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CRISIL Economy First Cut

New GDP math sends high-frequency indicators out of whack

Overview: *The Central Statistical Office (CSO) placed its advanced estimate of GDP growth for fiscal 2015 at 7.4%, up from 6.9% in fiscal 2014. As expected, agriculture growth is seen weak at 1.1% but the non-agriculture sector is presaged growing at a brisk 8.8%. The CSO's explanation for the upward revision in GDP for previous fiscals is premised on improved efficiency. For instance, the manufacturing sector is generating more value-added from the same level of input. This has led to faster growth in manufacturing GDP which is a measure of the value added. But this phenomenon will not last and eventually output will need to grow to generate higher GDP. Quarterly trends show a mild and transient slowdown in economic activity in the third quarter of the current fiscal. Estimates suggest fourth-quarter growth will rise to 7.6% so as to deliver 7.4% growth for the whole of fiscal 2015. Falling inflation (due to lower food and fuel inflation) and improving income visibility (especially farm incomes if monsoon is normal) will remain supportive of growth even in fiscal 2016. However, slower export demand, stressed bank balance sheets and high leverage in the infrastructure sector preclude strong upsides. We will soon come out with estimates for the next fiscal based on the new series.*

Implications of the revised GDP series

1. Lower growth in nominal GDP in fiscal 2015. As per advanced estimates, nominal GDP growth is seen at 11.5% in this fiscal, which is lower than the 13.4% assumed in the budget estimates. Therefore, *ceteris paribus*, a mere change in the denominator could nudge up the fiscal deficit ratio for this fiscal.

2. Structure of the economy changes: The share of agriculture and industry in GDP has risen, while that of services has fallen as a result of the revisions (*Figure 1*). For this fiscal, share of agriculture, industry and services in GDP is 16.2%, 31.2% and 52.5% if measured in terms of GVA at basic prices.

3. No notable turn in the investment cycle yet. A closer look at data explains that even as private consumption demand rose from 5.5% in fiscal 2013 to 6.2% in fiscal 2014, India Inc remained cautious on fresh investments. While there was some pick-up in investments from -0.3% in fiscal 2013 to 3% in fiscal 2014, a large part of the rise in consumer demand was also met by utilising existing inventory (*Figure 2*). In the current fiscal, further strengthening in private consumption demand to 7.1% and a gradual improvement in the ease of doing business will support at best a mild pick-up in investment (4.1% growth) and inventory restocking.

4. Deflator-based inflation indicates a much lower inflation level. The new GDP series accounts for much lower inflation than recorded by CPI-2010 base (*Figure 3*). Inflation computed based upon changes in the GDP deflator (ratio of nominal to real GDP) fell to 3.8% in this fiscal from 6.3% in the last, while CRISIL estimates CPI to fall to 6.7% from 9.5%.

5. Short-term lead indicators not useful in assessing GDP growth

- **The Index of Industrial Production (IIP) is no longer a reliable signal.** With the release of the new gross value-added (GVA) series, IIP data released each month with fiscal 2005 as the base year will now be a poor representative of industrial growth. A government press release has said the revised IIP series taking fiscal 2012 as the base year will only be released in March 2016. A comparison over the past quarters shows how the current IIP series inaccurately measures GVA, which is now much wider in scope (*Figure 4*). Manufacturing sector GVA is now estimated to grow at a 6.8% clip in this fiscal -- much higher than what the IIP numbers for the first eight months of the fiscal suggest (1.1%). IIP is a measure of output, while GDP measures value-added. According to the CSO, the value-added component in GDP is higher as inputs are being used more efficiently than before, and the new series captures this well.
- **Other high-frequency indicators also go out of whack**
  - Credit growth does not sync with the sharp pick-up in GDP growth now shown for this fiscal. Credit growth is expected to potter around at 12-14% compared with 14.3% as of fiscal 2014-end.
  - Growth in service tax collections (nearly 50% of it comes from finance, real estate and professional services) slowed 10.2% in the year so far (April to December), compared to 19.2% in the same period of fiscal 2014.

6. Need for re-based historical data. Past data with fiscal 2012 as the base year are needed for a detailed analysis of trends in GDP growth and to re-assess the growth potential of the economy. It will be interesting to watch how the Reserve Bank of India (RBI) reacts to this dilemma of higher growth and lower inflation, given that it just begun cutting policy rates.

7. Trends indicate a transient slowdown in the third quarter. Quarterly trends show a mild and transient slowdown in economic activity between October and December of the current fiscal. Estimates for the whole fiscal, however, suggest that growth will again rise to 7.6% in the fourth quarter – so as to deliver 7.4% full fiscal-year growth (Table 1).

Figure 1: Change in composition of GVA (2013-14)

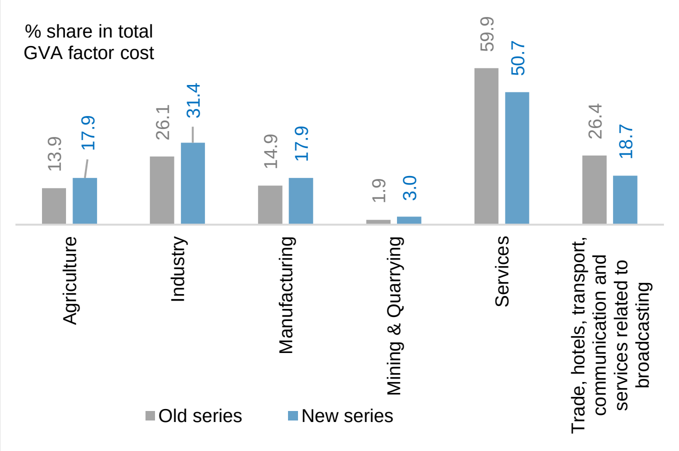

Figure 2: Fixed investment Vs destocking of inventory

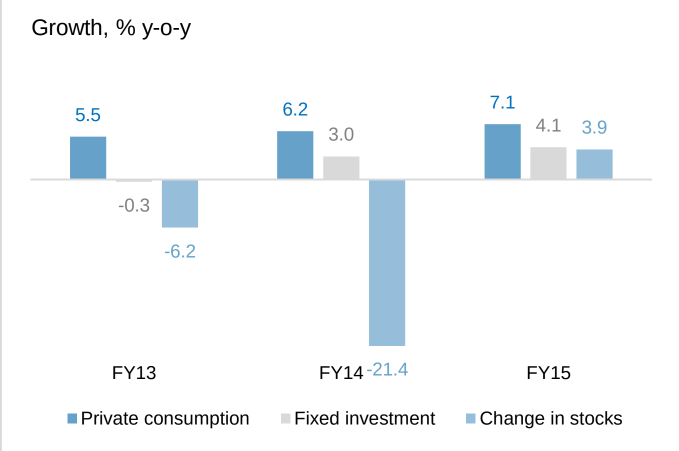

Figure 3: Inflation lower than perceived?

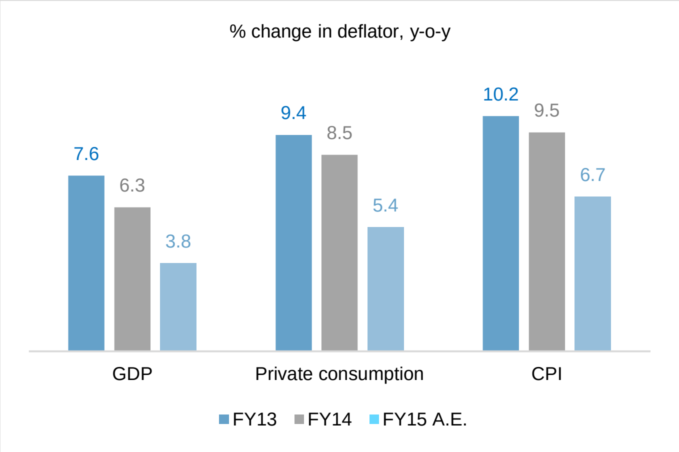

Figure 4: IIP an imperfect measure for new GDP series

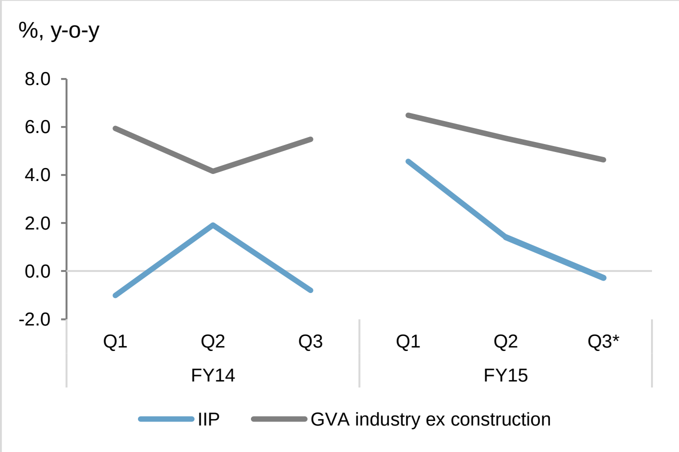

Table 1: What does Q4 GDP look like?

%, y-o-y	GVA	Agriculture	Industry	Manufacturing	Mining & Quarrying	Utilities	Construction	Services	Trade, hotels, transport, communication and services related to broadcasting	Financial, real estate & professional services	Public administration, defence and Other Services
Q1 FY15	7.0	3.5	6.1	6.3	5.1	10.1	5.1	8.6	9.4	11.9	1.9
Q2 FY15	7.8	2.0	6.0	5.6	2.4	8.7	7.2	10.1	8.7	13.8	6.0
Q3 FY15	7.5	-0.4	3.9	4.2	2.9	10.1	1.7	13.5	7.2	15.9	20.0
Q4 FY15 estimated	**7.7**	**-0.8**	**7.5**	11.0	-1.3	9.5	4.0	**10.0**	8.2	13.2	8.0

%, y-o-y	Q1 FY15	Q2 FY15	Q3 FY15	Q4 FY15 estimated
GDP	6.5	8.2	7.5	7.6
Private consumption	4.3	8.7	3.5	11.7
Government consumption	-2.0	5.8	31.7	4.5
Fixed investment	7.7	2.8	1.6	4.5
Change in stocks	3.4	2.7	1.4	8.0
Exports	9.3	-3.8	-2.8	1.0
Imports	-3.6	1.2	1.1	-0.7

Table 2: GVA at basic prices (annual) at constant prices

%, y-o-y	**GVA at basic prices**	**Agriculture**	**Industry**	Manufacturing	Mining & Quarrying	Utilities	Construction	**Services**	Trade, hotels, transport, communication and services related to broadcasting	Financial, real estate & professional services	Public administration, defence and other services
FY13	**4.9**	**1.2**	**2.4**	6.2	-0.2	4.0	-4.3	**8.0**	9.6	8.8	4.7
FY14	**6.6**	**3.7**	**4.5**	5.3	5.4	4.8	2.5	**9.1**	11.1	7.9	7.9
FY15 A.E.	**7.5**	**1.1**	**5.9**	6.8	2.3	9.6	4.5	**10.6**	8.4	13.7	9.0

Table 3: GDP (annual) at constant prices

%, y-o-y	**GDP**	**Private consumption**	**Government Consumption**	Fixed investment	Change in stocks	Valuables	Exports	Imports
FY13	**5.1**	**5.5**	**1.7**	-0.3	-6.2	3.3	6.7	6.0
FY14	**6.9**	**6.2**	**8.2**	3.0	-21.4	-48.7	7.3	-8.4
FY15 A.E.	**7.4**	**7.1**	**10.0**	4.1	3.9	28.2	0.9	-0.5

For all charts and tables:

Note: A.E. = Advance estimates

Source: CSO, CRISIL Research

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