ASIA TIMES Online
www.atimes.com

South Asia

Dec 18, 2010

India's growth not all shine

By Kunal Kumar Kundu

India's gross domestic product (GDP) figures for the second quarter of its fiscal year surprised on the upside as year-on-year growth was pegged at 8.9%. While the numbers are confidence boosting, it is important to realize that there is a statistical element to the latest number, while being very positive, rather than the data indicating a substantial improvement in actual performance.

Readers may recall that very recently India revised the way official inflation, as measured by the Wholesale Price Index (WPI), is calculated. Under the new methodology, inflation turns out to be lower than what it would have been under the old methodology. This adds a positive deflator effect to the final GDP numbers.

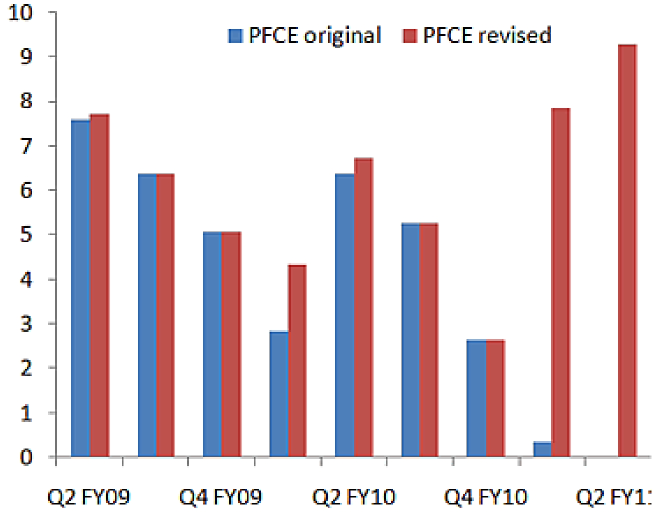
In fact, the press release of the Ministry of Statistics & Programme Implementation (MOSPI) shows that the year-on-year (YoY) GDP growth in the fiscal first quarter has also been revised upward (from 8.8% to 8.9%), and that is because of the deflator effect. Nevertheless, the deflator effect is not very high. The bigger reason is quality of data dished out by the government.

After the Q1 numbers were released on August 30, a hue and cry was raised by economists (yours truly included) on the quality of the number given by the government. While the GDP growth at factor cost (read production or income side) was up by 8.8%, GDP growth at market price (read expenditure or demand side) was up by a mere 3.7% - the second-lowest growth recorded under the new series. That raised questions about the authenticity of the data itself.

Not only was the divergence of GDP growth under the two methods of accounting more than 5% (an unprecedented event), it was clear that domestic demand was faltering since the demand-side GDP was hardly budging. In such a scenario, it was difficult to comprehend why production was cranking up in the absence of demand.

The next day, the government acknowledged that their number was incorrect and that they had used a wrong deflator. As a result, Q1 GDP by expenditure side was revised upward substantially to a YoY growth of 10.3%. Within that, growth in Private Final Consumption Expenditure (PFCE) or private expenditure (read consumer demand) was also revised upward - from the original growth rate of a mere 0.34% YoY to a revised rate of a very healthy 7.8% YoY.

It is important to note here that consumption expenditures account for more than 55% of India's GDP. Hence, a slowdown in consumer demand (as was reflected by the data) should have been a major concern. Which was why I was of the opinion that the annual GDP growth rate would struggle to touch 8%. Clearly, a wrong data set can lead to erroneous conclusions. In fact, the following chart makes for interesting reading.



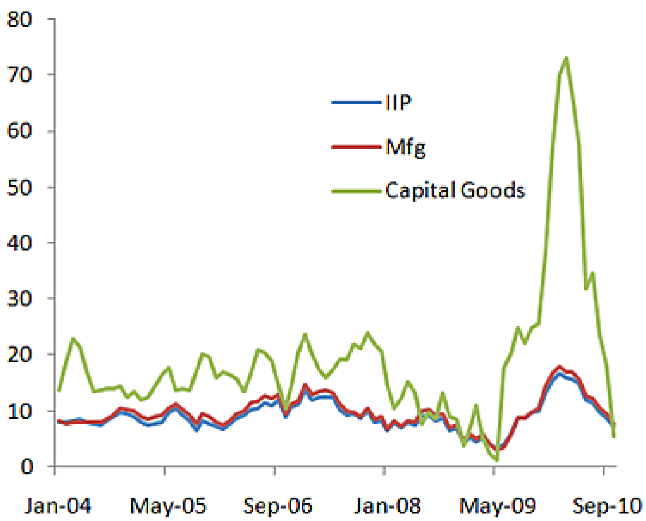
Source: MOSPI

As can be seen, the initial data released on August 30 was substantially understated as compared to the revised data released on September 1 and November 30.

Now, assuming that the latest set of data is correct, there is increased evidence that demand is better than what had been assumed earlier and is actually holding up nicely. Hence, the 8.9% growth is understandable.

Under this circumstance, I am revising my growth forecast for the full fiscal year upward to between 8.5% and 8.7%. While agriculture growth is expected to hold on given the low base effect, I am expecting the industry to slow down during the next two quarters.

Although the recently released Index of Industrial Production data for October (showing a YoY growth of 10.76%, after being in low single digits in the previous two months) buoyed the market, October is India's most important festival month, the cranking up of production is not surprising. However, the underlying weakness is quite evident. The three-month moving average (3MMA) data indicates a clear slowdown since February last.



Source: MOSPI

What is more worrying is the fall in capital goods production. Although it recorded double digit growth in October, it was the lowest double digit growth in more than a year.

In this regard, it is also important to note that inflation in India is likely to remain at elevated levels (given the historical under investment in the agriculture sector and high levels of commodity prices including that of oil) this year. With domestic demand showing strength (which is partly explained by preponement of demand given the expectation of interest rate hikes), the Reserve Bank of India (RBI) will have no other option but to raise interest rates to cool inflation. Elevated levels of inflation and high interest rates will act as a dampener for domestic demand going forward.

On a medium- to long-term basis, India's growth outlook remains strong and is likely to hover between 8 and 9%, mainly driven by relentless surge of urbanization, the demands of a young population and the increasing number of people (read consumers) moving to the medium and high income brackets.

Kunal Kumar Kundu *is Senior Practice Lead, Knowledge Services Division, Infosys Technologies Ltd. The views are those of the author, whose website is* http://kunalsthoughts.weebly.com.