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GDP data show India is in election mode

India's first quarter for FY14 surprised on the downside, as it recorded a growth of 4.35 per cent annualised rate (lowest since Q4 FY09), lower than Bloomberg consensus estimate of 4.7 per cent. While the GDP number got a boost from the expected uptick in theagriculture sector (a growth of 2.72 per cent), manufacturing contracted quite sharply by 1.19 per cent. As I had mentioned earlier, extensive demand destruction has resulted in substantial level of inventory accumulation.

In fact, although manufacturing showed some semblance of recovery during the last quarter of FY13, faltering domestic demand resulted in accumulation of inventory. When one looks at India's expenditure side GDP (GDP at market price) there is a component known as change in stocks/ inventory. To understand the effect of inventory on GDP growth, one needs to look at the change in the component change in inventory.

When there is inventory accumulation, this change is positive and has a positive impact on the GDP and when there is a drawdown, this change is negative and hence negatively impacts the GDP. As the chart shows, all the four quarters of FY13 saw substantial accumulation of inventory. Not surprisingly, the manufacturers responded by drawing down on inventory. In fact, domestic demand or Private Final Consumption Expenditure (PFCE) grew by a mere 1.62 per cent annualised rate during Q1 of FY14, the lowest in eleven years.

Fact is, given the extent of inventory that was accumulated during FY13, manufacturing will continue to be a drag in the current financial year unless there is a substantial uptick in domestic demand which would force the manufacturers to increase their capacity utilisation. This will probably only be possible if the investment cycle restarts. During Q1 of FY14, Gross Fixed Capital Formation (GFCF) contracted 1.12 per cent, clearly indicating weak sentiment.

While the Cabinet Committee on Investment (CCI) recently approved projects worth Rs 1.83 lakh crore, one can still expect substantial time lag before these fructify. Hence, major uptick is ruled out during the current year.

The data also reveal that India is indeed heading into election as is evidenced from increased social sector spending. In fact, the biggest boost to the economy was provided by community, social & personal services category which grew by as much as 9.4 per cent, the highest growth rate recorded by any segment. Even in the expenditure side GDP, Government Final Consumption Expenditure (GFCE) grew by a whopping 10.49 per cent.

The writer is a Delhi-based independent economist