Modest moderation likely in FY23 GDP outlook

Global cues continue to daunt the domestic growth outlook; the GDP is expected to grow by 6.2% in Q2FY23 and 7% in FY23.

Brickwork Ratings, Bengaluru, 29 September 2022: The prolonged war between Russia and Ukraine, and its adverse consequences have heightened the risk of a global recession. As central banks globally are aggressively raising interest rates to combat inflation, global growth recovery has weakened sharply, raising the fear of a recession in major advanced economies. Higher inflationary levels and a steady increase in the policy rate to combat the rising prices on the one hand and arrest the flight of capital on the other have increased the risk to the domestic growth outlook. As the inflation rate continues to exceed the tolerance level by a significant margin, a substantial increase in the policy rate looks unavoidable, further constraining the growth recovery. The RBI has already frontloaded the rate hikes and has raised the repo rate by 140 basis points since May 2022, and is expected to continue with further rate hikes to bring down the inflation to within its target range of 2% to 6%.

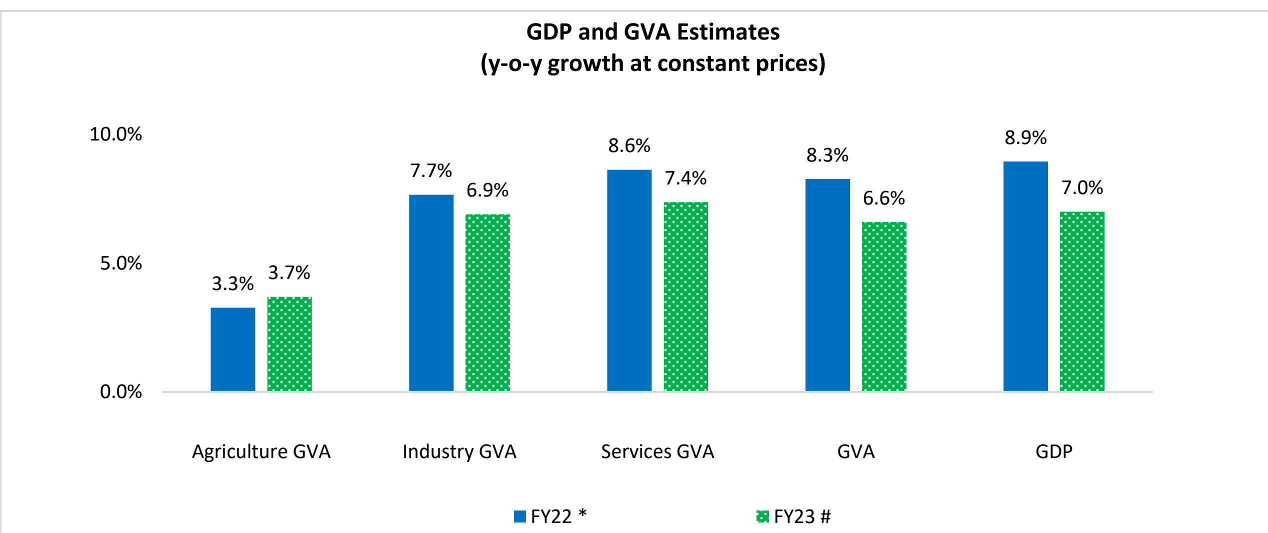
Renewed concerns on external sector challenges concerning growth outlook; domestic fundamentals remain strong

Although the Indian economy has been on the revival path after the severe contraction in FY20 due to the pandemic, there is continued uncertainty on the recovery progress due to adverse geopolitical conditions. As per the latest estimate by the Ministry of Statistics and Programme Implementation (MOSPI), Q1GDP growth is placed at 13.5%, in line with BWR's estimate, but much lower than the RBI's estimate of 16.2%. With the waning base effect and global headwinds, full-year growth is likely to remain lower than projected earlier. The economy is still grappling with supply-side disruptions, causing inflationary challenges, and thereby leading to sharp increases in policy tightening across the world. Widening interest rate differentials between advanced countries and India have heightened the risk of capital outflows as well, resulting in a steady depreciation in the Indian rupee against the US dollar in spite of the RBI using a considerable amount of foreign exchange reserves to protect the rupee value.

Despite the worsening external situation and geopolitical crisis, including sanctions and volatile commodity prices, the Indian economy continues to show strong underlying resilience so far in FY23. Some high-frequency indicators suggest a sustained, though gradual, recovery in investments and demand conditions. For instance, the manufacturing sector has recovered well, as seen by the manufacturing Purchasing Managers Index (PMI) averaging 55.2 points from April to August 2022 (as compared to 52.1 year ago). The services PMI has also averaged 57.8 points (50.2), signalling recovery, during the same period. The IIP and eight core industries too grew at 10% and 11.6%, respectively, in the first four months of FY23 over the previous year, in spite of the constraints caused by the supply shortage of essential materials such as semiconductors. This reflects increasing investment and consumption demand. It has also been seen that credit growth has improved across segments. Gross bank credit increased by 16.2% (y-o-y) as on 9 September 2022. The GST monthly collections rose by 32% in in the first five months of FY23 over the previous year. Moreover, the easing of crude oil prices due to the slowdown in the global economy and slowing global demand also bring some comfort on the external front. Brent crude oil prices dropped to below USD90 per barrel in September, from the USD116 per barrel on average in June 2022. Although recessionary conditions in the US and Europe could hurt domestic exports, lower crude oil prices will help ease imported inflation and reduce pressure on the current account. Nevertheless, inflation pressures are likely to remain a concern throughout this fiscal as the pressure on food prices is likely to continue for a few more months amid a low base and supply-side constraints, deficient rains in some parts of the country, and excess rains and floods in others.

Growth outlook for FY23

Overall, the domestic growth prospects have continued to be constrained by the ongoing geopolitical crisis, persistent supply-side bottlenecks and erratic monsoon behaviour. Higher inflation and increasing interest rates, and waning monetary support will add to the worries. Notwithstanding the downside risks to the growth momentum, the economy is still better positioned than that of many other emerging market economies, and the recovery process is likely to continue, albeit at a gradual pace. We expect the economy to show moderate growth in H2FY23. However, in Q2FY23, the growth numbers are likely to be high due to partial lockdowns imposed by many states in Q2FY22 due to the second wave of the pandemic.



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

GDP Projections by BWR

GDP and GVA Estimates at Constant Prices (year on year changes in %)				
Economic Activity	**Q1 FY23***	**Q2 FY23#**	**FY22***	**FY23#**
Agriculture, forestry and fishing	**4.5**	**2.5**	**3.3**	**3.7**
Industry	**8.6**	**5.3**	**7.7**	**6.9**
Mining and quarrying	6.5	5.0	12.6	7.6
Manufacturing	4.8	5.5	6.0	7.0
Electricity, gas, water supply and other utility services	14.7	6.0	7.8	8.0
Construction	16.8	4.5	10.0	6.0
Services	**17.6**	**6.7**	**8.6**	**7.4**
Trade, hotels, transport, storage and communication	25.7	8.0	11.6	8.0
Financial services, real estate and professional services	9.2	5.5	4.3	7.1
Public administration, defence and other services	26.3	7.5	12.5	7.0
Gross Value Added	**12.7**	**5.8**	**8.3**	**6.6**
Gross Domestic Product	**13.5**	**6.2**	**8.9**	**7.0**
* Estimates by CSO # BWR estimates				
Source: MOSPI, BWR Research				

Agriculture sector growth likely to be moderated

Agriculture remained the least impacted sector during the Covid-19 pandemic. After emerging as a major global supplier of essential agricultural products such as rice, marine products, wheat, spices and sugar, and recording the highest ever agricultural product exports in 2021-22, India's production of major kharif crops in 2022-23 is expected to remain lower than the targets set for the year. As per the first advance estimate for 2022-23 released by the Ministry of Agriculture and Farmers' Welfare, India's foodgrain production is expected to be around 149.92 Million Tonnes (MT) in the kharif season, which is likely to be lower than the target set for the year by 13.23 MT, and lower by 6.12 MT as compared to the previous year's level, as the uneven distribution of the monsoon has caused major damage to crops. The production of rice, which is the country's majorly consumed foodgrain, is expected to fall by 6% as compared to the previous year. Amid rising global demand for wheat due to supply disruptions from Russia and Ukraine, major wheat exporting countries, lower production comes as a drag on exports.

Industrial sector recovery continues; persistent supply constraints and cost push pressures may trim growth pace

The manufacturing sector has recovered so far in FY23 with a steady improvement in demand. The opening up of the economy and improved business conditions promise broad-based and steady progress in industrial activity. However, persistent supply challenges and increased input costs are prevailing constraints. In particular, semiconductor shortage is hurting the electronic and automobile industries. Production constraints were leading to 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. Easing commodity prices, which otherwise have increased the input cost burden following Russia's invasion of Ukraine, may bring some respite. However, persistent higher inflation may dent household incomes, as well as demand, endangering growth revival. Moreover, the global slowdown and recessionary conditions in advanced countries will dampen export demand.

Services sector growth to remain stagnant

The slowdown in the global economy poses a serious threat to the growth momentum in the services sector as well. However, the increased capital expenditure proposed in the union budget including the long-term interest-free loan of Rs. 1 trillion to the states and its multiplier effect on private investments may help the sector recover faster. Increased infrastructure spending proposed in the budget, if sustained, is likely to improve capacity utilisation. Pressure on containing the fiscal deficit is likely to constrain the government consumption demand, although better tax collections may allow for some leeway. A tightening in the monetary policy and higher interest rates may also add to the downside risks.

Overall, we revise the FY23 GDP growth estimates downwards to 7.0% from our earlier estimate of 7.3%. We expect Q2FY23 growth at 6.2% and around 4% growth for H2FY23.

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