

India: Where has all that stimulus gone?

A 6-year low of 5% GDP growth in 1Q FY2020 provides more reasons for the government and central bank to remain in policy-easing mode over the rest of the year.



Source: Shutterstock

5% GDP growth in 1Q FY2020

Worse than expected

6-year low GDP growth...

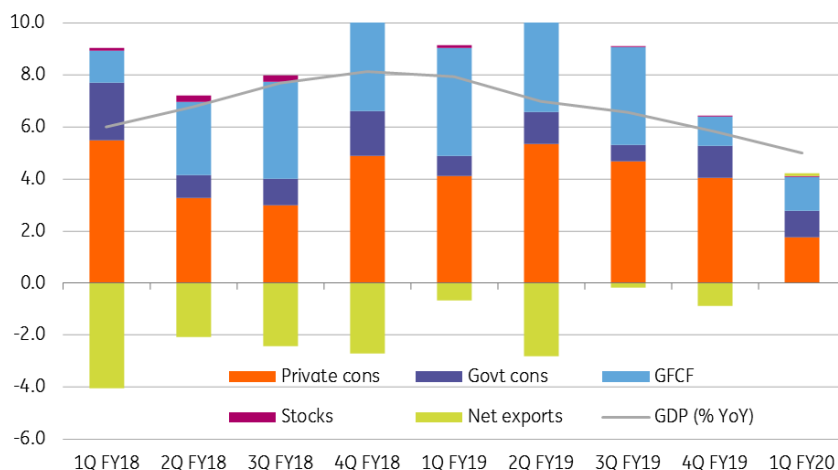
Contrary to the consensus of just a tick-down in growth, GDP in the first quarter of FY2020 (started in April this year) posted a sharp slowdown to 5% year-on-year from 5.8% in the previous quarter. The consensus median was 5.7% growth as against 5.8% in the previous quarter. We were more optimistic with our 6.0% forecast, which rested on the massive stimulus the authorities, both the government and the central bank, unleashed earlier this year in the election drive to boost growth.

Among the spending components, private consumption stood out to be the main source of GDP slowdown. 3.1% consumption growth more than halved from 7.2% in the previous quarter,

implying a 2.3 percentage point hit to GDP growth. There was also a sharp slowdown in government consumption (to 8.8% from 13.1%), which is at odds with fiscal stimulus. Growth of fixed capital formation improved slightly (to 4.0% from 3.6%), thanks to the aggressive policy rate cuts by the Reserve Bank of India (RBI).

Firmer exports were reflected in an improved net trade contribution to GDP growth (albeit zero overall), though these failed to sustain manufacturing as a source of GDP growth from the industry side, while services growth also slowed in the last quarter.

Weak private consumption dents growth



Bars may not stack up to total GDP growth due to statistical discrepancy.

Source: CEIC, ING

... paves way for more stimulus

Data suggests that all the stimulus that has gone into the economy this year -- as part of a surge in the election spending as well the RBI taking advantage of low inflation by slashing policy rates -- has failed to boost growth. The latest data also reflects significant policy lags (pointed out by an RBI policymaker in the latest policy minutes) with less than 40% of the rate cuts so far being transmitted to the banking system. The 110 basis point RBI policy rate cut this year was by far the most aggressive easing by any central bank in the world this year.

The question is: should the RBI pause easing and allow the rate cuts implemented time to filter down into the economy? We think so, though we are sceptical that they will actually do so now that growth has dipped well below the RBI's 6.9% growth forecast for the full FY2020 (revised recently from 7.0%).

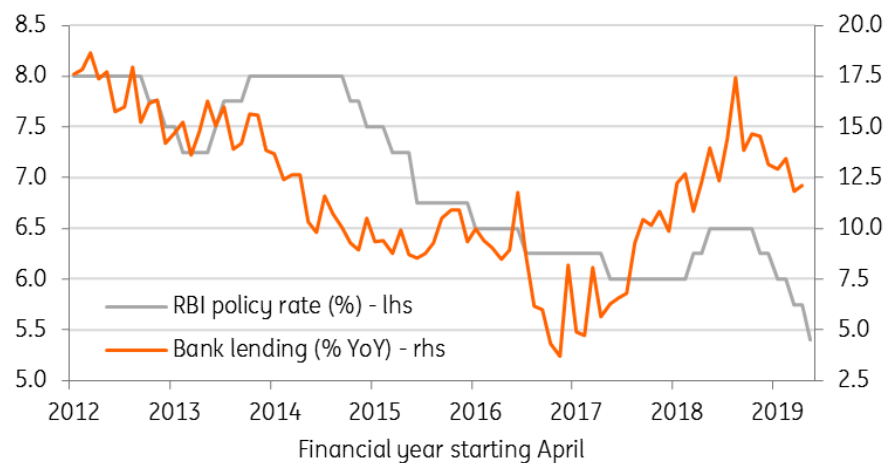
We retain our forecast of an additional 50bp of rate cuts over the rest of the year, taking the repo rate to 4.90%, the lowest in a decade and just shy of the 4.75% record low reached during the 2009 global financial crisis.

Furthermore, taking advantage of a \$24 billion windfall received from the RBI this year, the government unveiled additional stimulus just prior to the GDP release. We don't see it stepping off the stimulus pedal just yet.

However, we continue to caution about the inflationary implication of such massive policy

accommodation. We retain our view of inflation accelerating above the RBI's 4% policy target by the end of the year. So continued easing now may lead to considerable policy awkwardness later.

Monetary easing failing to stimulate bank lending



Source: Bloomberg, CEIC, ING