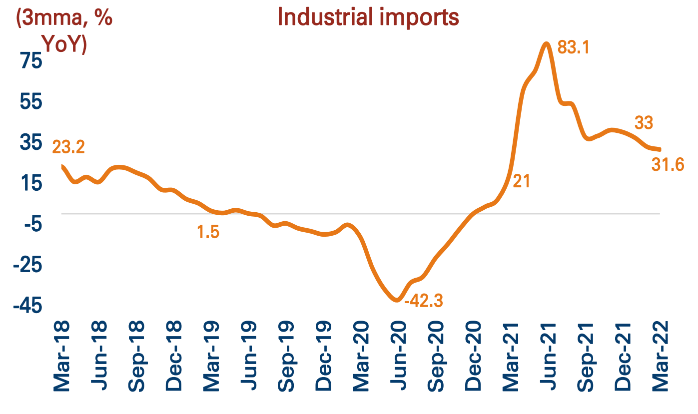


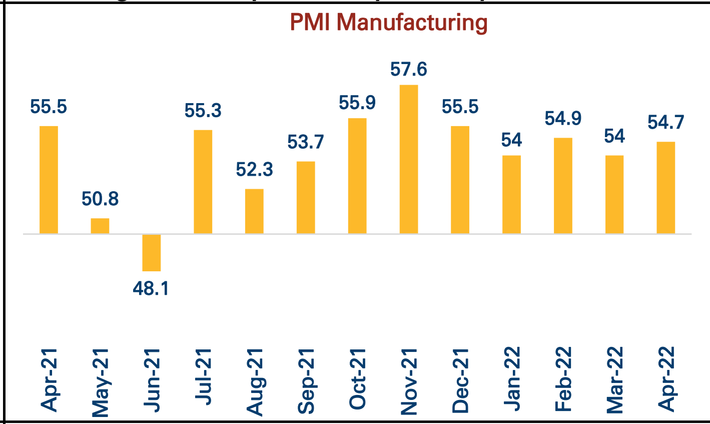
Mfg. sectors that saw a decline in EBITDA margin in Q4FY22



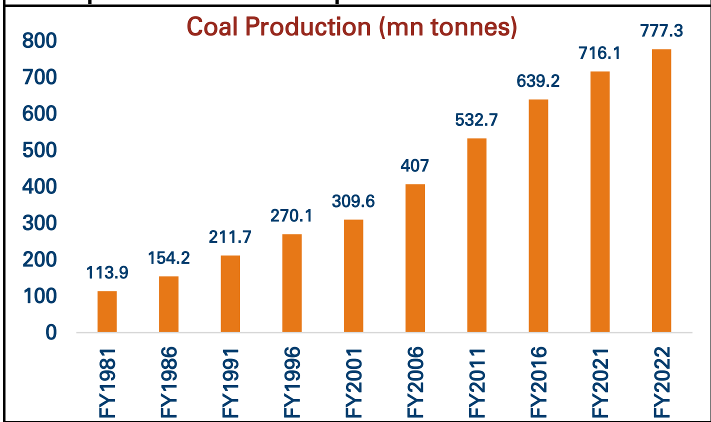
Source: Prowess IQ, CEIC & ICICI Bank Research

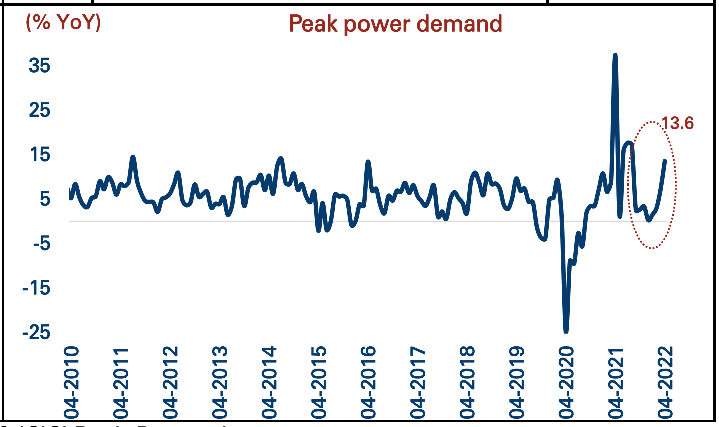
Industrial imports maintained traction	PMI mfg. in the expansionary territory….





Coal production inched up in FY22…..	Peak power demand remained robust in April 2022…





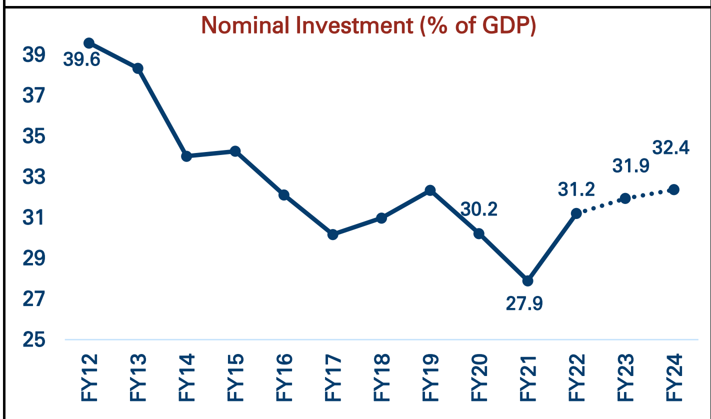
Source: CMIE, CEIC & ICICI Bank Research

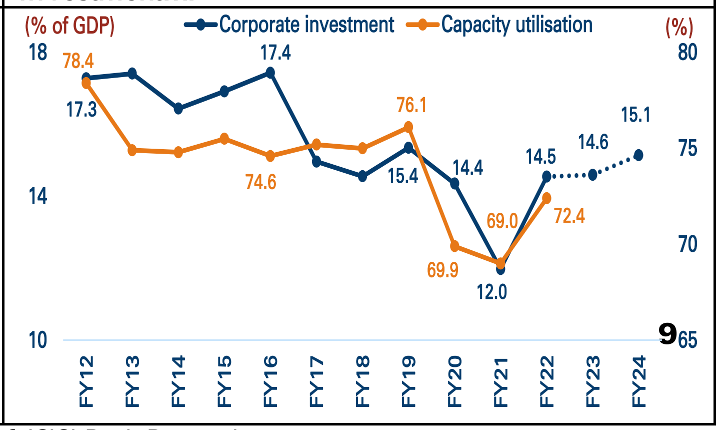
Investment to pick up gradually

Not only government, but corporate and real estate investments are now showing signs of revival. Capacity utilization in the corporate sector has now reached 72% in December 2021. Corporate investment and capacity utilization are inter-related (see chart below). Household investment is also rising on the back of real estate investments. Stamp duty collections rose by 35% in FY22. While rising nominal interest rates will have an impact on real estate demand, the underlying structural drivers—job creation and low inventory—remains strong for now.

Another indicator of pick-up in investment demand is project announcements. They have been increasing now. In addition to this, PLI scheme continues to invoke investor interest. India's FDI inflows also have been increasing and FDI inflows and GDP growth are highly correlated. **Should FDI inflows fall with equity returns coming down? Our research shows, FDI inflows are not related with equity market returns. Hence, pull factor of India's growth should ensure FDI inflows continue.**

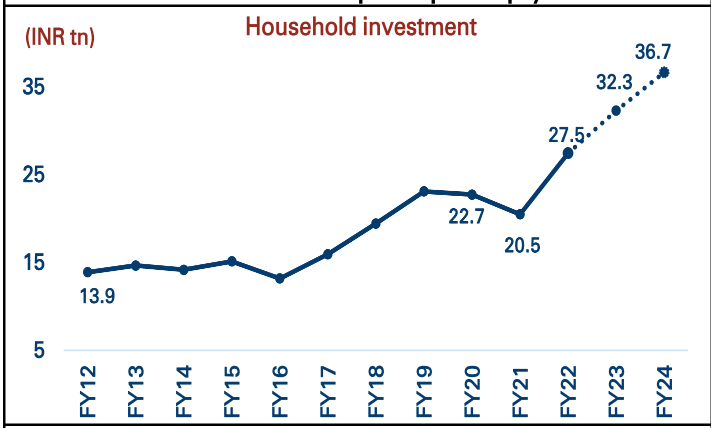
Investment to grow to ~32% of GDP in FY23	Increasing capacity utilization will boost corporate investment….



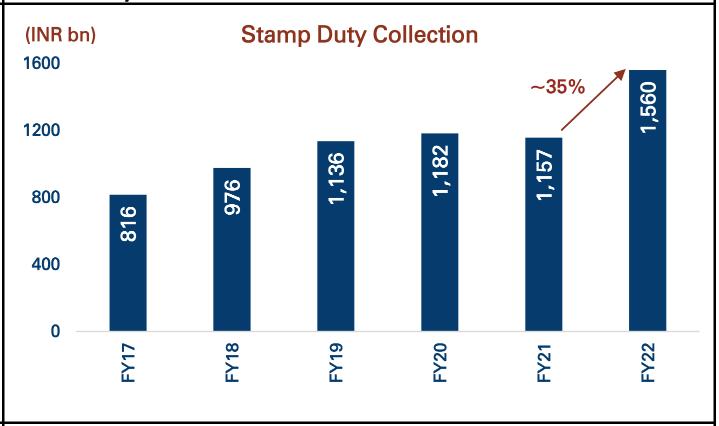


Source: CEIC, MOSPI & ICICI Bank Research

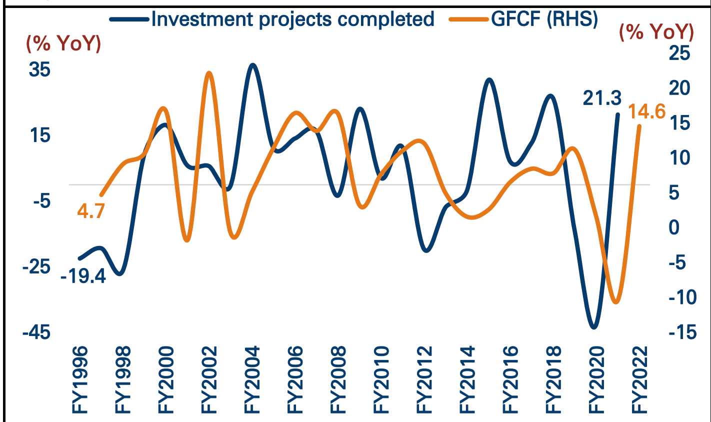
Household investment will pick up sharply…



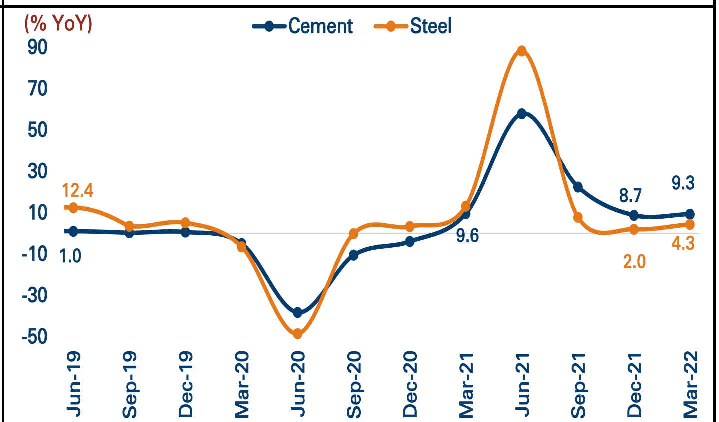
….led by real estate investments



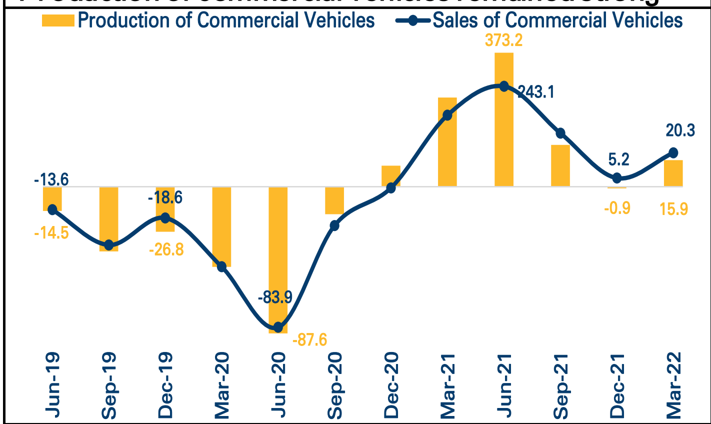
Investment projects completion increased by 14.6% YoY in FY22



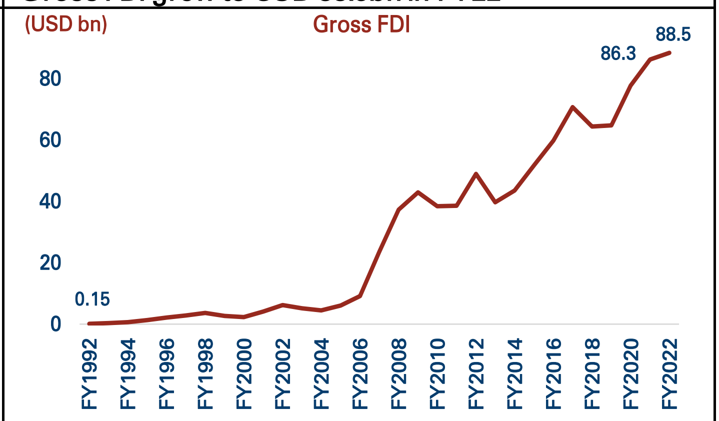
…Cement and steel production too inched up



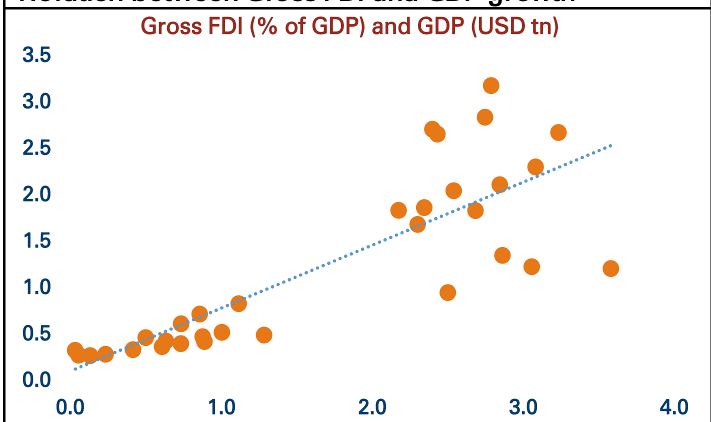
Production of commercial vehicles remained strong



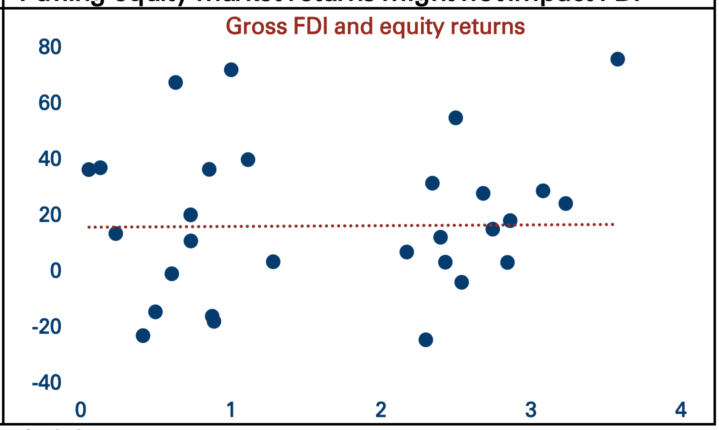
Gross FDI grew to USD 88.5bn in FY22



Relation between Gross FDI and GDP growth



Falling equity market returns might not impact FDI

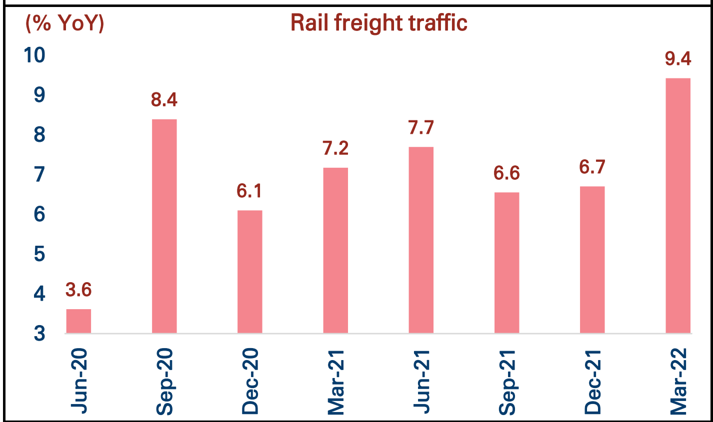


Source: CEIC, CMIE, RBI & ICICI Bank Research

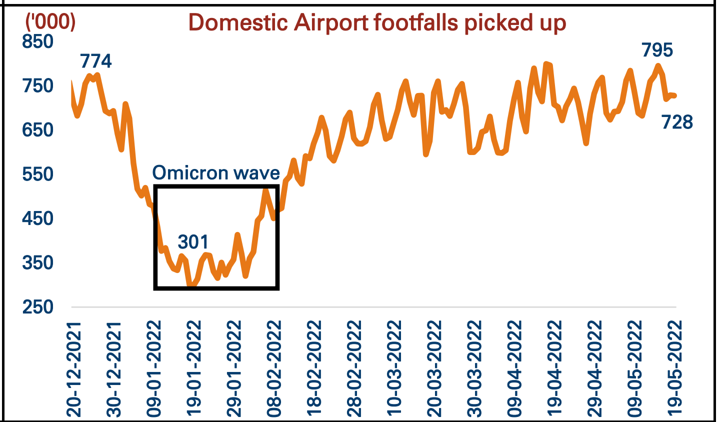
Services gaining traction

Services activity may continue to revive in the year as contact intensive services rebound. Domestic airport footfall has returned to pre-Omicron level. Rail freight continues to gain traction as coal, steel and food grains are being transported. Credit growth is also accelerating with a broad-based revival in underlying economic activity. GST collections are accelerating on the back of compliance and higher nominal GDP growth. Credit to services sector and services PMI point to a continuous improvement in services activity in the country. We expect this trend to sustain during the year. In fact, opening up of education, travel—domestic and international—when juxtaposed with doubling of airport and road infra in the country over the last few years implies underlying long-term growth of services economy in the coming years. **We expect services sector to grow by 8.8% in FY23 and 7.5% in FY24.**

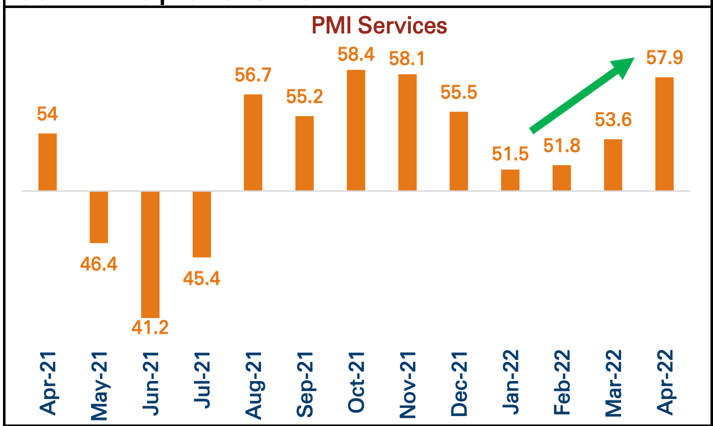
Rail freight traffic increased by 9.4% in Mar 2022



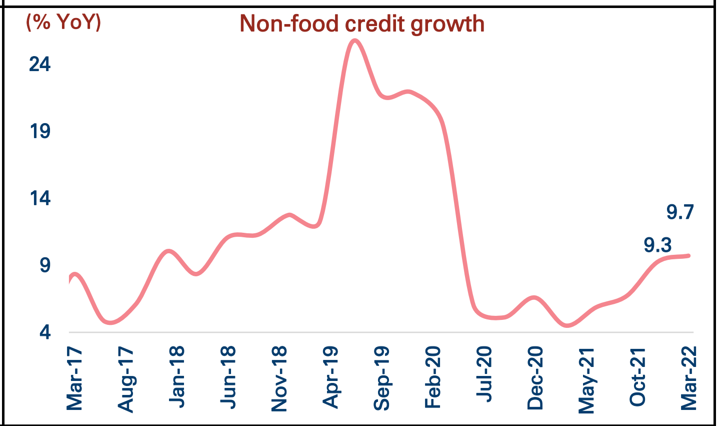
Domestic airport footfalls increased sharply after third wave



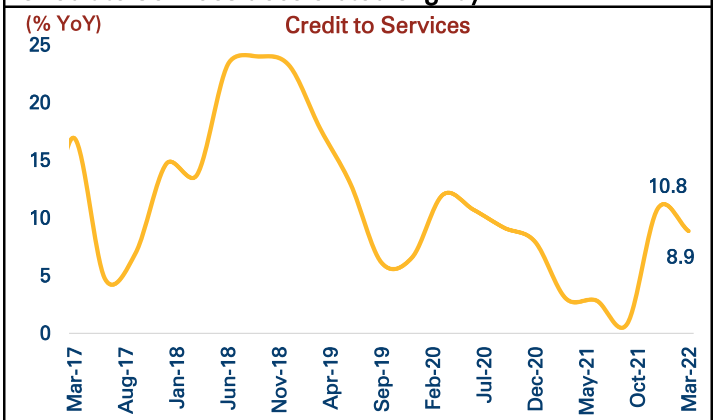
PMI services increased sharply in April to 57.9 from 53.6 in the previous month



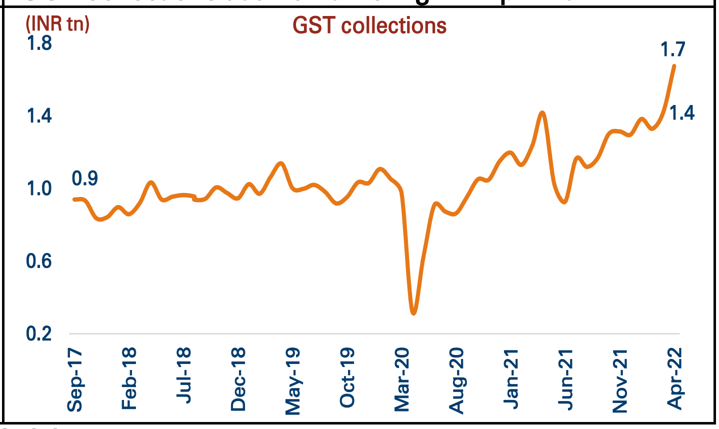
Credit growth remained strong too…



Credit to services decelerated slightly…



GST collections at an all-time high in April 2022



Source: CEIC, CMIE & ICICI Bank Research

Paring down FY23 growth to 7%

A global slowdown on the back of Russia-Ukraine war, global monetary tightening and lockdowns in China, will have an impact on India. While India's underlying growth drivers are strong, we see industrial activity being impacted by margin pressure, lower volume off-take on the back of higher prices and domestic monetary tightening. Exports too will see deceleration on the back of slowing global demand.

Thus, we see India's GDP growth at 7% in FY23. Global economy is expected to slow down further in FY24. Domestic and global rate cycle will ensure tighter financial conditions in India and the world. Monetary policy works with a lag. Thus, we see growth bottoming at 6.5% in FY24.

Yearly Growth estimates (% YoY)	FY19	FY20	FY21	FY22 SAE	FY22 (F)	FY23 (F)	FY24 (F)
Agriculture	2.1	5.5	3.3	3.3	3.2	3.0	3.2
Industry	5.3	-1.4	-3.3	10.3	9.9	4.7	5.6
Services	7.2	6.3	-7.8	8.6	8.6	8.8	7.5
GVA	5.8	3.8	-4.8	8.3	8.1	6.7	6.2
GDP	6.5	3.7	-6.6	8.9	8.5	7.0	6.5

Source: CEIC & ICICI Bank Research

Appendix

Activity indicators heatmap for each quarter

(% YoY)	Indicators	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Industry	Industrial Production	-35.6	-5.7	1.7	6.0	44.4	9.5	2.1	1.6
Mining	IIP Mining	-22.3	-7.0	-3.2	-0.1	27.5	17.1	6.1	3.8
	Core index: Coal	-15.0	5.4	5.2	-1.8	7.9	15.6	9.0	4.5
	Core index: Natural gas	-16.2	-10.1	-8.4	3.0	21.8	22.3	23.0	10.5
	Core index: Crude oil	-6.5	-5.7	-4.9	-3.6	-3.4	-2.4	-2.1	-2.7
Manufacturing	IIP Manufacturing	-40.3	-6.3	1.8	6.8	53.0	8.6	1.4	0.9
	PMI Manufacturing	35.1	51.6	57.2	56.9	51.5	53.8	56.3	54.6
	Automobile production	-79.8	-9.5	12.0	22.6	201.8	-4.5	-21.1	-17.8
	Exports	-36.6	-5.3	-4.2	20.4	86.1	38.6	41.0	23.8
Construction	Core index: Steel	-48.6	-0.1	3.3	13.1	88.4	7.8	2.0	4.4
	Core index: Cement	-38.3	-10.6	-4.0	9.6	57.8	22.5	8.7	9.3
	IIP infra & construction goods	-46.8	-1.6	5.3	9.7	84.0	11.7	3.9	7.5
Electricity	IIP electricity	-15.8	0.1	6.7	9.2	16.8	9.3	2.7	3.9
	Electricity generation	-18.1	0.6	5.1	9.5	17.3	7.3	2.4	2.2
	Electricity demand	-16.0	-1.0	6.3	8.5	16.4	9.4	3.3	4.3
	Peak power demand	-14.3	-2.5	4.5	8.6	17.0	12.4	3.1	4.0
Trade, hotels, transport, & communication services	GST Collections	-41.0	-7.8	7.7	13.7	81.9	28.2	20.3	15.9
	E-Way Bills	-50.5	-0.4	15.1	27.9	97.9	27.5	10.8	9.2
	Air Passenger Traffic	-94.1	-77.4	-56.3	-35.5	366.3	108.7	67.8	13.5
	Air Cargo Traffic	-63.7	-26.9	-11.9	2.5	141.2	25.7	10.0	-0.6
	Rail Freight Traffic	-26.6	3.3	11.1	16.9	52.7	16.5	14.1	11.1
	Cargo traffic	-19.6	-8.6	2.0	7.5	27.2	6.1	1.8	-2.0
	Telecommunication: No. of Subscribers	-1.7	-2.1	-0.9	0.9	3.2	3.1	1.1	-1.9
Financial & Real estate services	Non Food credit	6.3	5.7	5.9	6.0	5.8	6.5	7.8	8.7
	Aggregate deposits	-5.1	-4.2	1.3	7.4	11.7	13.2	12.4	8.4
	Life insurance	-18.6	15.8	-3.3	35.1	6.9	5.1	10.5	25.0
	Non-life insurance	-4.9	5.3	4.1	15.0	13.8	12.1	8.0	10.6
	Stamp duty collections	-61.6	-11.3	17.5	49.0	106.5	53.3	21.2	16.0
Public admin & defence services	Revex less interest	9.7	-14.2	22.9	192.6	-7.3	15.0	8.4	19.2
	Capex	40.1	-37.7	110.5	44.7	26.3	51.9	13.4	-2.9
Consumption	Motor Vehicle Sales	-74.1	-7.0	6.9	20.9	134.8	-2.6	-18.5	-15.5
	Two Wheeler sales	-74.2	0.2	13.4	24.3	85.7	-12.3	-24.8	-23.0
	Petroleum Consumption	-26.1	-12.1	1.1	0.3	15.6	6.0	-4.2	3.1
	Diesel consumption	-33.3	-15.8	-1.1	4.2	22.3	9.0	-3.7	0.0
	Consumer durables	-67.6	-9.8	7.0	17.7	122.9	9.9	-3.5	-5.1
	Consumer non-durables	-16.9	0.4	2.7	4.9	17.4	1.1	0.1	-2.9
	Toll Collection	61.4	181.0	139.3	64.6	157.7	71.7	56.1	40.9
	Gold imports	-93.5	48.5	42.8	247.9	1024.6	162.0	42.7	-52.5
	Tractor sales	-39.9	17.9	25.4	45.9	124.0	11.1	-4.5	-22.3
	Non-oil-non-gold imports	-43.1	-24.4	2.0	19.0	86.1	46.4	39.2	33.7
	Unemployment rate (%)	17.8	7.3	7.5	6.6	9.3	7.3	7.6	7.4
Investment	IIP Capital goods	-64.8	-12.8	-0.7	8.6	109.1	16.7	-2.4	1.4
	Imports of capital goods	-38.4	-16.0	0.9	15.5	73.1	22.1	23.0	23.2

Source: CEIC & ICICI Bank Research

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