

India Flash

Third quarter GDP growth slows, in line with expectations

India's growth momentum slowed in 3Q11, as expected, to a nine quarter low of 6.9% y/y from 7.7% in 2Q11. The outturn was in line with expectations, which had been marked down due slowing activity indicators, sluggish reform progress, and worsening global prospects. The outturn raises downside risks to our full-year growth outlook of 7.6% for 2011 and 8.0% for 2012.

- **Slump in industrial activity drags on growth.** Industrial activity in 3Q11 edged up 3.2% y/y from 5.1% in 2Q11, its slowest pace since March 2009. A contraction in mining (-2.9% y/y vs 1.8% in 2Q) and a sharp decline in the pace of manufacturing growth (2.7% vs 7.2%) largely offset higher growth across construction and electricity sectors. The slump is hardly surprising with momentum indicators such as industrial production, released earlier, suggested activity slowed to a post Lehman crisis low of 3.1% y/y in 3Q11.
- **Need to revive investment activity.** Gross fixed capital formation contracted by 0.6% y/y in 3Q11 from +7.9% in 2Q11. High borrowing costs on the domestic front coupled with tightening global liquidity conditions are increasingly crowding out private investment. Investment had last contracted during the Lehman crisis. To revive investment, further action will be needed on structural reforms to attract foreign capital, unclog the food supply chain and improve governance. The past month has seen some encouraging announcements, including the opening up of India's retail sector to foreign investment, but more needs to be done.
- **Exports will be weighed down by weakening external demand.** While most of India's growth comes from domestic demand, the deteriorating external environment has exacerbated the slowdown, raising additional vulnerabilities through the trade and capital flow channel. Exports grew at a robust pace of 27.4% y/y in 3Q11 from 24.3% previously but are likely to weaken in coming quarters as global demand shrinks.

Chart 1
India's GDP growth momentum pulls back in 3Q11

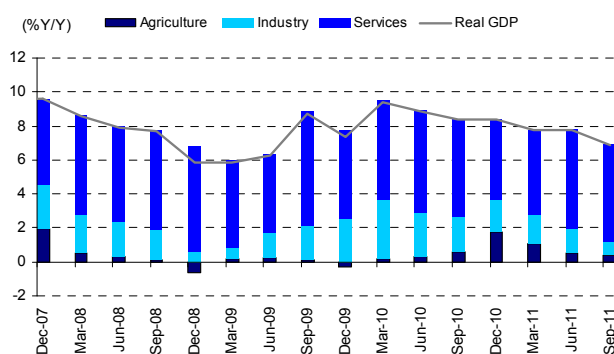
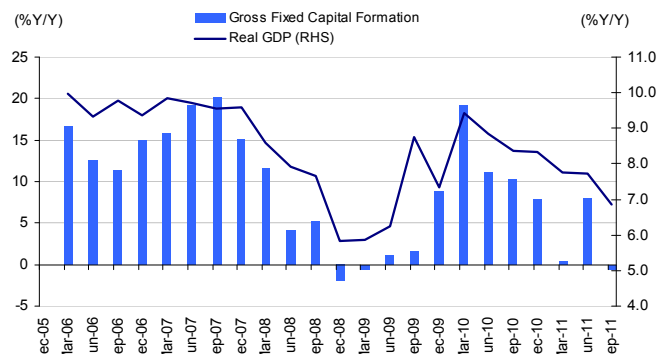


Table 1
Investment activity contracts, need for urgent boost



Stephen Schwartz
stephen.schwartz@bbva.com.hk
+852 2582 3218

Sumedh Deorukhkar
sumedh.deorukhkar@grupobbva.com
+91 2266301855