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ECOWRAP

GDP to grow by 5.78% in FY15

Based on GDP growth for Q1 FY15 at 5.7% (SBI at 5.88%), we are now revising our forecast for FY15 GDP to 5.78%. Non agricultural GDP expanded at 6%, the highest since Q4 FY12. Our optimism is based on a stronger manufacturing growth, led by a modest investment revival propelled by an earlier than anticipated jump in discretionary consumer spending. Agriculture is likely to post a modest 1% growth (vis-à-vis 4.7% in FY14), industry at 4.4% (vis-à-vis 0.4% in FY14) and services at 7.5% (vis-à-vis 6.8% in FY14). The widely anticipated pick-up in investment cycle could materially happen more towards end of Q3 FY15. More importantly, we are factoring in a pick-up in manufacturing activity, as there are evidence of sharp inventory drawdown in Q1 of current fiscal. Interestingly, inventory as % of GDP that declined significantly to 1.7%, increased to 1.8% during the quarter. It may be noted that inventory accumulation had jumped from 2.5% of GDP in FY05 to 4.1% of GDP in FY08, as India chugged along at an average growth rate of 9.5% during FY06-FY08. Hence such inventory build up as and when happens will be clearly growth supportive. Service sector growth rate should bounce back to 7.5% in FY15, on the back of resilient segments and a global recovery. Interestingly, the Jan Dhan scheme may act as a fillip to deposit growth and this may act as a positive drag on the Finance segment within Services. Agricultural growth should be around 1% in FY15. During Aug'14 month, rainfall has improved and was 91.7% of LPA (within projections). We are hopeful that rabi output that is rain independent should continue to have a larger pie in foodgrain output, as trends suggest. All in all, we should not be surprised if manufacturing sector posts an even stronger growth than 4.5%.

Q1 FY15 GDP at 5.7%

- The Q1 GDP figures defied consensus expectations (SBI: 5.88%, Consensus:5.5%), registering highest growth in last 10 quarters (Q3 FY12: 6.1%). The overall growth of 5.7% benefitted from favorable base in two sectors, mining and manufacturing both of which had contracted in Q1 FY14.
- Agriculture GDP expanded by 3.8% compared to 4.0% in Q1 FY14. However, the overall trends in the agricultural sector in this financial year will depend on the severity of surpluses/ deficits in major crop producing areas.

Table 1: GDP Growth Rate (% YoY)

Sector	FY14					Q1 FY15
	Q1	Q2	Q3	Q4	Annual	
Agriculture & Allied	**4.0**	**5.0**	**3.7**	**6.3**	**4.7**	**3.8**
Industry	**-0.4**	**2.6**	**-0.4**	**-0.2**	**0.4**	**4.2**
Mining & quarrying	-3.9	0.0	-1.2	-0.4	-1.4	2.1
Manufacturing	-1.2	1.3	-1.5	-1.4	-0.7	3.5
Electricity, gas & water supply	3.8	7.8	5.0	7.2	5.9	10.2
Construction	1.1	4.4	0.6	0.7	1.6	4.8
Services	**7.2**	**6.3**	**7.2**	**6.4**	**6.8**	**6.8**
Trade, hotels, transport & communication	1.6	3.6	2.9	3.9	3.0	2.8
Financing, insurance, real estate & bus. Services	12.9	12.1	14.1	12.4	12.9	10.4
Community, social & personal services	10.6	3.6	5.7	3.3	5.6	9.1
GDP at factor cost	**4.7**	**5.2**	**4.6**	**4.6**	**4.7**	**5.7**
Memo:						
GDP growth ex-Agriculture	4.8	5.2	4.7	4.3	4.7	6.0
GDP growth ex-Industry	6.6	6.1	6.4	6.4	6.4	6.2
GDP growth ex-Services	1.1	3.3	1.2	2.0	1.8	4.1

Source: CSO, SBI Research

- The outlook for mining going forward will depend crucially on the Hon. Supreme Court decision in coal allocation case. The final economic impact of this judgment may hit the mining sector in subsequent quarters and till such time the new policy on commercial exploitation of resources is SC compliant. The manufacturing sector also benefited from a favorable base as it had contracted 3.9% in Q1 FY13. Again the rebound in manufacturing is not reflected in change in stock which have stagnated in Q1 FY15.

- The star performer of Q1 growth was industrial sector which grew by 4.2% as against a contraction of 0.4% in Q1 FY14, aided by favorable base effect both in mining and manufacturing.
- Services sector growth moderated by almost 100bps in Q1 to 6.8% against 7.2% growth in the same quarter of previous year. Among services the resilient sectors i.e., 'financing, insurance, real estate & business services, and 'community, social & personal services' expanded by 10.4% and 9.1% respectively. Although 'trade, hotels, transport & communication' grew by merely 2.8%. However, going forward this sector is going to pull up with the transportation sector being the largest beneficiary of the investment push by the new Government.
- As an aside, the elections results were declared on 16-May and new Govt. took charge on 26 May. Not surprisingly therefore, that Government expenditure has grown by 13.4% reflecting the expenditure on General Elections in Q1 FY15!

Resilience of the GDP sub-sectors: Finance, Insurance, Real Estate & Business and Personal Services

- Some sections of GDP are growing rapidly and doesn't depend on overall economic situation and even on government expenditure. These are the resilient sectors of the economy and some of these sectors are in Finance, Insurance, Real Estate & Business and Personal Services. Even when GDP growth declined rapidly in post-crisis period these sectors showed enough resilient. The importance of Business Services in the Finance sector deserves specific mention.
- Business services are dynamic services with a continuously rising share (currently around 5% of GDP) and grew at the combined rate of 12.4% during FY09-12. Business services include services like computer-related services, R&D, legal services, accounting services and renting of machinery in order of importance (shares) as per India's National Accounts.

Table 2: Resilient Sectors of Economy (Average Growth in %)

Sectors	FY06-08	FY09-12
Business Services		
Renting of Machinery	16.8	17.9
Computer relating services	20.9	10.9
Legal services	8.2	8.2
Accounting	6.4	6.9
Research Development	19.0	20.1
Business Services	**18.8**	**12.4**
Personal Services		
Private household with employed person	9.6	9.8
Washing & cleaning of textiles	3.7	3.8
Hair dressing and other beauty treatment	3.9	4.0
Custom tailoring	12.9	13.0
Personal Services	**5.5**	**6.3**
Memo:		
GDP Growth	**9.5**	**7.7**
Financing, Insurance, Real estate & Business Services	**12.8**	**10.8**
Share of Business + Personal services in GDP growth	5.0	5.7

Source: CSO, SBI Research

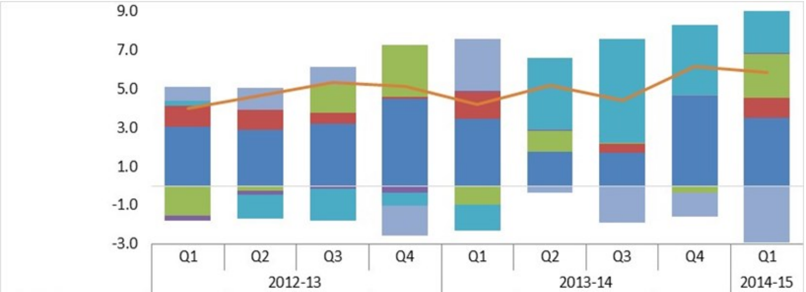
- Earlier, Business Services grew at around 18.8% during FY06-09. With the global economy projected to be buoyant in current fiscal (US Q2GDP growth at 4.2%), this segment will get an additional stimulus in FY15 (for example, consultancy, advisory services etc).

Election Economy added to the Consumption Expenditure and GDP

- From demand side, GDP at market prices expanded at 5.8% from 4.2% during the corresponding period last year. However, compared to last quarter growth of 6.1%, Q1 FY15 GDP eased marginally. Revival in consumer demand have contributed most to the first quarter GDP growth as share of consumption expenditure at current prices has reached 18-quarter high at 72.2%. Interestingly, consumer sentiments had revived even before the election results were announced and have continued to be encouraging till now. Year on year growth in private final consumption expenditure was at 5.6%, matching with the growth rate in the same quarter last year but lower than 8.2% growth registered last quarter.

- Among the consumption components, a strong revival in the government expenditure was recorded in the first quarter as the components expanded at 8.8% in Q1 FY14 against a contraction of 0.4% in the previous quarter.
- However, historically Govt. expenditure peaks in the first quarter but the segments contribution to GDP growth have increased to 13.4%, highest in last eighteen quarters. We believe that the election spending have aided significantly to the growth.
- The contribution of net exports have marginally slowed down as revival in domestic imports is seen after Govt. relaxed some of the gold import norms. Net exports contribution to GDP growth has come down to 3.0% point in Q1 FY15 from 3.7% in Q4 FY14. But compared to the same period last year (contribution was -1.3% point), the contribution is much higher.
- Investment activity in the economy have revived and contribution of investment to GDP growth have increased to 2.3% from a negative contribution of 0.3% and 0.9% during the last and first quarter of FY14, respectively.
- The widely anticipated pick-up in investment cycle could materially happen more towards end of Q3 FY15. More importantly, we are factoring in a pick-up in manufacturing activity, as there are evidence of sharp inventory drawdown in Q1 of current fiscal. Interestingly, inventory as a % of GDP that declined significantly to 1.7% of GDP, increased to 1.8% during the quarter. It may be noted that inventory accumulation had jumped from 2.5% of GDP in FY05 to 4.1% of GDP in FY08, as India chugged along at a average growth rate of 9.5% during FY06-FY08. Hence such inventory build up will be growth supportive.

Chart 1: Wtd. Contribution of to GDP, Expenditure side (in % points)



	2012-13 Q1	2012-13 Q2	2012-13 Q3	2012-13 Q4	2013-14 Q1	2013-14 Q2	2013-14 Q3	2013-14 Q4	2014-15 Q1
Discrepancies	0.7	1.1	0.9	-1.6	2.7	-0.4	-1.9	-1.3	-2.9
Net Exports	0.3	-1.3	-1.6	-0.7	-1.3	3.7	5.3	3.7	3.0
Inventory	-0.24	-0.2	-0.2	-0.3	0.02	0.07	0.01	0.02	0.05
GFCF	-1.5	-0.2	1.5	2.6	-1.0	1.1	0.1	-0.3	2.3
GFCE	1.1	1.0	0.5	0.1	1.4	0.0	0.4	0.0	1.1
PFCE	3.0	2.9	3.2	4.5	3.4	1.7	1.7	4.6	3.5
GDP	4.0	4.7	5.3	5.1	4.2	5.2	4.4	6.1	5.8

Source: SBI Research, MOSPI

Pick-up in Investment Cycle and De-accumulation of Inventory Leads Better Industrial Growth

- The primary contributor of GDP growth in Q1 FY15 was growth in industrial output. Industry which contracted by 0.4% in Q1 FY14 increased to 4.2% in Q1 FY15. All sub-sectors of industry showed remarkable performance. Currently economy is at the brink of pick-up in investment cycle and the first leg of investment cycle will be driven by the government's efforts to unplug the pipeline investments.
- Latest round of RBI survey on business outlook of the Indian manufacturing sector shows improvement for the second quarter of FY15 (114.7) as compared to previous quarter (111.1) and the corresponding quarter of previous year (112.7).
- The improvement in Business Expectation Index (BEI) is mainly due to improved optimism on overall business situation, production, order books, capacity utilization, imports, exports added with the reduced pessimism on cost of finance, cost of raw material and the profit margin.
- Growth is also evident from the pick-up of investment in infrastructure-related industries. Output in core sectors like coal, power, cement and steel shows better growth in recent and coming months. Earning from railway freight traffic also on increasing path (10% in July'14 vs. 1.3% in Jul'13).

- Our prognosis is that, most of the consumer durables companies have witnessed a good volume growth in recent months and to that extent, industrial growth is likely to be around 4.2-4.5% in FY15. Further, with consumer sentiments positive and discretionary spending on the rise, we are certain of a manufacturing recovery in FY15.

Agriculture Output: Fear of Drought Less Pronounced

- With sowing complete for most Kharif crops, the total area under the summer crops has declined to 96.62 million hectare in FY15, from 99.9 million hectare in FY14, due to deficient rainfall. Monsoon rainfall which was deficit of –22.5% till 31st July, came down to –17.3% till 31st August. During Aug'14 month, rainfall has improved and was 91.7% of LPA (within projections). Hence, we expect Rabi crop production to improve and agriculture GDP growth to be around 1% in FY15, compared to 4.7% in FY14.

Going Forward

- We are now revising our growth forecast for FY15 to 5.78%. Service sector growth rate should bounce back to 7.5% in FY15, on the back of the resilient segments and a global recovery. Interestingly, the Jan Dhan scheme may act as a fillip to deposit growth and this may act as a positive drag on the Finance segment within Services. Agricultural growth should be around 1%, as we are hopeful that rabi output that is rain independent should continue to have a larger pie in foodgrain output, as trends suggest. All in all, we should not be surprised if manufacturing sector posts an even stronger growth than 4.5%.