Economic Analysis

India | 3Q15 GDP growth picks up, RBI pauses

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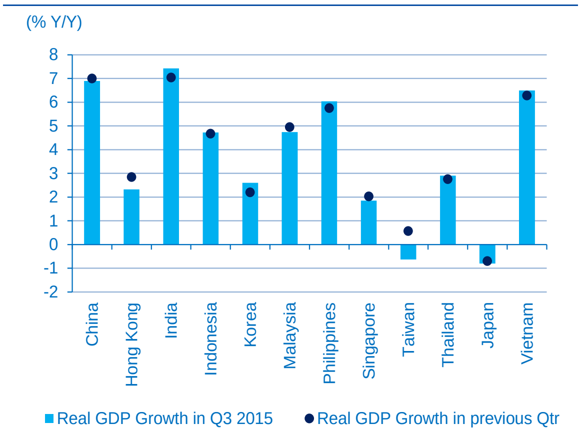
India's Q3 2015 real GDP registered stronger than expected growth, rising 7.4% y/y (Consensus: 7.3%; BBVA: 7.0%) compared to 7.0% in 2Q15. Headline growth was driven mainly by higher government consumption and firmer investment demand, which together offset slower private consumption and weak external demand. Excluding net indirect taxes, GDP growth (Gross Value Added) posted a similar pick up of 7.4% y/y from 7.1% previously, led by stronger manufacturing activity while services sector growth held steady. Looking ahead, we expect India's growth momentum to be supported by higher public spending and policy reforms to revive private investments. In this context, policy efforts to revive stalled road projects, sector-specific export incentives, divestment and e-auctions in energy sector, and faster clearances for foreign direct investments are reassuring. We peg India's GDP growth at 7.3% y/y in 2015 and 7.7% in 2016.

RBI maintains status quo: Having cut interest rates by a larger than expected 50 bps at its previous policy meeting on September 29th, the Reserve Bank of India kept benchmark repo rate unchanged at 6.75% in today's credit policy, in line with expectations. We believe India's rate cutting cycle is not over yet, but RBI awaits banks to transmit the bulk of its cumulative 125 bps rate cuts over 2015 (60 bps passed), and tests India's ability to stay on the disinflationary path with a focus on March 2017 CPI target of 5% y/y. RBI would be cognizant of upside risks to CPI inflation from a fading base effect, El Nino effect on winter crop, and the impact of the proposed 24% hike in total pay, allowance and pension of Central government employees.

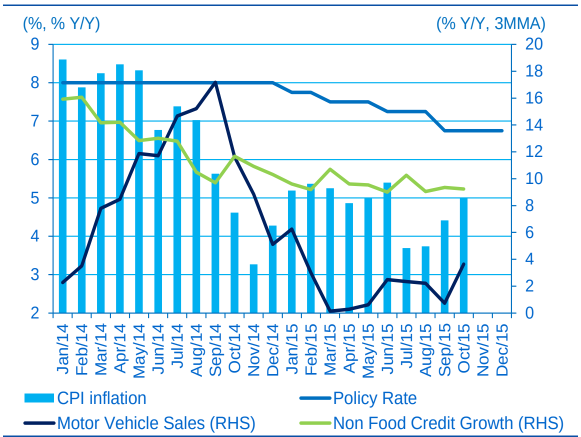
Winter session of Parliament will test Mr. Modi's ability to pass difficult reforms: The ongoing Winter Session of India's Parliament, which runs through December 23rd, has key reforms on its agenda. Chief amongst them includes the Goods and Services Tax Bill (GST), which aims to rationalize India's complicated indirect tax structure and multiple state levies into a nation-wide integrated single tax. If implemented, the GST would have a net positive impact on India's growth as it eliminates current tax distortions and the cascading effects of taxation for the producer, broadens the tax system, in turn boosting tax revenue, and facilitates easy movement of goods across states, thereby creating a common market. Hopes of a smooth passage of the GST bill are bleak however, given the government's weak mandate in the upper house of parliament as differences persist between the Modi Government and the main opposition Congress party over the proposed 'GST rate' and the additional 1% tax on interstate movement of goods.

Figure 1
India's Q3 GDP growth is highest in the region…



Source: BBVA Research, CEIC

Figure 2
RBI pauses, but rate cutting cycle isn't over yet



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