Press Release

Domestic demand pulls GDP growth to 6.3% in Q2FY23

Despite global headwinds, growth print may get close to 7.0% in FY23

30-Nov-2022

India's annualized GDP growth in Q2 FY23 has been largely in line with our forecasts, expanding by 6.3% YoY vs. 13.5% in Q1 FY23, the latter primarily the result of the favourable base impact created by the second Covid wave in the previous year. Importantly, the sequential momentum expanded by 3.6% QoQ, vs. a contraction of 9.6% recorded in the previous quarter. The data highlights that despite the incremental global headwinds, India's economic activities remained broadly resilient in the first half of FY23 drawing strength from the domestic macroeconomic buffers. Domestic tailwinds generated through normalization in the services sector , pent up demand particularly in the urban areas and the first normalized festive celebrations in nearly 3 years have been key drivers in Q2 FY23 which led the economy to expand by 7.2 % over the pre-Covid levels (i.e. Q2FY20).

Looking at the growth numbers from the demand side, private consumption and investments recorded an annualized strong growth print of 9.7% YoY and 10.4% YoY respectively. The emergence of pent-up urban demand for contact intensive services and central government's consistent capex push are likely underlying drivers behind these stable outturns. On the other hand, government consumption contracted for the first time in four quarters by 4.4% YoY from +1.3% in Q1 FY23. This predominantly reflects slower pace of revenue expenditure (ex-interest payments). Exports (of goods and services) and imports both recorded a mild moderation on annualized basis in Q2 FY23, registering a divergent trend from the monthly trade deficit numbers, that created a record high level in Q2 FY23.

On the other side, the GVA growth stood at 5.6% YoY in Q2 FY23 from 12.7% in Q1 FY23 and as compared to the pre-pandemic levels (Q1 FY20) it grew by 7.1% YoY. Interestingly, agriculture and allied sector maintained its momentum growing to 10-quarter high level of 4.6% in Q2 FY23. Despite erratic rains and late withdrawal of monsoon likely disrupting the kharif output, sowing of rabi crops remains strong because of increased moisture content, healthy reservoir levels and hike in wheat MSP announced by the Government that could keep the agriculture output buoyant in H2 FY23. Industry GVA contracted for the first time in nine quarters by 0.8% YoY in Q2 FY23 vs. a robust growth of 8.6% in Q1 FY23 led by contraction recorded in mining and manufacturing activities. Mining sector recorded a contraction on account of the adverse impact of monsoon, however, manufacturing output contracted for the first time since the first pandemic wave by -4.3% YoY in Q2 FY23 vs. +4.8% in Q1 FY23 led by weakening external demand, lower rural consumption, and high input cost pressures. While the high power demand amidst significant heatwave drove the output for electricity higher in Q1 FY23 to a robust 14.7%, the onset of monsoon eased the demand causing the output to ease in Q2 FY23 to 5.6% YoY.

Expectedly, recovery in services sector continues to remain somewhat strong expanding by 9.3% YoY. The decline in the intensity of the pandemic and end of the southwest monsoon aided demand for hotels, hospitality and transport sectors supported by the pent up factor. The festive season also pushed domestic mobility to a yet another post pandemic high in Q2 FY23, continuing to support the recovery in contact intensive services.

So far, the domestic economic activities continue to display resilience though we do see some of the indicators displaying a lower YoY print in H2FY23. At a granular level, domestic consumption recovery is primarily being led by urban demand (pent-up/festive demand), while rural demand remains on a relatively weaker track. While Kharif harvest and a good Rabi output can potentially provide support to rural demand amidst easing inflation over the next two quarters, urban demand may see some impact of the 190 bps (and possibly counting) rate hike so far.

On the other hand, investment activity is expected to pick up in H2 given the high capacity utilization levels and imports of capital goods. Offering added support is government's capital expenditure, having risen by a strong strong 49.5%YoY during H1 FY23, though states appear to be lagging on this front.

Having said so, global growth conditions remain fragile amidst confluence of factors such as synchronized monetary policy tightening on the back of high price pressures and lingering geopolitical uncertainties that have been reverberating across economies. The adverse impact of slowing global growth, has now started manifesting in India's export performance. While overall exports have been easing since the start of FY23, for the month of Oct-22, merchandise exports slipped to USD 29.8 bn coming below USD 30 bn mark for the first time in the last 20 months. While a part of this downside could be seasonal, nevertheless outlook on exports remains clouded. IMF in its latest update to the World Economic Outlook report, slashed its growth forecast for 2023 World GDP and World Trade by 20 bps and 70 bps to 2.7% and 2.5% - this marks a sharp loss of momentum vis-à-vis IMF's 2022 growth estimates of 3.2% and 4.3% earlier.

Looking ahead, on annualised basis, as the favourable statistical effect tapers further, incremental GDP growth is expected to be on decelerating path. For Q3 and Q4, growth is likely to slip closer to 4.0%. This factors in increased external risks and their impact on domestic growth, despite support from factors such as strength in services demand, upside in Rabi sowing, capex-oriented government expenditure and the cool down in global commodity prices. Taking into account these upside and downside factors we continue to peg India's GDP growth at 7.0% in FY23.

Summarises Suman Chowdhury, our Chief Analytical Officer "India's GDP growth in Q2FY23 at 6.3% YoY has been largely in line with our forecast and expectedly, has been driven by a strong recovery in the services sector. The pent up demand has led to a 14.7% YoY growth in GVA from trade, transport, hotel and communication segment. What is noteworthy is the growth in private consumption expenditure which stood at 9.7% YoY in Q2; this had already been corroborated by our proprietary **AMEP** index print which on an average grew by 12.7% in Q2FY23 over Q2FY22. However, the manufacturing sector may continue to see a lack of momentum due to the decline in exports and impact the overall growth print for FY23. The downside risks to our 7.0% GDP growth forecast for FY23 have increased due to the intense global headwinds. We continue with our expectations of a moderate hike of 30-35 bps in the repo rate in Dec-22 as the growth data has been in line with RBI's forecasts."

Annexure

Table 1: Key highlight of GDP data (% YoY)

	% YoY	% YoY	% QoQ	Vs Q2 FY20 (%)
	Q1 FY23	Q2 FY23	Q2 FY23	Q2 FY23
Private Consumption	25.9	9.7	1.0	10.39
Government Consumption	1.3	-4.4	-18.9	-22.72
Gross Fixed Capital Formation	20.1	10.4	3.4	17.39
Exports	14.7	11.5	5.0	24.92
(less) Imports	37.2	25.4	6.4	44.81
GDP	**13.5**	**6.3**	**3.6**	**7.16**

Table 2: Key highlight of GVA data (% YoY)

	% YoY	% YoY	% QoQ	Vs Q2 FY20 (%)
	Q1 FY23	Q2 FY23	Q2 FY23	Q2 FY23
Total	**12.7**	**5.6**	**1.9**	**7.2**
Agriculture, forestry and fishing	4.5	4.6	-14.0	12.1
Industry	8.6	-0.8	-3.1	6.5
Mining and quarrying	6.5	-2.8	-21.9	2.8
Manufacturing	**4.8**	**-4.3**	**-1.2**	**5.9**
Electricity, gas, water supply services	14.7	5.6	-3.0	11.0
Construction	16.8	6.6	-1.5	7.4
Services	**17.6**	**9.3**	**8.7**	**6.5**
Trade, hotels, transport, comm. services	25.7	14.7	16.0	1.8
Financial ser., real estate and profess. services	9.2	7.2	5.0	7.1
Public admin., defence and other services	26.3	6.5	6.8	12.2

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