Economic Analysis

New GDP calculations chart a "V shaped" recovery for India but raise pertinent questions

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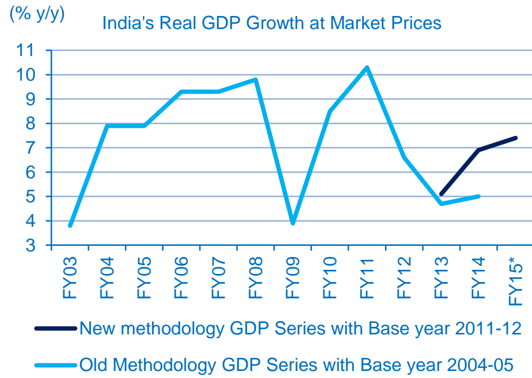
A "V" for India rather than a "U". India's newly revised GDP calculations stun widely-held perception that the economy is long struggling to return to a high growth path, having grown at a low 5% annual rate over the past three years. Instead, revised GDP data suggests that India saw a dramatic "V shaped" recovery during the fiscal year ending March 2014 (FY14) and that its real GDP growth has possibly surpassed China's over the past year (See Figure – 1). The revisions carried by India's Central Statistics office entail, 1) Shifting GDP base year to the one ending March 2012 (FY12) from 2004-05, 2) Switching to GDP at market prices from factor cost, 3) incorporating more-detailed data on corporate sector, local bodies, national surveys and the financial sector and 4) conceptual changes in the calculation method.

Under the new methodology, India's real GDP growth in FY15 is estimated at 7.4% y/y, compared to 6.9% y/y in FY14, driven by private and government consumption expenditure, which together offset subdued investment activity and slowing external demand. From a three-year horizon, the revisions paint an even rosier picture with real GDP growth having rebounded more than 200 bps from just 5.1% y/y in FY13. In stark contrast, the older calculations, which were based on the 2004-05 base year, pegged India's economic growth at near 5.5% y/y in FY15 compared to 4.7% and 4.5% in the previous two years. On a quarterly basis, India's GDP growth slowed to 7.5% y/y last quarter (4Q14) from 8.2% y/y in Q3 as per the new methodology. The slowdown was led by weakening domestic demand, sluggish gross capital formation and continued contraction in exports, which together offset a sharp pick up in government consumption.

Playing Catch-Up with China – Questions Galore. Prima facie, the new GDP methodology might have helped India catch up with China on paper. It however raises several pertinent issues that undermine the methodology's robustness and warrants further clarifications and incremental data to estimate India's GDP growth trajectory going forward. In particular, the new growth outturns' do not corroborate with higher frequency indicators and ground level evidences that reflect broad economic underperformance over the past three years. This is characterized by falling capacity utilization, slack in motor vehicle sales, slowing credit growth, rising non-performing loans of the Indian banking sector and an overhang of stalled infrastructure projects (See Figure – 2).

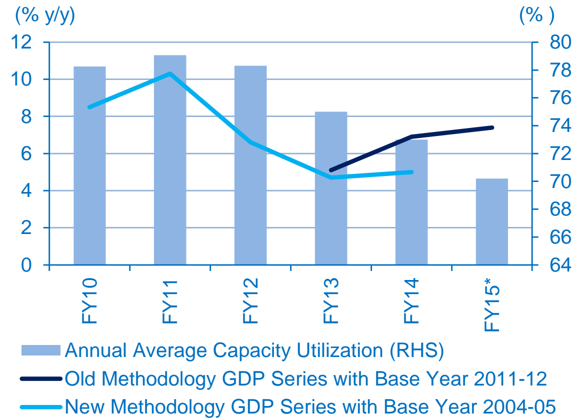
Expect RBI to look beyond the GDP uptick, to maintain its accommodative monetary policy stance. The sharp revision in India's GDP growth has important implications for RBI's reaction function, particularly driven by its assessment of India's new output gap. The difficulties in calculating India's new growth potential stem from an absence of historical time series based on the new revisions. However, given ongoing disinflationary trends and on-ground evidence of a much more gradual recovery, we expect RBI to stick to its ongoing policy easing cycle conditional on prudent fiscal management by the government. Against this backdrop, we continue to expect additional 50 bps easing in policy rates by the RBI in 2015 with a likely 25-50 bps rate cut at its next policy meeting on 7th April.

Figure 1
New GDP calculations indicate that India saw a 'V' shaped recovery in 2013-14 from 5.1% to 6.9%...



*FY15: Fiscal Year ending March 2015; Source: BBVA Research, CEIC

Figure 2
…However new GDP outturns do not square with high frequency data like falling capacity utilization



*Fiscal year ending March; Source: BBVA Research, CEIC

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