Macro Review

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Q2FY21 GDP points to a strong recovery; FY21E revised up to -8.0%

India's second quarter GDP (Q2FY21) contracted by 7.5% YoY**—**a significant and higher-than-expected (Bloomberg consensus: -8.2%) improvement from a 23.9% YoY contraction in the previous quarter. The rebound was primarily led by a strong recovery in investments (-7.3% YoY) and exports (-1.5%), partly compensating for a sharp contraction in public (-22.2% YoY) and private (-11.3% YoY) consumption. By economic activity, Gross Value Added (GVA) contracted by 7.0% YoY on the back of a less-than-expected contraction in the Industrial sector (-2.1%), thanks to an unexpected expansion in the manufacturing sector (+0.6%)**—**reflected in robust growth in corporate profits in Q2. Services sector, on the other hand, disappointed (-11.4%) owing to lower Govt. spending (community, social & personal services) and a sequentially steeper contraction in financial, real estate and business services. Growth in the Agriculture sector remained steady at 3.4%.

Faster normalisation of business activities amid gradual lifting of lockdown restrictions, improvement in rural demand and restocking ahead of the festive season has supported economic growth in the quarter gone by. That said, the national accounts data in Q2 mainly captures the organised corporate sector where the recovery has been robust. The impact of lockdown has been far more severe on the informal sector which has got hit by aggressive cost rationalisation by the formal sector**—something that doesn't r**eflect in the GDP data yet. The Q2 figures, therefore, face over-estimation bias, and are susceptible to downward revisions.

The recovery has extended into the third quarter of the fiscal, with several high frequency indicators including PMI, auto sales, GST collections recording an expansion, thanks to a strong festive-led demand. However, it remains to be seen if the demand recovery sustains beyond the festive season, particularly in the wake of decline in household incomes and rise in COVID-19 cases in some states. Additionally, a second wave of infections in the **US/Europe is likely to weigh on India's exports to these countries. We revise our FY21 GDP growth estimate** upwards from -10.5% to -8%, with growth in FY22 now expected at 9.5%, supported by a favourable base.

India's GDP fell by a much lower 7.5% in Q2FY21—a meaningful improvement from 23.9% contraction in the previous quarter.

- Q2FY21 GDP growth surprises positively: The second quarter's national accounts data points to a faster-than-expected economic recovery post the stringent nation-wide lockdown imposed in the previous quarter. The Indian economy contracted a much lower 7.5% YoY in Q2FY21—a meaningful improvement from 23.9% contraction in the previous quarter and much better than market expectations of a 8.2% decline. The rebound was primarily led by a much more moderate contraction in investments and exports, partly compensating for a sharp drop in public and private consumption. The GVA in Q2FY21 shrank by 7.0%, largely led by an unexpected expansion in manufacturing and steady growth in agriculture, partly offset by lower Government spending and a sharp contraction in financial, real estate & business services. Nominal GDP contracted by 4.0% YoY vs. 22.6% contraction in the previous quarter.

A sharp rebound in investment and exports partly made up for a huge contraction in Government consumption

- A sharp rebound in investments drive GDP growth: After contracting by a record-high 47.1% YoY in the previous quarter, Gross Fixed Capital Formation (GFCF)—a reflection of investment demand in the economy—fell by a much lower 7.3% in Q2FY21, partly off a low base, marking the fifth consecutive quarter of an YoY contraction. This was primarily led by an expected pick-up in consumption demand ahead of the festive season. Private consumption also contracted by a sequentially lower 11.3% YoY, primarily led by a pick-up in rural demand, thanks to a normal monsoon and Government's policy support, even as urban demand remained muted. Government consumption, on the other hand, declined by a sharp 22.2% YoY—the first YoY contraction in 22 quarters and the steepest in last 15 years. This is partly reflected in the Government's monthly accounts which show a sharp drop in the Centre's revenue spending in the second quarter after front-loading expenditure in the first quarter. A strong recovery in global growth outlook and an aggressive policy support provided an impetus to India's exports, even as imports remained weak. This translated into a positive contribution of trade balance to India's GDP for the second quarter in a row. Excluding Government consumption, GDP growth in Q2FY21 works out to be -5.4%.

- Sector-wise, manufacturing led the GVA improvement: By economic activity, the recovery was primarily led by a much lower-than-expected contraction in the industrial sector of 2.1% YoY vs. 38.1% drop in the previous quarter, marking the fourth consecutive quarter of an YoY contraction. This was on the back of a modest expansion in the manufacturing sector (+0.6% YoY), albeit off a low base, thanks to restocking ahead of the festive season. Electricity sector also registered a decent 4.4% YoY growth, supported by higher demand from industrial and commercial establishments as the lockdown was gradually lifted. Mining and construction activity, however, remained muted, contracting by 9.1% and 8.6% YoY respectively, partly attributed to incessant rainfall in the second half of the quarter and shortage of labour.

Q2FY21 GVA fell by a much lower 7% YoY, led by an unexpected expansion in manufacturing sector, partly offset by reduced Government spending.

  Growth in the Agriculture sector remained steady at 3.4% YoY, supported by strong *Kharif* sowing and strong policy support. Services sector, on the other hand, disappointed and contracted by a 11.4% YoY, following a 20.6% YoY contraction in the previous quarter. While trade, hotels, transport & communication declined by an expected 15.6% YoY amid sustenance of restrictions on these sectors, financial, real estate & business services fell by a sequentially steeper 8.1%. Importantly, the community, social & personal services declined by a huge 12.2% YoY—the steepest in last 15 years, reflecting a sharp drop in spending by the Centre as well as states in the second quarter.

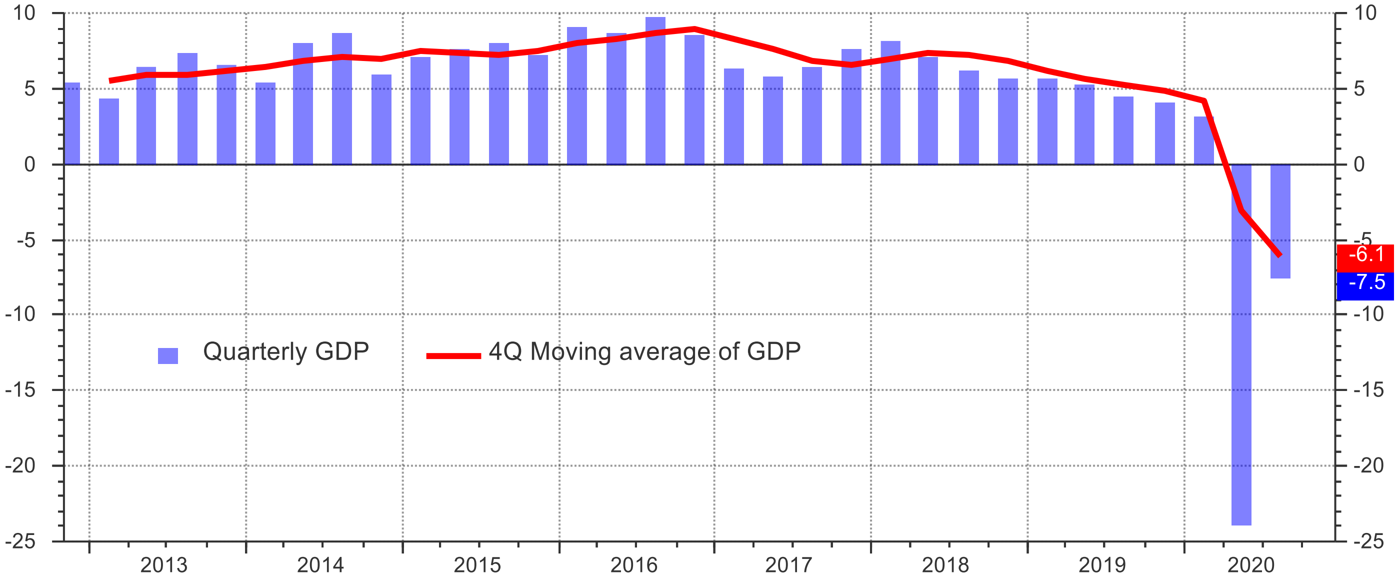
- Q2FY21 GDP data susceptible to downward revisions: Faster normalisation of business activities amid gradual lifting of lockdown restrictions, improvement in rural demand and restocking ahead of the festive season has supported economic growth in the quarter gone by. That said, the national accounts data in Q2 mainly captures the organised corporate sector where the recovery has been robust. The impact of lockdown has been far more severe on the informal sector which has got hit by aggressive cost rationalisation by the formal sector—something that doesn't reflect in the GDP data yet. The Q2 figures, therefore, face over-estimation bias, and are susceptible to downward revisions.

- Expect FY21 GDP growth at -8%: Economic recovery has extended into the third quarter of the fiscal, with several high frequency indicators including Manufacturing PMI, auto sales, GST collections recording an expansion, thanks to continued normalisation of business activities and a strong festive-led demand. However, it remains to be seen if the recovery in consumption and investment demand sustains beyond the festive season, particularly in the wake of decline in household incomes and rise in COVID-19 cases in some states. Additionally, a second wave of infections in the US/Europe is likely to weigh on India's exports to these countries. We revise our FY21 GDP growth estimate upwards from -10.5% to -8%, with growth in FY22 now expected at 9.5%, supported by a favourable base. Importantly, a faster and effective roll-out of the COVID-19 vaccine remains crucial for a credible and sustainable economic recovery.

We now expect FY21 GDP growth at -8% vs. -10.5% estimated earlier, with growth in FY22 pegged at 9.5%, supported by a favourable base

Figure 1: India sees the worst contraction on record in Q1 FY21

India's first quarter GDP (Q1FY21) growth slipped to -23.9%—the first contraction in four decades and the worst ever—confirming the stringency and impact of the national lockdown.



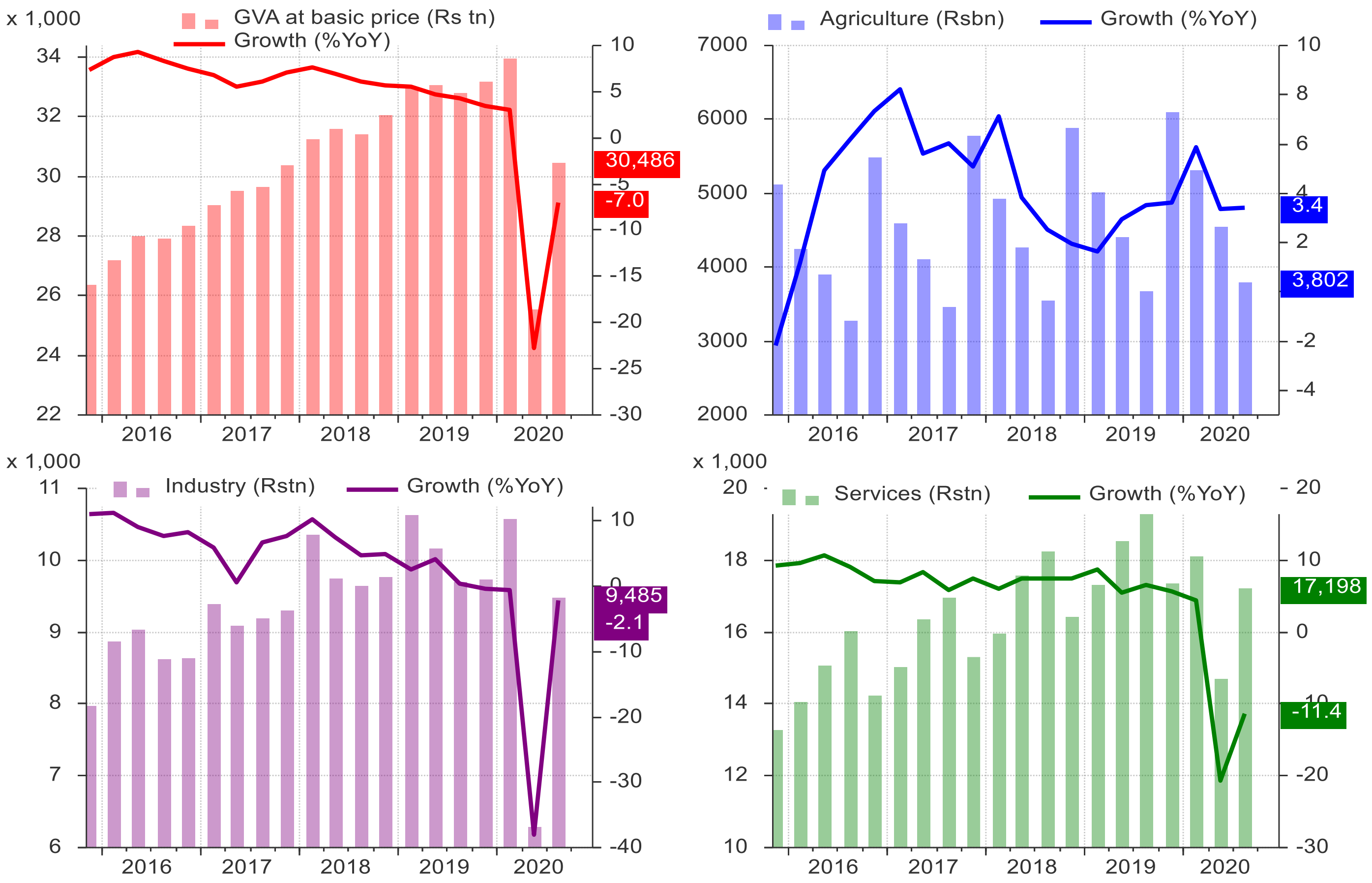
Source: Refinitiv Datastream, NSE

Figure 2: Quarterly growth trend (2011-12=100) (%YoY)

	FY19				FY20				FY21	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Gross Domestic Product (GDP)	7.1	6.2	5.6	5.7	5.2	4.4	4.1	3.1	-23.9	-7.5
Private Consumption (PFCE)	6.7	8.8	7.0	6.2	5.5	6.4	6.6	2.7	-26.7	-11.3
Government Consumption (GFCE)	8.5	10.8	7.0	14.4	6.2	14.2	13.4	13.6	16.4	-22.2
Gross Capital Formation (GCF)	10.8	11.4	11.5	5.0	5.3	-2.9	-4.3	-5.8	-47.5	-8.9
Gross Fixed Capital Formation (GFCF)	12.9	11.5	11.4	4.4	4.6	-3.9	-5.2	-6.5	-47.1	-7.3
Net trade	-10.8	65.6	-18.7	-58.5	-4.1	-46.0	-57.5	14.9	-164.5	-161.2
Exports	9.5	12.5	15.8	11.6	3.2	-2.2	-6.1	-8.5	-19.8	-1.5
Imports	5.9	18.7	10.0	0.8	2.1	-9.4	-12.4	-7.0	-40.4	-17.2
Gross Value Added (GVA)	6.9	6.1	5.6	5.6	4.8	4.3	3.5	3.0	-22.8	-7.0
Agriculture	3.8	2.5	2.0	1.6	3.0	3.5	3.6	5.9	3.4	3.4
Industry	7.5	4.8	5.0	2.6	4.2	0.5	-0.3	-0.6	-38.1	-2.1
Mining and Quarrying	-7.3	-7.0	-4.4	-4.8	4.7	-1.1	2.2	5.2	-23.3	-9.1
Manufacturing	10.7	5.6	5.2	2.1	3.0	-0.6	-0.8	-1.4	-39.3	0.6
Electricity	7.9	9.9	9.5	5.5	8.8	3.9	-0.7	4.5	-7.0	4.4
Construction	6.4	5.2	6.6	6.0	5.2	2.6	0.0	-2.2	-50.3	-8.6
Services	7.4	7.4	7.4	8.7	5.5	6.5	5.7	4.4	-20.6	-11.4
Trade, Hotels, Transport, Storage, Comm.	8.5	7.8	7.8	6.9	3.5	4.1	4.3	2.6	-47.0	-15.6
Fin. Svcs, Real Estate & Business Svcs.	6.0	6.5	6.5	8.7	6.0	6.0	3.3	2.4	-5.3	-8.1
Community, Social & Personal Svcs.	8.8	8.9	8.1	11.6	7.7	10.9	10.9	10.1	-10.3	-12.2

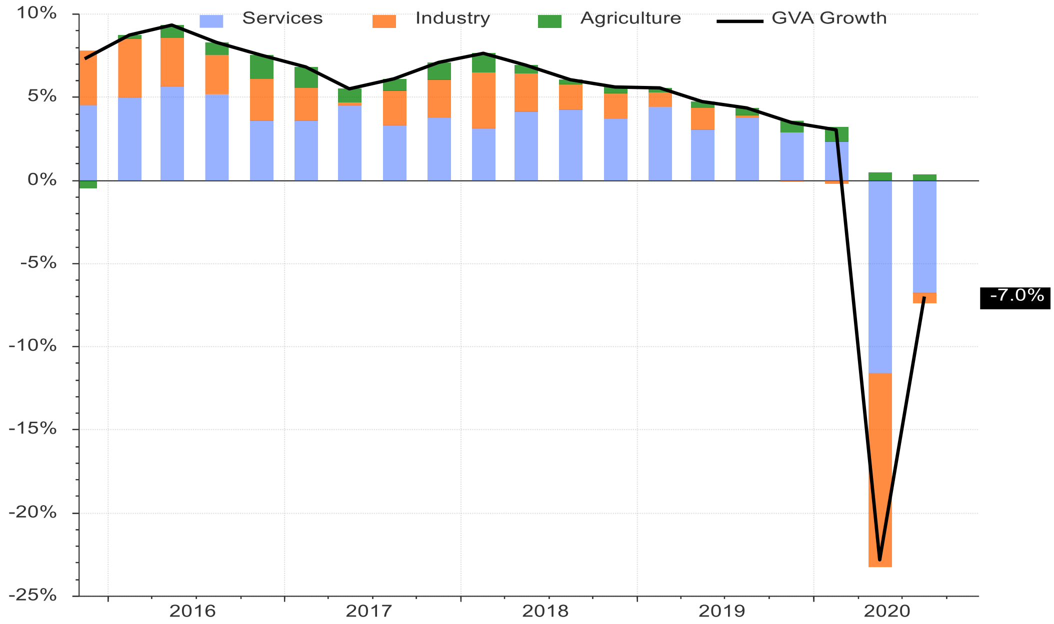
Source: CSO, NSE

Figure 3: Gross value added (GVA) across sectors:
By economic activity, improvement was led by less-than-expected contraction in the Industrial sector (-2.1%), thanks to an unexpected expansion in the manufacturing sector (+0.6%)—reflected in robust growth in corporate profits in Q2. Services sector, on the other hand, disappointed (-11.4%) owing to lower Govt. spending (community, social & personal services) and a sequentially steeper contraction in financial, real estate and business services. Growth in the Agriculture sector remained steady at 3.4%.



Source: Refinitiv Datastream, NSE

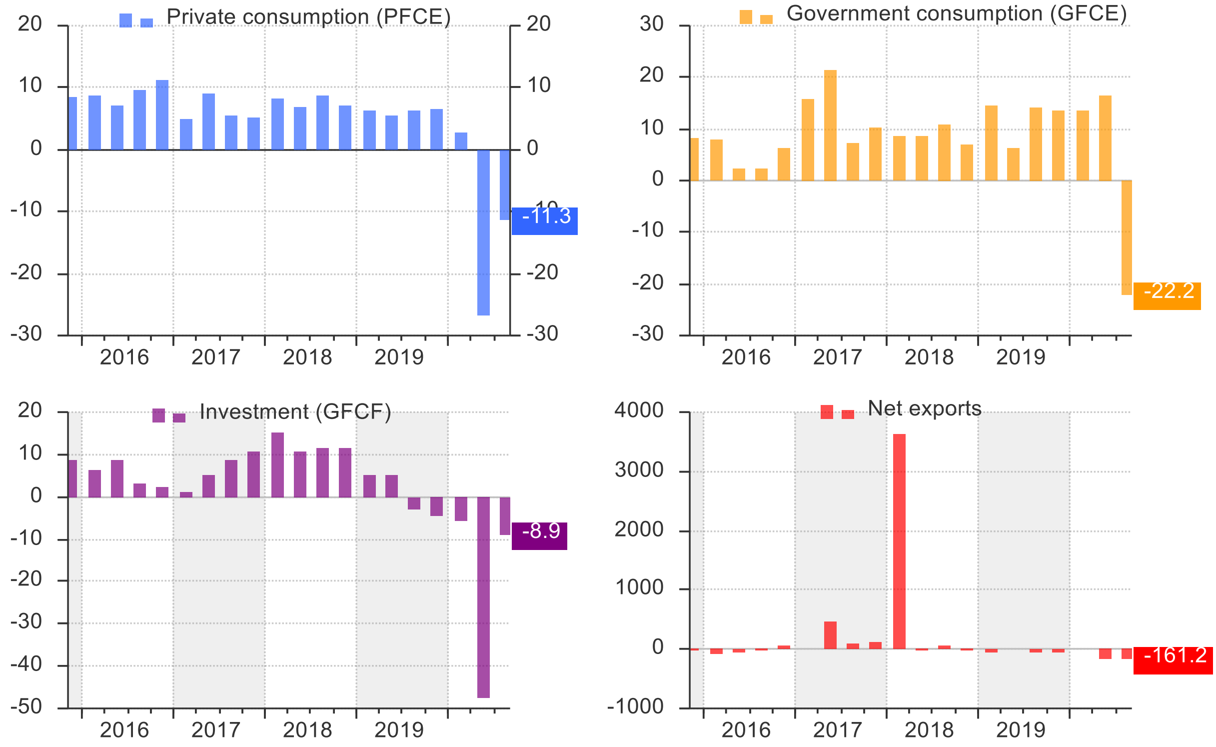
Figure 4: India GVA sector share of growth (%)



Source: Refinitiv Datastream, NSE

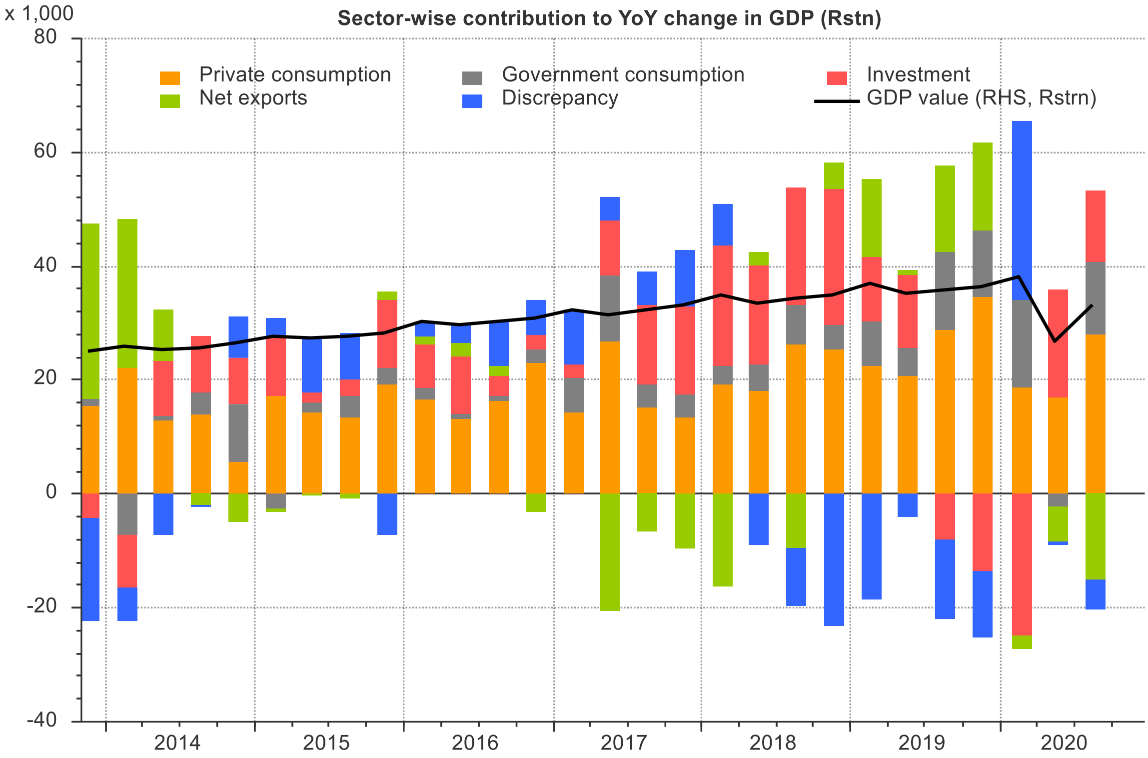
Figure 5: Quarterly GDP growth by sectors (%YoY)

The Gross Fixed Capital Formation (GFCF)—a reflection of investment demand in the economy—fell by a much lower 7.3% in Q2FY21, partly off a low base, marking the fifth consecutive quarter of an YoY contraction. Private consumption also contracted by a sequentially lower 11.3% YoY, primarily led by a pick-up in rural demand. Government consumption, on the other hand, declined by a sharp 22.2% YoY—the first YoY contraction in 22 quarters and the steepest in last 15 years.



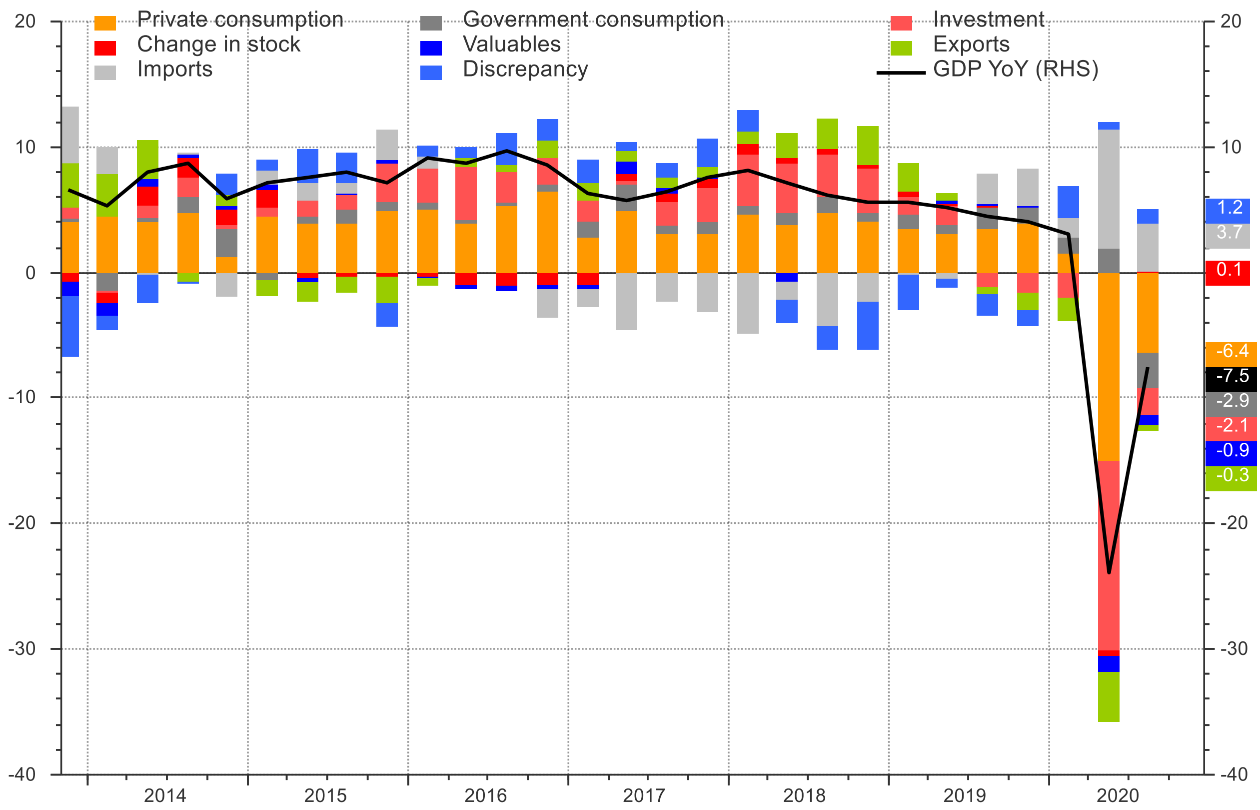
Source: Refinitiv Datastream, NSE

Figure 6: Sector-wise contribution to YoY change in quarterly GDP (Rstrn)



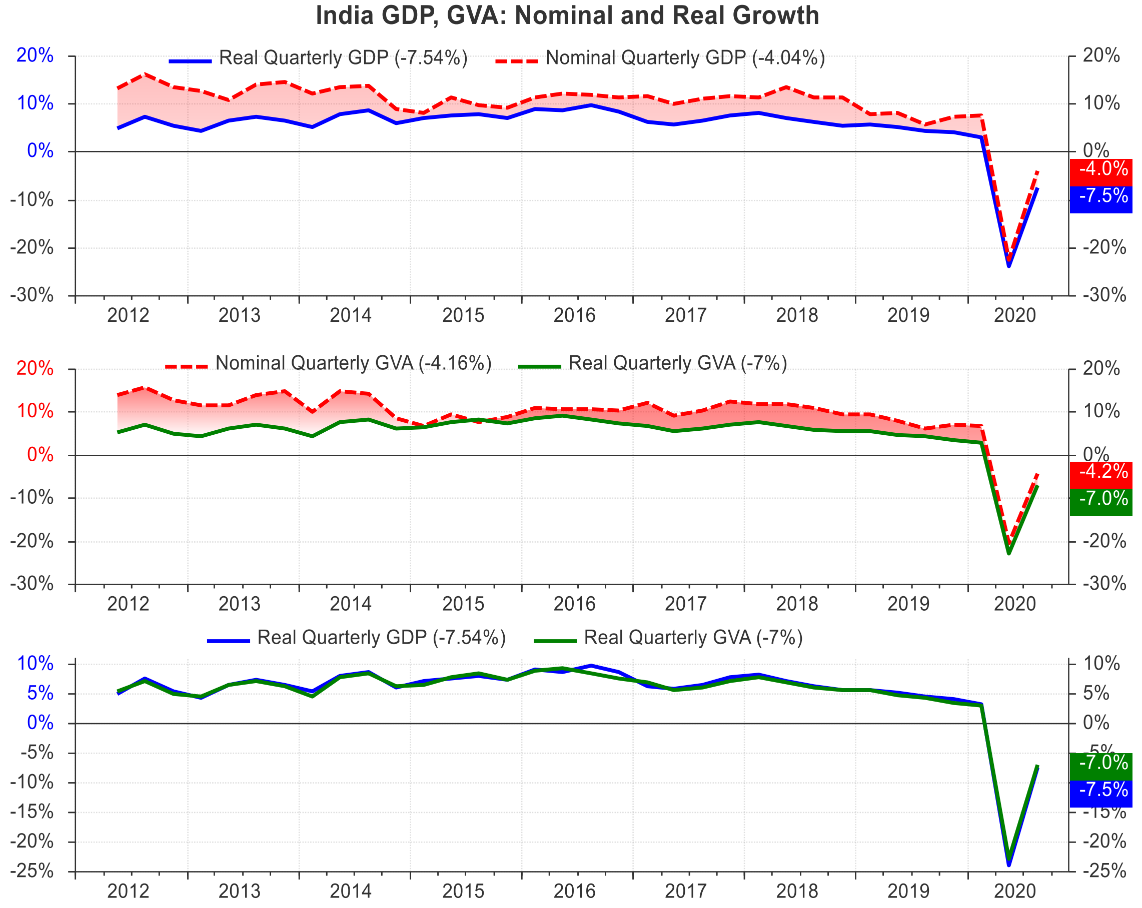
Source: Refinitiv Datastream, NSE

Figure 7: India GDP sector share of growth (%)



Source: Refinitiv Datastream, NSE

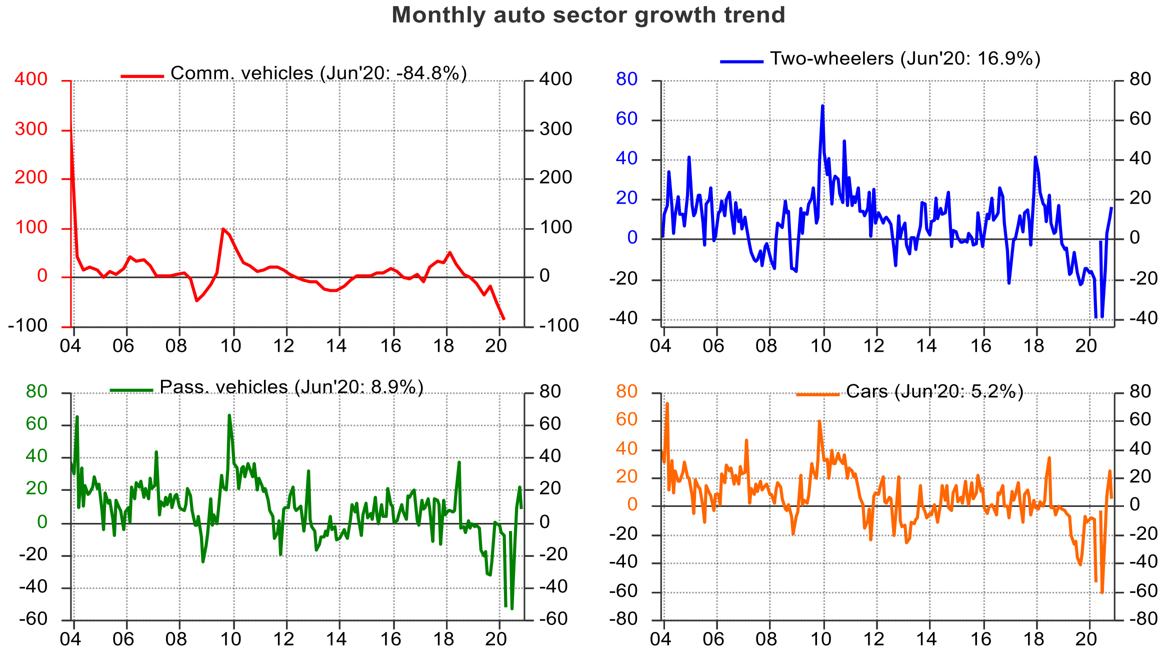
Figure 8: Nominal vs. real GDP and GVA growth



Source: Refinitiv Datastream, NSE

FY21 GDP growth estimate revised up to -8%: Economic recovery has extended into the third quarter of the fiscal, with several high frequency indicators including Manufacturing PMI, auto sales, GST collections recording an expansion, thanks to continued normalisation of business activities and a strong festive-led demand. However, it remains to be seen if the recovery in consumption and investment demand sustains beyond the festive season, particularly in the wake of decline in household incomes and rise in COVID-19 cases in some states. Additionally, a second wave of infections in the US/Europe is likely to weigh on India's exports to these countries. We revise our FY21 GDP growth estimate upwards from -10.5% to -8%, with growth in FY22 now expected at 9.5%, supported by a favourable base. Importantly, a faster and effective roll-out of the COVID-19 vaccine remains crucial for a credible and sustainable economic recovery.

Figure 9: Auto sales growth trend



Source: Refinitiv Datastream.

Figure 10: Non-oil non-gold imports recovers

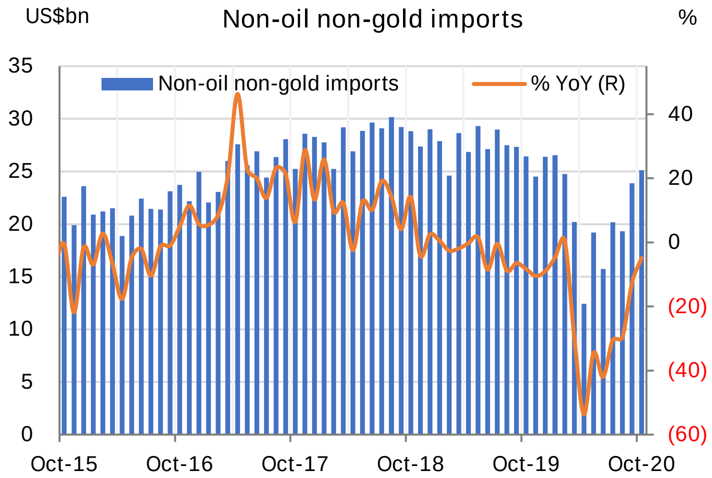
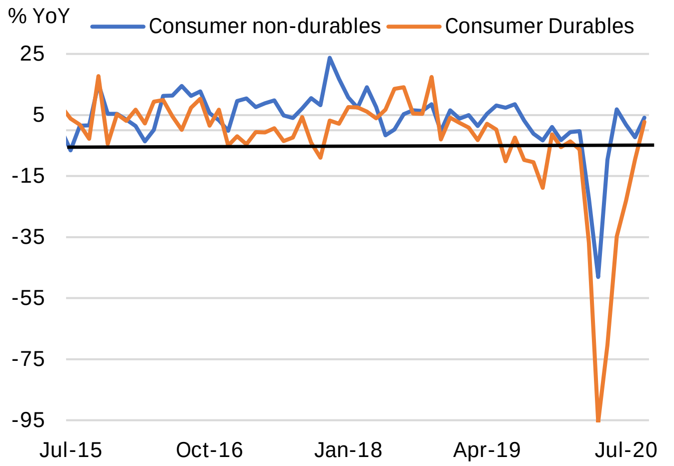
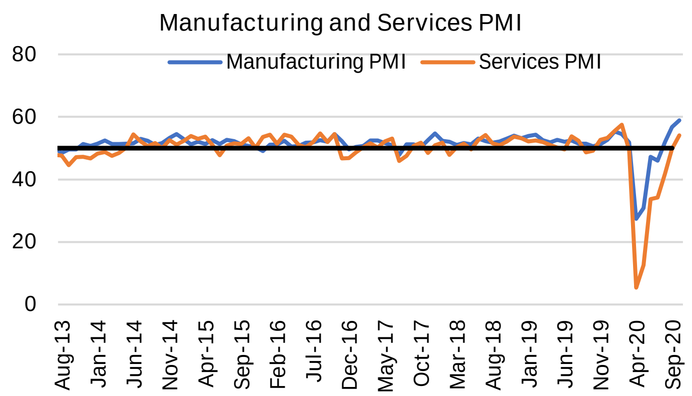


Figure 11: Consumer good production



Source: CMIE Economic Outlook, RBI.

Figure 12: Manufacturing and Services PMI moves in **the expansion zone...**



Source: CMIE Economic Outlook, Refinitiv Datastream.

Figure 13: **...and is much** higher than other economies

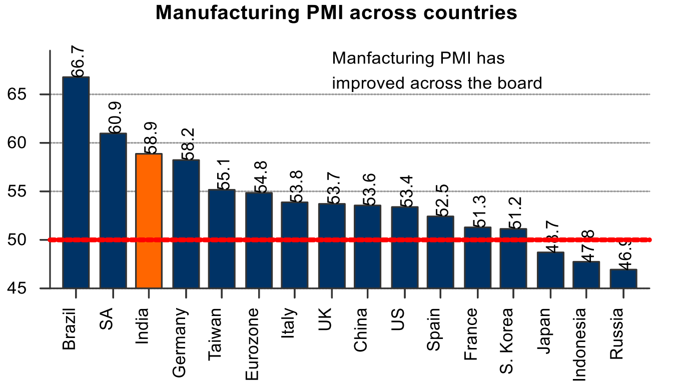


Figure 14: E-way bills have picked up to higher than pre-COVID levels...

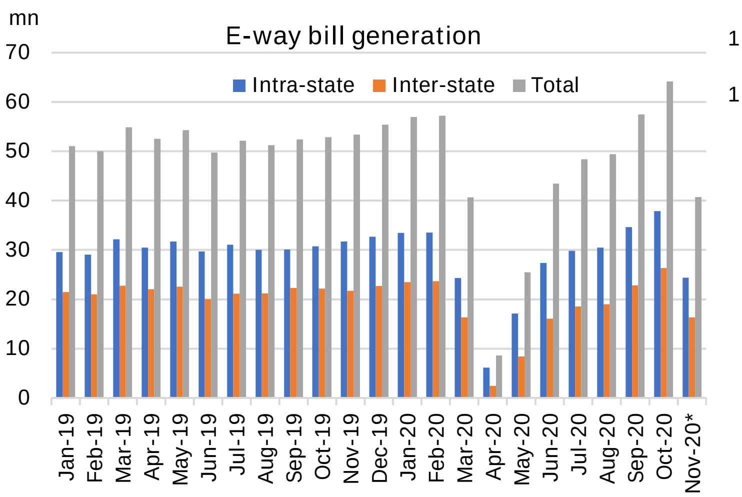
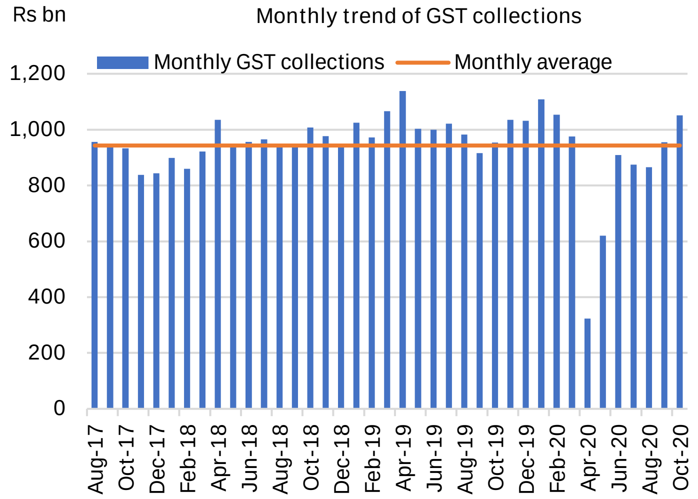
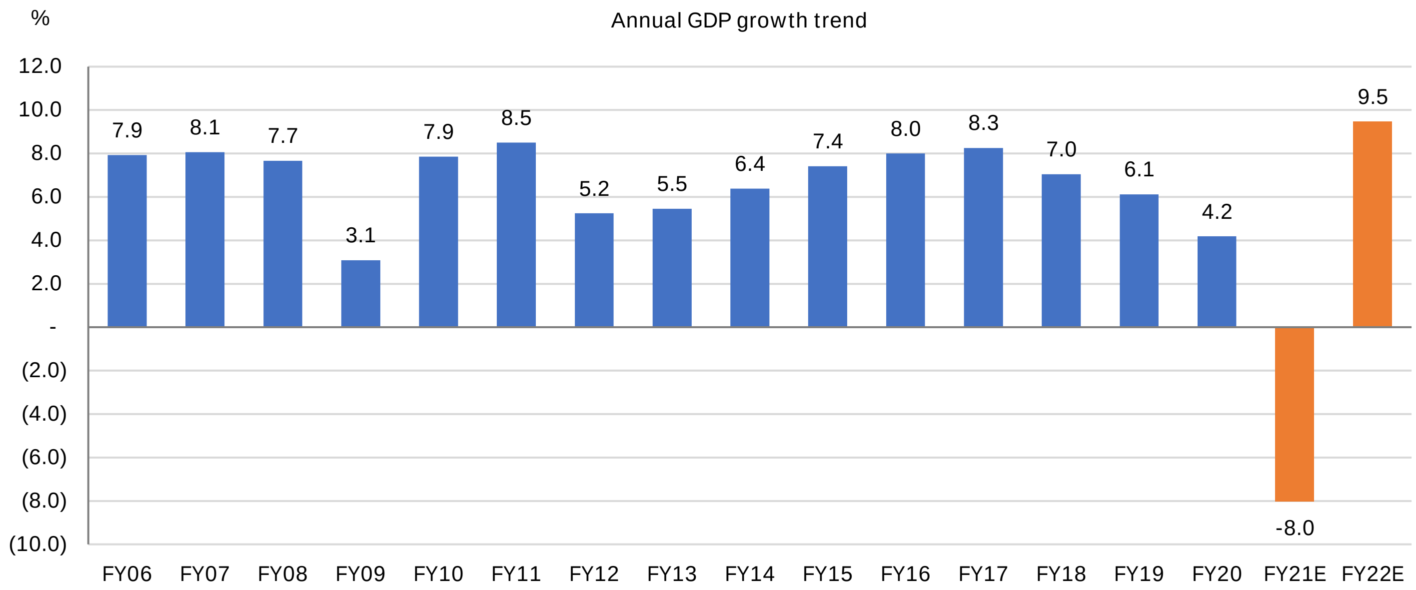


Figure 15: ...and so have GST collections



Source: GSTN, CMIE Economic Outlook. * November data is as of November 22nd, 2020.

Figure 16: Annual GDP growth trend: Expect FY21/FY22 GDP growth at -8%/9.5%



Source: CSO, CMIE Economic Outlook, NSE.

Economic Policy & Research, NSE

Tirthankar Patnaik, PhD	tpatnaik@nse.co.in	+91-22-26598149
Prerna Singhvi, CFA	psinghvi@nse.co.in	+91-22-26598316
Runu Bhakta, PhD	rbhakta@nse.co.in	+91-22-26598163
Ashiana Salian	asalian@nse.co.in	+91-22-26598163

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