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India's Latest GDP Growth Figures: Glaring Macroeconomic Concerns

A close analysis of India's higher growth rate in the last financial year reveals some disturbing signs of emerging vulnerabilities on both the supply and demand sides of the macro-economy. Stagnant agriculture and the frail health of industry need to be addressed to keep the economy on a steady trajectory.

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India's GDP (Gross Domestic Product) grew by 7.3 per cent in 2014-15 according to the latest official estimates of annual national income.[2] This is almost the same as 7.4 per cent indicated in the advance estimates of national income released in February 2015. The annual estimates are based on provisional estimate of GDP for the last quarter (Q4) of 2014-15, i.e. January-March 2015.

The GDP growth for 2014-15 marks an improvement over the 6.9 per cent registered in 2013-14. Notwithstanding the improvement, the latest growth figures point to some emerging vulnerabilities that can develop into macroeconomic concerns over the coming months. These concerns figure on both the supply and demand sides.

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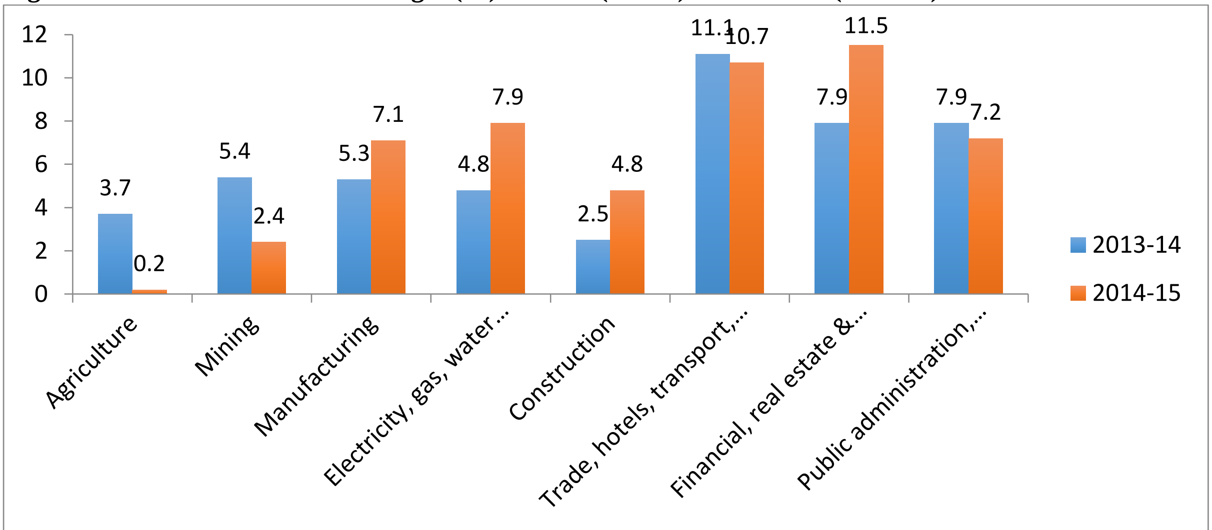
2 'Provisional Estimates of Annual National Income 2014-15 and Quarterly Estimates of Gross Domestic Product For the Fourth Quarter (Q4) 2014-15', 29 May 2015, Central Statistics Office, Ministry of Statistics and Programme Implementation, Government of India, http://mospi.nic.in/Mospi_New/upload /nad_press_release_29may15.pdf (Accessed on 2 June 2015).

Supply-Side: Farm Stagnation Compounds Factory Woes

A comparison of the year-on-year (y-o-y) growth rates in Gross Value Added (GVA) reflects a major shift in the structural composition of growth between 2013-14 and 2014-15 (Figure 1). The growth in agriculture has fallen sharply in 2014-15. The decline has been most pronounced in the later quarters of 2014-15. Indeed, both Q3 (October-December 2014) and Q4 (January-March 2015) of 2014-15 recorded negative growth rates in agriculture.[3] A barely positive overall growth rate of 0.2 per cent for agriculture in 2014-15 is due to the already moderate kharif (summer season) crop being followed by a weaker rabi (winter season) crop.

Deficient monsoon adversely affected agricultural output throughout 2014-15. Expectations of a good winter harvest were dashed by a deficient north-east monsoon (October-December 2014) that led to a decline in the sown-area and the crop-output. Apart from deficient monsoon, a sharp fall in global prices of India's major agricultural exports such as wheat, rice, cotton and sugar has led to a lower cultivation of these crops.[4] A drop in food grain production and its concomitant effect on the overall agricultural output has also been disturbing news for the Modi Government.

Figure 1: Sectoral Growth Percentages (%) in GVA (Y-o-Y) at Constant (2011-12) Prices



Source: Central Statistics Office, Ministry of Statistics and Programme Implementation, Government of India; http://mospi.nic.in/Mospi_New/upload/nad_press_release_29may15.pdf (Accessed on 2 June 2015).

3 Statement 5, as in 2 earlier.

4 'Crop area down, negative growth looms in farms', *Financial Express*, 13 December 2014. http://indianexpress.com/article/india/india-others/crop-area-down-negative-growth-looms-in-farms/99/ (Accessed on 2 June 2015).

The National Income estimates of the CSO show a higher growth in manufacturing in 2014-15 compared with 2013-14 (Table 1). These estimates are at variance with the Index of Industrial Production (IIP) figures released earlier. According to the latter figures, manufacturing grew by only 2.3 per cent in 2014-15, while in 2013-14, it grew at a negative rate of 0.8 per cent.[5]

Notwithstanding the release of both these estimates by the same agency – the Central Statistical Organisation – the variation in growth rates is striking. The variation might be partly attributed to difference in methodologies including different base years for the two estimates as well as the fact that national income estimates measure growth in value added while the IIP records growth in output through indices. Nonetheless, confusion remains over the actual state of affairs in manufacturing. Variations are also noticed between the IIP's estimates of growth in mining and electricity vis-à-vis those in the National Income estimates. The former indicate these at 1.4 per cent and 8.4 per cent for mining and electricity in 2014-15, whereas the corresponding estimates from the National Income figures are 2.4 per cent and 7.9 per cent. The degree of divergence for both these sectors, however, is less than that for manufacturing.

Going by the National Income estimates, manufacturing GVA experienced an almost 2 percentage point increase in 2014-15 over 2013-14. A look at the quarterly break-up of growth in GVA shows a steady decline over Q1 (April-June 2014), Q2 (July-September 2014) and Q3 (October-December 2014) with the growth rates being 8.4 per cent, 7.9 per cent and 3.6 per cent respectively.[6] The growth rate of GVA for Q4 has been provisionally estimated at 8.4 per cent, leading to the overall annual estimate of 7.1 per cent for manufacturing. The Q4 estimate is based on the IIP and the financial performance of the corporate sector as available till December 2014. Revised estimates for Q4, following the availability of more recent data, might see a downward correction and, therefore, a reduction in the overall growth of the manufacturing sector.

[5] 'Quick Estimates of Index of Industrial Production and Use-based Index for the Month of March 2015 (base 2004-05 = 100), Central Statistics Office, Ministry of Statistics and Programme Implementation, Government of India; 12 May 2015; http://mospi.nic.in/Mospi_New/upload/iip_12may15.pdf (Accessed on 2 June 2015).

[6] As in 2 earlier.

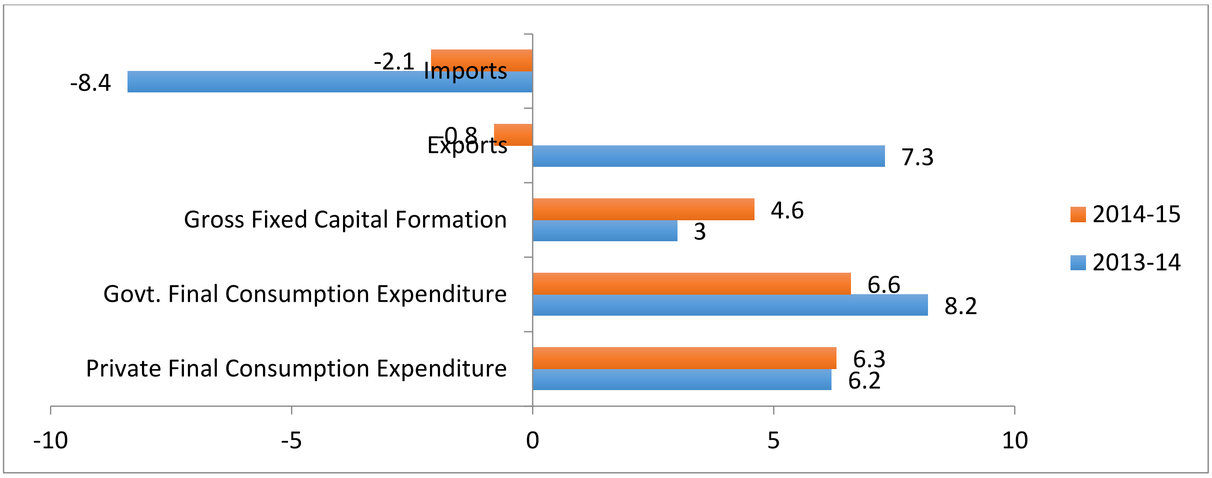
Services have been the key drivers of GDP growth in 2014-15. They were equally instrumental in 2013-14 as well. ‘Financial, real estate and professional services’ recorded 11.5 per cent growth in 2014-15, much higher than 7.9 per cent in 2013-14. This is an expected outcome, given the buoyancy witnessed by financial markets in India during 2014-15 and the high capital inflows from Foreign Institutional Investors (FIIs) for the greater part of the year. The performance of financial and professional services would have also been facilitated by the large expansion and rapid growth in India’s electronic commerce industry.

What is striking about the performance of services is the relatively lower growth of ‘trade, hotels, transport and communication services’ and ‘public administration, defence and other services’ during 2014-15. The former grew by 10.7 per cent in 2014-15 compared with 11.1 per cent in 2013-14, whereas the latter grew by 7.2 per cent in 2014-15 compared with 7.9 per cent in 2013-14 (Figure 1). The growth rates point to both sectors having been robust in 2013-14 itself; the change in government and subsequent developments have at best contributed to maintaining the robustness without taking it any higher notches. Significant accelerations of the economic activities in hospitality, transport and communication sectors over and above 2013-14 are yet to be noticed.

Demand-Side: Investment Remains the Worry

Private ‘final consumption’ expenditure shows almost identical rates of growth in both 2013-14 and 2014-15 (Figure 2). This points to the largely unchanged levels of consumer and household real incomes in both years, which have manifested in similar incremental growth in consumer expenditure as well as demand. Fiscal disciplining by the Modi Government, primarily the rationalisation of oil subsidies, has led to a lower growth of government’s final consumption expenditure.

Figure 2: Growth (%) (Y-O-Y) in Expenditure, Capital Formation & Trade at Constant (2011-12) Prices



Source: Central Statistics Office, Ministry of Statistics and Programme Implementation, Government of India; http://mospi.nic.in/Mospi_New/upload/nad_press_release_29may15.pdf (Accessed on 2 June 2015).

Investment and external trade remain concerns on the demand-side. Gross fixed capital formation (GFCF) shows a higher growth of 4.6 per cent in 2014-15 (Figure 2). As a proportion of GDP, however, GFCF has declined to 30.0 per cent in 2014-15 from 30.7 per cent in 2013-14.[7] A lower contribution of investment to GDP points to the fact that growth continues to be driven more by consumption. Consumption-driven growth is vulnerable to fluctuations in real income. The lower share of investment in GDP also points to a low maturation of projects in the pipeline, particularly the delays experienced by various public-private-partnership (PPP) projects.

The external sector remains a net negative contributor to GDP (Figure 2). Negative growth in imports, while reflecting low oil prices, also points to a lower demand for imported inputs from domestic industry. This vindicates concerns over the persistence of weaknesses in domestic manufacturing. Export growth, on the other hand, has turned negative in 2014-15, underscoring the low demand that affects the prospects of several of India's export-oriented industries in global markets.

The Prognosis: Macroeconomic Concerns Deepen

Notwithstanding a higher estimate of GDP for 2014-15, the composition of the GDP growth underscores the deepening of macroeconomic concerns.

7 Statement 1, as in 2 earlier.

Prospects of agricultural stagnation loom large in the near-term, given the projected shortfall in the monsoon in 2015-16. With rainfall in the forthcoming monsoon projected to be less than 90 per cent of the long period average, agricultural output might decline further in 2015-16.[8] Manufacturing is yet to show signs of a broad-based recovery. Agricultural contraction is likely to impede manufacturing growth through lower demand for both consumer and capital goods. Weak agriculture can also accentuate supply shortages and augment inflation. This is evident from the continuation of the Reserve Bank of India's cautious posture on interest rates.

Financial services – the main drivers of economic growth on the supply side – might not be able to maintain their current robustness once the sentiment-driven surge in capital flows ebbs. FII inflows have already begun reversing course on concerns over the growth outlook. This will aggravate the demand-side concerns of investment failing to become a major driver of aggregate demand and economic growth.

The Modi Government has experienced unusually benign external economic conditions in its first year. It also benefitted from wide-ranging positive sentiments. The second year might not be as favourable. Reviving agriculture will be the foremost macroeconomic challenge. Crop scarcity, higher prices and weak manufacturing produce a more sombre outlook for GDP in the coming quarters.

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[8] 'Monsoon to be more deficient than expected', *The Hindu*, 2 June 2015; http://www.thehindu.com/news/national/monsoon-to-be-more-deficient-than-expected/article7274912.ece (Accessed on 3 June 2015).