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Economics Group

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Indian Real GDP Growth Moderates in Q4 2015

Indian real GDP growth slowed a bit in Q4 2015 but remained robust at 7.3 percent. The details of the report were not as strong as the headline, but we expect growth will generally remain solid going forward.

Strong Topline Reading but Fundamentals Miss the Mark

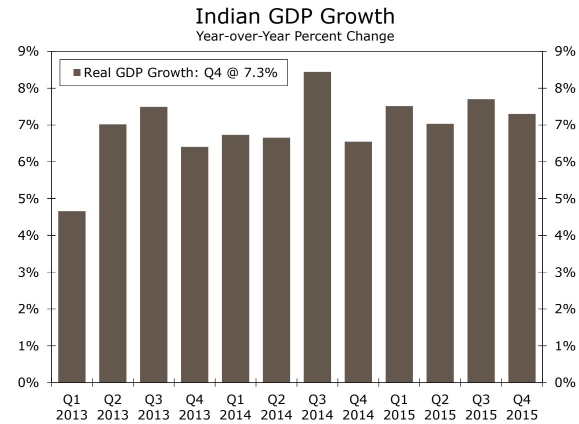
Data released this morning showed that real GDP in India grew 7.3 percent from a year earlier in Q4 2015. While this marks a slowdown from the upwardly-revised 7.7 percent growth rate in the prior quarter, it was above the consensus estimate of 7.1 percent. Indian authorities estimate real GDP will expand 7.6 percent in fiscal year 2015-16 (Q2 2015-Q1 2016) which, if realized, will exceed the growth pace of 7.2 percent in fiscal year 2014-15.

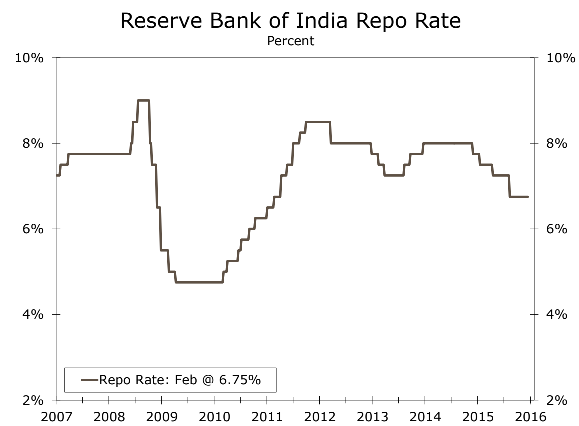
Growth was led by private consumption, which rose 6.4 percent from a year earlier. Meanwhile, other components of the report were somewhat less encouraging. In particular, fixed investment spending slowed sharply and grew only 2.8 percent on a year-over-year basis, down from 7.6 percent in the prior quarter. The sharp deceleration in investment spending coincides with an outright 3.2 percent contraction in industrial production in November, the first decline in output in more than a year. Real exports declined 9.4 percent from a year ago, but the more significant 10.8 percent decline in imports caused net exports to add to overall GDP growth. Moreover, the largest year-over-year increase in inventories since Q4 2014 provided further boost to the headline GDP figure.

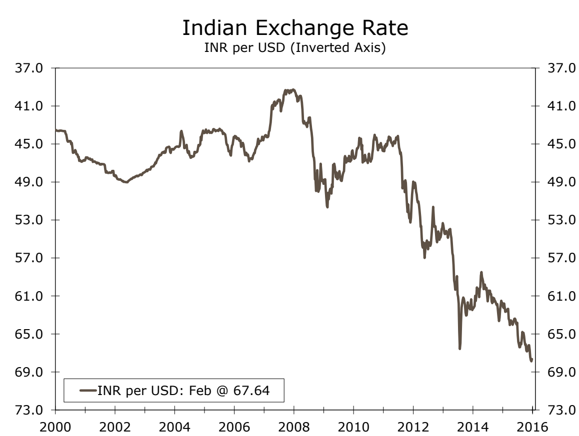
Implications for Monetary Policy

The low inflation environment that characterized the Indian economy during late 2014 and most of 2015 allowed the Reserve Bank of India (RBI) to cut its main policy rate 125 bps over the same time period (middle chart). However, like many emerging economies, India has seen its currency depreciate considerably vis-à-vis the dollar over the past two years or so (bottom chart). As oil and other commodities, which comprise a significant amount of India's imports, are priced in dollars, Indian consumer prices have not seen the downward pressure witnessed in other major economies. Instead, CPI inflation has actually steadily risen over the past few months, and reached a 14-month high of 5.6 percent in December. Rising inflation has likely been the impetus for the RBI to keep its main policy rate steady at its last two meetings.

While the positive effects of prior rate cuts should continue to underpin generally strong real GDP growth in India, the specter of rising inflation will likely cause the RBI to refrain from further rate cuts in the near term. However, even in the absence of further accommodation, we expect real GDP will continue to grow between 7 and 8 percent throughout this year and next. If this growth pace is realized, India will overtake China as the world's fastest growing major economy. That said, there are a number of issues, including low labor force participation among females, inadequate infrastructure, rigid labor markets and corruption that may impede the ability of the Indian economy to reach its true economic potential.







Source: CEIC, IHS Global Insight and Wells Fargo Securities, LLC

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