India: Where is Modi's pre-election boost to economy?

Five-year low GDP growth and escalation of trade risks lead us to downgrade our growth outlook for FY2019-20 to 6.6% from 6.8%. Still, we find it hard to justify yet another central bank policy rate cut this week

Source: Shutterstock

5.8%

GDP growth in 4Q FY18-19

Worse than expected

GDP growth hits 5-year low in 4Q FY18-19

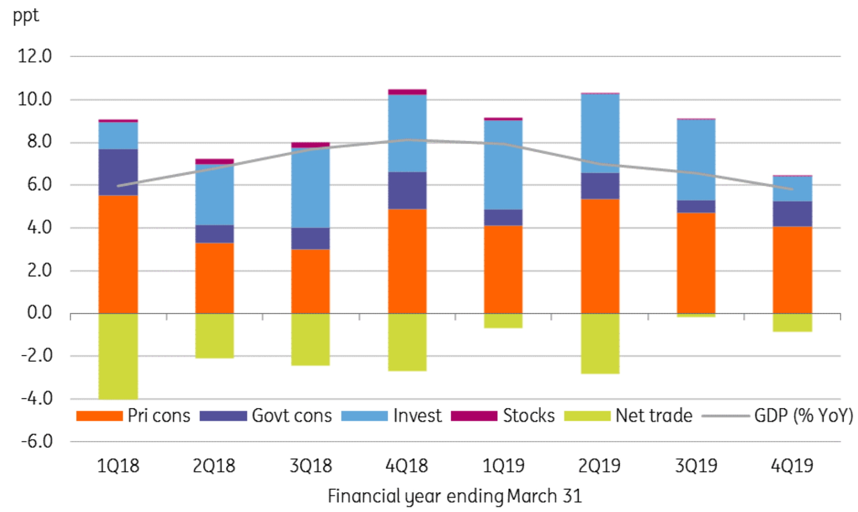
India's economic growth slowed sharply in the January-March quarter, the final quarter of the fiscal year 2018-19. Gross domestic product (GDP) grew by 5.8% year-on-year - a significant underperformance relative to the consensus median estimate of 6.3% growth (ING forecast 6.0%), and down from 6.6% in the previous quarter. This was the weakest economic performance since the Modi government came to power five years ago.

Investment, with a sharp slowdown in growth to 3.6% YoY from 11.7% in the previous quarter, was the biggest drag on GDP growth. Not just that, the contribution of private consumption and net trade also weakened. On the flip-side, growth of government consumption more than doubled, thanks to election spending. By sectors, agriculture and manufacturing stood out as the main sources of GDP slowdown.

In addition to these factors, the authorities blamed prevailing problems in of non-bank finance companies (the shadow banking sector) for the economy's slowdown, and they expect the resultant liquidity and lending headwinds to growth to continue to overshadow the growth prospects in the current quarter.

This puts annual FY2018-19 growth at 6.8%, down from 7.2% in the previous fiscal year and also the slowest in the last five years.

Expenditure-side sources of GDP growth



Source: CEIC, ING

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

The pre-election fiscal boost failed to support growth

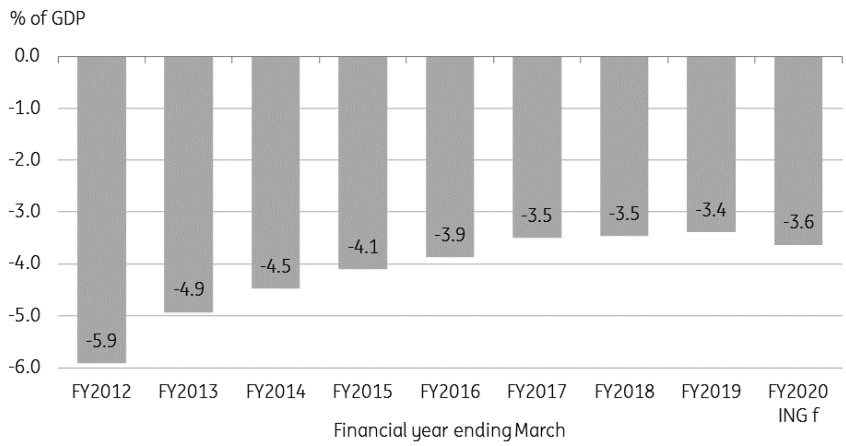
The economy tanked despite all the fiscal boost it received before the general election. Released alongside GDP on Friday was data on public finances showing on-target FY2018-19 fiscal deficit of INR 6.45 trillion (3.4% of GDP), though the target was revised higher from INR 6.2 trillion (3.3% of GDP) in the interim budget or vote of account before the elections.

And even though this was slightly better than the 3.5% deficit in the previous financial year, we don't think there is enough here to credit the government's fiscal management. The annual revenue growth of 7.4% was little changed from the previous year despite the streamlining of the Goods and Services Tax, while there was a significant acceleration in capital spending growth to 15.4% YoY from -8.3%.

We expect weak public finances to continue to weigh on investor sentiment this year. Even as the government aims to maintain the deficit at 3.4% of GDP in FY2019-20, the risk of another overshoot remains high as the Modi administration will likely be spending the rest of the year in fulfilling its election promises. Look out for Modi's newly appointed finance minister, Nirmala

Sitaraman, unveiling the final budget in about a month (5 July).

Government budget deficit



Source: CEIC, ING

From political to trade uncertainty

The economy ended the FY2018-19 on a weak note, which clouds the prospects for the following year.

Indeed, the first quarter of the current fiscal year was hampered by political uncertainty. And just as the economy was about to take some breather from the political uncertainty, the external uncertainty of the US President Trump expanding his battlefield of the trade war to India has gone up sharply.

The US Treasury in its latest report removed India from the monitoring list of countries suspected of manipulating their currencies for export advantages, but President Trump has just proclaimed India to be out of the developing countries enjoying trade benefits under the generalised system of preference (GSP).

The intensified economic risks, both domestic and external, lead us to downgrade our forecast of GDP growth for the current fiscal year to 6.6% from 6.8%.

6.6%

ING's GDP growth forecast for FY19-20

A downgrade from 6.8%

Still, no strong case for central bank easing this week

The steeper-than-expected slowdown in economic growth in the last quarter doesn't really strengthen the argument of the Reserve Bank of India continuing to ease the policy at the meeting scheduled this week (Thursday, 7 June). This may sound a bit odd.

However, a prudent and proactive policy shouldn't be reliant on historical data in the first place. Secondly, the RBI has already cut rates twice in the current quarter and has been supporting the banking system liquidity through its open market purchases and swap auctions (USD/INR swaps). This should prove to be sufficient monetary policy thrust for an economy that's also potentially facing a significant inflation risk from supply shocks to food and fuel prices.

Negative agriculture GDP growth in the last quarter foreshadows higher food prices in the future, while a supply shortage due to the US sanctions on Iranian oil poses the risk of higher fuel prices. Loose fiscal policy and a weak currency are among other factors contributing to higher inflation in the future. While we don't see these inflation risks materialising just yet, excessive policy loosening could backfire with a steeper inflation spike amid already elevated inflation expectations.