India Flash

1Q GDP growth slows sharply; room for policy maneuver?

India's economy slowed sharply in the first quarter as real GDP growth fell to 5.3% y/y from 6.1% y/y in the fourth quarter, marking the slowest growth in over a decade. The latest outturn was well short of the consensus (6.1%) as well as our expectation (6.3%), and was driven by a slowdown in the services sector, along with a contraction in manufacturing activity. Private consumption, traditionally India's major growth engine, has weakened considerably due to a challenging investment climate, widening twin deficits, rising inflation and a global risk-off environment. The weak GDP outturn supports our expectation of 50bps in interest rate cuts over the course of 2012, but also suggests our 6.8% y/y growth expectation for this year will likely need to be revised downwards. An increase in government initiatives may help revive growth momentum, and policymakers have begun introducing new measures (as seen in yesterday's decision to allow foreign retail investors to purchase domestic corporate bonds). Recent weakness in the rupee presents a challenge, however, as inflation remains high, thus limiting the government's options.

- **The slowdown in the services sector means growth worries will continue.** The services sector was the key driver behind India's growth slowdown, as it declined to 7.9% y/y from 8.9% y/y the previous quarter. The drag on the services sector, which accounts for 60% of India's GDP, is gaining traction in the second quarter of this year amid a further worsening of sentiment, signaling that India's growth may not have bottomed.

- **Slowing consumer spending, lack of fiscal remedies present further downside risks.** Consumption growth slowed to 5.8% y/y in 1Q12 (from 6.1% previously). Given the government's drive for further fiscal consolidation, a lack of fiscal support along with weakening consumer demand may put India's medium-term growth outlook at risk.

- **Exports rise after sharp rupee depreciation, incipient signs of policy reforms present hope on the margins** The sharp depreciation in Indian rupee over the last quarter should help support India's exports as well as domestic industries. However, government reforms can go far in reversing India's growth momentum. Possibilities include speedier implementation of policy reforms aimed at boosting investments, attracting foreign capital and enhancing efficiency in food supply chains.

Chart 1
India's 1Q12 GDP growth slows sharply

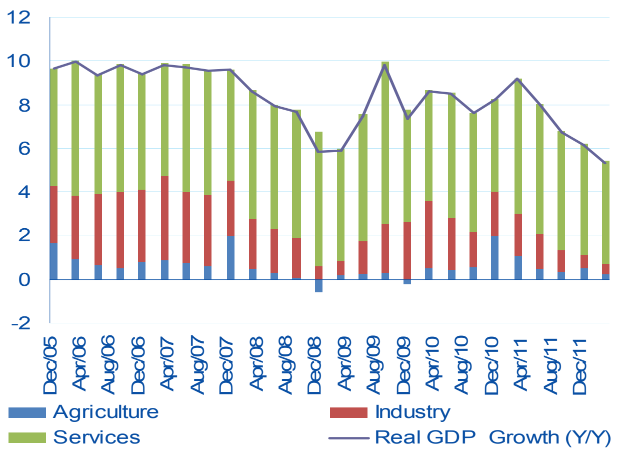
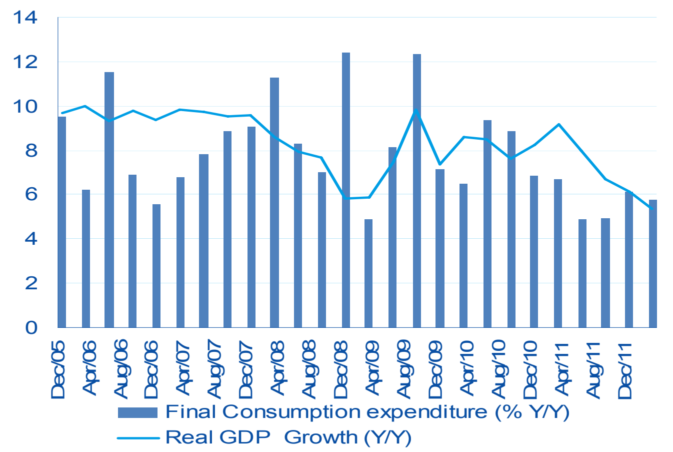


Chart 2
Consumption growth has weakened



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