

Both real GDP and GVA growth slipped below 6% to seven-quarter low in Q2-FY25

12 December, 2024

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Key takeaways

- In Q2-FY25, both real GDP and GVA growth slipped below 6% to seven-quarter low. Real GDP growth eased to 5.4%YY (Bloomberg survey: 6.5%) from 6.7% in Q1, while real GVA growth moderated to 5.6% from 6.8%.
- Net indirect taxes (NIT) are included in GDP, and as NIT remained muted, real GVA growth stayed above that of GDP for the second straight quarter, and the gap between the two was mildly higher than in Q1.
- The drag on GVA growth was mainly from industry, as above normal monsoon dampened mining activity and demand for electricity. Also, slow pace of pick up in government spending, lower consumer demand and firms' pricing power are likely to have hit manufacturing. Farm sector growth improved but was below average for the quarter. Services growth eased but remained above 7%, though again below historical trend for Q2.
- On the expenditure side, the year-on-year growth in private consumption and investment eased compared to Q1, government consumption rebounded, and the contribution of net exports improved. However, the 'others' component comprising valuables, discrepancies and changes in stocks deducted from growth. Excluding 'others', real GDP growth was above 7% in both Q1 and Q2, indicating strong underlying fundamentals. In FY24, this component had added strongly to growth.

- The RBI MPC has projected GDP growth to average 7% in H2-FY25, up from 6% in H1. Base effects were unfavorable in Q2 and are slated to worsen in H2, so growth momentum will need to strengthen.
- Record Kharif output and buoyant conditions for Rabi produce, likely pick up in government spending, improvement in high frequency data post the slump in Q2, range-bound commodity prices, and expected rebound in credit growth post the latest CRR cut are expected to support growth in H2-FY25.
- Risks to outlook include uncertain global backdrop, including risks pertaining to protectionist policies and recent rise in food prices, with likely spillovers to currency movements, trade and FII flows, and external account balance. Domestically, adverse climate events could impact both agriculture output and food inflation.

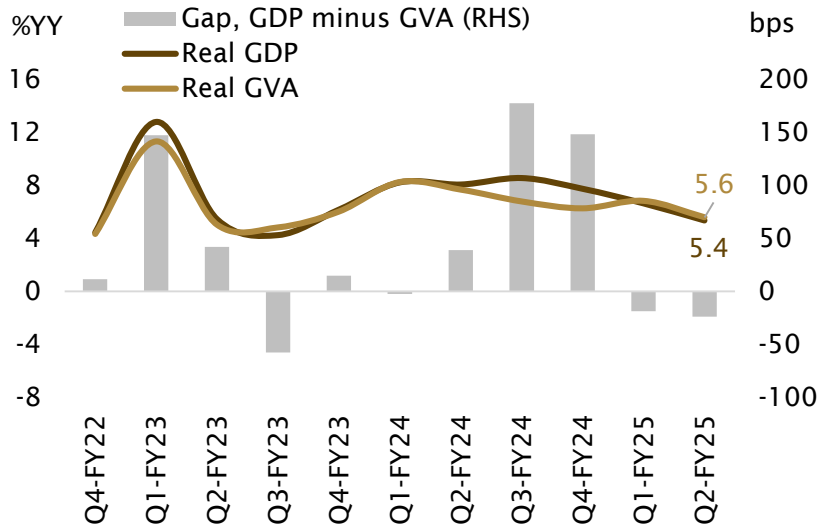
Govt. consumption rebounded, private consumption eased but held firm in Q2; industrial growth was a drag on GVA



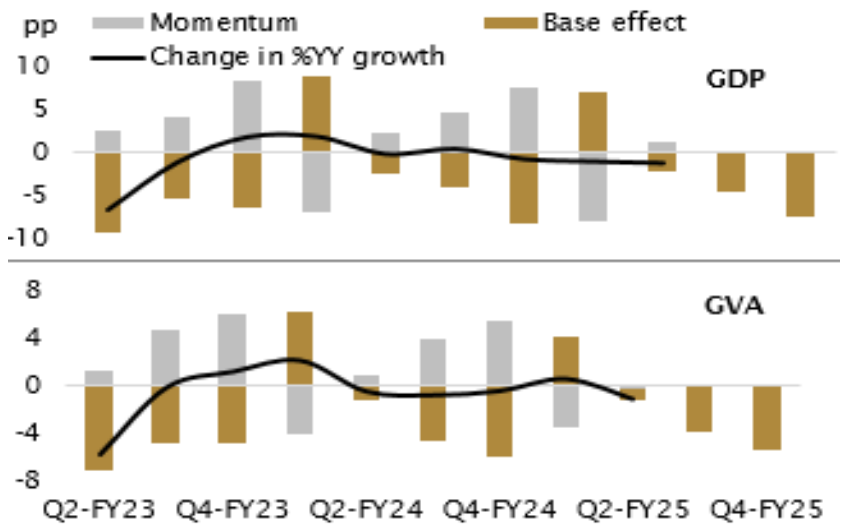
Both GDP and GVA growth slipped below 6% in Q2-FY25

- Both real GDP and GVA growth moderated to sever-quarter low in Q2-FY25 and slipped below 6%. Real GDP growth eased to 5.4%YY from 6.7% in Q1-FY25, while real GVA growth was at 5.6% versus 6.8% in Q1.
  - Real GVA growth remained above that of real GDP for the second consecutive quarter, and the gap between the two widened slightly, though remained narrow at 24bps, compared to 19bps in Q1.
  - Net indirect taxes (NIT), which are included in GDP, grew at a tepid pace for the second straight quarter in Q2. In both real and nominal terms, NIT had posted double-digit year-on-year growth in each quarter of FY24 (except in Q1, when real NIT growth was slightly low but still firm at 7.9%).
  - Also, nominal GDP growth eased to 8%YY (the slowest in 15 quarters) from 9.7% in Q1, resulting in moderation in GDP deflator at 2.5% from 2.8% in Q1.
- In sequential terms, real GDP grew 1.1%QQ, higher than the long term average (LTA) of 0.5% for the quarter (FY12-20), so the moderation in year-on-year growth was due to unfavorable base effects, which are expected to exacerbate in Q3 and Q4. However, the sequential momentum tends to be strong in Q3 and Q4, which could offset some of the impact of unfavorable base.
- Real GVA growth fell 0.4%QQ, shallower than the average (FY12-20) decline of 0.6% for the quarter. This contraction, and an unfavorable base, dragged down year-on-year growth. Similar to GDP, base effects are slated to worsen in Q3 and Q4, though based on historical trends, momentum is likely to improve.

Both GDP and GVA growth slipped below 6% in Q2-FY25



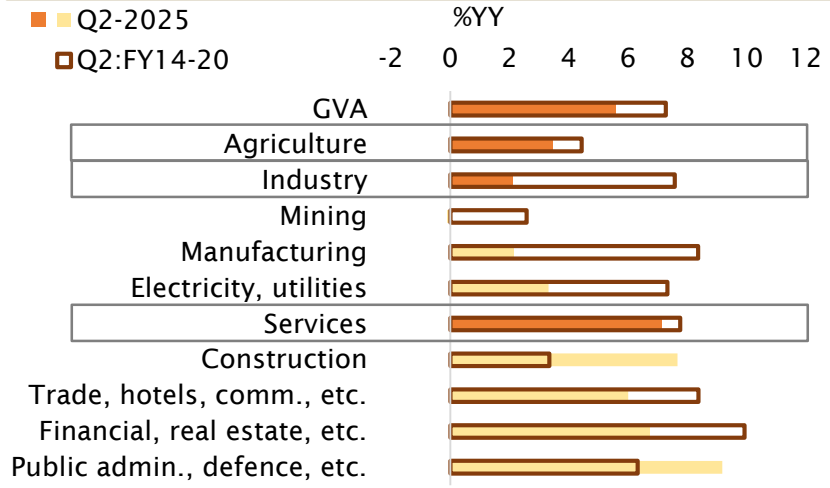
Base effects slated to worsen in Q3 and Q4

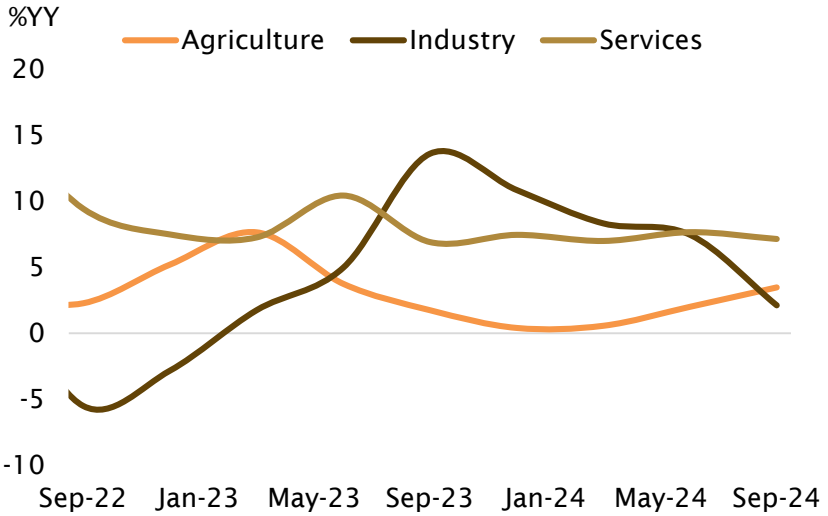


Industrial sector underperformance dragged down GVA growth

- The year-on-year growth in agriculture improved to 3.5%YY in Q2 from 2.0% in Q1 but remained below the pre-pandemic (FY13-20) average of 4.4% for the quarter. The contribution of farm output to GVA growth improved to 0.4pp from 0.3pp in Q1 but stayed below the pre-pandemic average of 0.6pp for Q2.
- Pre-pandemic trends show that industrial growth tends to peak in Q2, averaging 7.6%YY. However, in Q2-FY25, growth eased to six-quarter low of 2.2%YY from 7.4% in Q1 due to weakness in manufacturing that constitutes 80% share in industry. Mining output also fell (-0.1%YY), and electricity output eased (3.3%) after double-digit growth in Q1, as above average monsoon hit mining activity and demand for electricity.
  - Industry added 0.5pp to year-on-year GVA growth in Q2, lower than 1.6pp in Q1 and the pre-pandemic average of 1.4pp.
- The year-on-year growth in services growth moderated to 7.1%YY from 7.7% in Q1, and was below pre-pandemic average for the quarter at 7.8%. The contribution of services to year-on-year GVA growth was 4.7pp, mildly less than 5.0pp in Q1 and below the historical average of 4.9pp for Q2.
  - Among sub-sectors, financial and real estate services constitutes the largest share (~40%), followed by trade, PADO* and construction. In Q2, year-on-year growth and contribution to GVA was below pre-pandemic average in case of trade and financial services groups. Compared to Q1, year-on-year growth eased across sub-sectors, except for trade and communication services that saw an uptick.

Industrial growth slipped below that of farm and services sectors due to manufacturing slump, fall in mining output

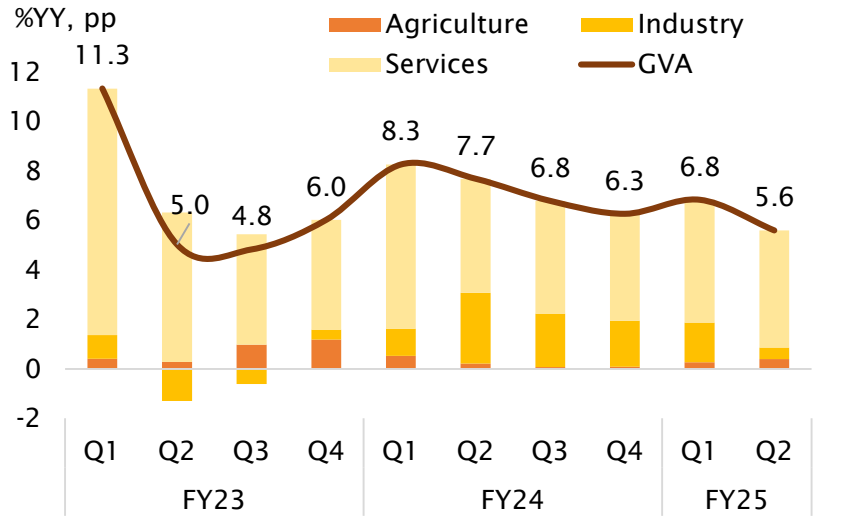




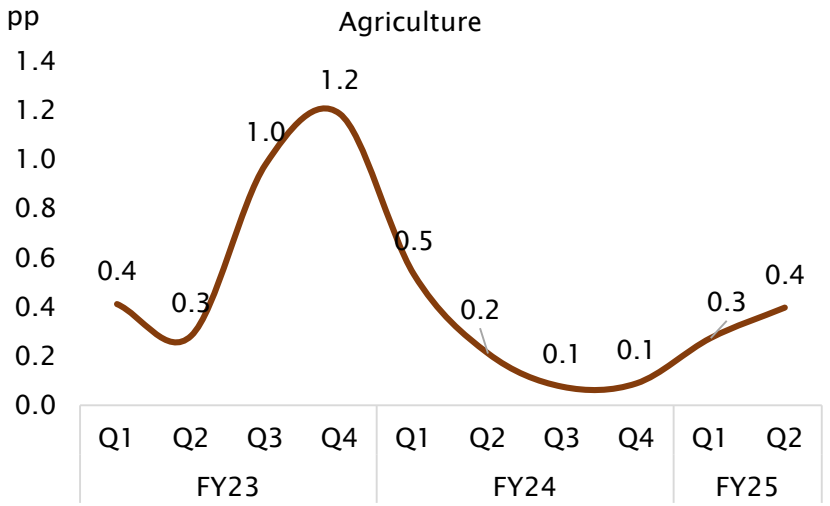
*Note: PADO stands for public administration, defence and other services

Contribution of sectors to year-on-year GVA growth

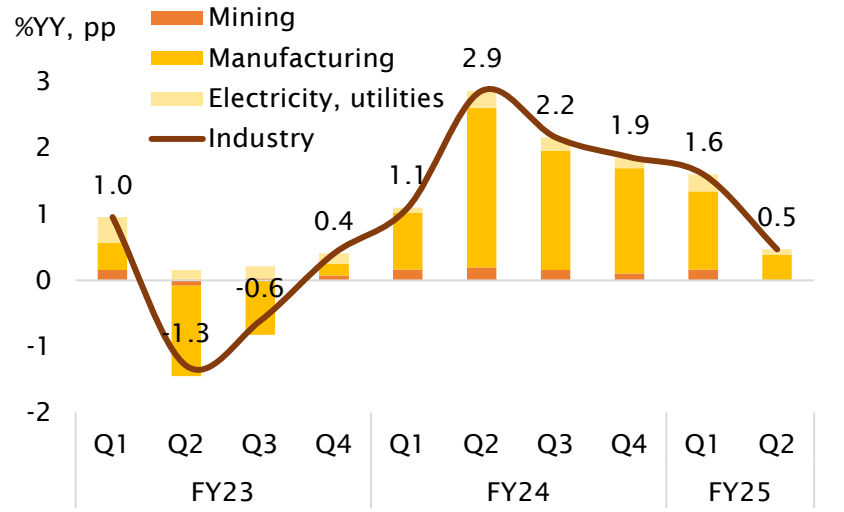
Despite easing, services added the most to GVA in Q2



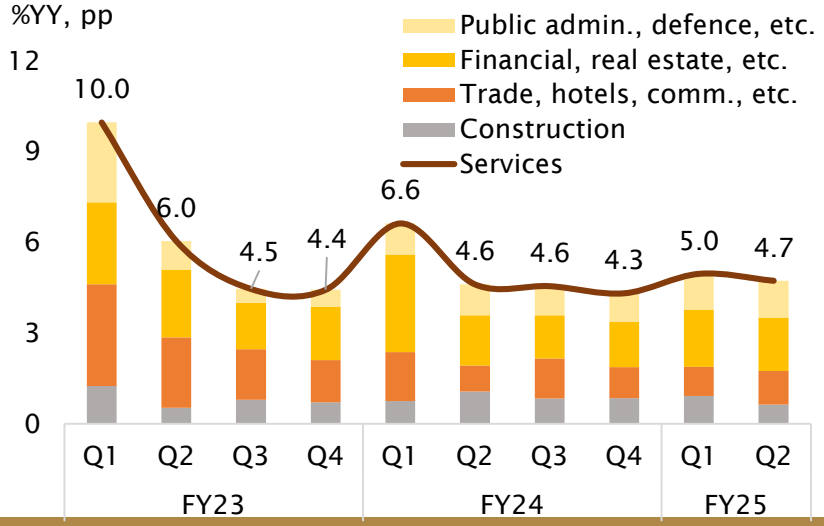
Farm contribution up but below 0.6pp average for Q2



Manufacturing slump dragged contribution of industry



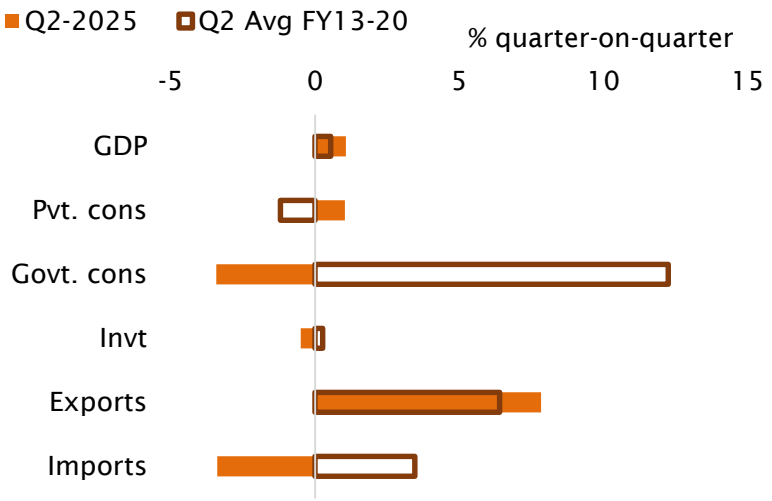
Trade, PADO added more to growth compared to Q1



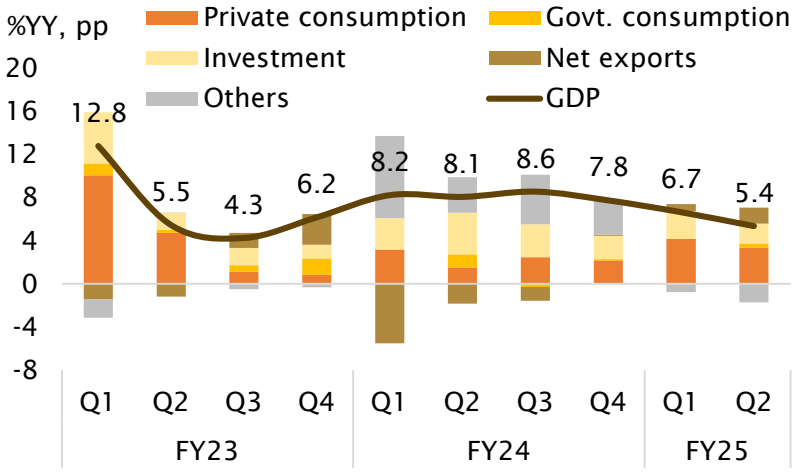
Excluding ‘others’, underlying GDP drivers remained firm in Q2

- The sequential GDP growth in Q2 at 1.1%QQ was above the pre-pandemic average for the quarter at 0.5%, supported by growth in private consumption and exports. In terms of contribution to year-on-year growth, private consumption added more than 60%, followed by investment, net exports, and public consumption.
  - The ‘others’ component comprising valuables, discrepancies and changes in stocks deducted from growth, and excluding this component, real GDP growth was above 7% in both Q1 and Q2, indicating strong underlying fundamentals. In FY24, this component had added strongly to growth.
- Private consumption growth eased to 6%YY from 7.4% in Q1 and was below the pre-pandemic average of 7.5% for the quarter. However, growth in private consumption still held firm compared to 4% average in FY24 due to sequential momentum that partly offset unfavorable base effects.
- Government consumption growth rebounded in Q2 to 4.4%YY from 0.2% decline in Q1. Despite being below the pre-pandemic average of 6.4% for the quarter, growth was positive due to favorable base effects that offset the sequential quarter-on-quarter decline.
- Investment growth moderated to six-quarter low of 5.4%YY from 7.5% in Q1 due to sequential contraction and unfavorable base effects. However, growth was above pre-pandemic average of 5.2% for the quarter.
- The contribution of net exports to year-on-year GDP growth improved to 27% from 10% in Q1. Base effects were unfavorable for both exports and imports, even as sequential growth in exports was above average.

Q-o-q GDP growth in Q2 above pre-pandemic average



Excluding others, real GDP growth was above 7% in Q2



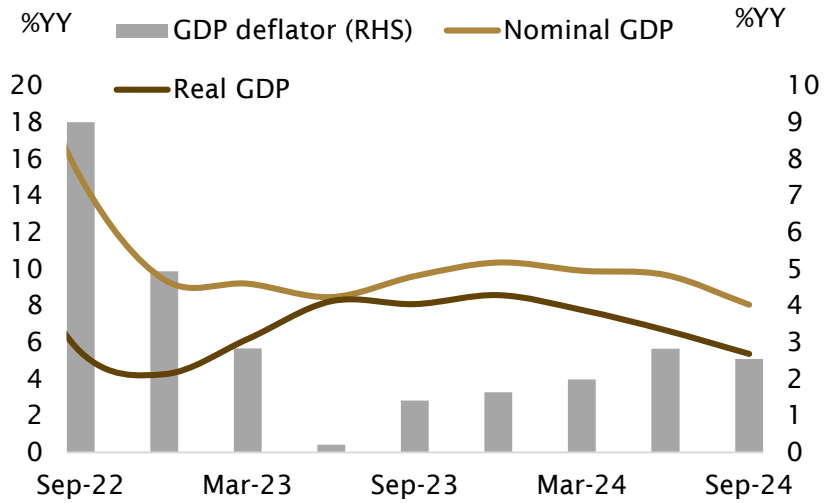
Others include discrepancies, valuables, change in stocks

Outlook

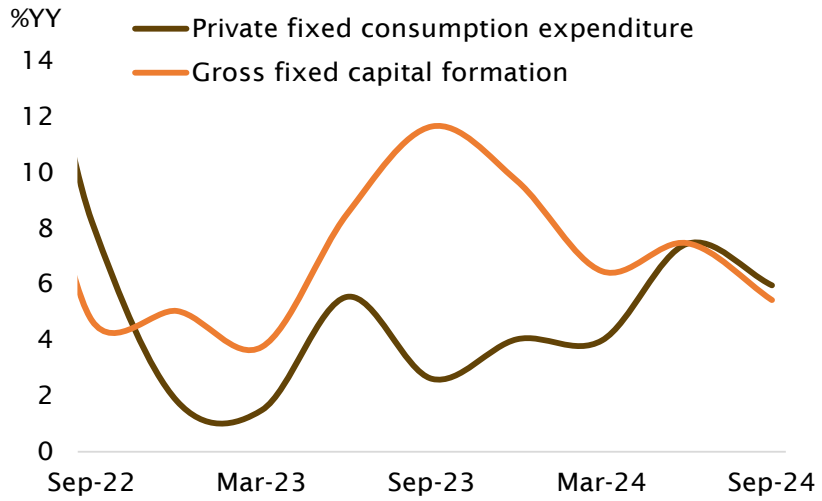
- Historically, growth in the first half of fiscal year has typically been higher than in the second half, though there have been exceptions, and the current fiscal is likely to be one. Latest forecasts from the RBI MPC have penciled in average growth of 7% for H2, up from 6% in H1. Base effects are slated to be unfavorable in both Q3 and Q4, so momentum will need to pick up. And there are reasons to believe that momentum could strengthen in H2.
  - **Farm output:** The first advance estimates of Kharif crop for FY25 show record produce and Rabi output is expected to be solid amid ongoing sowing progress, reservoir levels and soil moisture conditions. This could further boost farm output in H2, though risks remain from unexpected adverse climate events.
  - **High frequency data:** After weakening in Q2-FY25, particularly in August and September, there are signs of improvement in economic activity based on high frequency data in October and November, though the trends remain mixed, indicating more of resilience or a shallower rebound from the slump in Q2.
  - **Capital expenditure:** Capex spending at the Centre has picked up post the election-induced pause in Q1 but the pace of increase has remained tepid, with fiscal year-to-date spending remaining below the levels in the respective period of FY24. Though the expected expansion in H2 could support overall economic growth, there is a reasonable probability of an undershoot for the full year vis-à-vis the budget estimates.
  - **Revenue spending:** Even as public capex has been muted, revenue spending has been on track on year-to-date basis, buoyed by general elections earlier in the year and poll-bound states thereafter. This is expected to buoy consumption in the near-term.
  - **Credit conditions:** Credit growth has eased in recent months due to RBI's regulatory steps announced in November 2023. However, the 50bp cut in CRR at the latest MPC meet could ease liquidity conditions, and prompt banks to reaccelerate the pace of lending, thereby supporting economic activity and growth.
  - **Domestic inflation:** The RBI's latest policy statement and 'state of the economy' article in its monthly bulletin reiterated how inflation is curbing urban consumption and firms' profits, thereby necessitating the RBI to maintain its focus on lowering inflation on a durable basis to support growth.
  - **Commodity prices:** Though commodity prices were a bit volatile in 2024 due to geopolitical tensions and uncertain global trade policies, the Bloomberg commodity index remains close to levels at the start of 2024. Except for precious metals that rallied on safe haven demand, most commodity prices, including energy, remain range-bound, sustaining a potential tailwind for domestic industrial activity that has slumped in recent months. However, global food prices have been on the rise recently and need to be watched out for.
  - **Global uncertainties:** Post the recent US Presidential outcome, an uncertain global backdrop will be the largest wildcard amid risks of protectionist policies playing out in 2025. The potential spillovers are already unfolding and likely to be felt further in currency movements, FII flows, trade policies, and external balance.

Appendix

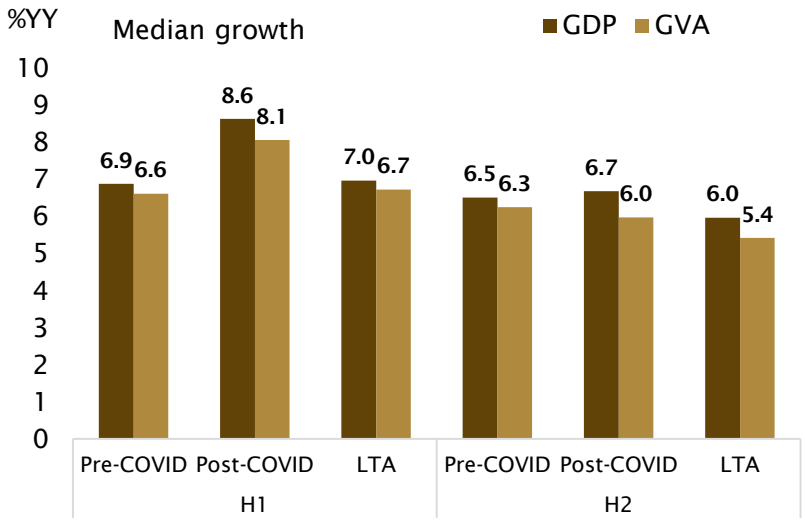
Deflator eased amid moderation in real, nominal GDP



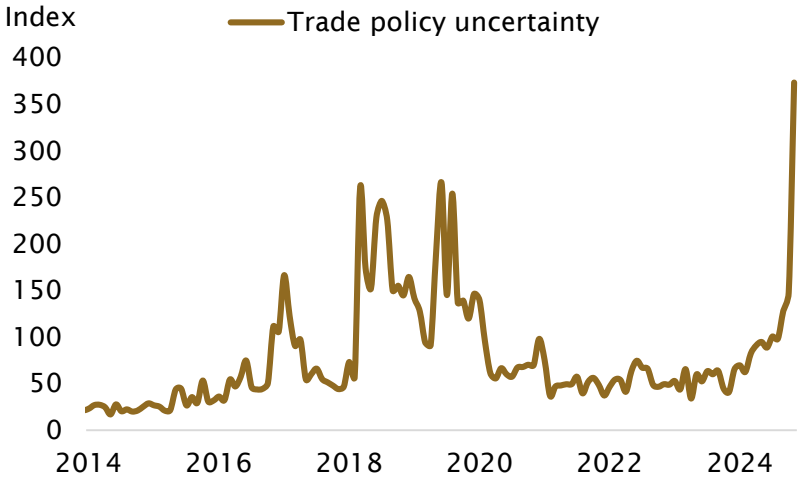
Private consumption growth eased after improving in Q1



Domestic growth typically tends to be stronger in H1



US trade policy uncertainty has spiked post election outcome



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