

Economic Analysis

India | Q2 GDP growth slows as investments dip

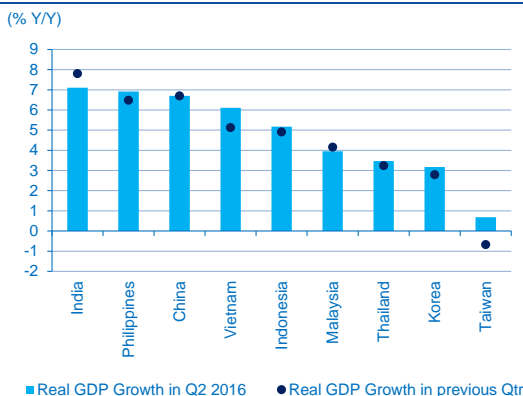
Sumedh Deorukhkar / Le Xia

India's Q2 2016 real GDP registered slower growth at 7.1% y/y (Consensus: 7.6%; BBVA: 7.4%) from 7.9% in 1Q16, driven mainly by lower net indirect tax payout and extended investment weakness, which offset robust consumption demand. Excluding net indirect taxes, real GDP (Gross Value Added) steadied at 7.3% y/y from 7.4% y/y previously, led by higher growth momentum in manufacturing and services. Looking ahead, we expect real GDP growth to average 7.6% y/y and 7.8% y/y in 2016 and 2017 respectively. Underpinning growth is strengthening consumption demand on the back of monetary and fiscal accommodation, above normal monsoon rains and structural reform momentum. However, a revival in sluggish private investment activity and negative exports growth is crucial for high GDP growth to sustain. On monetary policy front, the recent pickup in inflation is expected to be transient, and we thus foresee room for a final 25 bps rate cut by the RBI when inflation abates towards the end of 2016 (Current Repo Rate : 6.5%).

Passage of the GST Bill provides a major fillip to India's reform momentum: Last month, India's parliament passed the long awaited Goods and Services Tax Bill - a nationwide value added tax that will subsume most indirect taxes, enable voluntary tax compliance due to input tax credit and facilitate investment decisions independent of tax considerations. India currently suffers from a highly fragmented, multi layered and complex indirect tax system. Effective implementation of the GST would ensure equitable taxation, reduce cascading effect of taxation, broaden tax collection, achieve logistics efficiency, enhance transparency and simplify the tax structure. This in turn would aid India's fiscal matrix, reduce manufacturing costs, create a cohesive national market for business and is expected to underpin GDP growth.

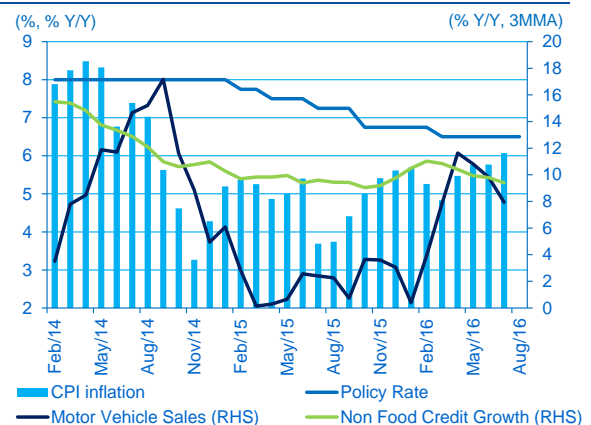
However, GST Bill passage does not ensure GST implementation. The Bill needs to be ratified by at least half of state legislatures and thereafter a GST council will be formed to take all major GST related decisions. Key contentious issues being 1) finalizing the optimum revenue-neutral GST rate, 2) center-state revenue sharing including the initial compensation for manufacturing states on account of revenue loss with the onset of GST, and 3) the nature of dispute settlement mechanism. In addition, ensuring a robust tax IT infrastructure is equally essential. Led by concerted consensus building efforts by the Modi Government, we expect a staggered implementation of the GST Law in India starting FY18.

Figure 1
India's 2Q16 GDP growth slows



Source: BBVA Research, CEIC

Figure 2
Recent pick-up in inflation expected to be transient, RBI likely to ease again in future



Source: BBVA Research, CEIC

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