

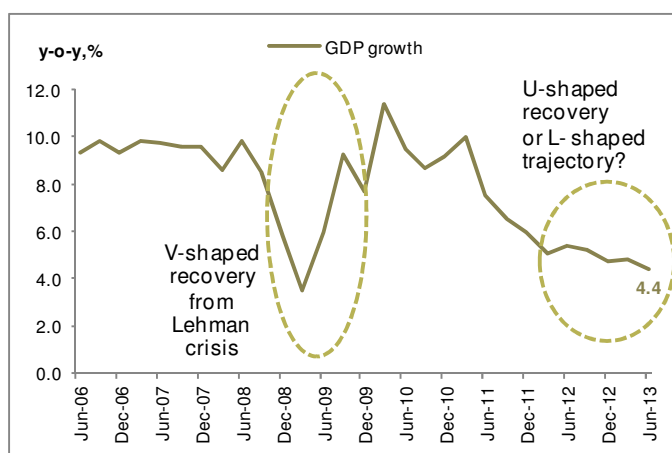


August 2013

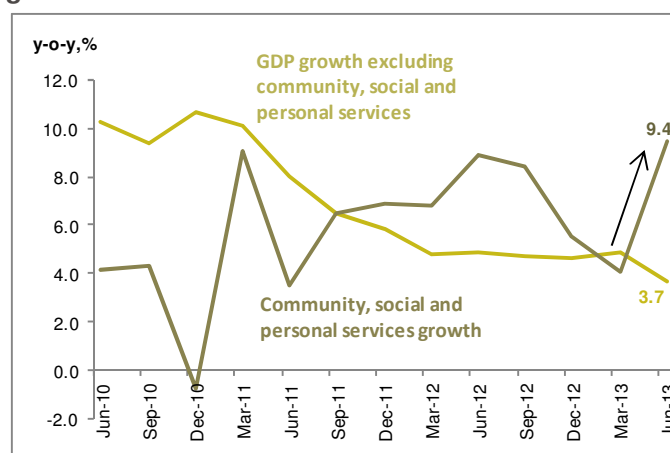
# CRISIL Economy First Cut

## GDP: U-shaped Recovery or L-shaped trajectory?

**Figure 1: Economy on a L-shaped path**



**Figure 2: Government spending unable to cushion growth**



Source: CSO, CRISIL Research

**Overview:** Unlike the sharp recovery from the Lehman crisis (V-shaped) in 2009, this time the growth is following an L-shaped trajectory and is likely to oscillate around the 5 per cent trough in 2013-14. Today's data release points towards this. The Indian economy grew at 4.4 per cent in Q1, 2013-14, even lower than 4.8 per cent in the Q4, 2012-13. Government spending was a significant driver of growth as private consumption growth weakened further to 1.6 per cent and investments fell by 1.2 per cent compared to a year ago amidst lack of policy reforms, procedural delays and persistent supply-side bottlenecks. Higher government spending lifted growth of community, social and personal services to 9.4 per cent in Q1, 2013-14 as compared to 4.0 per cent in the previous quarter. If not for a sharp increase in government spending, community, social and personal services would have, at best, maintained its average growth rate of the past few quarters and GDP growth in the Q1, 2013-14 would have been even lower at around 4.0 per cent.

However, higher government spending to boost growth, as seen in Q1, 2013-14, will not be sustainable for the coming quarters. Slowing growth is having an adverse impact on tax revenues and the depreciating rupee is raising the subsidy burden of the government. In the first quarter alone, the actual fiscal deficit was almost half of the budgeted deficit for the entire fiscal year. For the remaining quarters, it looks increasingly likely that the government will have to cut back expenditure sharply from budgeted levels to maintain its fiscal deficit target (4.8 per cent of GDP).

Additionally, liquidity tightening measures implemented by the RBI have raised the borrowing costs of commercial banks by almost 300 basis points. Any near-term reversal of these measures looks increasingly unlikely given the sharp depreciation of the rupee. Moreover, inflationary risks have also re-emerged due to a weak rupee lowering the likelihood of a repo rate cut. Higher lending rates will further lower investment demand, delaying a recovery in the manufacturing sector which

contracted by 1.2 per cent in Q1, 2013-14, compared to a year ago. The mining sector continues to suffer on account of regulatory mining bans in some states. Even if these issues were resolved immediately, no significant push to growth would be felt in 2013-14 due to its lagged impact.

Any recovery in growth, therefore relies largely on agriculture. An above normal and well distributed monsoon has significantly improved the outlook on agriculture. Cumulative rainfall during July to August was 10.9 per cent in excess of normal at the All-India level and the sowing area is 6.8 per cent higher than last year. This creates an upside to our current agricultural growth estimate of 3.5%. But the momentum in industry and services is likely to remain weak. Overall we now see downside to our GDP growth forecast of 5.5 per cent for 2013-14 resulting in a painful L-shaped trajectory for growth, atleast in 2013-14.

**Table 1: Supply-side components (Growth, y-o-y %)**

	FY13PE	Q4FY12	Q3FY13	Q4FY13
<b>GDP at factor cost</b>	<b>5</b>	<b>4.7</b>	<b>4.8</b>	<b>4.4</b>
<b>Agriculture</b>	<b>1.9</b>	<b>1.8</b>	<b>1.4</b>	<b>2.7</b>
<b>Industry</b>	<b>2.1</b>	<b>2.5</b>	<b>2.7</b>	<b>0.2</b>
Mining & Quarrying	-0.6	-0.7	-3.1	-2.8
Manufacturing	1.0	2.5	2.6	-1.2
Electricity, gas and water supply	4.2	4.5	2.8	3.7
Construction	4.3	2.9	4.4	2.8
<b>Services</b>	<b>7.1</b>	<b>6.7</b>	<b>6.6</b>	<b>6.6</b>
Trade, hotels, transport & communication	6.4	6.4	6.2	3.9
Financing, insurance, real estate and business services	8.6	7.8	9.1	8.9
Community, social & personal services	6.6	5.6	4.0	9.4

**Table 2: Demand- side components (Growth, y-o-y %)**

	FY13PE	Q4FY12	Q3FY13	Q4FY13
<b>GDP at market price</b>	<b>3.2</b>	<b>4.1</b>	<b>3.0</b>	<b>2.4</b>
Private Consumption	4.0	4.2	3.8	1.6
Govt. Consumption	3.9	2.2	0.6	10.5
Fixed Investment	1.7	4.5	3.4	-1.2
Change in Stocks	73.4	75.8	76.0	-0.4
Exports	3.0	-3.5	-0.6	-1.2
Imports	6.8	4.2	3.3	0.7

Source: Central Statistical Organisation (CSO), CRISIL Research

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