Q1 GDP signals weaker sequential growth momentum

Rupa Rege Nitsure | September 01, 2021

India's first quarter GDP (Q1, FY22) growth has been lauded by many as it came in at a healthy 20.1 percent (y-o-y) primarily aided by a very weak base of the last year, when the country was subjected to a strict nation-wide lockdown. However, the year-on-year comparison offered by a volatile time-series data is always illusory.

If one closely looks at the absolutes and the quarter-over-quarter variations in real terms (at constant prices), one sees a significant loss of growth momentum across almost all sectors of the economy. Except for agriculture and allied activities, a majority of the industrial sectors and services have fallen below their pre-COVID-19 production levels.

Even from the expenditure side, the levels of private final consumption expenditure and gross fixed capital formation (investment) are significantly lower in Q1, FY22 versus their pre-pandemic levels in Q1, FY20.

What is more worrisome is the reversal in trend that we have observed in the past three quarters. The economy's gross value added that had steadily improved in the previous three quarters witnessed a sharp dip in the first quarter of FY22, thanks to the localised lockdowns and targeted restrictions imposed by several states amid the deadlier second wave. Obviously, maximum sequential deterioration was seen in the contact-intensive sectors such as construction and 'trade, hotel, transport, communication & broadcasting' services. The only bright spot was 'exports' that reported a sequential expansion in Q1, FY22 thanks to a pick-up in the global trade activity.

It is also clearly seen that against the backdrop of elevated fiscal gap and high public debt, the central government is trying to control its revenue/consumption spending. In sequential terms (Q-o-Q), the 'value added' coming from the public administration, defence and other services, as well as the government's final consumption spending, has declined sizably between Q4, FY21 and Q1, FY22. The fact that the government is trying to control its revenue spending is also reflected in the sharp increase in the cash balances of the central government with the Reserve Bank of India (RBI).

The fact that the second wave had more adverse impact on 'demand' as compared to the first wave is clearly borne out by the national accounts statistics. The private final consumption expenditure that had steadily gone up sequentially in the preceding three quarters dipped by 17.4 percent (Q-o-Q) and the government consumption expenditure that had sequentially increased in the preceding two quarters declined by 7.6 percent (Q-o-Q) in Q1, FY22. Even investment demand (as measured by gross fixed capital formation) declined by 23.6 percent (Q-o-Q) in Q1, FY22 after showing a steady pick-up in the previous three quarters.

The latest quarterly GDP statistics vindicates the MPC's (Monetary Policy Committee) stance on August 6 to stay accommodative until growth impulses are nurtured to ensure a durable economic recovery. India's economic growth process is still quite uneven. Recent gains in economic activity have again taken a break in the latest week. Key high frequency indicators such as power generation and office visits have shown a dip again.

Recent surveys by the CMIE and the RBI reveal that consumer sentiments remain sticky at the low levels they fell to after the lockdown was imposed in March, 2020. Agriculture and rural belts are suffering from three major risks — massive disruption due to the COVID-19's second wave, uneven and patchy monsoon, and the slower pace of vaccination as compared to the urban areas.

There is also a risk of losing the export growth momentum due to the renewed surge in COVID-19 infections in several countries. While the improved pace of vaccination has rekindled hope, a spike in the Delta variant is likely to delay the timing of the recovery.

Against this backdrop, we don't expect policymakers to reduce policy stimulus or tighten the monetary policy in a hurry despite the build-up of cost push inflationary pressures. Unless accompanied by strong domestic demand, cost-push inflation alone will not generate a sustained increase in the overall price level.

We also need to learn relevant lessons from other countries that are learning to live with the virus. They have realised that rolling lockdowns and restrictions are a necessary part of economic recovery. They are encouraging people to change their pandemic mindset and focus on avoiding severe illness and death instead of infections, which are harder to avoid.

Under any circumstances we need to avoid the stringent lockdowns that will only postpone another surge unless the period is effectively used to vaccinate a large number of people.

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