Economic Analysis

India | Q2 GDP growth slows as investments dip

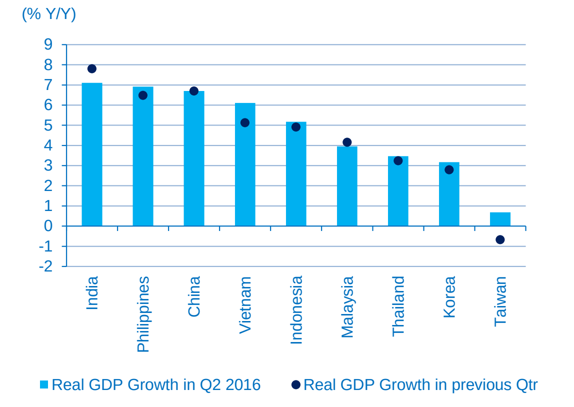
Sumedh Deorukhkar / Le Xia

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.

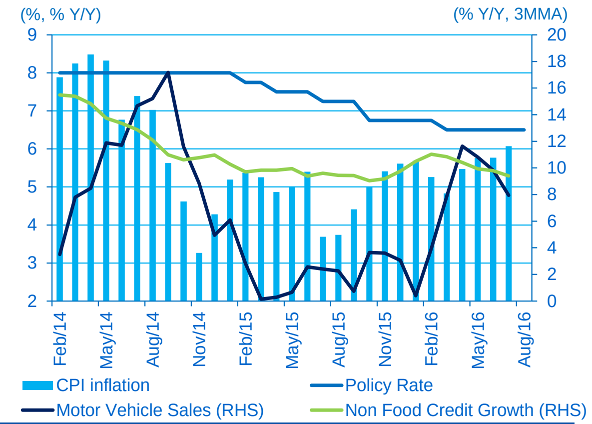
However, GST Bill passage does not ensure GST implementation. The Bill needs to be ratified by at least half of state legislatures and thereafter a GST council will be formed to take all major GST related decisions. Key contentious issues being 1) finalizing the optimum revenue-neutral GST rate, 2) center-state 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

DISCLAIMER

This document and the information, opinions, estimates, forecasts and recommendations expressed herein have been prepared to provide BBVA Group's customers with general information and are current as of the date hereof and subject to changes without prior notice. Neither BBVA nor any of its affiliates is responsible for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, to undertake or divest investments, or to participate in any trading strategy. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. Other than the disclosures relating to BBVA Group, the contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA or any of its affiliates and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. To the extent permitted by law, BBVA and its affiliates accept no liability of any type for any direct or indirect losses or damages arising from the use of this document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, derivatives, options on securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying securities. Investors should also be aware that secondary markets for the said instruments may not exist. Before entering into transactions in futures, derivatives, or options, investors should review all documents on disclosures for risks of investing in options and/or futures at the following websites:

Options - http://www.finra.org/Industry/Regulation/Notices/2013/P197741

Futures - http://www.finra.org/Investors/InvestmentChoices/P005912

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. More specifically, this document is in no way intended for, or to be distributed or used by an entity or person resident or located in a jurisdiction in which the said distribution, publication, use of or access to the document contravenes the law which requires BBVA or any of its affiliates to obtain a licence or be registered. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

The remuneration system concerning the analysts responsible for the preparation of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons").