Taking the upside surprise in Q3-FY24 GDP growth with a pinch of GVA

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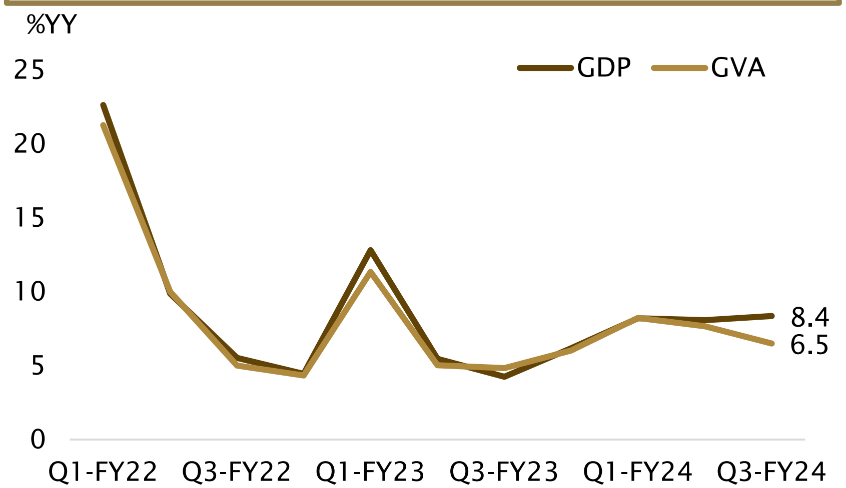
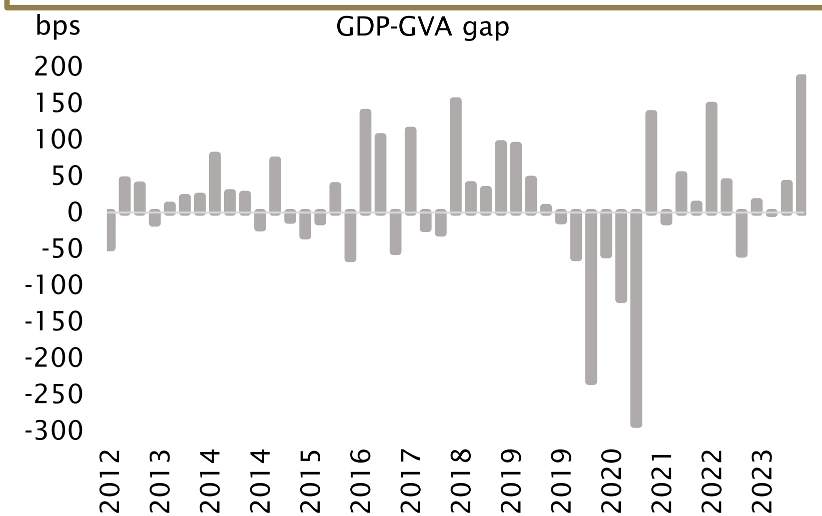
Key takeaways

- Real GDP growth at 8.4%YY in Q3-FY24 surprised on the upside (Bloomberg estimate: 6.6%), even as growth measured by gross value added (GVA) on the supply side was more realistic at 6.5% (Bloomberg estimate: 6.4%). The wedge between the two measures of growth was driven by high net indirect taxes on the back of lower subsidies and base effects.
- In addition to the latest quarter data, the NSO released second advance estimate for FY24, which was revised slightly higher for GDP at 7.6% (from 7.3%), and kept unchanged for GVA growth at 6.9%.
- There were also significant data revisions to GDP numbers for FY22 and FY23. Real GDP growth for each of the three quarters of FY24 so far was revised higher to above 8%, either implying lower imputed growth for Q4-FY24, or a reasonable probability of real GDP growth close to 8% in FY24.
- The government's continued thrust on infrastructure development and better prospects for farm output could support growth in FY25, through risks remain from uncertainties around monetary policy changes and geopolitical disruptions, lagged effect of monetary policy tightening on private consumption, and impact of fiscal consolidation on public spending.
- The upside surprise in latest GDP data is unlikely to alter the central bank's cautious pause, as strong growth defies the need for policy easing, unless warranted to counter the impact of higher real interest rates and policy rate divergences vis-à-vis major economies.

Real GDP growth surprised on the upside in Q3-FY24



GDP-GVA gap widened due high indirect taxes

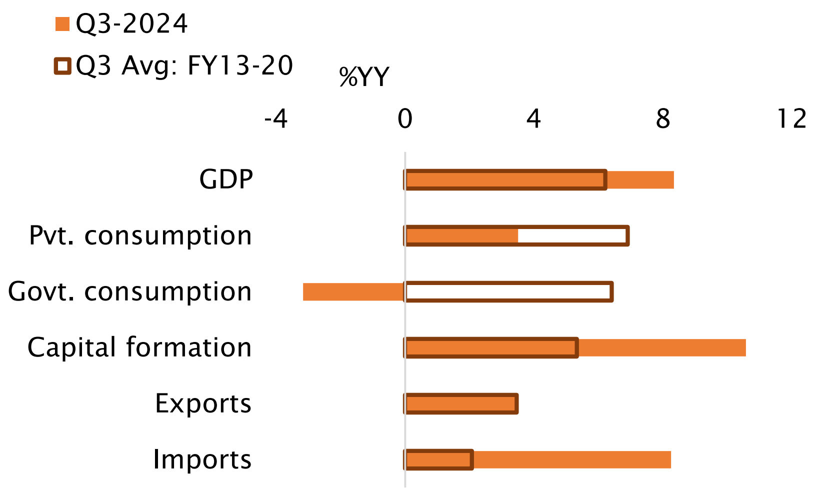


GDP growth surprised on the upside in Q3-FY24; GVA growth realistic

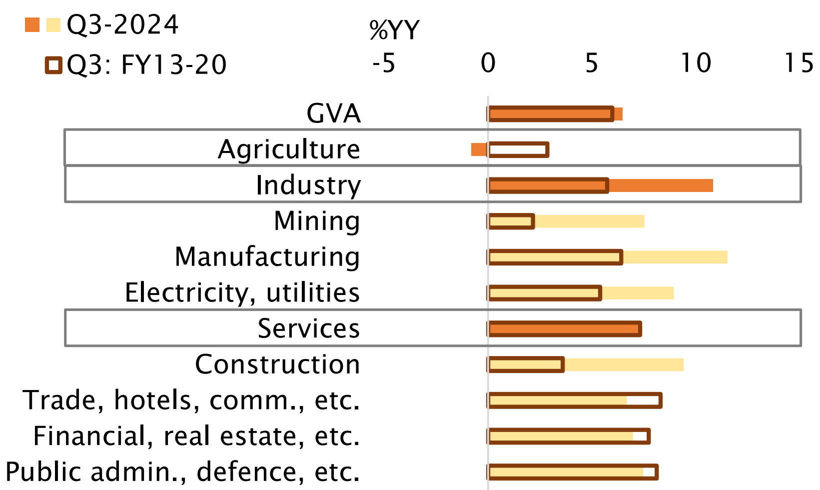
- **Real GDP surprised on the upside in Q3-FY24, growing 8.4%YY (Bloomberg est. 6.6%), up from 8.1% in Q2. Real GVA growth, which sums up activity by sectors and excludes net indirect taxes, increased at a more realistic pace of 6.5% (Bloomberg est. 6.4%).**

- **On the expenditure side**, GDP growth was higher than the series average for the quarter. (The current GDP series starts 2011-12, with year-on-year numbers starting a year after.) Growth was **supported by investment or gross fixed capital formation (GFCF)**, which continued to grow by double digits for the second consecutive quarter. Private consumption growth was lower than average, though higher than the previous quarter due to the festive season. Government consumption fell after posting double-digit growth in Q2. Net exports stayed negative for the third straight quarter amid moderation in both export and import growth compared to the previous quarter.
- By sector, **GVA growth was in line with the series average** for the quarter. **Industrial growth was above average**, and remained in double digits for the second straight month, tracing the trend in manufacturing segment. The **improvement in services sector** growth compared to Q2 was driven by **trade, hotels, communication, etc. and financial, real estate, etc.** sub-sectors. However, **agriculture sector production fell** amid lower Kharif output.

GDP by expenditure growth exceeded expectations



GVA by sector growth close to series average in Q3



Latest NSO estimates for FY24 suggest modest, sub-6% growth in Q4

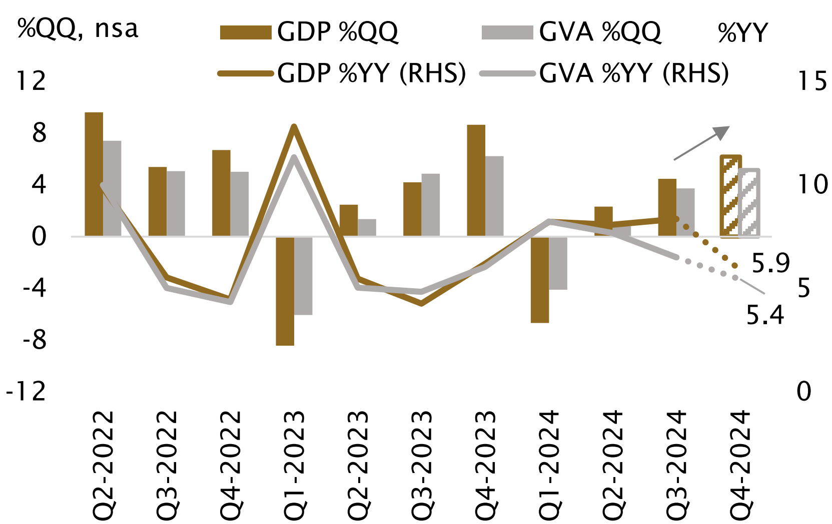
- In the second advanced estimates (SAE) for FY24, the national statistical office revised real GDP growth for FY24 to 7.6%, up from7.3% in the first advance estimates. GVA growth estimate was retained at 6.9%.

- Latest estimates for FY24 suggest that both GDP and GVA growth is expected to moderate to sub-6% year-on-year in Q4, even as quarter-on-quarter growth would improve. The gap between GDP and GVA year-on-year growth that reached 1.9pp in Q3 due to high net indirect taxes is expected to narrow to 0.5pp in Q4.

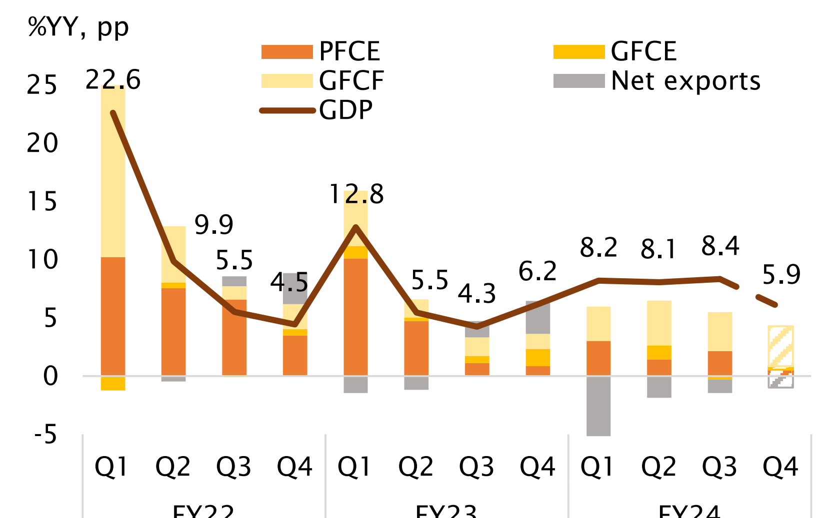
- On the expenditure side, **contribution from investment or gross fixed capital formation (GFCF) to year-on-year GDP growth is expected remain robust in Q4. Public consumption could improve** after declining in Q3. However, **private consumption growth is likely to moderate** to a 14-quarter low, as boost from the festive season fades and the lagged impact of tighter monetary impulse and macro-prudential regulations further trickle down to the economy.

- In terms of sectors, **agriculture output is expected to remain in contraction**, while **industrial growth momentum is likely to moderate. The onus of supporting GVA growth will be borne by the services sector in Q4.**

Imputed GDP for Q4

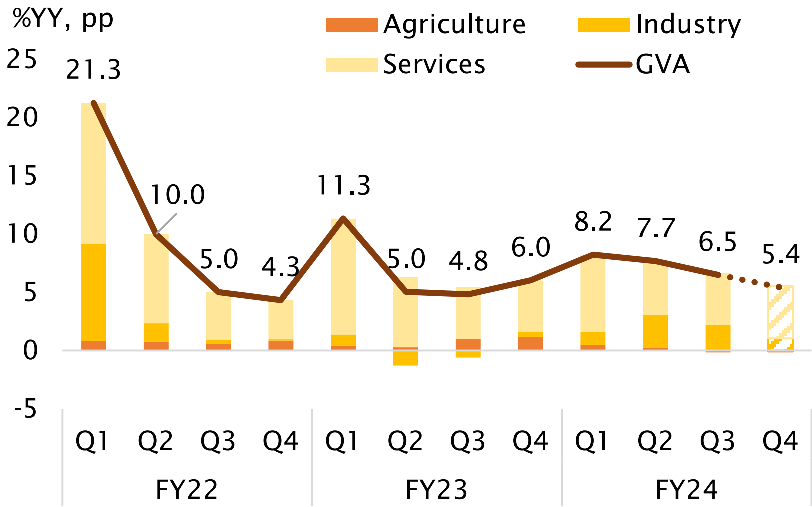


GFCF to contribute the most to GDP growth in Q4

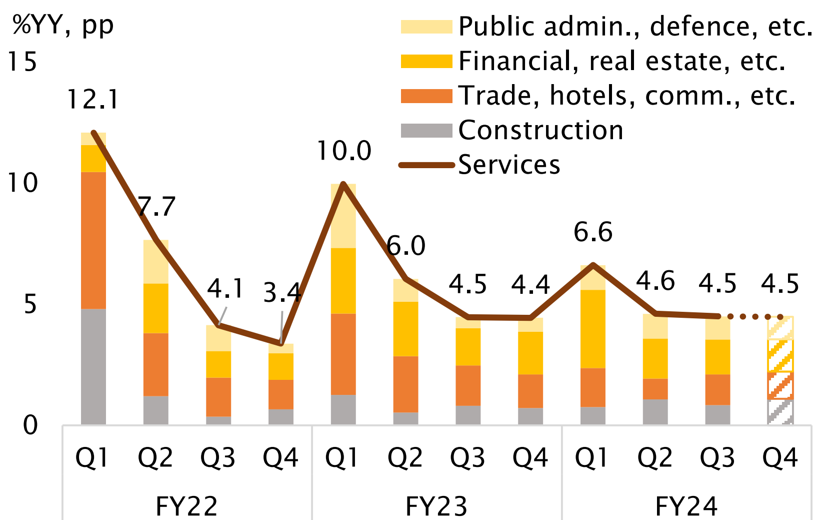


GVA growth in Q4 to be supported by services sector

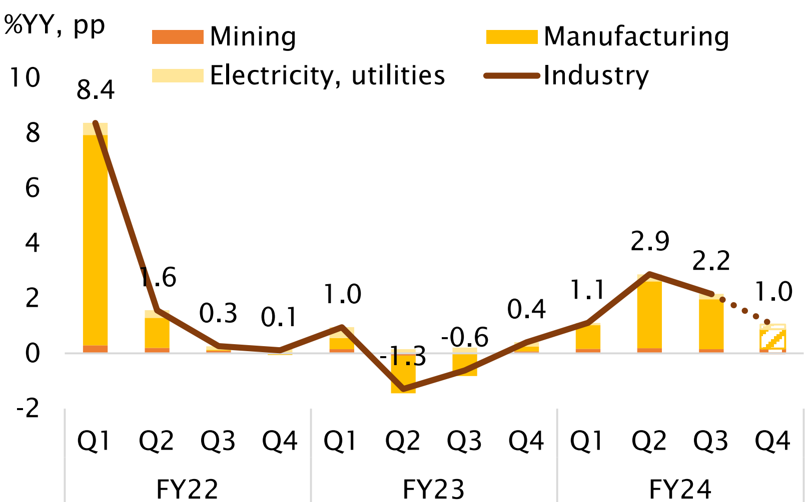
GVA by sector



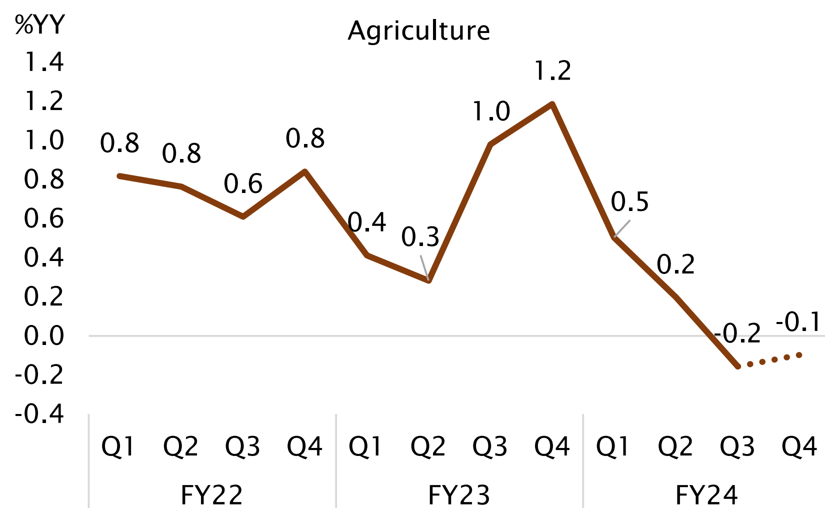
GVA by sector: Contribution to services sector



GVA by sector: Contribution to industry



GVA by sector: Agriculture



Data revisions indicate real GDP growth to be closer to 8% in FY24

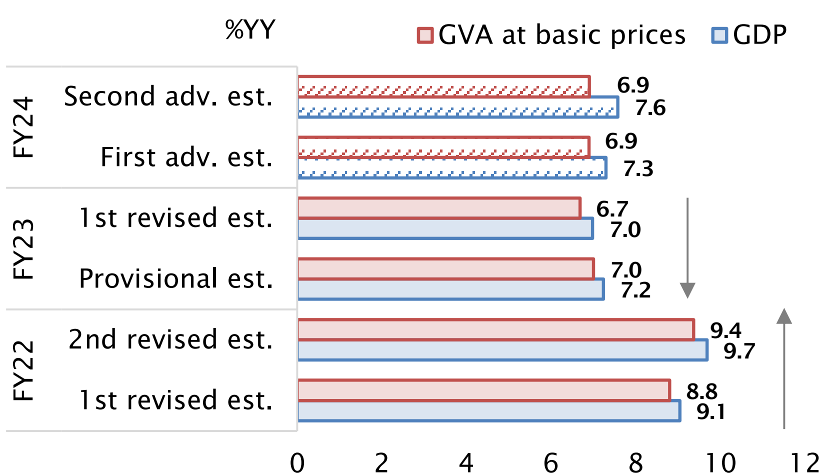
- In addition to revisions to FY24 GDP growth estimates, the NSO also updated recent historical data for FY22 and FY23. **Both GDP and GVA growth numbers for FY22 were raised, while those for FY23 were cut.**
- On the expenditure side, the upward revision to FY22 numbers was driven by investment and private consumption, and masks the significant downward revision to government consumption. The opposite holds true for the following year FY23, for which public consumption data was revised up.
- In terms of gross value added by industry, latest revisions entail lower industrial growth in FY22, and in fact negative growth in FY23, while services sector growth was revised upwards for both the years.
- Also, **real GDP growth was raised for each of the quarters in FY24 to above 8%, signaling that growth for the full year could surpass NSO's Second Advance Estimate of 7.6%, unless growth slows to sub-6%, as noted earlier.** The NSO notified that it will discontinue the third revised estimates for financial years, implying that FY22 numbers will not undergo further revisions.

%YY	FY22		FY23		FY24	
	1st RE	2nd RE	PE	1st RE	FAE	SAE
GVA	8.8	9.4	7.0	6.7	6.9	6.9
Agriculture	3.5	4.6	4.0	4.7	1.8	0.7
Industry	10.5	9.6	2.4	-0.6	6.9	8.3
Mining	7.1	6.3	4.6	1.9	8.1	8.1
Manufacturing	11.1	10.0	1.3	-2.2	6.5	8.5
Electricity	9.9	10.3	9.0	9.4	8.3	7.5
Services	9.6	10.6	9.5	9.9	8.1	7.9
Construction	14.8	19.9	10.0	9.4	10.7	10.7
Trade, hotels, comm., etc.	13.8	15.2	14.0	12.0	6.3	6.5
Financial, real estate, etc.	4.7	5.7	7.1	9.1	8.9	8.2
Public admin., defence, etc.	9.7	7.5	7.2	8.9	7.7	7.7
GDP	9.1	9.7	7.2	7.0	7.3	7.6
GFCE	6.6	0.0	0.1	9.0	4.1	3.0
PFCE	11.2	11.7	7.5	6.8	4.4	3.0
GFCF	14.6	17.5	11.4	6.6	10.3	10.2
Exports	29.3	29.6	13.6	13.4	1.4	1.5
Imports	21.8	22.1	17.1	10.6	13.2	10.9
Net taxes	12.1	13.6	10.1	10.6	12.5	15.5

RE: Revised estimate (est.); PE: Provisional est.;
FAE: First advance est.; SAE: Second advance est.

%YY	GDP		GVA	
	Revised	Old	Revised	Old
Q1-FY24	8.2	7.8	8.2	7.8
Q2-FY24	8.1	7.6	7.7	7.4
Q3-FY24	8.4		6.5	

Data revisions

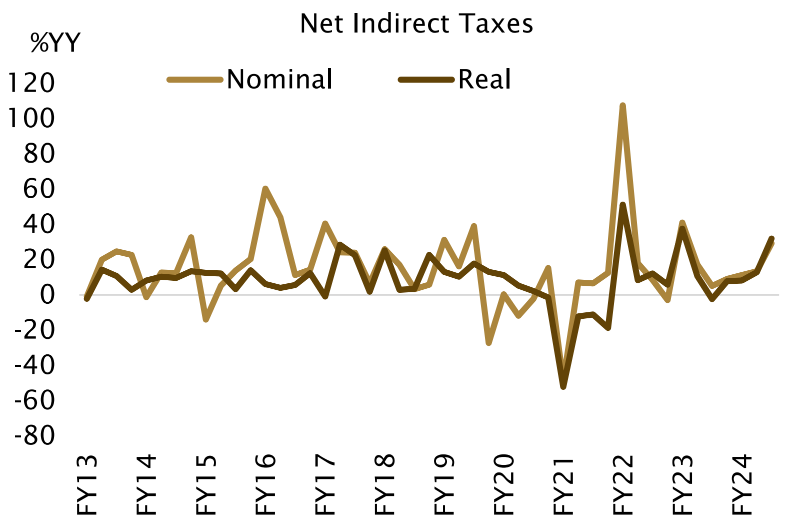


GDP-GVA growth gap widened in Q3 due to high net indirect taxes

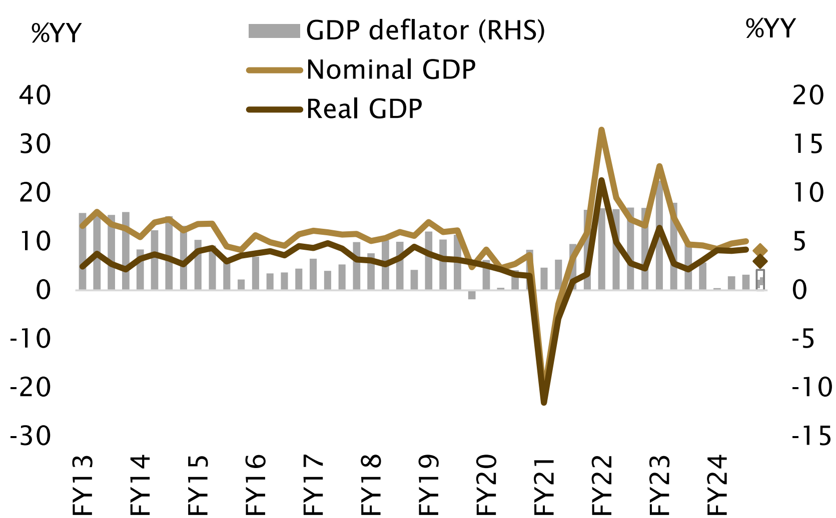
- **The growth gap:** The gap between real GDP and GVA growth widened to 185 basis points, the highest since the latest series starting 2011-12. Real GDP growth includes net indirect taxes (indirect taxes minus subsidies) that surged to 32%YY during the quarter due to lower subsides and favorable base effect.
  - During April-December 2023, major subsidies were at 74% of Budget Estimates (BE) for FY24, against 110% of BE in the corresponding period of FY23.
  - Also, major subsidies were at 2.1% of GDP in FY23, compared to 1.5% of GDP in FY24.
  - Base effect was also favorable, with net indirect taxes contracting 2.6%YY in Q3-FY23.
- Such high gaps between the two measures of growth were also observed during the pandemic years (232bps in Q1-FY21 and 291bps in Q4-FY21) but on the other side, with GDP growth being lower than GVA.

- **The GDP deflator:** The GDP deflator continued to increase for the third consecutive quarter, though it remains below the series average of around 4.5%. Imputed numbers based on NSO's SAE for FY24 suggest the deflator to rise further in Q4.
- Volatility in global prices that have a larger bearing on the wholesale price index and moderating domestic inflation indicate mixed signals for the future trajectory of the deflator.

High net indirect taxes widened GDP-GVA gap in Q3



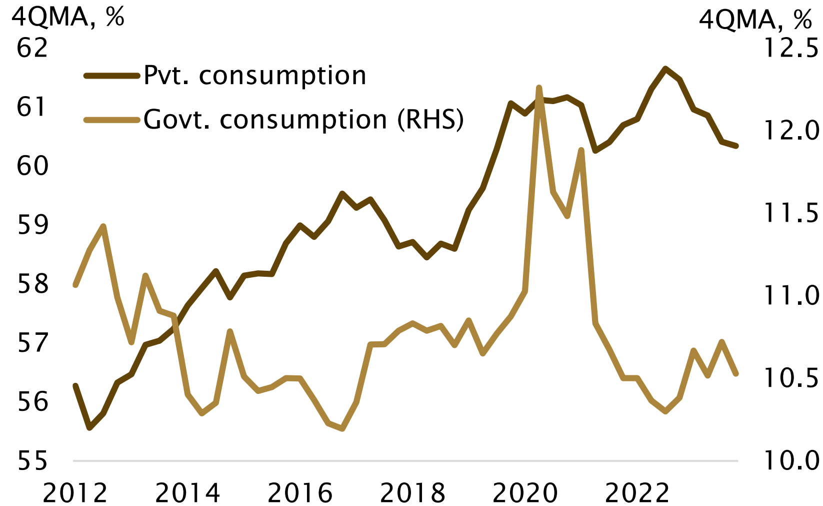
GDP by expenditure



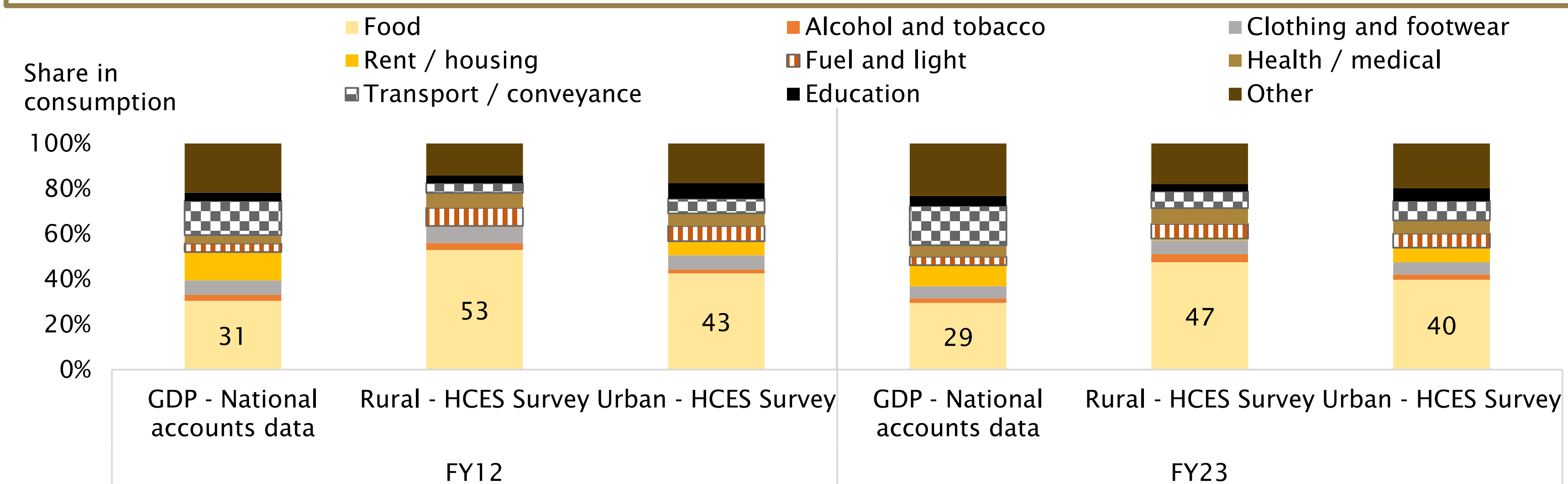
GDP data, household survey show lower share of food in consumption

- In the post-pandemic years, investment has played a larger role in driving domestic growth, though consumption continues to have a dominant share in GDP. The share of private consumption peaked at 61.1% in FY21 and is expected to have moderated to 60.3% in FY24. **The share of food within consumption has also eased slightly since FY12.**
- The latest round of Household Consumption Expenditure Survey (HCES) FY23 shows that **the share of expenditure on food has moderated in both rural and urban areas**, when compared to the previous round of survey held in FY12.
- This could have **ramifications for the weight of food in the consumer price index in future revisions.** Presently, this weight stands at 45.9%.

Share of consumption in GDP



Share of food in private consumption has eased, based on both – national accounts data and latest household survey



Note: Household survey values account for imputed values of items received free through social welfare programs, out of home produce, gifts, loans etc.

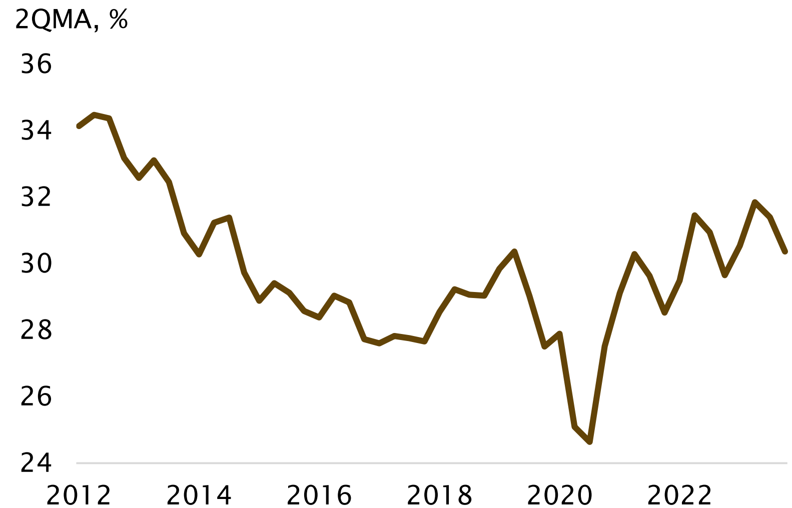
Real estate continues to attract largest share in overall investment

- The share of investment or gross fixed capital formation (GFCF) in GDP slumped to 27.3% in FY21 from 34.3% in FY12, and is expected to increase to 31.3% in FY24.

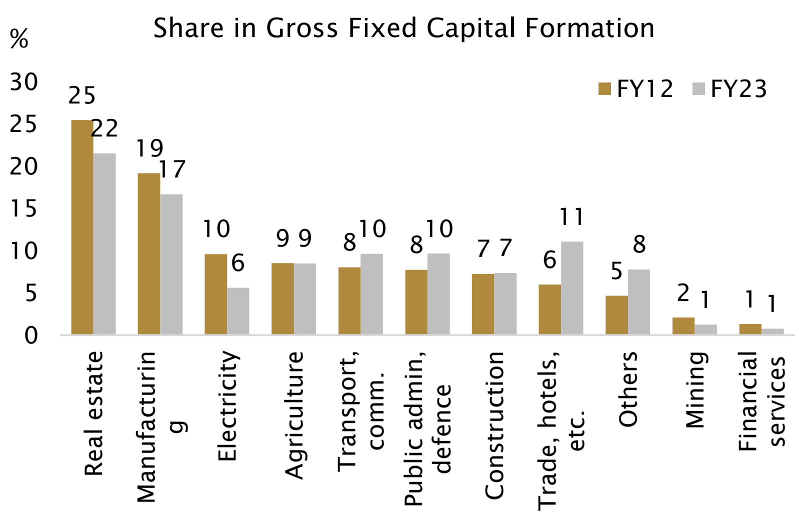
- Latest detailed annual data till FY23 suggests that among sectors, **real estate and manufacturing continued to attract the largest share of investment in FY23, though their shares have eased since FY12.** In addition to these two, share in GFCF has also moderated in case of electricity, mining, and financial services.

- Sectors with higher share in GFCF since FY12 include trade, hotels, etc.; public administration and defense; transport and communication services.

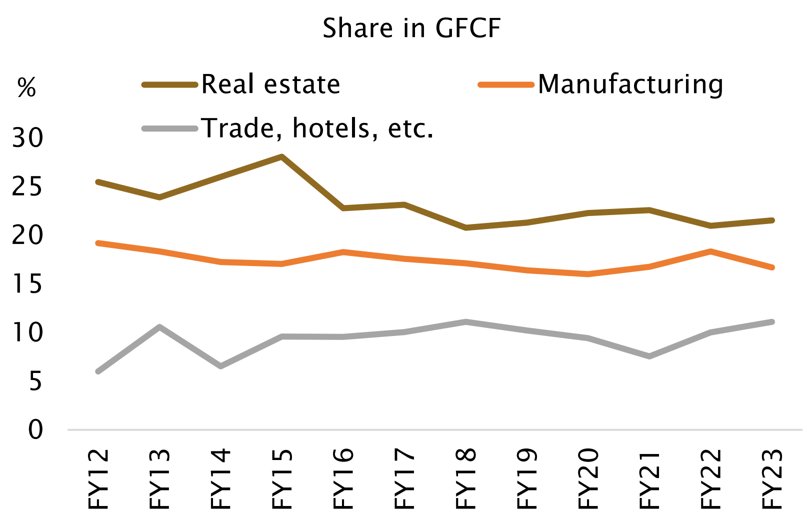
Share of gross fixed capital formation in GDP



Real estate continues to have largest share in GFCF



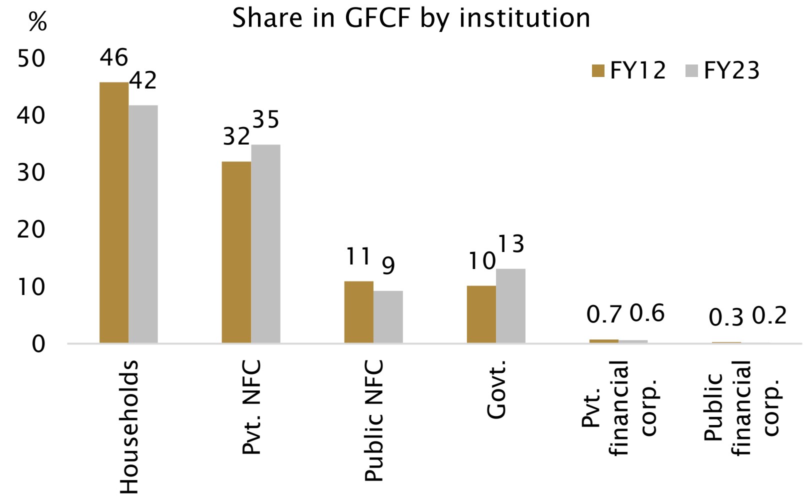
Invt. in trade, hotels, etc. has recovered post-pandemic



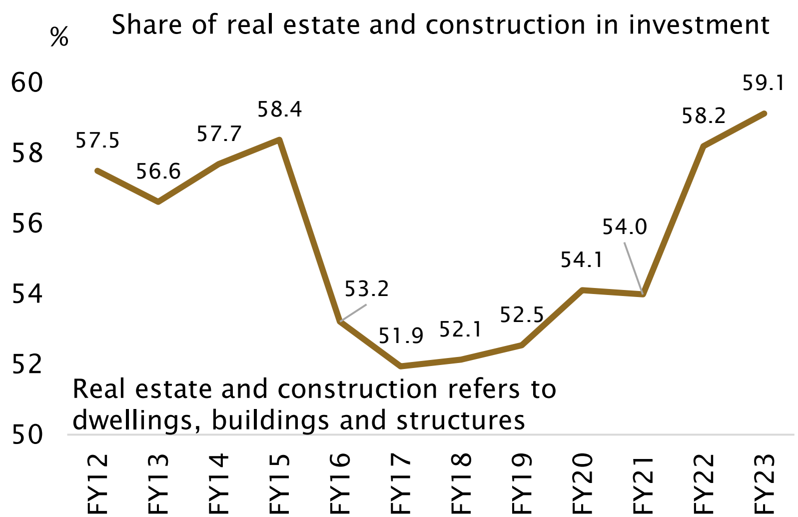
Investment by asset shows rising share of real estate, construction

- Households continue to dominate share in GFCF. However, this share has eased since FY12, while that of private non-financial firms has increased.
- By asset, **data for dwellings, buildings and structures; which could also be interpreted as real estate and construction; shows rising share in GFCF in the post-pandemic period.** The rise in share in FY23 was driven by private non-financial sector and government, partly reflecting the thrust on physical infrastructure capex.
- The recovery of household real estate investment from the slump in FY16 was paused by the pandemic. **Recent data and anecdotal evidence point to housing demand recovery**, as indicated by credit growth, fiscal support, and channeling of household savings towards physical assets.

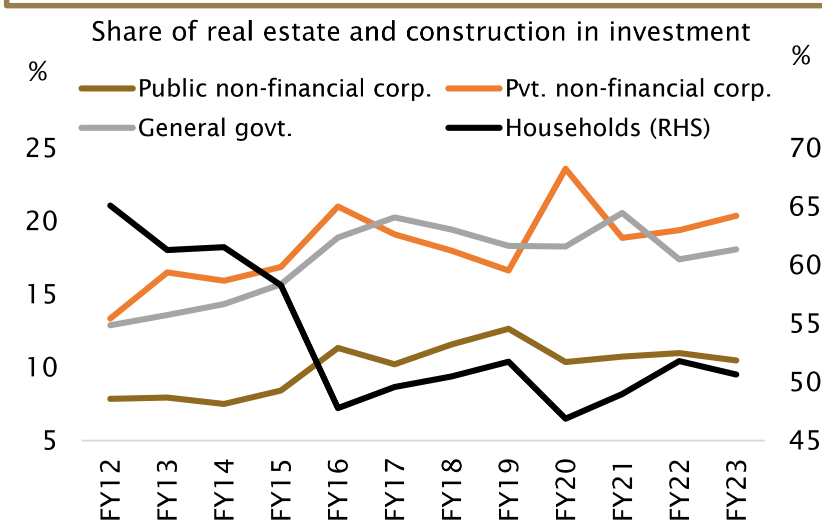
Households continue to dominate share in GFCF



Rising share of real estate in GFCF post-pandemic



Partial recovery in household real estate investment



Outlook and policy implication

- **Outlook:**
  - **Upward data revisions to quarterly GDP growth numbers for FY24 suggest growth could surpass NSO's second advance estimate of 7.6%YY.** Based on this estimate, imputed numbers indicate GDP growth of 6% in Q4 (5.9% to be precise), which matches latest RBI's forecast for the quarter. However, RBI forecast for the full year FY24 stands lower (7%) than NSO's estimate. Year-to-date real GDP growth stands at 8.2%YY compared to 7.5% during Q1-Q3 FY23.
  - **Latest PMI numbers indicate that growth momentum continued in Q4-FY24** with higher prints in January for both manufacturing and services sectors. Despite a strong reading in February, services PMI eased slightly from January, while manufacturing PMI continued to increase. Core sector growth moderated in January to 3.6%YY from 4.9% in December amid decline in output of refinery products and fertilizers, even as cement and steel sector output posted strong growth.
  - **Agriculture output prospects are likely to be better in FY25**, compared to the estimate of 0.7%YY for FY24 (revised lower from 1.8% in first advance estimate). Rabi sowing has progressed well and exceeded last year's levels. Reports of waning El Nino conditions and likely emergence of La Nina conditions in June-August augurs well for agriculture outlook. This bodes well for rural consumption.
  - The Union Interim Budget for FY25 signaled continuity in its **ongoing thrust on infrastructure development, which could continue to support investment in the economy.**
  - **Risks to growth outlook** remain from these factors:
    - **Uncertainties due to 1) impact of prolonged and/or further escalation of geopolitical tensions** such as disruptions at the Rea Sea that could continue to impart volatility to global commodity prices, raise logistics costs and undermine trade flows 2) **monetary policy uncertainty and the impact on financial market stability.**
    - **Impact on consumption 1) lagged impact of monetary policy tightening** and macro-prudential regulations on private consumption 2) **impact of lower fiscal deficit on government consumption.**

- **Policy implication: The upside surprise in latest GDP data is unlikely to alter the central bank's cautious pause. In fact, it might only strengthen its current stance, as strong growth defies the need for policy easing, unless warranted to counter the impact of higher real interest rates and policy rate divergences vis-à-vis major economies.**

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