



Economics Group

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Indian Economy Picks Up Further in Q4

Economic output in India surpassed expectations in Q4, growing 7.2 percent year over year. After several quarters of slower growth, broad-based strength was apparent across multiple sectors in the Q4 print.

Recent Growth Turnaround Continued Through End of 2017

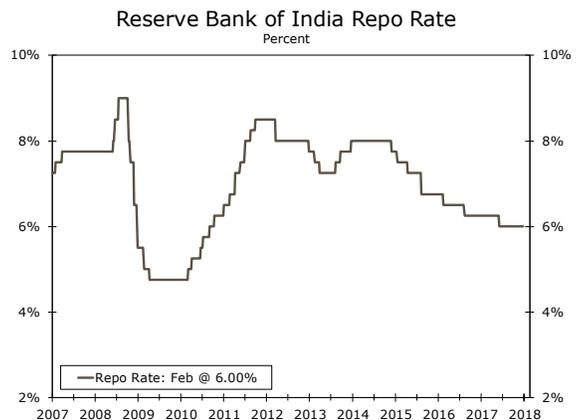
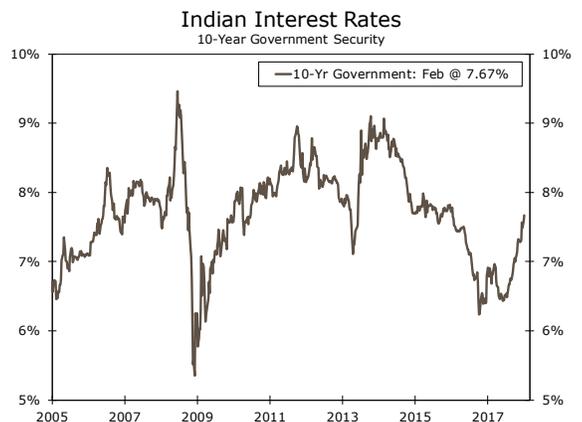
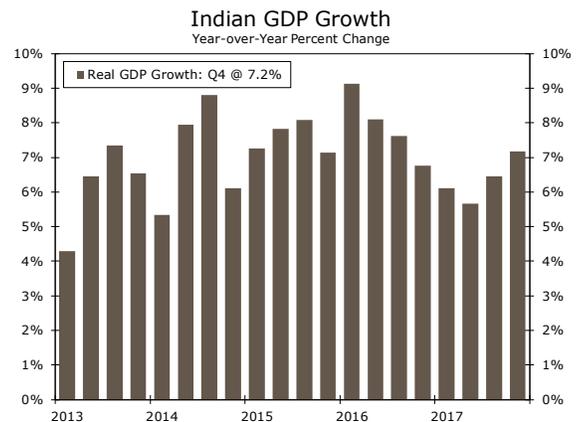
Real GDP growth in India jumped in Q4, increasing 7.2 percent year over year and coming in above the upwardly-revised 6.5 percent rate registered in Q3 (top chart). Fixed investment spending led the charge, up 12 percent from a year ago, more than reversing the 2.1 percent decline to start the year in Q1-2017. On the production side of the Indian economy, gross value added in the manufacturing sector rose roughly 8 percent year over year, matching the best pace seen in a year. Industrial production growth has clearly strengthened as a strong global backdrop helps offset some disruptions related to the rollout of the goods and services tax (GST) last year.

That said, export growth slowed sharply in Q4, suggesting the disruptions may have continued to weigh on growth. A recent report from economists at the Reserve Bank of India (RBI) found evidence that the GST rollout weighed on exports early in Q4, but the effect faded as the quarter progressed.* In addition, despite the topline beat, private consumption growth also slowed further in Q4, rising 5.6 percent year over year. This was the slowest pace of growth since Q2-2015. Inflation picked up in Q4, which may have taken a bite out of consumers' purchasing power.

An acceleration in government consumption also helped drive growth higher in Q4. Government expenditures increased 6.1 percent year over year after slowing significantly in Q3 to 2.9 percent as the base effects from an earlier surge in government spending began to fade. Longer-term bond yields in India have risen amid faster inflation, growth and concerns about the budget deficit (middle chart). The minutes from the last RBI meeting noted that "fiscal slippage as indicated in the Union Budget could impinge on the inflation outlook," while also citing concerns about the deterioration in public finances risking crowding out private financing and investment.

RBI Will Likely Remain on Hold, At Least for Now

A perfect storm of demonetization, rupee appreciation, falling food prices and slowing economic growth pushed inflation below 2 percent by mid-2017. Sluggish growth and inflation led the RBI to cut its repo rate 200 bps since 2015 (bottom chart). However, inflation has since moved closer to the RBI's 4 percent target (with a +/- target band of 2 percentage points) and the economic expansion has firmed. The RBI left rates unchanged at its most recent meeting on February 7, and as we noted in our last write-up back in December the RBI will likely need to see a sustained pickup in growth/inflation before beginning to tighten policy. Today's print is an encouraging step in this direction, but with slowing consumption growth, rising long-term interest rates and disruptions from structural economic reforms still echoing through the economy, the RBI is likely to proceed with caution in the near term.



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

*Tomar, S., Mathur, S. & Ghosh, S. (2018). [Working Capital Constraints and Exports: Evidence from the GST Rollout](#). Reserve Bank of India.

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