



GDP Growth, Q2FY12: Pace of GDP Growth eases to 6.9%, de-growth in investment presents a worrying sign

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The gross domestic product (GDP) at factor cost (constant prices) expanded by 6.9% in year-on-year (y-o-y) terms in the second quarter of fiscal year 2011-12 (Q2FY12), largely in line with our expectations. Growth was led by a 9.3% expansion of the services sector, and dampened by the 3.2% growth displayed by both the agricultural and industrial sectors.

The pace of GDP growth moderated considerably in Q2FY12 as compared to the 8.4% growth recorded in Q2FY11. This was primarily led by a marked slowdown in industrial growth to 3.2% in Q2FY12 from 7.1% in Q2FY11. Moreover, the pace of growth of the agricultural and services sectors also underwent a moderation in Q2FY12 relative to the same quarter in the previous year. Despite the healthy monsoon rainfall, growth of the agricultural sector eased to 3.2% in Q2FY12 from 5.4% in Q2FY11, reflecting the base effect. Growth of the services sector eased mildly to 9.3% in Q2FY12 from 9.6% in Q2FY11.

The slowdown in industrial growth to 3.2% in Q2FY12 largely reflects the moderation in the growth of the manufacturing (2.7% in Q2FY12, 7.8% in Q2FY11) and construction (4.3% in Q2FY12, 6.7% in Q2FY11) sub-sectors as well as the de-growth of 2.9% in mining & quarrying output. However, the pace of growth of the electricity, gas & water supply sub-sector improved substantially to 9.8% in Q2FY12 from 2.8% in Q2FY11.

Within the services sector, the pace of growth eased for community, social & personal services (6.6% in Q2FY12, 7.9% in Q2FY11) and trade, hotels, transport & communication (9.9% in Q2FY12, 10.2% in Q2FY11). However, financing, insurance, real estate & business services recorded improved growth (10.5% in Q2FY12, 10.0% in Q2FY11).

Table 1: Growth of GDP & Components (in %, constant 2004-05 prices, y-o-y)

	Q1	Q2	Q1	Q2
	2010-11	2010-11	2011-12	2011-12
Agriculture & Allied	2.4%	5.4%	3.9%	3.2%
Industry	9.1%	7.1%	5.1%	3.2%
Services	10.4%	9.6%	10.0%	9.3%
GDP at factor cost	8.8%	8.4%	7.7%	6.9%
PFCE	9.5%	9.0%	6.3%	5.9%
GFCE	6.7%	6.4%	2.1%	4.0%
GFCF	11.1%	10.3%	7.9%	-0.6%
Exports	9.8%	10.5%	24.3%	27.4%
less Imports	15.2%	11.4%	23.6%	10.9%
GDP at market prices	9.1%	8.6%	8.5%	6.7%

Source: Central Statistics Office (CSO), ICRA Estimates

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Growth of GDP at market prices (at constant 2004-05 prices), reflecting demand-side factors, slowed to 6.7% in Q2FY12, from 8.6% in Q2FY11. Notably, gross fixed capital formation (GFCF) underwent a de-growth of 0.6% in Q2FY12, as compared to an expansion of 10.3% in Q2FY11 and 7.9% in Q1FY12. Although a slowdown in investment growth in Q2FY12 was anticipated, the contraction of GFCF in Q2FY12 is a cause for concern.

Moreover, the pace of growth of both private final consumption expenditure (PFCE) and government final consumption expenditure (GFCE) moderated in Q2FY12 relative to Q2FY11. While exports recorded a sharp 27.4% growth (at constant 2004-05 prices), imports expanded at a milder pace of 10.9% in Q2FY12; accordingly, net imports declined considerable in Q2FY12.

During Q2FY12, GDP at market prices expanded at a pace of 6.7% relative to the 6.9% growth of GDP at factor cost, with indirect taxes less subsidies expanding by 5.2%. The low growth of the latter is likely to partly reflect the changes in the duty structure for crude oil and petroleum products introduced by Gol in June 2011 as well as the refunds of direct taxes.

Notably, the pace of growth of real GDP at factor cost for Q2FY11 has been revised downward to 8.4% from 8.9%, largely on account of a downward revision in growth of manufacturing (to 7.8% from 10%) and trade, hotels, transport & communication (to 10.2% from 10.9%). Additionally, the pace of growth of real GDP at market prices for Q2FY11 has been revised downward to 8.6% from 9.1%, largely on account of a downward revision in growth of gross domestic capital formation (to 10.6% from 12.1%). At the same time, the growth of private final consumption expenditure (to 9.0% from 8.9%) and exports (to 10.5% from 10.2%) underwent a mild upward revision.

Pace of growth of GDP at factor cost moderates to 6.9% in Q2FY12, broadly in line with expectations

GDP growth at factor cost (at constant 2004-05 prices) moderated to 6.9% in Q2FY12 from 8.4% in Q2FY11 (refer *Chart 1*), led largely by a slowdown in industrial growth as well as a moderation in the pace of growth of the agriculture & allied and services sectors.

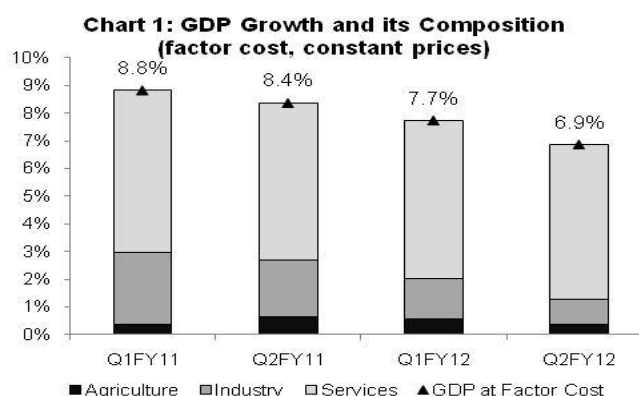
Moreover, on a sequential basis, the pace of GDP expansion moderated relative to the 7.7% growth recorded in Q1FY12.

The contribution of the services sector to the overall GDP growth increased even as that of the industrial and agricultural sectors declined in Q2FY12 relative to Q2FY11.

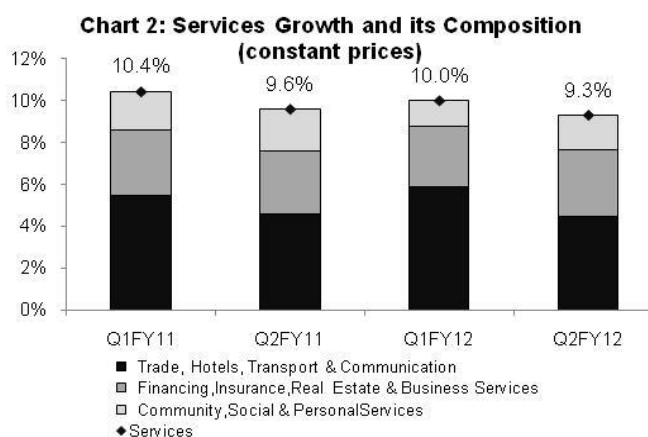
Services sector remains key growth driver:

The services sector expanded by 9.3% in Q2FY12, somewhat slower than the 9.6% growth in Q2FY11 and the 10.0% growth in Q1FY12. Nevertheless, the services sector has remained the primary driver of GDP growth in the recent quarters. The contribution of the services sector to the GDP growth improved to 81% in Q2FY12 from 68% in Q2FY11.

Growth of the services sector in Q1FY12 was led by trade, hotels, transport & communication, which expanded by a healthy 9.9% in Q2FY12, as compared to 10.2% in Q2FY11. However, the pace of growth of this sub-sector slowed in sequential terms relative to the 12.8% growth in Q1FY12.



Source: Central Statistics Office (CSO), ICRA Analysis



Source: Central Statistics Office (CSO), ICRA Analysis

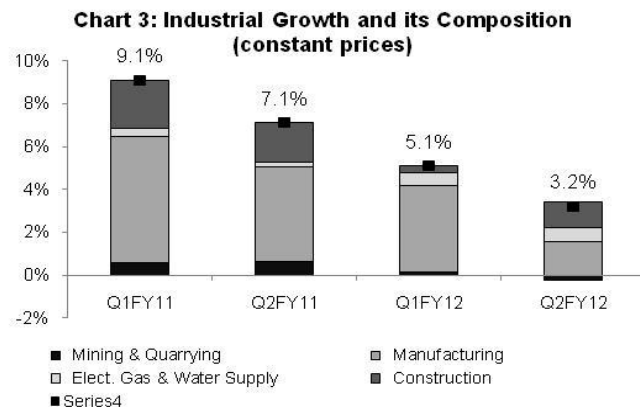
The pace of growth of community, social & personal services, which include public administration & defence and other services, declined to 6.6% in Q2FY12 from 7.9% in Q2FY11. However, growth pickup in sequential terms, as compared to the 5.6% growth in Q1FY12. This is in line with the trends for government final consumption expenditure revealed by the demand side data.

The pace of growth of financing, insurance, real estate & business services (FIRB) improved to 10.5% in Q2FY12 relative to both the 10% growth in Q2FY11 and 9.1% growth in Q1FY12.

While the share of community, social & personal services in overall GDP (at constant prices, factor cost) remained largely steady in Q2FY12 relative to Q2FY11 (at around 15%), the share of trade, hotels, transport & communication (to 28% in Q2FY12 from 27% in Q2FY11) and financing, insurance, real estate & business services (to 19% in Q2FY12 from 18% in Q2FY11) recorded an improvement.

Industrial growth decelerates further: The industrial sector expanded by a low 3.2% in Q2FY12, considerably lower than the 7.1% growth in Q2FY11, led by the moderation in manufacturing and construction growth and a de-growth in the mining & quarrying sector.

Manufacturing growth slowed sharply to 2.7% in Q2FY12 from 7.8% in Q2FY11 and 7.2% in Q1FY12. Construction growth slowed to 4.3% in Q2FY12 from 6.7% in Q2FY11. However, the pace of growth improved in sequential terms, relative to the low 1.2% growth recorded in Q1FY12.



Source: Central Statistics Office (CSO), ICRA Analysis

The mining & quarrying sub-sector underwent a contraction of 2.9% in Q2FY12, as compared to the healthy 8.0% growth in Q2FY11, which is largely related to the dip in natural gas production and coal output.

The growth of electricity, gas & water supply improved to a robust 9.8% in Q2FY12 from 2.8% in Q2FY11. This is likely to be largely led by the improvement in growth of electricity generation; data provided by the IIP indicates that growth of electricity generated improved to 10.5% in Q2FY12 from 2.1% in Q2FY11.

Agricultural growth moderates in Q2FY12: Following the above-normal monsoon rainfall in 2011, the agriculture and allied sector recorded a 3.2% expansion in Q2FY12. However, the pace of growth slowed relative to the 5.4% growth in Q2FY11, reflecting the base effect. Data released by the Government indicates an increase in production during the *kharif* season for 2011 (First Advance Estimates) relative to 2010 (Fourth Advance Estimates) of foodgrains (to 123.88 million tonnes or MT from 120.20 MT), oilseeds (to 20.89 MT from 20.85 MT), cotton (to 36.1 million bales from 33.43 million bales) and sugarcane (to 342.2 MT from 339.17 MT).

Growth of real GDP at market prices slows to 6.7% in Q2FY12

Expenditures of GDP at market prices (at constant 2004-05 prices), reflecting the demand side factors, expanded by 6.7% in Q2FY12, slower than the 8.6% growth recorded in Q2FY11.

Gross fixed capital formation contracts in Q2FY12: In a worrying trend, gross fixed capital formation displayed a de-growth of 0.6% in Q2FY12, as compared to an expansion of 10.3% in Q2FY11. Moreover, the performance in Q2FY12 stands in contrast to the healthy 7.9% growth in Q1FY12. The deteriorating investment scenario reflects the cumulative impact of rising interest rates and dampened business confidence, which have resulted in a slowdown in execution of planned projects as well as new projects announcements. Moreover, issues related to availability of inputs have resulted in a delay in the pace of capacity addition in certain sectors, for instance gas-based power plants.

Pace of growth of private consumption expenditure moderates further: The growth of private final consumption expenditure moderated to 5.9% in Q2FY12 from 9.0% in Q2FY11. Moreover, the pace of consumption growth eased somewhat as compared to the 6.3% expansion in Q1FY12, highlighting the impact of the prevalent high inflation and interest rate scenario on consumption demand.

Low growth of government consumption expenditure: The pace of growth of government final consumption expenditure slowed to 4.0% in Q2FY12 from 6.4% in Q2FY11. However, the pace of growth improved to an extent as compared to the low 2.1% growth in Q1FY12. This partly reflects the pickup in growth of Govt's revenue expenditure to 15% in Q2FY12 from 7% in Q1FY12, based on data published by the Controller General of Accounts.

Sharp growth of exports and imports: At constant 2004-05 prices, exports recorded a sharp 27.4% growth in Q2FY12, indicating rising volumes of exports. Contrastingly, imports expanded at a mildly slower pace of 10.9% in Q2FY12 relative to the 11.4% growth in Q2FY11. Moreover, the pace of growth of imports declined sharply in Q2FY12 as compared to the 23.6% growth recorded in Q1FY12.

With exports recording a substantially faster expansion in Q2FY12 as compared to imports, net imports declined considerably in Q2FY12.

Outlook

The macroeconomic outlook has deteriorated in the recent months on account of various factors such as a weakening of business sentiments, depreciation of the Indian rupee and the ongoing debt crisis in Europe, amongst others. Investment growth is likely to remain sluggish in the coming quarters, unless implementation of economic reforms and clarity on various regulatory and policy issues results in a marked improvement in business confidence. Domestic consumption demand is unlikely to display a substantial pickup in the near term, until inflation and interest rates moderate substantially from the prevailing levels. While the attractiveness of exports would be boosted by the depreciation of the Indian rupee, new orders would be critically dependant on the growth outlook and consumer confidence in the Advanced Economies. Accordingly, manufacturing growth may remain sluggish in the coming months, although inventory restocking subsequent to the festive season may provide a limited boost in Q3FY12. The unfavourable trends for the mining & quarrying sub-sector may persist in Q3FY12, with the continuing ban on mining in some districts of Karnataka, and instances of strikes and agitations in key mining areas in October 2011. However, the services sector is expected to continue to display a healthy expansion in the ongoing fiscal year, supporting overall economic growth. Moreover, the replenishment of reservoirs following the healthy monsoon is likely to result in a favourable *rabi* harvest in 2011-12, supporting rural incomes and demand. Overall, ICRA expects GDP at factor cost to expand by 7.3-7.5% in the current fiscal year.

Given that the initial estimate of GDP growth for Q2FY12 (6.9%) is broadly in line with our forecast (7.0%), we continue to expect the Central Bank to keep the repo rate unchanged until at least April 2012, in order to signal its intention to contain inflation, unless there is a substantial external shock or credit event.

Annexure

Table 2: GDP & its components (constant 2004-05 prices)

	Y-o-Y Growth (%)			GDP in Rs. Crore		
	Q2FY11	Q1FY12	Q2FY12	Q2FY11	Q1FY12	Q2FY12
GDP at factor cost	8.4%	7.7%	6.9%	1,148,473	1,226,338	1,227,256
Agriculture, Forestry & Fishing	5.4%	3.9%	3.2%	131,550	167,091	135,789
Industry	7.1%	5.1%	3.2%	327,722	343,212	338,249
<i>Mining & Quarrying</i>	8.0%	1.8%	-2.9%	25,509	26,832	24,774
<i>Manufacturing</i>	7.8%	7.2%	2.7%	187,763	196,699	192,849
<i>Electricity, Gas & Water Supply</i>	2.8%	7.9%	9.8%	22,894	25,042	25,137
<i>Construction</i>	6.7%	1.2%	4.3%	91,556	94,639	95,489
Services	9.6%	10.0%	9.3%	689,201	716,035	753,218
<i>THTC</i>	10.2%	12.8%	9.9%	311,166	337,872	342,080
<i>FIRB</i>	10.0%	9.1%	10.5%	208,645	224,574	230,627
<i>CSPS</i>	7.9%	5.6%	6.6%	169,390	153,589	180,511

Source: CSO, ICRA Estimates

Table 3: GDP & its components (constant 2004-05 prices)

	Y-o-Y Growth (%)			GDP in Rs. Crore		
	Q2FY11	Q1FY12	Q2FY12	Q2FY11	Q1FY12	Q2FY12
GDP at market prices	8.6%	8.5%	6.7%	1,237,610	1,315,395	1,321,038
PFCE	9.0%	6.3%	5.9%	741,624	795,683	785,463
GFCF	6.4%	2.1%	4.0%	135,400	136,935	140,883
Exports	10.5%	24.3%	27.4%	262,098	320,247	333,947
less Imports	11.4%	23.6%	10.9%	356,753	433,824	395,512
Gross Domestic Capital Formation	10.6%	9.6%	1.2%	480,359	497,108	486,174
GFCF	10.3%	7.9%	-0.6%	405,567	410,533	402,994
Change in Stocks	6.5%	4.7%	1.5%	44,808	45,852	45,499
Valuables	21.8%	39.3%	25.7%	29,984	40,723	37,681
Discrepancies	23.1%	-97.5%	19.1%	-25,117	-755	-29,918

Source: CSO, ICRA Estimates



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