GDP growth likely to be capped at 9% in FY22: Brickwork Ratings

The second wave of COVID-19 infections has forced the state governments to impose restrictions on economic activities, thus weakening recovery progress.

Brickwork Ratings, Mumbai, 27 April 2021: The deadly second wave of COVID-19 has brought India's nascent economic recovery from the pandemic to an abrupt halt. Many state governments have imposed lockdowns or similar restrictions to contain the virus spread. These lockdowns restrict most of the normal economic activities, thus putting livelihoods at risk. The concern of an uncertain future has led to the start of the exodus of many migrants from urban agglomerations. This has added to the humanitarian crisis due to the non-availability of beds, ventilators and oxygen supplies. The situation is unprecedented, with a heart-breaking situation being witnessed in crematoriums and burial grounds. The repercussions of the past lockdowns have already wounded economic health, and the current situation only adds to the despair. In this scenario, the earlier presumptions of a "V"-shaped economic recovery is unlikely.

The Indian economy entered the calendar year 2021 with bright hopes of achieving double-digit growth in FY22, backed by a dramatic decline in new COVID infections, in addition to progress in developing an effective vaccine for COVID-19. Although the presumed growth was mainly due to the low base effect, the improved performances of some leading indicators in the third quarter of FY21 brightened the expectation of a quick recovery. However, this euphoria was short-lived as the recent sharp increase in new COVID cases and the second wave of COVID-19 infections across the country has heightened economic uncertainty. The ongoing health crisis has once again derailed recovery progress, and the disruption is likely to continue in at least the first quarter of the current fiscal. The major activities which require social distancing are likely to suffer the most like trade, hotels and transport sectors, which are already reeling under the stress. Manufacturing will also be significantly impacted from both the demand and supply sides. Although not many restrictions have been imposed on the transportation of goods, supply chain disruptions are bound to occur due to, inter-alia, the diversion of oxygen from manufacturing units. The distress in economic activities caused by the pandemic in terms of job losses, along with sharp decline in income and consumption, has been unprecedented, and has already resulted in a more than Rs 11 trillion loss to the GDP in FY21. As per the second Advance Estimates (AE) of the GDP released by the Ministry of Statistics and Programme Implementation (MOSPI), the economy is estimated to contract by 8% in FY21, which is close to our estimate of -7.5%.

Normal monsoon predictions bode well for agriculture sector outlook

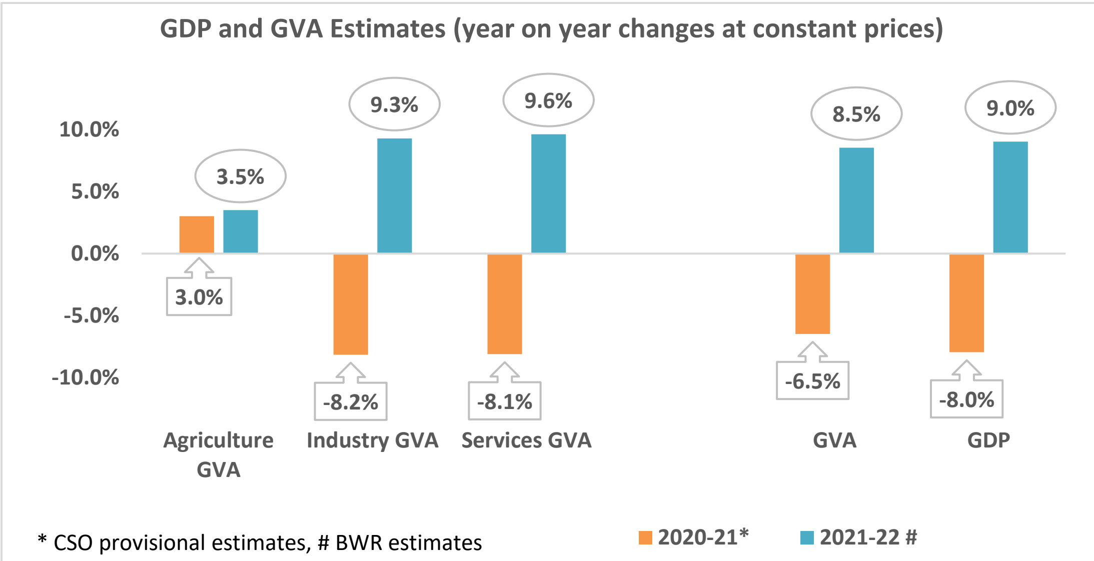
The pandemic has not as much affected agricultural activities like other sectors of the economy, although there could be disruptions in marketing and processing. Agriculture is largely dependent on normal monsoons, and the first stage forecast of a near normal southwest monsoon for 2021 by the India Meteorological Department brightens the hope for a better kharif output in the current year. The smooth implementation of farm reforms also holds the key to steady progress in farm activity. We continue to expect stable growth for the agricultural sector and retain our earlier forecast of 3.5% growth in FY22.

Industrial sector recovery again distressed by lockdown imposition

With the gradual easing of the lockdown, industrial activities reported better performances and positive growth in Q3FY21 after consecutively remaining in the negative zone for five quarters. However, both, the eight core sectors and IIP, a proxy for industrial growth, again slipped into a sharp contraction in February 2021, reflecting restrained demand conditions. The manufacturing PMI also declined in March 2021. The decision to divert oxygen from industrial units to hospitals for medical purposes may also pose a near-term challenge for select manufacturing industries such as steel and cement. Higher government spending on infrastructure may continue, but the construction sector is expected to remain under stress with reverse migration taking place, resulting in a shortage of labourers. Considering the increased stress on manufacturing sector activities and falling demand due to the recent lockdowns, we revise our estimates on industrial sector growth to 9.3% from the earlier estimate of 11.5% for FY22.

Services sector will take longer to recover; financial services may not be affected much

The contraction in the services sector was the severest during the first wave when the pandemic hit. The travel, tourism and hospitality sectors have been badly hit and are unlikely to recover soon with repeated lockdowns. Continued social distancing measures will have a considerable impact on sectors subjected to these norms. Thus, a restoration in trade, transport, tourism, hotels and restaurants looks grim in the current situation, and recovery is only be prolonged further. Financial services are not likely to be impacted much with the recent restrictions, while the loss of lives and rising infections continue to have an impact on their businesses. Timely intervention by the government and RBI through fiscal and monetary policy measures has helped financial services mitigate some losses in FY22. However, in an environment of constrained fiscal and monetary space, we do not expect much additional relief coming from the government other than the budgeted expenditures. With prices soaring high, the chances of any monetary stimulus are also very low. If the price situation deteriorates, the RBI too will have limited freedom to enhance liquidity. The first quarter of the year is crucial as the progress of recovery in the other quarters will depend on how quickly and effectively the challenges posed by the pandemic are dealt with. In this precarious situation, we expect the services sector to grow at a lower rate of 9.6% in FY22 (from 11.8% estimated earlier).



Source: MOSPI, CSO and BWR Research

GDP outlook for FY22

Unlike in the first wave, the pandemic in the second wave is seen to be widespread. States such as Uttar Pradesh, Uttarakhand and West Bengal, where the number of cases in the first wave was not very high, are reporting an alarming number of cases in the second wave. Metro cities have already been facing severe losses and are reeling under the acute shortage of medical supplies to save lives. It is not clear when the curve will be flattened, and COVID positive rate is reduced. The progress in vaccination has been slow, and it will take considerable time for a significant part of the population to be immunised. At the same time, as the global situation is much better than that in India, unlike when the first wave struck, India as an investment destination would become less attractive. In this situation, it is critical to arrest the spread through social distancing protocols and accelerate the pace of vaccination. Like last year, the budget presented by most states needs to be reworked to take account of both lower revenues and higher expenditures. The centre too will have to spend much more than budgeted to ensure the vaccination of all adults as this is for the national (even global) public good.

We continue to believe that until the virus spread is contained and a substantial part of the population is vaccinated, sectors that are impacted by social distancing norms and those adversely affected by supply disruptions, labour shortage and demand reduction will continue to trail and may take longer to return to a sustained growth path. Revival in sectors that fall under discretionary spending may also be further delayed due to the second wave. Nevertheless, **the outlook for growth continues to remain positive mainly due to the low base, and we revise FY22 GDP growth to 9% from the earlier estimates of 11%.**

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