

## Q2FY20 GDP: Investments drag GDP growth to sub-5%

India's GDP growth declined for the sixth consecutive quarter, with Q2FY20 GDP rising by 4.5%, in line with the Consensus estimate<sup>1</sup> of 4.6%, and the lowest in over six-and-a-half years. Investment has been the biggest drag this time, with Gross Fixed Capital Formation rising by a modest 1.0% in Q2FY20—the lowest in over five years—a consequence of muted demand, weak business confidence and low capacity utilisation. Private consumption growth, however, has improved sequentially to 5.1% in Q2FY20, even as it remains much below the historical average (~7%). Fiscal spending has been the only saviour, rising by a strong 15.6% YoY and contributing nearly 41% to incremental GDP in Q2FY20—the highest contribution in over 11 years. At a sector level, while growth in agriculture and services sectors remained steady on a sequential basis, industrial sector growth fell sharply, led by a moderation across the board, the most severe being in Manufacturing.

While a favourable base is likely to support GDP growth over the next few quarters, any tangible recovery may take time to materialise, and would be driven by an effective monetary transmission and impact of recent fiscal/external measures taken by the Government. Moreover, fiscal deficit already over the annual target implies limited headroom for expansionary policy. On the positive side, benign crude oil prices and plentiful rains bode well for the economy. We expect the RBI to cut policy rate by another 25bps in December.

- **GDP growth falls to sub-5%:** Second quarter GDP growth fell to 26-quarter low of 4.5% (5.0% in Q1FY20 and 7.0% in Q2FY19), in line with the Consensus estimate of 4.6%, as a sharp deceleration in investment growth more than offset a modest recovery in private consumption. The Gross Value Added (GVA) growth also dropped to 4.3% in Q2FY20 (vs. 4.9% in Q1FY20 and 6.9% in Q2FY19)—the lowest in the new series (base year 2011-12), largely led by a sharp deceleration in the industrial sector growth, led by slowdown across the board, particularly manufacturing, even as growth in services and agricultural sectors remained broadly steady.
- **Government spending the only saviour:** The Q2GDP growth was severely dragged down by lacklustre investment, with GFCF (Gross Fixed Capital Formation) growing at a 19-quarter low of 1.0% in Q2FY20 (vs. 4.0% in Q1FY20 and 11.0% in Q2FY19). This is largely a consequence of muted demand environment, weak business confidence, low capacity utilisation and tight financial conditions. Private consumption, however, has seen a modest improvement, rising by 5.1% in Q2FY20 vs. an 18-quarter low of 3.1% in Q1FY20 (9.8% in Q2FY19), supported by a festival-led demand. Government spending has remained the mainstay for yet another quarter, with GFCE (Govt. Final Consumption Expenditure) growing at a six-quarter high of 15.6% in Q2FY20, excluding which GDP growth was 3.1%.
- **Sector-wise, Manufacturing remains a drag for yet another quarter:** Among the sectors, agriculture sector growth remained broadly steady at 2.1% in Q2FY20, nearly half of the average growth over the last seven years, as extended and heavy rainfall hit farm output. Further, industrial growth fell to 0.5% in Q2FY20—the lowest in the new series, led by slowdown across the board. While mining sector was hit by heavy rainfall during last quarter, manufacturing sector growth decelerated sharply to -1.7%, reflecting weak demand consumption and investment demand in the economy. Services sector remained the only silver lining for yet another quarter, growing at 6.8% in Q2FY20, the lowest in over two years, largely supported by strong Government spending (Community, Social & Personal Services), excluding which GVA growth was 3.2%.
- **A shallow recovery ahead, supported by a favourable base:** GDP growth has declined for the sixth consecutive quarter, and while it is expected to improve over the next few quarters, a large part of it would be because of a favourable base. Moreover, strained fiscal balances are likely to keep the Government's hands tight in the second half. The monetary/fiscal measures taken by the RBI/Government would also take a few quarters to bear fruit. On the positive side, high reservoir levels and soil moisture, thanks to a prolonged and an above normal rainfall, have improved prospects for the *Rabi* season. This, along with benign crude oil prices, bodes well for the Indian economy. While the monetary transmission mechanism is expected to take a few quarters to work its way through, we expect the Central Bank to cut policy rates by another 25bps in December.

<sup>1</sup> Bloomberg Consensus Forecasts.

**Figure 1: Quarterly growth trend (2011-12=100) (%YoY)**

	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
<b>Gross Domestic Product (GDP)</b>	<b>7.0</b>	<b>6.6</b>	<b>5.8</b>	<b>5.0</b>	<b>4.5</b>
Private Consumption (PFCE)	9.8	8.1	7.2	3.1	5.1
Government Consumption (GFCE)	10.9	6.5	13.1	8.8	15.6
Gross Capital Formation (GCF)	11.0	11.2	3.6	3.7	0.5
Gross Fixed Capital Formation (GFCF)	11.8	11.7	3.6	4.0	1.0
Net trade of goods & services	84.8	3.9	33.4	-1.9	-31.2
Exports of goods & services	12.7	16.7	10.6	5.7	-0.4
Imports of goods & services	22.9	14.5	13.3	4.2	-6.9
<b>Gross Value Added (GVA)</b>	<b>6.9</b>	<b>6.3</b>	<b>5.7</b>	<b>4.9</b>	<b>4.3</b>
<b>Agriculture</b>	<b>4.9</b>	<b>2.8</b>	<b>-0.1</b>	<b>2.0</b>	<b>2.1</b>
<b>Industry</b>	<b>6.7</b>	<b>7.0</b>	<b>4.2</b>	<b>2.7</b>	<b>0.5</b>
Mining and Quarrying	-2.2	1.8	4.2	2.7	0.1
Manufacturing	6.9	6.4	3.1	0.6	-1.0
Electricity	8.7	8.3	4.3	8.6	3.6
Construction	8.5	9.7	7.1	5.7	3.3
<b>Services</b>	<b>7.3</b>	<b>7.2</b>	<b>8.4</b>	<b>6.9</b>	<b>6.8</b>
Trade, Hotels, Transport, Storage, Comm.	6.9	6.9	6.0	7.1	4.8
Fin. Svcs, Real Estate & Business Svcs.	7.0	7.2	9.5	5.9	5.8
Community, Social & Personal Svcs.	8.6	7.5	10.7	8.5	11.6

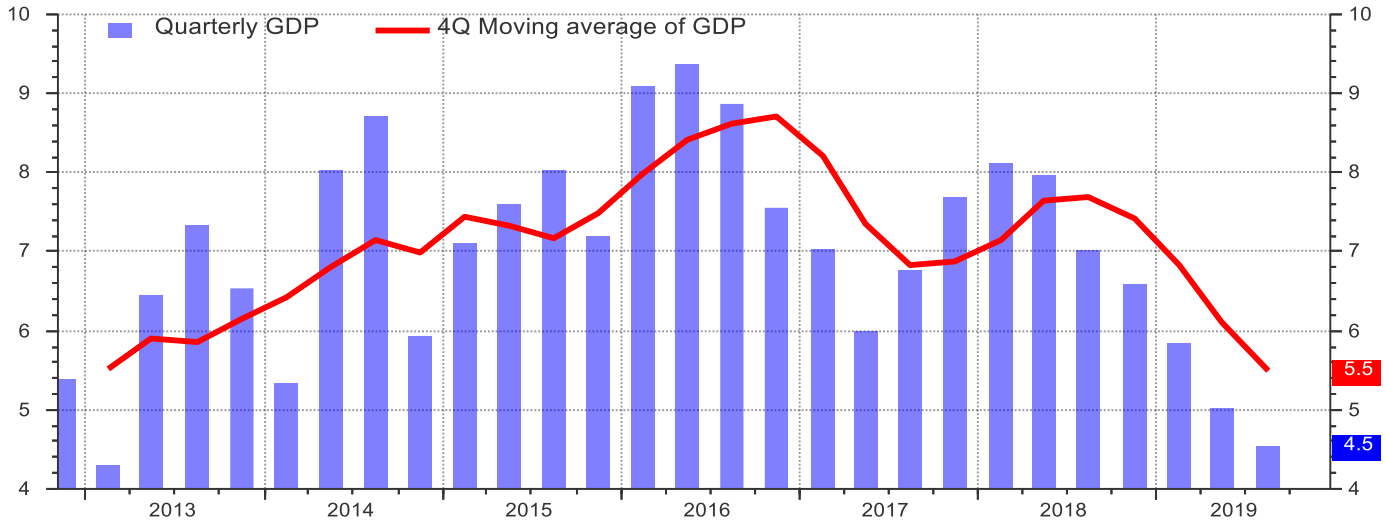
Source: CSO, NSE

**Figure 2: Annual growth trend (% YoY)**

	FY16	FY17	FY18	FY19
<b>Gross Domestic Product (GDP)</b>	<b>8.0</b>	<b>8.2</b>	<b>7.2</b>	<b>6.8</b>
Private Consumption (PFCE)	7.9	8.2	7.4	8.1
Government Consumption (GFCE)	7.5	5.8	15.0	9.2
Gross Capital Formation (GCF)	7.0	5.8	12.9	4.3
Gross Fixed Capital Formation (GFCF)	6.5	8.3	9.3	10.0
Net trade of goods & services	-9.1	-7.2	263.1	31.0
Exports of goods & services	-4.6	0.0	0.0	0.0
Imports of goods & services	-2.8	0.0	0.0	0.0
<b>Gross Value Added (GVA)</b>	<b>8.0</b>	<b>7.9</b>	<b>6.9</b>	<b>6.6</b>
<b>Agriculture</b>	<b>0.6</b>	<b>6.3</b>	<b>5.0</b>	<b>2.9</b>
<b>Industry</b>	<b>9.6</b>	<b>7.7</b>	<b>5.9</b>	<b>6.9</b>
Mining and Quarrying	10.1	9.5	5.1	1.3
Manufacturing	13.1	7.9	5.9	6.9
Electricity	4.7	10.0	8.6	7.0
Construction	3.6	6.1	5.6	8.7
<b>Services</b>	<b>9.4</b>	<b>8.4</b>	<b>8.1</b>	<b>7.5</b>
Trade, Hotels, Transport, Storage, Comm.	10.2	7.7	7.8	6.9
Fin. Svcs, Real Estate & Business Svcs.	10.7	8.7	6.2	7.4
Community, Social & Personal Svcs.	6.1	9.2	11.9	8.6

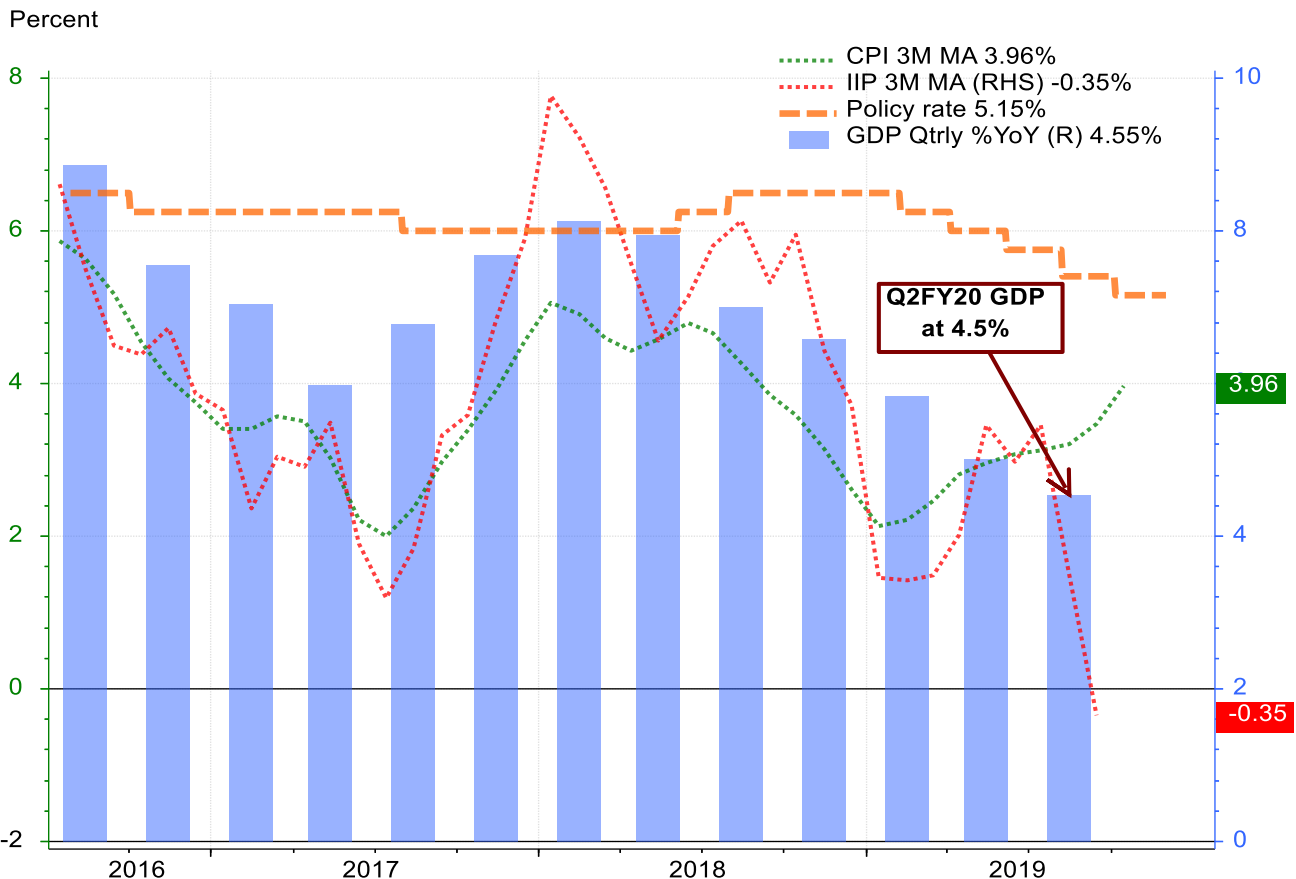
Source: CSO, NSE

**Figure 3: India quarterly GDP growth falls to 26-quarter lows (%):** Growth at 4.5% in Q2FY20 is now sequentially weaker for the sixth quarter in a row and is the weakest in last 26 quarters. Adjusted for seasonal effects, the 4QMA growth is firmly trending lower to 5.5% now.



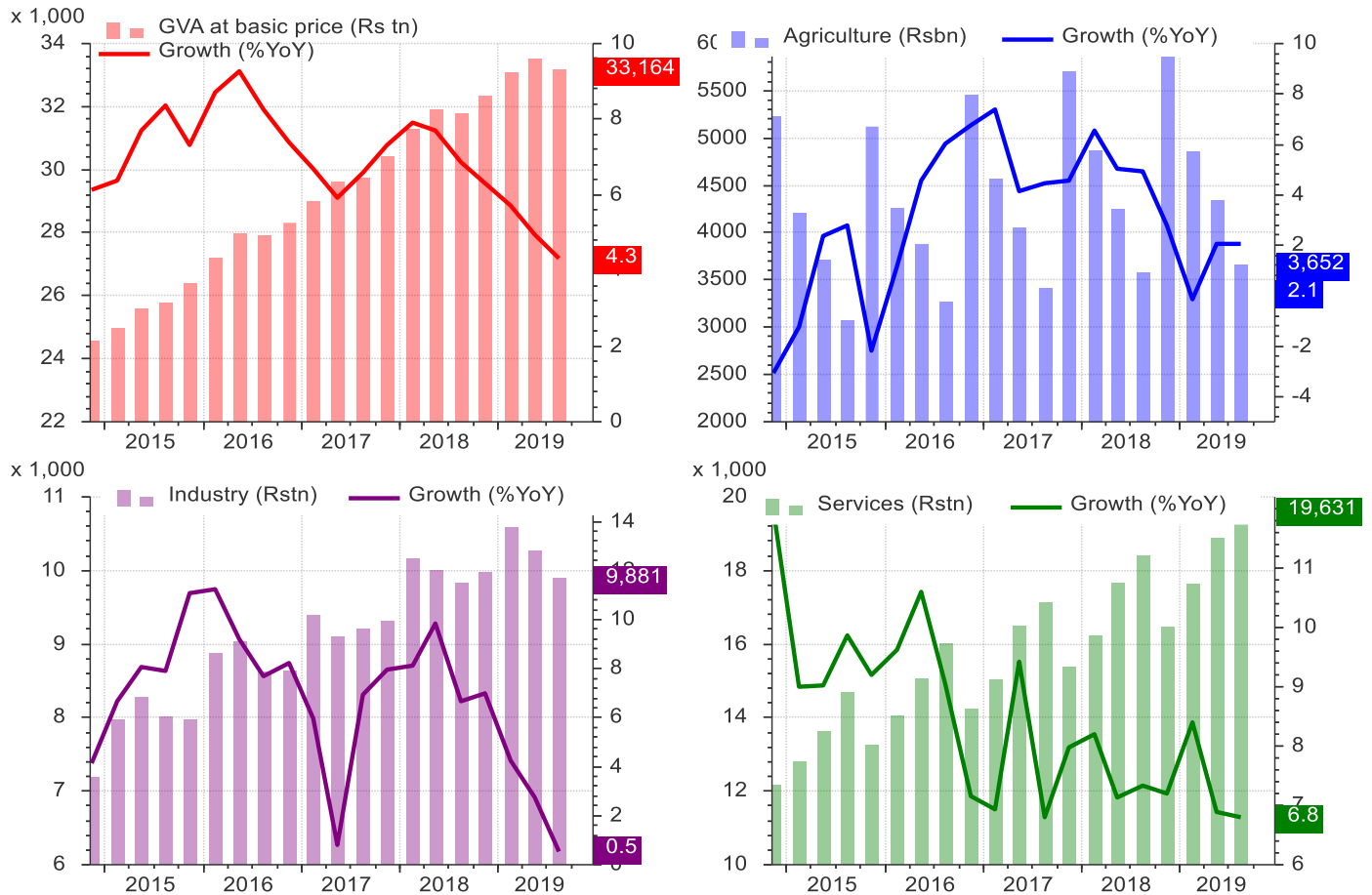
Source: Refinitiv Datastream, NSE

**Figure 4: Macro indicators in a snapshot:** The central bank's 5<sup>th</sup> cut in the policy repo this year has yet to translate into lower cost of funds for the economy, given the pace of monetary transmission. While inflation has picked up over the last few months, it has been largely on account of food inflation (vegetables) even as core has continued to decline, reflecting weak demand conditions. This is likely to keep the room open for further monetary easing.



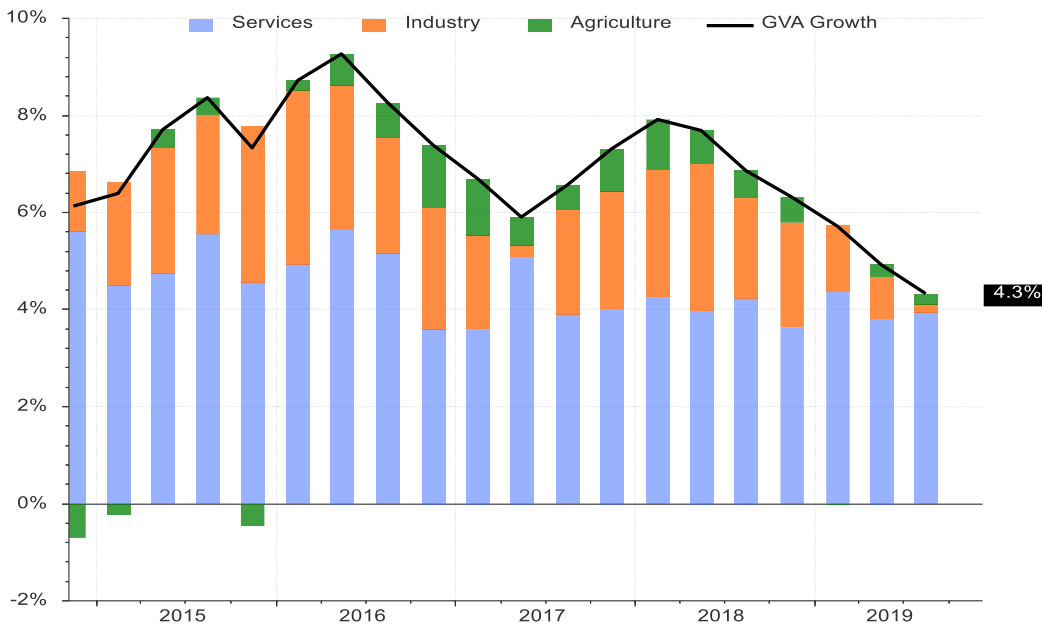
Source: Refinitiv Datastream, NSE

**Figure 5: Gross value added (GVA) across sectors:** While GVA growth for Agriculture and Services sectors remained broadly steady on a sequential basis, Industry sector growth has come off sharply to a mere 0.5% in Q2FY20—the lowest level in the new series (base year 2011-12). This is also reflected in several high frequency indicators such as industrial production, eight-core sector growth and manufacturing PMI, amongst others.



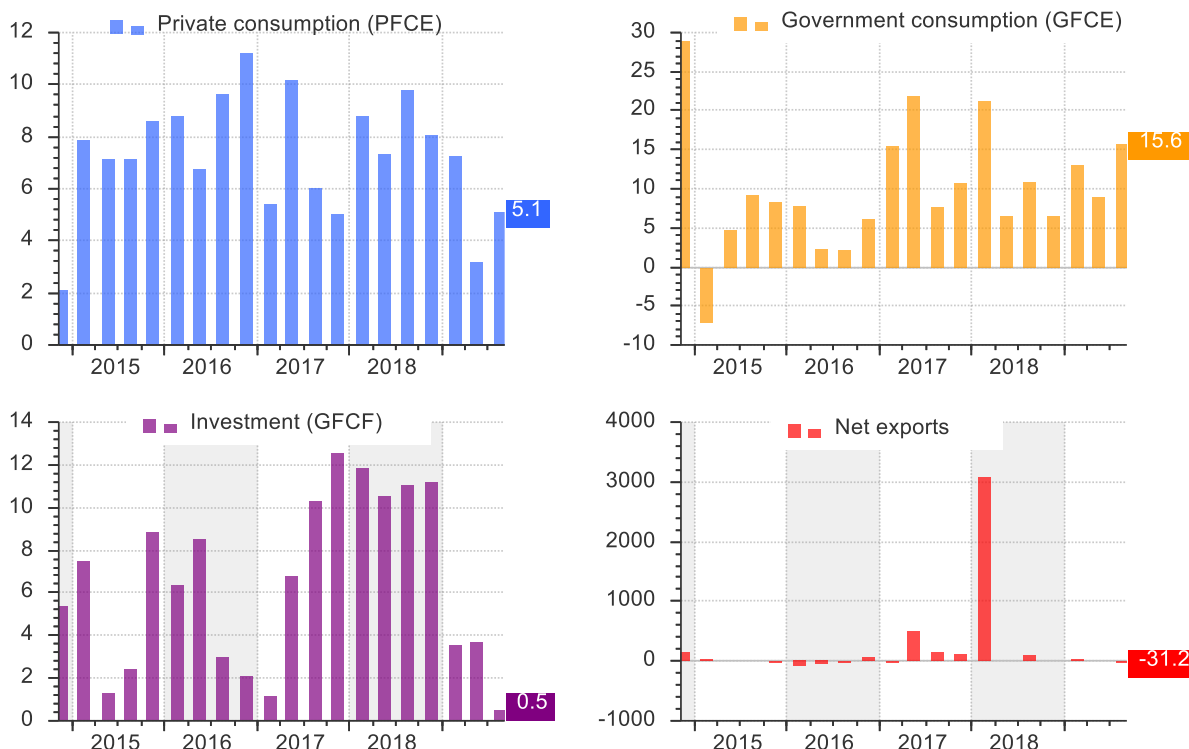
Source: Refinitiv Datastream, NSE

**Figure 6: India GVA sector share of growth (%):** The Industry sector's contribution to overall GVA growth has also come off sharply from an average of 32% in FY19 to mere 3.7% in Q2FY20—the lowest in the new series.

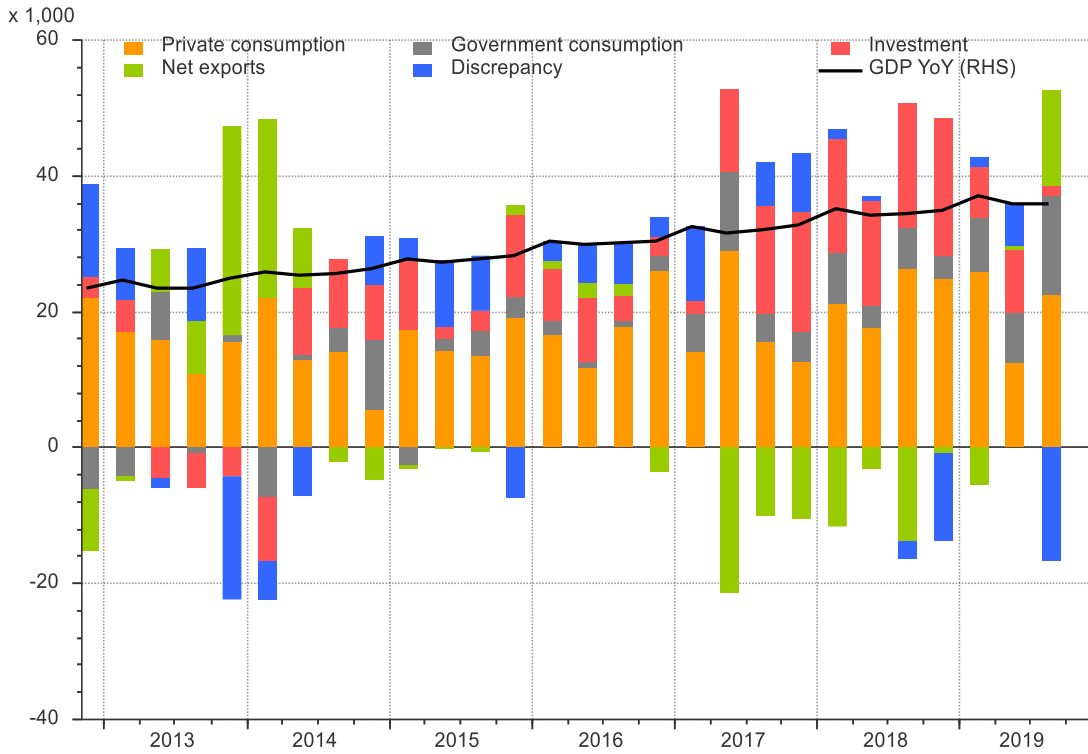


Source: Refinitiv Datastream, NSE

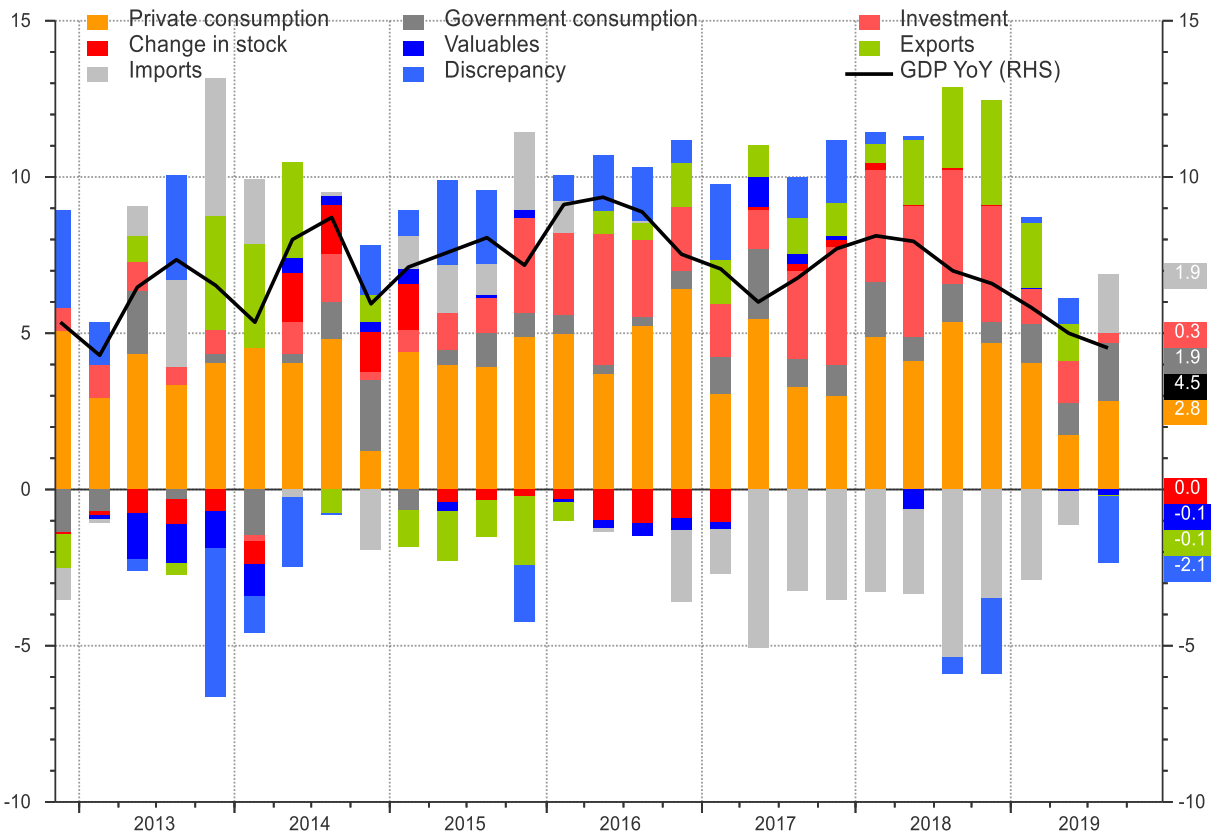
**Figure 7: GDP sector quarterly growth (%YoY):** Consumption—the mainstay of Indian economy—has seen some improvement in the September quarter. While growth in private consumption has improved from an 18-quarter low of 3.1% in Q1FY20 to 5.1% in Q2FY20, growth in Government consumption came in at a six-quarter high of 15.6%, thanks to a surge in Government spending in the second quarter after a lull start to the fiscal. Investment growth (Gross Fixed Capital Formation), however, has fallen sharply to a 19-quarter low of 1.0% in Q2FY20—a consequence of muted demand environment, weak business confidence, low capacity utilisation and tight financial conditions.



Source: Refinitiv Datastream, NSE

**Figure 8: GDP sector quarterly contribution (%GDP)**


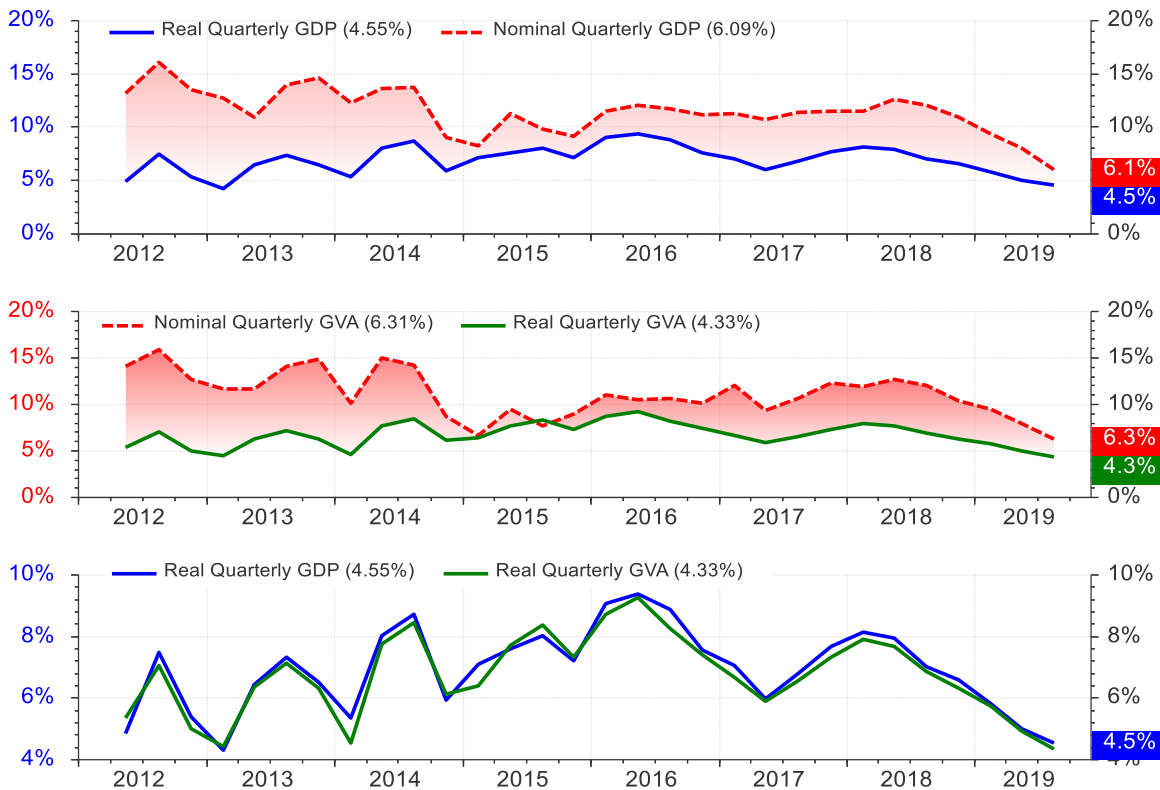
Source: Refinitiv Datastream, NSE

**Figure 9: India GDP sector share of growth (%)**


Source: Refinitiv Datastream, NSE

**Figure 10: Nominal vs. real GDP and GVA growth** Low inflation has meant that there is minimal gap between growth at the real and nominal levels, roughly the same across output and expenditure.

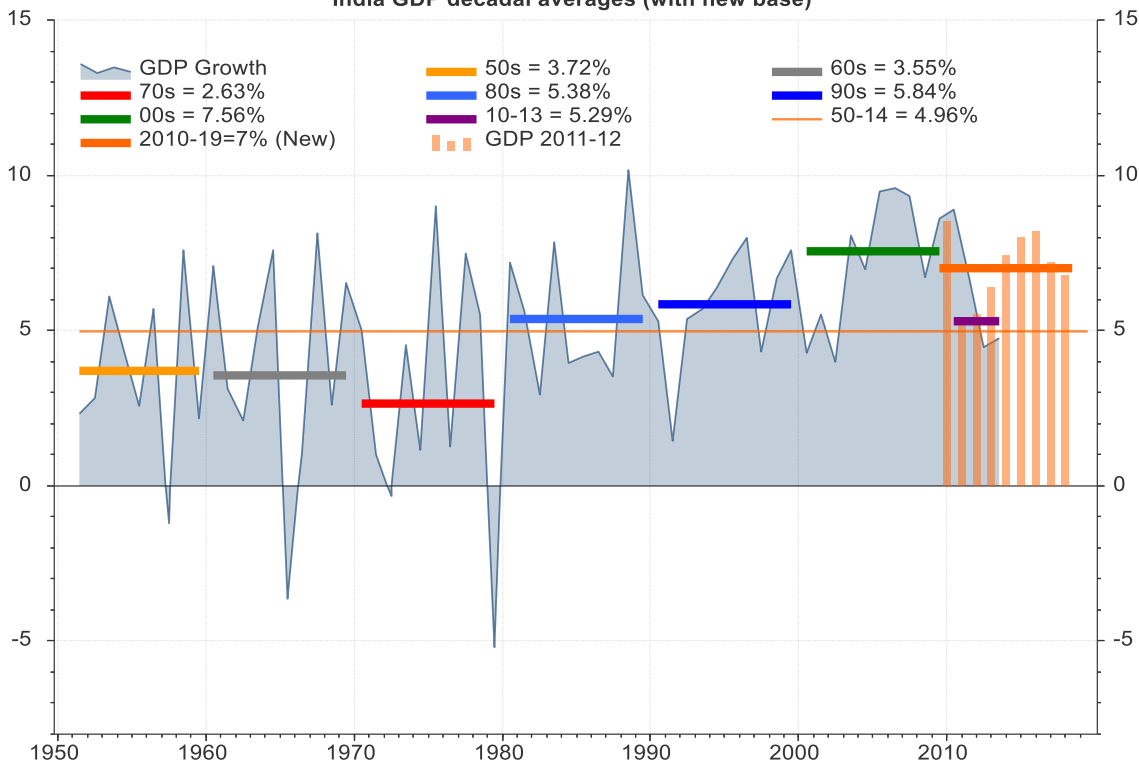
**India GDP, GVA: Nominal and Real Growth**



Source: Refinitiv Datastream, NSE

**Figure 11: The long-term India growth story**

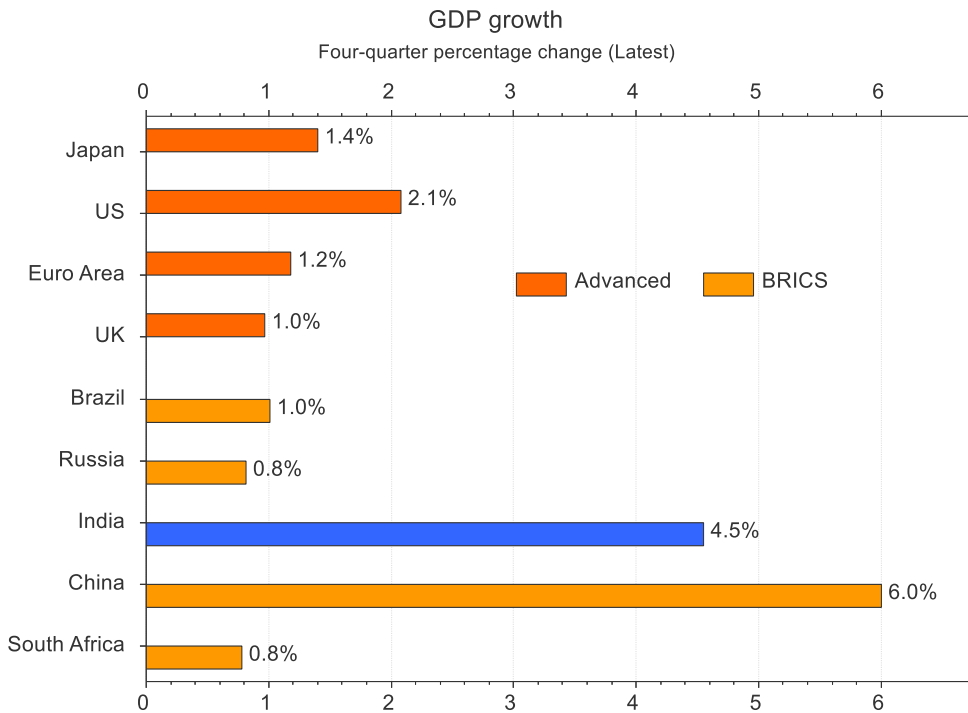
**India GDP decadal averages (with new base)**



Source: Refinitiv Datastream, NSE

From a long-term perspective, India's GDP growth has seen a steady change over the 70 years. The chart above depicts average decadal growth since the 1950s till present day. A number of observations can be made: National income growth remained around the 3% figure in the 50s and 60s, the so-called Hindu rate of growth, but annual growth remained volatile. The 70s saw growth dip to around 2.6%, thanks to the war, and two oil crises. Growth began to pick up again in the 80s, and accelerated in the 2000s, reaching 7.6% over 2000-09, thanks to liberalisation policies of the 90s, and a supportive global environment. The Global Financial Crisis (GFC) saw a sharp drop in growth (5.3% in the old base), but a resilient, largely domestic economy recovered soon enough, and growth has averaged 7% since 2010 (New base of 2011-12), despite the recent slowdown that has now stretched for four years.

**Figure 12: India growth vs. major economies in the world**



Source: Refinitiv Datastream, NSE



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