

India: Economic growth returns to potential range

The latest GDP data may instil some confidence in the Indian rupee. But the worst isn't over yet as downside risks to growth still persist while the country's twin-deficit problem and beleaguered banking system cloud prospects for the currency



7.2% YoY GDP growth
Oct-Dec 2017

Better than expected

Growth returns to the potential range

Indian's economic growth returned to the potential range of 7-8%. Gross domestic production (GDP) grew by 7.2% year-on-year in the October-December quarter of 2017, the third quarter of the current financial year ending in March 2018. This beat the consensus forecast of 7.0%. Growth in the previous quarter also was revised to 6.5% from 6.3%. It was a broad-based acceleration in

the main economic sectors, led by manufacturing at 8.1% (prior 6.9%), construction at 6.8% (prior 2.8%), and financial and real estate services at 6.7% (prior 6.4%). On the expenditure side, the fiscal thrust stood out with 6.1% growth in government spending (prior 2.9%) while fixed capital formation surged 12% (prior 6.9%).

But the worst isn't over yet

Data shows the economy remains on track to achieve the official growth forecast for fiscal 2017-18, which has been revised to 6.6% from 6.5% (ING forecast 6.5%, consensus 6.6%). However, this also depends on the sustainability of the current pace of growth in the final quarter of fiscal 2017-18. This, in turn, hinges on the extent of damage to confidence from a spate of bad economic news recently, including fiscal slippage, elevated consumer price inflation, and a troubled banking sector. And full-year growth will still be short of the 7.1% seen in fiscal 2016-17.

Possibly more hawkish central bank stance

The better-than-expected economic performance could lead the Reserve Bank of India (RBI) to step up its anti-inflationary rhetoric. The RBI has been warning about inflation risk in the period ahead on the grounds of a widening fiscal deficit, administrative hikes in minimum support prices for farm products and housing allowance for civil servants and the transmission of higher global oil prices to domestic fuel prices. This, and the recent sell-off in the Indian rupee, could shift the consensus within the six-member RBI Monetary Policy Committee toward a rate hike; only one MPC member voted for a rate hike at the January meeting.

INR to remain an underperforming Asian currency

The Indian rupee was Asia's second-worst performer in February after the Philippine Peso. A strong GDP report isn't sufficient to suggest the worst is behind us, while India's twin-deficit problem and the beleaguered banking system continue to overshadow prospects for local financial assets. We expect the INR to remain among Asia's underperforming currencies through 2018.