

Economic Analysis

India's Q2 GDP moderates but details encourage

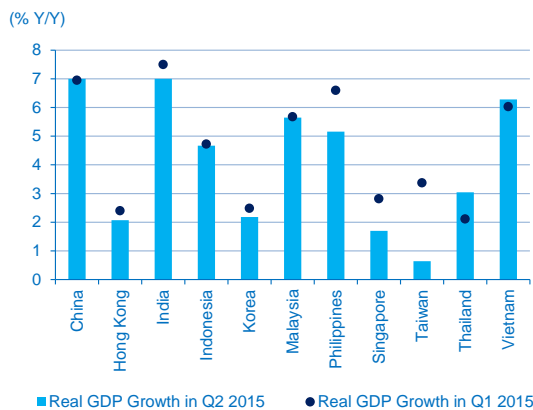
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India's Q2 2015 real GDP growth fell short of expectations, easing to 7.0% y/y (Consensus: 7.4%; BBVA: 7.5%) compared to 7.5% in the previous quarter. Headline growth was dragged mainly by weaker than expected net indirect taxes and exports contraction. However, excluding net indirect taxes, GDP growth (Gross Value Added) saw a robust pick up of 7.1% y/y from 6.1% in Q1, driven by an increase in agriculture and construction activity. From the expenditure side, government consumption and fixed investments grew at a faster clip while private consumption slowed to a still respectable pace of 7.4% y/y. Going forward, we expect India's GDP growth to improve over 2H15 as higher productive public spending offsets weak external demand and slower private consumption; and maintain our full year 2015 GDP growth estimate at 7.6% y/y.

Limited room for interest rate cuts in 2015: Comments by Governor Rajan in the wake of recent spike in global financial volatility, triggered by China's unexpected Yuan devaluation, were relatively hawkish as he emphasized that household inflation expectations were still high and it was important to focus on bringing inflation credibly lower. Given RBI's focus on anchoring inflation at lower levels to facilitate sustainable and high growth in the long term, we maintain our out-of-consensus view of no further interest rate cuts by the RBI in 2015. Despite a benign CPI inflation outturn in July, we expect that the imminent Fed rate hike, long lags in monetary policy transmission and uncertainty surrounding the impact of monsoon rains (still 11% below normal) would likely keep RBI on hold in 2015.

India outshines most other economies but stalled progress on key reforms can unnerve investors: Amid the ongoing global financial turmoil, India's macro fundamentals are amongst the strongest in the region. Recent activity indicators including PMI, motor vehicle sales and indirect tax collections, have improved while new stress loan formation of Indian banking sector edged lower. India's FX reserves stand at an all-time high of USD 380 billion while foreign direct investment (FDI) inflows have surged into more productive and labor intensive manufacturing sectors – expected to surpass USD 50 bn in 2015 from USD 41 bn in 2014. On the flipside, however, progress on structural reforms has largely disappointed. While recent banking sector reforms including steps to reduce bank NPLs are positive, the government's inability to implement important legislative reforms such as Goods and Services Tax Bill and Land acquisition bill is a key risk for India's otherwise promising growth story.

Figure 1
India's Q2 GDP growth amongst highest in region



Source: BBVA Research, CEIC

Figure 2
India's external fundamentals remain favorable

	Fiscal Sustainability		External Sustainability		Liquidity Management	
	Central Govt Debt (% of GDP)		Current Account Balance (% of GDP)		Debt as share of FX Reserves (%)	
	May/2013	Current	May/2013	Current	May/2013	Current
India	46.8	43.7	-4.3	-1.0	33.6	23.8
Indonesia	22.8	27.1	-4.2	-1.8	49.0	41.0
Philippines	47.8	47.6	4.3	5.4	23.2	23.1
Thailand	28.7	30.9	-3.2	6.0	38.6	38.1
Malaysia	54.7	52.1	1.7	2.6	71.5	86.4

Source: BBVA Research, CEIC

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