Research

Economy to contract by 7 to 7.5% in FY21: Brickwork Ratings

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The better-than-expected second quarter (Q2) GDP estimate has raised the hopes of a faster recovery in the second half of the current fiscal (H2FY21). On 27 November 2020, the Ministry of Statistics and Programme Implementation (MOSPI) released Q2FY21 GDP data, wherein the contraction in the economy was estimated at a much lower 7.5%, compared with the 23.9% contraction in Q1FY21. With this, the contraction in H1FY21 stands at 15.7%.

Although Q2 estimates have brought in some cheer in an otherwise gloomy scenario, the distress in economic activities caused by the lockdown has been sharp and is still continuing. With the lockdown being relaxed in phases, economic activities are slowly reaching pre-COVID levels, but are not completely there yet. The moderate recovery reported in some high-frequency indicators recently is also largely attributed to pent-up demand, but if the recovery sustains, the H2FY21 is likely to witness positive growth.

Agriculture sector a bright spot; recovery in services to likely be delayed

The agricultural sector, as expected, will continue to drive the growth momentum in the remaining part of the fiscal. Our earlier projections on agricultural growth were almost close to the CSO's estimates, and in the subsequent quarters also, we believe the growth rates will continue to be better than those recorded last year, despite the high base effect.

It is evident that the COVID-19 impact on both the industry and services sectors was the severest in Q1, but with the gradual easing of the lockdown, industrial activities reported a marked improvement in Q2. Contractions slowed down considerably in Q2, with the manufacturing sector reporting positive growth after a span of three quarters.

The contraction in services was the severest. Social distancing measures are likely to constrain the recovery process in this sector, particularly in the trade, hotels, transport and communication services.

The government and RBI policy responses through measures such as lowering interest rates, offering credit guarantees and liquidity boosting measures, restructuring loans and providing the moratorium have helped the financial sector and manufacturing industries manage financial stress and other constraints better. However, given the stressed fiscal situation, wherein the centre's fiscal deficit is likely to be at 7%-8% of the GDP, the prospects of a proactive intervention by the central and state governments does not look optimistic. Given the elevated inflation level, any additional monetary easing by the RBI will also entail high risk and therefore, will be constrained.

Growth outlook

A sharp and unprecedented economic contraction was witnessed in Q1, and hence, a 7.5% contraction in Q2 brought in some optimism on recovery, although uncertainties still persist on account of a possibility of the second wave of the pandemic. Additionally, the possibility of finding an effective vaccine adds to the confidence. Along with a steady recovery, the lower base effect is likely to be favourable. Furthermore, if there are some proactive government actions through stimulus measures, the growth contractions could also be marginally lower than these estimates. At the same time, downside risks to these estimates have also not been ruled out as these estimates may undergo- downward revisions, given the difficulties in securing real-time data, particularly that related to the unorganised sector, which was severely impacted during the lockdown period.

Based on the latest growth indicators and Q2 GDP numbers, we have revised upwards our GDP projections for FY21 at -7% to -7.5% from our earlier estimates of -9.5%. We continue to project that the contraction will remain in Q3, although at a lower rate of around -3% to -3.2%, and growth is most likely to turn positive in Q4.

Source: **Equity Bulls**