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GDP to grow at 7% in fiscal 2018

CRISIL Outlook | September 2017

CRISIL has trimmed its fiscal 2018 growth forecast for India by 40 basis points to 7% from 7.4% earlier, after data for the first quarter showed GDP growth at 5.7%, the slowest in the past three years.

The demonetisation-driven cash crunch hurt economic growth, especially small enterprises, while the imminent rollout of the Goods and Services Tax (GST) spurred destocking and a slowing of production brought down manufacturing growth.

The 7% growth forecast implies a GDP growth of 7.4% on average in the remaining three quarters.

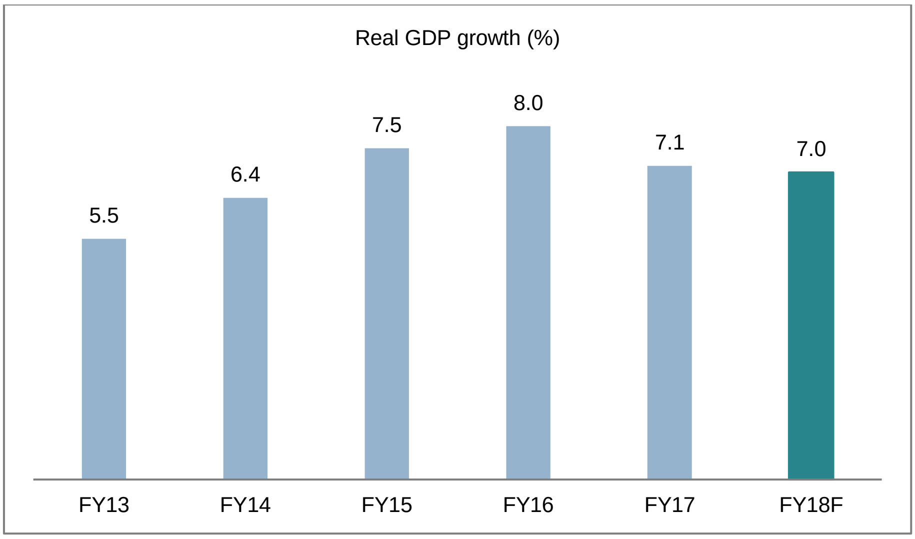
We believe the sharp decline in growth in the first quarter is transitory and the economy will grind up slowly over the next few quarters as the impact of demonetisation and destocking fades. The Purchasing Manager's Index (PMI) for August already signals a pick-up in manufacturing activity.

The growth will continue to be consumption-led, given

- Normal monsoon
- Softer interest rates and inflation
- Pay commission implementation by the states which will push up purchasing power
- Pent-up demand (demand postponed due to the demonetisation)

The downside risk to our growth outlook is from the GST implementation being more disruptive than what we anticipate.

Snipped a bit



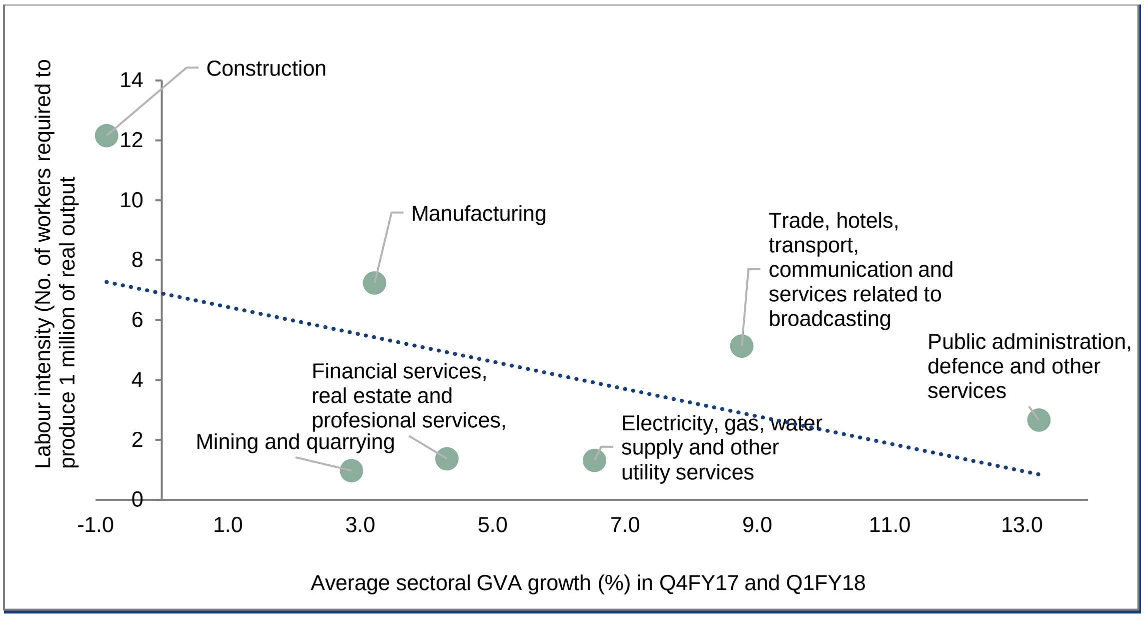
Source: Central Statistical Office, CRISIL

The first-quarter GDP numbers released last week brought the growth concerns to the fore. At 5.7% in Q1 fiscal 2018, real GDP growth declined secularly for the fifth straight quarter after peaking at 9.1% in Q4 fiscal 2016. It was also the slowest pace of growth since Q4 fiscal 2013, when growth had slumped to 4.3%.

Another worrisome feature of the growth slowdown is that the sectors with high potential to absorb labour force have seen a sharper dip**.** Most of the sectors that grew fast have low labour intensity and low share in overall output. This suggests that slower economic growth could also have shaved off employment growth in the economy.

Slower growth, fewer jobs

Labour-intensive sectors have decelerated in the past two quarters



Source: CSO, NSSO, CRISIL Research

In the past two quarters, three sectors have grown much faster than GDP: 1) Trade, hotels, transport, communication and services related to broadcasting; 2) Electricity, gas, water supply and other utilities, and 3) Public administration, defence and other services. Of these, only the trade, hotels and restaurants sub-sector is labour intensive, requiring about 6 workers to produce Rs 1 million worth of output. But the share of this sub-sector in total output is low at ~12%. In contrast, a fast-growing sector like public administration, defence and other personal services, despite having a larger share in output, has low labour intensity of only 3. And sectors with higher labour intensity – such as construction (12) and manufacturing (7) – have been undershooting overall GDP growth.

Going ahead, growth will be a grind up

In the wake of unusually low growth in the first quarter – which confirms the vulnerabilities of Indian economic growth – ***we scale down our real GDP growth forecast for fiscal 2018 as a whole to 7%, from 7.4% earlier***.

Indian economy can only grind its way up in an environment of subdued global growth and weak domestic investments. This fiscal would see some added headwinds in the form of GST related disruptions, even as the economy tries to recover from the impact of last year's demonetisation drive.

The details

We believe the GST-related disruptions would limit the upside to growth for a few more quarters as there are uncertainties around the possibility of changes to the given tax structure, and as businesses adjust to this new regime. At the same time, the benefit of extremely low commodity prices last year may not be available to the corporates this year and hence the bottom line may remain under pressure.

On the external front, though global growth prospects this year appear somewhat better relative to last year, factors such as the falling trade intensity of growth, geo-political risks and uncertainties surrounding the pace of normalisation of monetary policy in advanced nations, and appreciation of rupee would mean contribution of exports to domestic economic growth would be limited. Manufacturing growth could, therefore, slow down to 7.6% in fiscal 2018 from 7.9% last fiscal.

Agricultural growth, however, is expected to be buoyant. The rainfall in 2017 has as of August-end been normal at an all-India level, at just 3% below the long period average, or what is considered normal. Six states have seen deficient rains (that is, rainfall deficiency more than 10% of normal) while nearly 8 states have been inundated by excess rains, causing floods and flood-like situation.

The rains have been somewhat unevenly distributed. Some large crop producing states such as Haryana, Uttar Pradesh and Punjab have received less-than-normal rainfall, but the impact is by and large absorbed by their adequately large irrigation cover. On the other hand, states such as Kerala, Madhya Pradesh and Karnataka have not only received inadequate rainfall but also have relatively lesser irrigation cover. But since these states together contribute less than 5% of all-India kharif production, the overall sowing is progressing at a healthy pace.

As of August-end, total kharif sowing was 3.3% higher on-year and 5% higher than normal. But given the high base of 4.9% last fiscal, agriculture is estimated to grow at best around 3%.

The services sector may perform a little better this year as we expect some improvement in areas such as Trade, hotels & transportation (as agriculture production remains robust and construction activity is expected to gather pace), and Financial Services, Real Estate and Professional Services (on account of improved performance of the capital markets and some pick-up in consumer credit on the back of improved rate transmission post demonetisation).

On the whole, we estimate services sector growth at 8.1% in fiscal 2018 compared with 7.7% last fiscal.

Given this scenario, GDP growth in fiscal 2018 is estimated at 7%, compared with 7.1% last fiscal, with downside risks in the form of greater than anticipated GST-related disruptions.

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