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Economics Group

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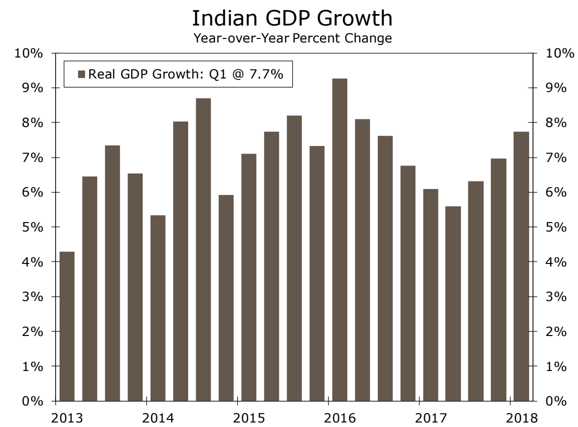
Indian Q1 GDP Data Show Robust Economic Recovery

The Indian economy accelerated for the third consecutive quarter, rising 7.7 percent year over year. With inflation in check and the economic recovery gathering steam, the RBI is likely on hold for now.

GDP Data Show Continued Recovery in Indian Economy

Data released today showed that Q1 real GDP in India grew a robust 7.7 percent year over year, surpassing consensus estimates and reaffirming our view that India's economy has found firmer footing (top chart).

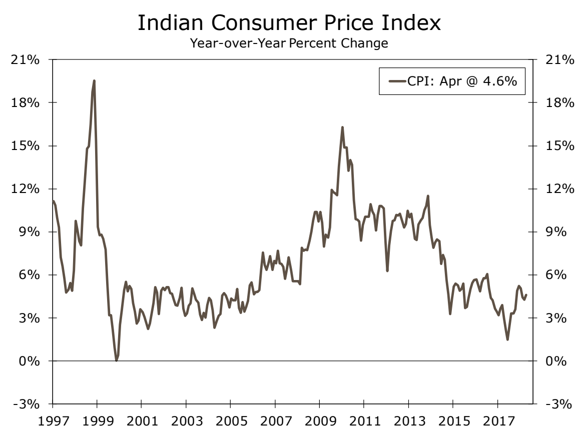
Government consumption surged, rising nearly 17 percent year over year. Investment spending exhibited similar strength in the face of rising interest rates, as gross fixed capital formation growth jumped to its fastest pace in nearly two years. Private consumption also accelerated, while import growth again outpaced export growth. On the supply side of the economy, some weakening in the service sector was more than offset by strength in more production-oriented industries. Growth in value added in the construction sector touched double digits for the first time since the data series began seven years ago, and manufacturing output posted a healthy 9.1 percent increase over the year.



Central Bank on Hold for Now

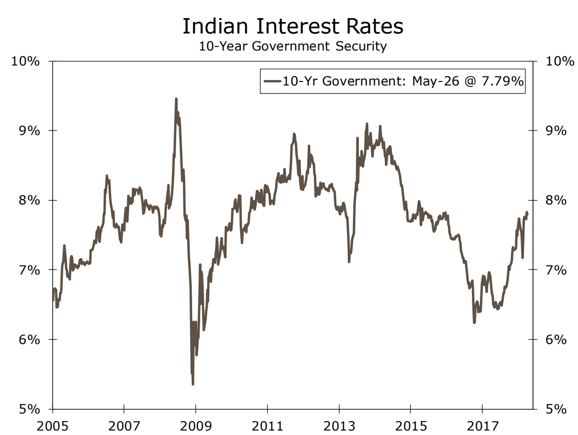
In a March report on India, we made the case that "India's economy should be a top performer over the next few years." Today's data are supportive of this notion that India's economy has turned the corner after an economic slowdown driven by structural reforms surrounding demonetization and the rollout of the goods and services tax.

The Reserve Bank of India (RBI), which had been cutting its main policy rate over the 2015-2017 period to combat a slowdown in economic growth and inflation, has been on hold since last summer. After peaking at 5.2 percent in December 2017, year-over-year consumer price inflation has eased a bit amid slower food price growth. The central bank targets headline inflation of 4 percent over the medium term, and the current level of inflation is not too far off this level (middle chart).



With inflation in check and economic growth gaining momentum, it seems fair to start asking whether the RBI has reached an inflection point in the current easing cycle. For now, the central bank seems content to stand pat. Concerns over rising global protectionism have been a staple in recent meeting minutes, as have trepidations regarding fiscal slippage. Nominal interest rates have easily been keeping pace with the pickup in inflation, de facto tightening financial conditions to an extent (bottom chart).

In addition, India is an energy importer, making the threat of rising oil prices a potential headwind. Food prices can be volatile generally and especially in India, and they account for nearly half of the country's CPI, adding additional uncertainty to the inflation outlook. Widespread emerging market financial contagion or an acceleration in prices could force the central bank's hand. Given current conditions, however, the RBI seems content to assess the incoming data and let the recovery continue unperturbed.



Source: Bloomberg LP, CEIC, IHS Markit and Wells Fargo Securities

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