Geopolitical headwinds disrupt economic recovery; FY23 GDP growth to likely be around 7.5%: Brickwork Ratings

Receding Covid-19 caseloads, coupled with lifting of restrictions, are expected to improve growth prospects in the coming fiscal. However, supply side disruptions caused by the Russia-Ukraine war and shortages of critical components like semiconductors are likely to pose inflationary worries and significant downside risks to the growth momentum.

Brickwork Ratings, Bengaluru, 1 April 2022: The economy has been reeling under the effects of the pandemic since 2020, and GDP growth nosedived to (-) 6.6% in FY21 due to the imposition of the nationwide lockdown and restrictions imposed on economic activities. Subsequent waves of the pandemic and repeated lockdowns kept economic recovery constrained during FY22, yet the Indian economy recovered faster than many other emerging economies. The International Monetary Fund (IMF) in its January 2022 World Economic Outlook update has lowered global growth estimate for 2022 to 4.4% (from 4.9% estimated in the October 2021 WEO), but revised India's growth projection upwards (for FY23) to 9% from 8.5%. Although, the rapid spread of the highly transmissible Omicron variant, rising commodity prices and global supply constraints have kept the outlook gloomy in the beginning of 2022, falling caseloads and relaxations from Covid-19-related restrictions on economic activities have brought in some relief. The Economic Survey 2021-22 has pegged GDP growth at 8-8.5% for FY23, and the RBI forecasted 7.8% growth. The pace of domestic growth also appeared to be back on track when the government presented its budget on 1 February.

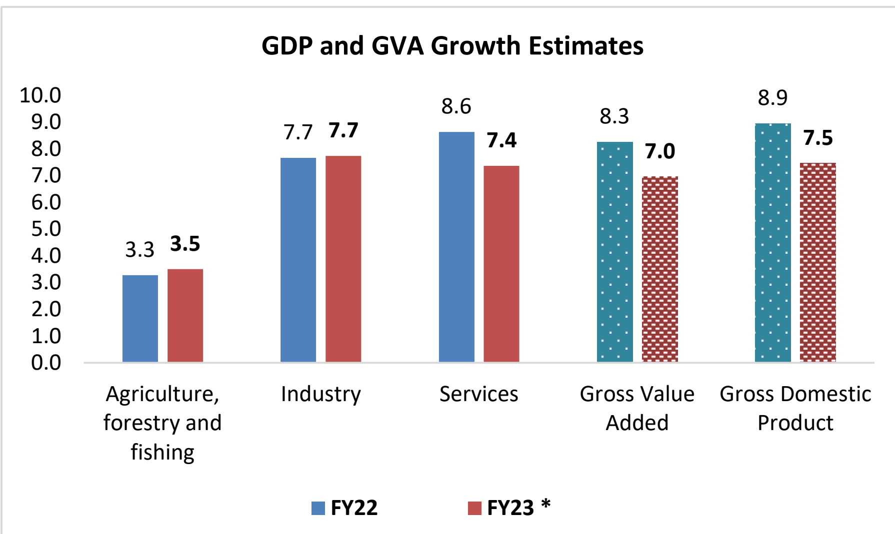
Recovery at a halt

The economy was progressing well even in the wake of shortage in critical items essential for manufacturing like semiconductors. However, Russia's war with Ukraine beginning 24 February 2022, has suddenly changed the growth dynamics, stoking serious supply chain disruptions and meteoric rise in the energy related supplies. Over 70% of the world supply of critical inputs like palladium and neon are produced in these countries and this is likely to create further shortages in the already beleaguered manufacturing of chips. The Russia-Ukraine war has led to crude oil prices escalating to near record highs, which again poses a serious threat to India's economic outlook. It can be recalled that the growth and fiscal estimates in the Union Budget were prepared assuming crude oil prices remaining within a range of USD 75-80/barrel in FY23. Crude oil prices have remained above USD 100/barrel since 28 February. The continuing war-led supply and trade disruptions and sanctions and sharp rise in international crude oil and input prices are likely to impact growth significantly. Not only supply disruptions, but also high cost-push factors are threatening to create higher inflationary expectations. CPI inflation has already crossed the MPC's upper tolerance level of 6% for two consecutive months since

January 2022, and continued supply disruptions caused by the ongoing geopolitical developments may further increase inflationary pressures.

Advanced economies have already started increasing their policy rates due to record high inflation levels, and the RBI may also begin changing the stance from accommodative to neutral from the next monetary policy committee meeting, although it may not start the cycle of increasing rates immediately. Although the economy may not have entered into the stagflation mode yet, rising inflationary pressures and weakening growth prospects pose serious risks.

Growth outlook



Note: FY22 data are Second Advance Estimates * FY23 BWR Estimates.
Source: CSO, Mospi and BWR Research

Downside risks loom; India is still better-placed than other major economies

Despite the ongoing geopolitical developments and rising cost-push pressures, the Indian economy appears to have been better-positioned than many other economies. The RBI has remained accommodative with its monetary policy stance for more than two years to support economic recovery, despite looming inflationary worries. The government also has taken a number of steps to support economic activities, helping the economy recover from the Covid-19 pandemic disruptions. In the union budget 2022 also, it has laid greater emphasis on growth acceleration and increased the capital expenditure targets to a record level of 2.9% of the GDP, and it has pegged the fiscal deficit at 6.4% of the GDP for FY23 to support growth.

Domestic growth indicators are still showing signs of progress due to supportive monetary and fiscal policies. The government's efforts to sustain investment and consumption demand reflect in the recent improvements in credit growth. India's trade situation remains strong, with merchandise exports crossing the target of USD 400 billion well before the end of fiscal year 2022. India's forex reserves at above USD 630 billion provide the much needed cushion for external shocks such as rising crude oil prices and a depreciation in the rupee. The latest data on the manufacturing and services Purchasing Managers Index (PMI) also signals a slight recovery, with the Composite PMI output index improving to 53.5 in February 2022 from 53 in January. Dismal IIP growth indicates a tepid revival, but this is also due to continued semiconductor shortages, which have led to delays in vehicle supply, restricting automobile sales. The core sector growth too shows improvements.

Agriculture sector likely to sustain growth momentum

The agriculture sector has made noteworthy progress despite the Covid-19 pandemic. India emerged as a major global supplier of food and essential agricultural products such as rice, marine products, wheat, spices and sugar, recording the highest ever agricultural product exports in 2021-22. As per the second advance estimates of production of major crops for the year 2021-22 released by the Ministry of Agriculture and Farmers' Welfare, India's foodgrain production is slated to exceed the targets and cross 316 million tonnes. The production of rice, wheat and cereals improved notably compared to the previous year. For the next fiscal too, given the prediction of a likely normal monsoon in 2022 by Skymet, the sector may sustain its pace of growth. Global demand for wheat is also likely to increase due to supply disruptions from Russia and Ukraine, which are the major wheat exporting countries. Although India's wheat exports are miniscule (at USD 1.7 billion so far in FY23 which accounts for just 0.5% of the total exports), they have risen by four times during the April 2021 to January 2022 period compared with the corresponding period in the previous year. There are better prospects for Indian agri commodities exports, however rising input cost pressures may dampen the growth prospects.

Industrial sector growth may remain under stress due to slowdown in manufacturing sector

The manufacturing sector has recovered well in the first two quarters of FY22, with a steady improvement in demand. The progress in vaccination and easing of lockdown restrictions promised broad-based and steady progress in industrial activity. However, supply shortages in semiconductors due to increased demand for chips hit manufacturing activity, particularly in electronic and automobile industries. Production constraints were causing a prolonged slowdown in these sectors, while adverse geopolitical developments have added to the uncertainty and insecurity. We expect growth in the industrial sector to remain subdued in FY23, if the supply constraints prolong further. Elevated commodity prices, which have increased the input cost burden, may also dampen recovery in FY23. Demand may perk up if the pandemic situation subsides further; however, rising price pressures may dent household incomes, increasing downside risks to growth.

Services sector growth to remain stagnant

Repeated restrictions on the back of the pandemic waves curtailed the recovery progress in contact-intensive sectors. In addition, geopolitical risks and a global demand slowdown posed additional risks to the services sector growth momentum. However, the increased capital expenditure proposed in the union budget and its multiplier effect on private investments may help the sector recover faster and increase employment as well. Increased infrastructure spending proposed in the budget was also expected to enhance productivity. Higher capacity utilisation would usher in the virtuous cycle of higher investments and growth, but with the inflation rate crossing the upper bound of the target, acceleration in growth with price stability is difficult. The downside risks emanating from the resurgence of the Covid-19 variants also cannot be ignored. In addition, in the next fiscal, the RBI will also begin tightening its monetary stance.

GDP projections for Q1 and FY23

Q1 and FY23 GDP and GVA Estimates (year on year changes at constant prices)				
Economic Activity	**Q1 FY22***	**Q1 FY23#**	**FY22***	**FY23#**
Agriculture, forestry and fishing	**3.5**	**3.6**	**3.3**	**3.5**
Industry	**46.6**	**12.5**	**7.7**	**7.7**
Mining and quarrying	17.6	7.0	12.6	8.0
Manufacturing	49.0	12.0	6.0	7.5
Electricity, gas, water supply and other utility services	13.8	15.0	7.8	8.5
Construction	71.4	15.0	10.0	8.0
Services	**10.5**	**14.1**	**8.6**	**7.4**
Trade, hotels, transport, storage and communication	34.3	25.0	11.6	8.0
Financial services, real estate and professional services	2.3	10.0	4.3	7.1
Public administration, defence and other services	6.3	10.0	12.5	7.0
Gross Value Added	**18.4**	**12.0**	**8.3**	**7.0**
Gross Domestic Product	***20.3***	***12.5***	***8.9***	***7.5***
* Second Advance estimates by CSO # BWR estimates Source: MOSPI, BWR Research				

The impact of the pandemic on economic activities may be waning, but the downside risks emanating from the resurgence of the Covid-19 variants cannot be neglected. In addition, persistent supply-side bottlenecks, along with rising international crude oil prices and commodity prices exerting cost push pressures, are adding to the woes. The growth rates in Q1 may be skewed more downwards than expected earlier. **Due to a low base, GDP growth may remain in double digits in Q1 FY23, and we expect 12.5% growth over Q1FY22. For the full fiscal, we expect GDP growth at 7.5% over FY22.**

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