Economic Analysis

India | Robust Q1 GDP dims further rate cut hope

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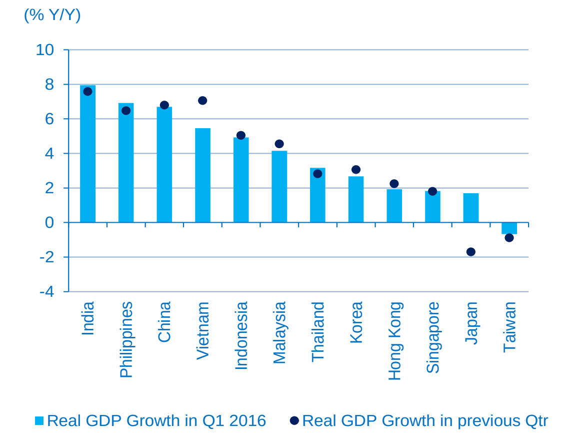
India's Q1 2016 real GDP registered robust growth, up 7.9% y/y (Consensus: 7.4%; BBVA: 7.3%) from 7.2% in 4Q15, driven mainly by strong private consumption, which offset negative investment contribution. Excluding net indirect taxes, real GDP (Gross Value Added) grew 7.4% y/y from 6.9% y/y in 4Q15, as higher agriculture output augmented strong 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. A revival in private investments and exports will be a key for growth to sustain going forward. In the wake of an improving but unbalanced growth recovery, RBI will likely adopt a wait and watch policy approach, characterized by a status quo on June 7th while leaving room for a final 25 bps rate cut later in 2016. The nature of monsoon rains, commodity-currency interplay and pace of Fed rate hikes, will influence RBI's rate decisions ahead.

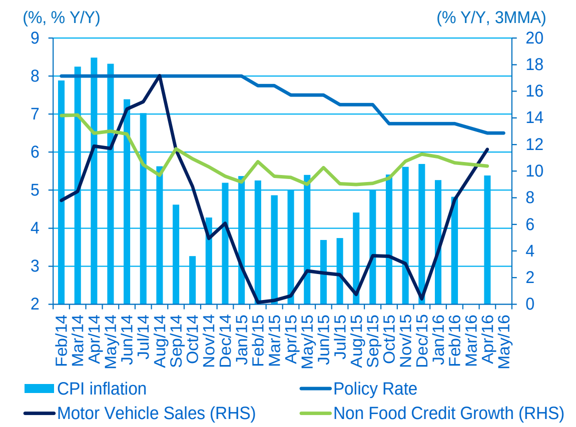
2 years of Modi government – more hits than misses: India's rise to the top of Asia's GDP growth table despite a tough external environment can be attributed to three key factors – 1) Modi government's success with incremental yet effective policy reforms, 2) Credible Central Bank policymaking focused on taming inflation and safe guarding financial stability, and 3) Cyclically boost from low oil and commodity prices. Key government measures include those aimed at a) enhancing the ease of doing business by reducing administrative bottlenecks, addressing governance issues, rationalizing regulatory norms, speedy single window approvals to business permits, expanding the digital platform to boost tax compliance and policy interface, ease foreign investment limits across key sectors and expedite liquidation process of distressed firms, and selective divestment b) a boost to productive public investments and reviving stalled infrastructure projects, and c) fiscal consolidation through subsidy reforms, expanding the role of direct benefit transfers. On the flipside, the government continues to struggle with difficult structural reform implementation, such as the Goods and Services Tax Bill – a unified countrywide indirect tax system - , the Land Acquisition Bill and labor reforms. Given political limitations at the national level, the Centre has encouraged competitive federalism alongside greater devolution of funds to states, in turn empowering them to push through harder reforms at the local level. This apart, the government will be tested in its ability to strengthen India's banking sector, especially public sector banks, which are saddled with high NPLs and low capital levels, as it undermines private capex recovery and investor confidence over the sustainability of India's growth story.

Figure 1
India's 1Q16 GDP growth beats expectations



Source: BBVA Research, CEIC

Figure 2
Expect RBI keep rates unchanged on June 7th



Source: BBVA Research, CEIC

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