

India Flash

Q3 GDP growth eases to 5.3% y/y, with gradual recovery anticipated

India's real GDP growth edged lower in 3Q12 to 5.3% y/y from 5.5% in Q2 (BBVA: 5.7%, Consensus: 5.3%) as a pickup in the services sector failed to offset weakness in industrial and agricultural activity. On a seasonally adjusted basis (non-annualized), we estimate Q3 GDP grew at its slowest pace since December 2009, at 1.0% q/q from 1.3% in Q2, dragged down by subdued external demand, stalled investment activity, and the impact of a subpar monsoon on agriculture. Looking ahead, we expect a gradual improvement in India's growth momentum on the back of further traction in policy reforms, easing price pressures and a growth supportive policy stance by the RBI. With growth broadly stable at low levels and given RBI's cautious stance on inflation, we foresee the rate easing cycle to restart only in 1Q13. Today's GDP outturn presents some downside risk to our full-year projection of 5.6% GDP growth in 2012.

- **A closer look reveals broad based moderation.** Digging deeper, we find that Q2 GDP growth was dragged lower by a slowdown across most sectors, weighed by private consumption expenditure and exports on the expenditure side, and agriculture and industry on the income side. Meanwhile, the services sector gained 7.2% y/y in Q3, from a three-year low of 6.9% y/y in Q2, driven mainly by higher government spending. Overall, services sector growth remains subdued, averaging 7.3% y/y so far in 2012 compared to 9.9% during the same period last year. This in turn highlights the critical need to spur infrastructure development, revive investment sentiment and reduce political uncertainty.
- **Execution of structural reforms is key to sustaining an economic recovery.** Amid relatively benign global growth prospects, India's economic recovery will hinge on three factors: (i) policy clarity and execution to foster investment, (ii) credible fiscal consolidation measures, and (iii) and the interplay of currency-commodity prices on inflation. On policy, the ongoing winter session of Parliament will be crucial with key legislation being tabled for approval, chiefly higher foreign investment limits in insurance and pension, amendments to banking, and the Companies law and land acquisition bill. Meanwhile, we expect India's fiscal deficit woes to persist amid revenue shortfalls and expenditure over-runs. In this context, the government's move towards direct cash transfer of subsidies and tax reforms augurs well for long term fiscal consolidation.

Chart 1

India's 3Q12 GDP growth edges lower to 5.3% y/y

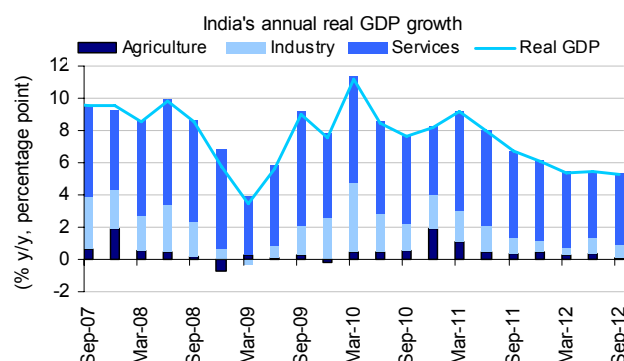
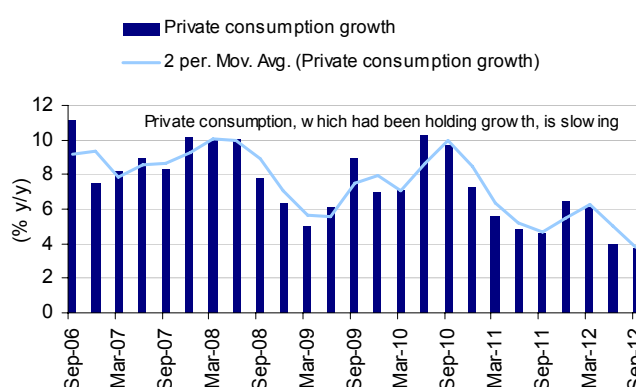


Chart 2

Extended slowdown in private consumption growth has been a key drag on headline GDP



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