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What India's GDP Figures Really Mean

By Kunal Kumar Kundu

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Despite signs that the economy is slowing, the Reserve Bank of India is unlikely to be tempted to cut the policy rate this calendar year, says Kunal Kumar Kundu.

India's gross domestic product growth eased to 5.3% in the second fiscal quarter, the slowest pace since January-March 2009. The economy is showing signs of bottoming out, but it is possible that the latest figure, released Friday, could be revised downward.

For starters, the farm sector growth rate of 1.2% might be overestimated given the drought-like conditions prevalent this year. The impact of the dry weather ought to have been felt in the July-September quarter.

The slower growth in the quarter was largely due to the service sector, which grew 7.1%, its slowest pace also since January-March 2009, when it grew 6.2%. It was the sixth-straight quarterly slowdown for the sector. Manufacturing grew just 0.8%, but industry overall expanded 1.2%, mainly on the back of greater mining activity. The mining sector grew 1.9% year-on-year in the second quarter.

Looking at the expenditure side data, the GDP growth rate was a mere 2.8%. While there tends to be some difference between GDP calculated by the income method (also known as GDP at factor cost) and GDP calculated by the expenditure method (also known as GDP at market price), the difference of growth rates calculated by these two methods was as high as 2.47 percentage points, which is way too wide for comfort. In fact, it was the third biggest difference in GDP data calculated under these two methods, and raises doubts about the quality of data collected and disseminated by the government.

Also, a closer look at the expenditure side data clearly indicates that consumer fatigue that has set in. Private domestic demand grew at an annual rate of 3.68%, the slowest since 2004, while government expenditure was robust at 8.67%. Clearly social sector spending by the government, with an eye on the 2014 general election, continues unabated. This pushes up the growth rate, at the cost of a higher fiscal deficit as revenue collection remains weak. Data released Friday by the Controller General of Accounts showed the cumulative fiscal deficit for the seven months of this fiscal year (April-October) was 71.6% of the budget. Even more worryingly, the revenue deficit for this period has already reached 81.4% of the budget.

In essence, the government is continuing to stimulate the economy by going beyond its means. Given the failure of the 2G spectrum auction and anaemic disinvestment revenue generation so far, India will likely pay a price of such profligacy through a high fiscal deficit, low capital formation and mounting inflationary pressure.

Despite signs that the economy is slowing, the Reserve Bank of India is unlikely to be tempted to cut the policy rate this calendar year. Rather it will continue to keep an eye on the liquidity situation and opt for a combination of open market operations — buying government securities and thereby releasing liquidity in the market — and further cuts to the cash reserve ratio if necessary.

The first rate cut move will only materialise during the first quarter of 2013. For the full year, I expect GDP growth to be in the region of 5.6%-5.8%.

Kunal Kumar Kundu is senior economist at RGE India, based in New Delhi. The views expressed are his own.