INDIA GDP & MONETARY POLICY
SEPTEMBER 2017

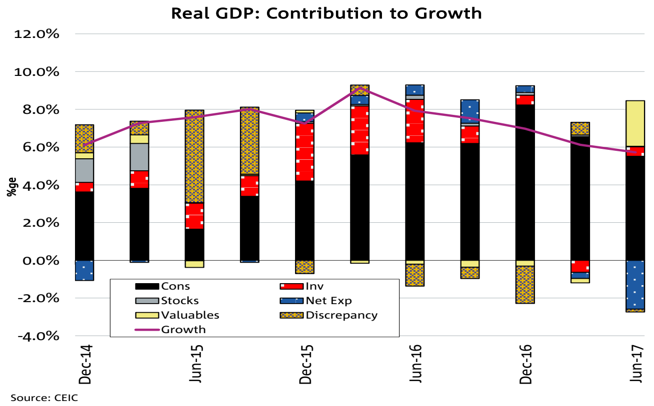
NAB Group Economics

The Indian economy expanded by 5.7% yoy in the June quarter, the slowest since March 2014. Net exports detracted from growth, and capital spending remained muted. NAB Economics is forecasting the economy to grow by 6.8% and 7.4% in 2017 and 2018 respectively, as implementation issues surrounding the GST begin to recede. The ability to generate an enduring improvement in private capital expenditure remains a crucial challenge for the Indian economy.

GDP Outcome

The Indian economy decelerated in the June quarter, growing by 5.7% yoy, the lowest since March 2014, and weaker than the 6.1% in March. Uncertainties surrounding the GST (which came into effect on 1st of July), as well as a weak export performance were the principal reasons for this weak outcome. The performance in the June quarter was even more disappointing when one considers that the base effects turned more favourable this quarter. The 5.7% yoy growth in the June quarter follows a 7.9% expansion in June quarter, 2016. By contrast, March quarter's 6.1% increase followed from a stronger 9.1% in March quarter, 2016.

GDP by expenditure

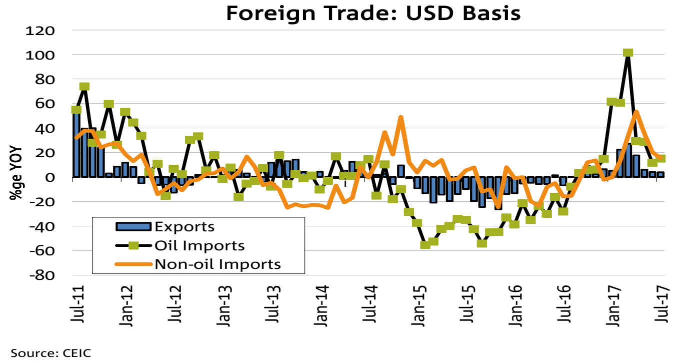


In terms of components, consumption was the most significant, contributing 5.5%. However, the share of consumption has been steadily falling over the last few quarters. Investment spending made a very modest positive contribution, 0.5%, an improvement from the -0.6% contraction in the March, but still indicative of a weak investment climate. Valuables were the second biggest positive contributor (2.4%). However, the weakest component was net exports, which detracted -2.6% from growth.

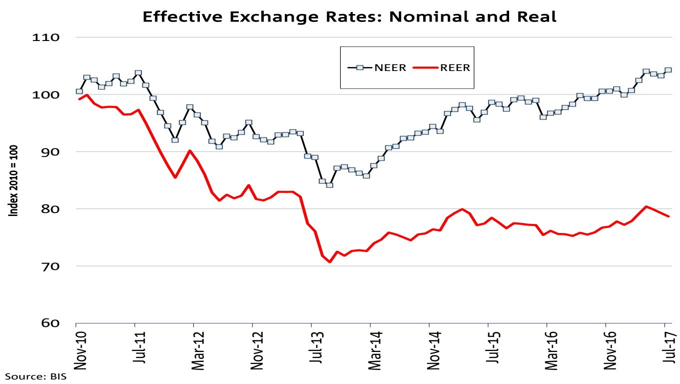
The merchandise trade data also reveals the weakness in exports, and still solid imports. Exports appear to be negatively impacted, in part, by a stronger currency. The Indian rupee was last trading around INR64.2/USD, and remains relatively strong both in nominal and real (inflation –adjusted) terms.

In terms of imports, major import groups include electronic goods, machinery as well as gold. It appears that expenditure on valuables is reflected in gold imports. The Indian government recently banned the procurement of zero duty gold from South Korea.

Weak exports amid steady imports

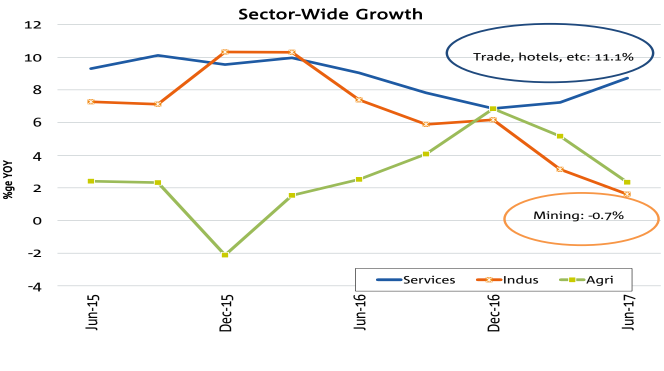


Stronger effective exchange rates



Date **September 2017** | Author **John Sharma**–Economist – Sovereign Risk

GVA by sector



Source: CEIC

By sector, the slowdown was driven by weakness in industry. Overall, industry GVA grew by a restrained 1.6%. The mining sector contracted (-0.7%), while manufacturing decelerated sharply to 1.2%: down from 5.3% in the March quarter. It appears that the slowdown in manufacturing has been impacted by uncertainties regarding the GST.

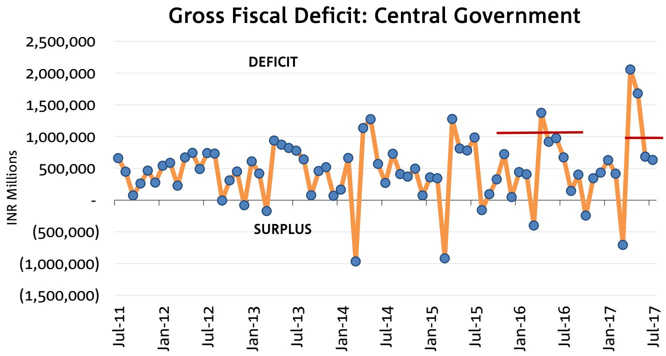
On a more positive note, there was an uptick in services. The services sector expanded by 8.7%, its quickest since June 2016. Within this segment, the performance of the trade, hotels, transport and communications was the best overall, expanding by 11.1% (6.5% in the March quarter). This outcome reflects, in part, the infusion of cash into the system following remonetisation, as well as strong growth from international tourism arrivals during the April-June period.

Inbound tourism

Source: CEIC

Public services (9.5%) also performed strongly, though lower than the unsustainable, 17% outcome in the March quarter. It will be difficult for the public services sector to sustain very high rates of growth over the coming quarters. India's fiscal deficit for the April-July period (1st four months) has reached 92% of budgeted estimates; by contrast, the deficit was 74% over April-July 2016. The Government will either have to raise the deficit, or curb expenditure (and thereby growth prospects).

Fiscal deficit

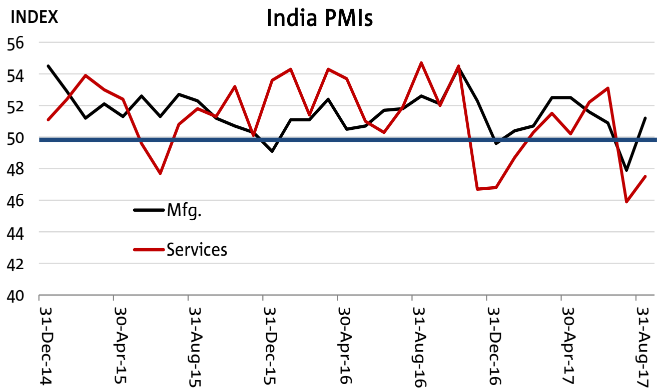


Source: DX

Partial Indicators

The partial indicators show similar trends to the GDP data, such as soft investment activity. Purchasing Managers Indexes – an early indicator of activity – contracted for both manufacturing and services following the introduction of the GST in July, 2017. While manufacturing moved into positive territory in August, services remains in contractionary mode, albeit somewhat less negative in August. There are concerns that the teething problems with regards to GST implementation could lead to liquidity problems, particularly for SMEs, potentially impacting their credit ratings.

PMIs

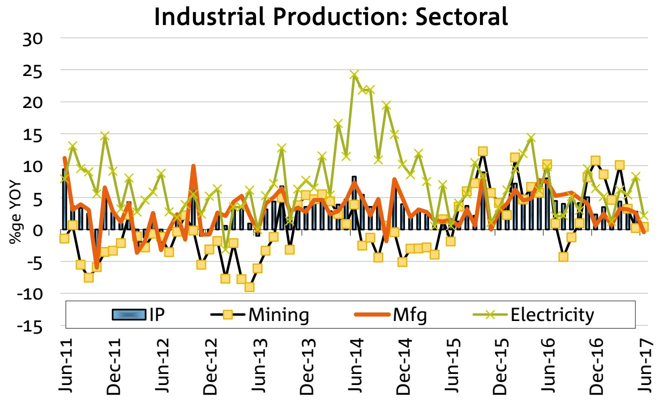


Source: Bloomberg

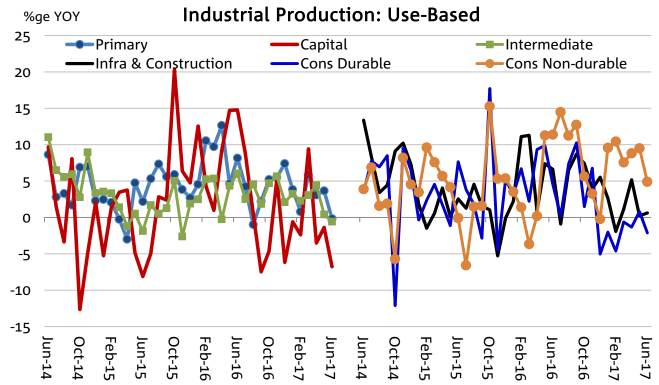
Other indicators also point to general weakness. Industrial production declined (-0.1%) in June, and grew by a moderate 2.1% in the June quarter 2017. During June 2016, industrial production grew by a much more robust 7.1%.

Within industrial production, both mining and manufacturing recorded sub 2% growth in the June quarter, while electricity production grew by 5.7%. By use, we can clearly see some of the weakness evident in investment expenditure. Both capital expenditure as well as durable goods production remain very weak. Infrastructure related spending has performed better, reflecting government spending on roads and highways.

IIP: Sectoral and Use



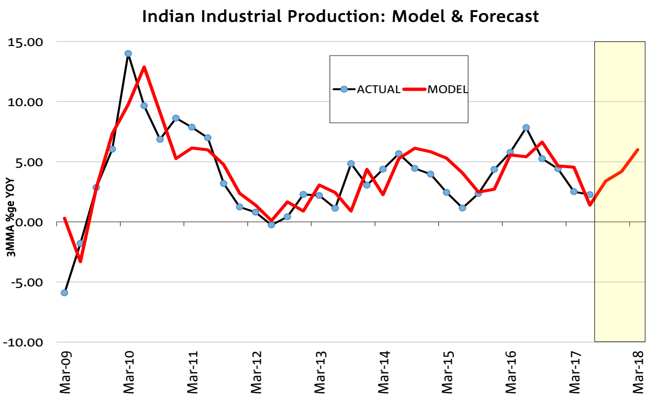
Source: CEIC



Source: CEIC

Looking ahead, industrial production is expected to gradually improve over the coming quarters. Modelling by NAB Economics using a 'leading indicator' approach suggests that industrial production is expected to rise from around 3.4% in the September quarter to around 6.2% in March quarter 2018.

Outlook for Industrial Production



Source: NAB Economics/CEIC

Outlook

NAB Economics is forecasting a 6.8% outcome in calendar 2017, rising to 7.4% in 2017 and 7.6% in 2018. Inflationary pressures remain muted, allowing Indian corporates the benefit of a lower interest rate regime. Further, the problematic issues relating to GST implementation should recede over time, and India is likely to reap some of the benefits of a single market that the GST regime provides. Finally, progress by the RBI and Finance Ministry to address some of the legacy problems related to stressed assets should also provide support. In this regard, ratings agency Moody's has assigned a stable outlook for the Indian banking sector. A challenge for the Indian economy relates to generating a sustainable improvement in private investment spending.

CONTACT THE AUTHOR

John Sharma
Economist – Sovereign Risk
John_sharma@national.com.au
+613 8634 4514

Tom Taylor
Head of International Economics
Tom_Taylor@national.com.au
+613 8634 1883

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities

Riki Polygenis
Head of Australian Economics
+(61 3) 8697 9534

James Glenn
Senior Economist – Australia
+(61 3) 9208 8129

Phin Ziebell
Economist – Australia
+61 (0) 475 940 662

Amy Li
Economist – Australia
+(61 3) 8634 1563

Behavioural & Industry Economics

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tom Taylor
Head of Economics, International
+(61 3) 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia

Economics
Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

David de Garis
Senior Economist
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy
Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Rodrigo Catril
Currency Strategist
+61 2 9293 7109

Interest Rate Strategy
Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Alex Stanley
Senior Interest Rate Strategist
+61 2 9237 8154

Credit Research
Michael Bush
Head of Credit Research
+61 3 8641 0575

Andrew Jones
Credit Analyst
+61 3 8641 0978

Distribution
Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand

Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Senior Economist
+64 4 474 6923

Jason Wong
Currency Strategist
+64 4 924 7652

Caro Down
Publications & Web Administrator
+64 4 474 9771

UK/Europe

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Asia

Christy Tan
Head of Markets Strategy/Research, Asia
+852 2822 5350

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055