

India Flash

Q2 GDP growth edges higher but outlook is still cautious

India's real GDP growth picked up in 2Q12 to 5.5% y/y (BBVA: 5.1%, Consensus 5.3%), as favorable base effects helped support year-on-year industrial and agriculture output, even as services continued to slow. While the GDP outturn beat expectations, downside risks to the outlook continue to linger given the global slowdown, slack domestic investment, and concerns over fiscal policy and the pace of economic reforms. At the same time, possible further policy easing, a revival of monsoon conditions, and efforts to boost investment reforms should cushion GDP growth going ahead. We maintain our call for a 50 bps cut in interest rates during the remainder of 2012, although a cut at the next policy meeting in September seems unlikely given high inflation and the absence of fiscal reforms. Today's GDP outturn is in line with our full-year projection of 5.6% GDP growth in 2012.

- **Services sector slowdown continues, hitting a three-year low.** A steady deterioration in India's services sector growth to a three year low of 6.9% y/y in Q2 presents downside risks to India's longer term growth prospects. Dragged mainly by trade and transport services, the composition of slowdown highlights the critical need to spur infrastructure development, revive investment sentiment and reduce political uncertainty.
- **Private consumption growth weakens.** Private consumption growth, which contributes 60% to GDP, fell to a multi-year low of 4.0% y/y in Q2 from 6.1% in Q1 as high inflation, tight credit conditions, and financial market uncertainty hit consumer sentiment. Although momentum indicators such as vehicle sales, order books and credit growth suggest an extended slowdown, efforts to revive economic reforms and a revival in monsoon rains should lift sentiment and support consumption growth.
- **Improving monsoon deficit bodes well for growth outlook:** Risk to growth and inflation from a sub-par monsoon have receded, albeit not entirely. India's overall monsoon deficit has improved significantly to 12% below normal in August from a 25% shortfall in July. The late catch up in rains is expected to cushion growth as it helps boost the winter (Rabi) crop, power generation and groundwater recharge.

Chart 1
India's 2Q12 GDP growth picks up, but services sector slowdown continues

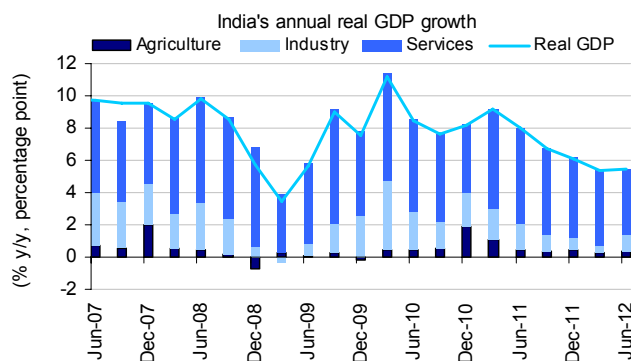
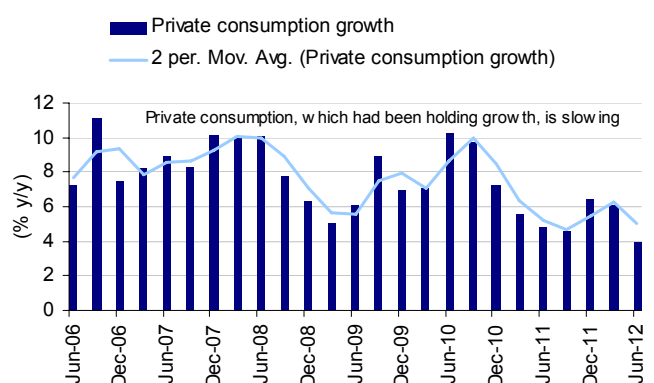


Chart 2
Private Consumption growth has slowed to a multi year low



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