

Q2 GDP SHOWS SURPRISING RESILIENCE: IS IT GOOD ENOUGH TO LAST?

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India's Q2FY21 GDP growth showed surprising resilience with contraction of only -7.5% in real terms, while the market consensus was higher. With improvement in manufacturing, due to lifting of lockdown measures GDP contraction has slowed down significantly. Agriculture sector continued to perform well with growth at 3.4%. Services remained in the negative territory, although the decline was contained as Trade, Hotels, Transport, Communication & Services related to broadcasting showed recovery.

Though the whole press release is full of surprising numbers, the most astonishing number is the positive growth in Manufacturing Q2. Despite being the worst affected sector in Q1 (due to lockdown), it is quite puzzling that how manufacturing turned itself around. The IIP manufacturing and Manufacturing GVA growth are highly correlated (almost more than 0.90) and this correlation collapsed in Q2 when IIP manufacturing declined by 6.7% (average of Jul/Aug/Sep) while manufacturing GVA grew by 0.6%. We believe one possible reason for this could be stellar Corporate GVA numbers in Q2 on the back of massive purge in costs. Further, we observed small companies, with turnover of up to Rs. 500 crore, are more aggressive in cutting cost, displaying reduction in employee cost by 10-12%. This could turn a potential headwind in future in terms of a drag on consumption. Additionally, there is evidence of inventory build up that could act as a drag on future manufacturing growth. Interestingly, Government consumption expenditure has also nosedived in Q2, that is difficult to explain, as such expenditures are typically pro cyclical.

The absolute numbers of services sector in Q2FY21 is Rs 17.19 lakh crore, while in Q3FY20 it was Rs 17.35 lakh crore, only Rs 15K crore less. This indicates that the services sector has reached the pre-covid level. Is it because of behavioral changes during pandemic like massive transport of goods once the economy opened up and a massive boost to communication and broadcasting with people mostly working from home?

One good thing is that the investment demand has improved with resumption in COVID-induced stalled projects. However, the patchy growth across sector reflects in domestic demand figures, which are showing modest recovery sequentially. The falling imports and continued contraction in investment suggests a poor domestic absorption and intermediate demand. The reading of Q2 GDP suggests that output gap has not corrected to the point that it will be a concern for demand pull inflation. Further the inflationary pressure in agriculture goods despite and expanding output has further capped policy option. The policy option must move towards continued easing mobility of goods and give massive thrust to construction and infrastructure sector. More focus should be on increasing the ease of doing business and private sector participation.

On a positive note ASCBs incremental credit growth has turned positive in Nov'20 and grew by 0.3% (YTD) as on 06 Nov'20, compared to 0.8% growth during the corresponding period of last year. We believe, going forward Emergency Credit line guarantee Scheme (ECLGS) would play a major role in the sequential improvement in the bank credit. Banks have sanctioned Rs 2.03 lakh crore, out of which Rs 1.48 lakh crore has been disbursed till Oct'20 under the scheme.

The recent measures that the government has taken are in the right direction and should be pursued to further spur the economic momentum. Economic momentum as given by the business activity index shows steady improvement in the latest week after a temporary blip witnessed during the Diwali week owing to holidays. The SBI Business Activity index has jumped to the highest level since 9 March.

Now an interesting tidbit. Till now GDP growth data for Q3 2020 has been released (including India) for 49 countries. Most of the economies grew in the range of negative 0-10% in Q3 2020 (44 as compared to 20). The average decline of these 49 economies is 12.4% in Q3 2020 as compared to 5.6% decline in Q2. Clearly, the narrative has changed!

INDIA'S GDP GROWTH DECLINE ARRESTED

- ◆ India's GDP growth rebound stupendously from a decline of 23.9% in Q1 FY21 to a decline of 7.5% in Q2 FY21. The better than expected growth was primarily due to significant rebound in the sectors like manufacturing, construction and 'Trade, hotels, transport, communication & services related to broadcasting'. Real GVA declined by 7.0% in Q2 as compared to -22.8% in Q1. This indicates that the impact of lockdown imposed due to Covid-19 is withering out expediently.
- ◆ **Agriculture:** The agriculture & allied activities increased by 3.4% in Q2 (same as in Q1) as this was the least affected sector during the pandemic.

Sectors	GVA at Basic Price by Economic Activity (YoY%)						
	FY20					FY21	
	Q1	Q2	Q3	Q4	Annual	Q1	Q2
Agriculture	3.0	3.5	3.6	5.9	4.0	3.4	3.4
Industry	4.2	0.5	-0.3	-0.6	0.9	-38.1	-2.1
Mining & quarrying	4.7	-1.1	2.2	5.2	3.1	-23.3	-9.1
Manufacturing	3.0	-0.6	-0.8	-1.4	0.0	-39.3	0.6
Electricity, gas, water supply & other utility services	8.8	3.9	-0.7	4.5	4.1	-7.0	4.4
Construction	5.2	2.6	0.0	-2.2	1.3	-50.3	-8.6
Services	5.5	6.5	5.7	4.4	5.5	-20.6	-11.4
Trade, hotels, transport, communication & services related to broadcasting	3.5	4.1	4.3	2.6	3.6	-47.0	-15.6
Financial, real estate & professional service	6.0	6.0	3.3	2.4	4.6	-5.3	-8.1
Public administration, defence and Other Services	7.7	10.9	10.9	10.1	10.0	-10.3	-12.2
Total GVA at Basic Price	4.8	4.3	3.5	3.0	3.9	-22.8	-7.0
GDP	5.2	4.4	4.1	3.1	4.2	-23.9	-7.5

Source: CSO & SBI Research

- ◆ **Industry:** The most noticeable improvement was recorded in industry segment which declined by merely 2.1% in Q2 as compared to whopping decline of 38.1% in Q1. The most interesting phenomenon is the positive growth in manufacturing sector. Even the Q2 manufacturing GVA of Rs 5,79,683 is greater than the Q2 of FY19 and FY18. The positive growth in ‘Electricity, gas, water supply & other utility services’ is quite expected. The rebound in construction sector is also surprising given the fact that Q2 months are monsoon months and construction activities remain muted in these months. Also past data always shows that growth in construction Q2 is less than the Q1 or does it indicate continued traction in road sector construction activities?
- ◆ **Services:** Services sector exhibited a decline of 11.4% in Q2 FY21 in comparison to -20.6% in Q1 FY20. There has been a recovery in ‘Trade, Hotels, Transport, Communication’ sector but in other sectors like ‘finance, insurance, real estates etc’ & ‘public admin, defence and other services’ growth contracted further to -8.1% & -12.2% in Q2, compared to -5.3% and -10.1% in Q1 respectively. Interestingly, the absolute numbers of services sector in Q2FY21 is Rs 17.19 lakh crore, while in Q3FY20 it was Rs 17.35 lakh crore, only Rs 15K crore less. This indicates that the services sectors has reached the pre-COVID level.

DEFLATOR INCREASED IN Q2

- ◆ Overall the GDP deflator has shown an increase of 3.8% yoy growth in Q2 FY21, with positive increase in agriculture and services. Within services, deflator has increased significantly in case of trade, hotels, transport, communication and broadcasting. At current prices, the gross value added of this service is Rs 7.02 lakh crore (-10.3% yoy) while at constant price it is Rs 5.16 lakh crore (-15.6% yoy). In Q1, this service contracted around 47% in both real and nominal terms leading to a small deflator change.
- ◆ For industry, the deflator has shown an overall negative yoy change but YoY change in deflator in manufacturing and construction have increased. Deflator for Mining and Quarrying continues to decline in Q2 FY21.

IIP MANUFACTURING & MANUFACTURING GVA

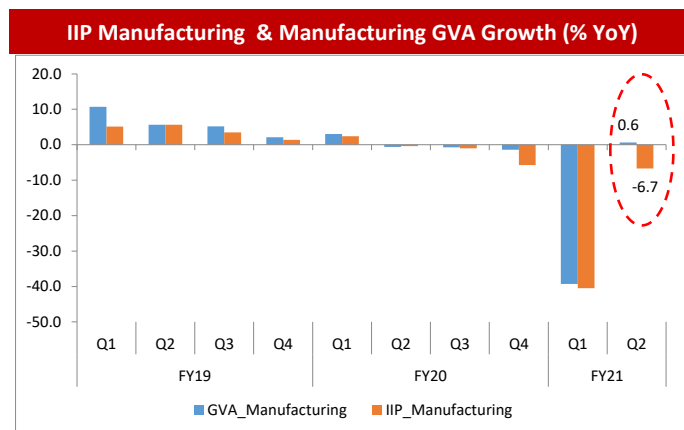
- ◆ Though the whole press release is full of surprising numbers, the most surprising number is the positive growth in Q2. Despite being the worst affected sector in Q1 (due to lockdown), it is quite puzzling that how manufacturing turned itself around. The IIP manufacturing and Manufacturing GVA growth is highly correlated (almost more than 0.90) and this correlation collapsed in Q2 when IIP manufacturing declined by 6.7% (average of Jul/Aug/Sep) while manufacturing GVA grew by 0.6%. This data require proper explanation.

EXPENDITURE STORY

- ◆ On the demand side, the most important concern has improved. The private consumption has improved in the Q2. However, the y-o-y growth remains in the negative territory at -11.3%. The government fixed capital expenditure growth has plummeted to -22.2%. The share of private consumption to GDP has nonetheless remained 200 bps less than Q2FY20. The imports have been mostly in contraction mode, as oil prices continue to be subdued. Although exports have improved, they are still growing negatively. Change in stocks has turned positive in Q2 on account of higher inventory, as was widely expected.

Sectors	FY20					FY21	
	Q1	Q2	Q3	Q4	Annual	Q1	Q2
Agriculture	5.5	4.8	10.0	6.7	7.1	2.2	4.2
Industry	1.9	0.0	-0.4	1.6	0.8	-2.2	-0.6
Mining & quarrying	2.1	-4.8	-6.7	0.3	-2.0	-23.5	-9.7
Manufacturing	1.5	-0.1	-0.7	0.4	0.3	0.0	1.1
Electricity, gas, water supply & other utility services	0.7	-0.4	1.9	7.6	2.4	1.9	-7.2
Construction	2.7	0.9	1.1	2.2	1.7	-2.3	0.2
Services	3.1	1.9	2.6	3.5	2.8	2.8	4.4
Trade, hotels, transport, communication & services related to broadcasting	2.7	1.0	1.2	2.5	1.9	-0.7	6.2
Financial, real estate & professional service	2.3	0.6	0.8	2.0	1.4	1.0	2.5
Public administration, defence and Other Services	4.6	4.6	5.6	5.8	5.2	5.8	5.5
Total GVA at Basic Price	3.1	1.8	3.4	3.7	3.0	2.9	3.1
GDP	2.7	1.4	3.2	4.3	2.9	1.8	3.8

Source: CSO & SBI Research



Source: SBI Research

	FY20					FY21	
	Q1	Q2	Q3	Q4	Annual	Q1	Q2
Total final consumption expenditure	8.6	10.4	11.9	9.4	10.1	-16.7	-9.6
Private final consumption expenditure	8.5	8.9	10.8	7.7	9.0	-24.5	-7.7
Government final consumption expenditure	9.5	17.5	18.8	20.1	16.3	20.2	-18.0
Gross fixed capital formation	7.9	-1.6	-3.3	-4.1	-0.4	-47.9	-7.0
Change in Stocks	10.2	4.7	3.9	4.4	5.7	-17.6	9.4
Valuables	17.0	16.9	8.5	5.0	11.9	-89.7	-51.1
Exports	6.4	-0.4	-2.4	-5.0	-0.6	-17.1	0.8
Less Imports	5.4	-7.7	-8.7	-3.3	-3.8	-38.5	-15.6
Discrepancies	-30.1	-137.8	-240.4	195.6	-50.1	-79.2	-231.7
GDP At Market Price	8.1	5.9	7.4	7.5	7.2	-22.6	-4.0

Source: CSO & SBI Research

- ◆ The investment demand has improved with resumption in COVID-induced stalled projects. However, the patchy growth across sector reflects in domestic demand figures which are mostly showing modest recovery sequentially. The falling imports and continued contraction in investment suggests a poor domestic absorption and intermediate demand.

ASCBs Sector-Wise Credit Flow (Rs bn): Oct 2020

Sectors	YTD (Apr-Oct, FY20)		Monthly Growth (Rs bn)							YTD % (Apr-Oct, FY21)		% YoY	
	Rs bn	%	Apr'20	May'20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Rs bn	%	Oct'19	Oct'20
Agri. & Allied	234	2.1	-65	-51	67	163	-12	264	242	609	5.3	7.1	7.4
Industry	-990	-3.4	-208	-228	136	-539	-426	-38	-350	-1653	-5.7	3.4	-1.7
MSE (Priority)	-138	-1.3	-486	-231	546	-318	39	226	-18	-241	-2.1	5.8	6.8
Infrastructure	-361	-3.4	13	0	139	-146	-314	-79	-161	-548	-5.2	6.8	-2.0
Services	-632	-2.6	-208	-311	-146	187	42	248	3	-184	-0.7	6.5	9.5
NBFCs	721	11.3	50	-81	-58	-51	33	58	-238	-286	-3.5	26.8	9.2
Personal Loans	1690	7.6	-629	-119	115	409	169	236	398	578	2.3	17.2	9.3
Housing (Including Priority)	1086	9.4	-83	-16	68	117	19	103	135	343	2.6	19.4	8.2
Other Personal Loans	617	10.2	-269	10	9	205	96	124	204	378	5.2	22.0	14.3
Gross Bank Credit	582	0.7	-1100	-442	271	121	-360	715	295	-501	-0.5	8.4	5.5

Source: SBI Research

CREDIT GROWTH IMPROVED

- RBI has released the sector-wise credit-data for Oct'20, which indicates that except Industry, credit has increased in all other major sectors, though lesser than Sep'20. There has been a significant increase in credit to Personal Loans, which is higher than the Pre-Covid growth of Rs 348 billion in Feb'20. Credit demand is coming back to traction in all sub-segments like housing, vehicle loans & other personal loans.
- Our estimates of the short-term consumer leverage (presented as sum of credit card, personal loans, advances against FD, shares, bonds outstanding, etc.) which had reached a peak in FY18 at Rs 1.56 lakh crore, declined significantly to Rs 1.29 lakh crore in FY19. However during FY20, it has increased marginally to Rs 1.35 lakh crore, reflecting possibly consumer stress. The consumer deleveraging, which had declined till now in FY21 has turned positive in Oct'20 (Rs 22844 crore) due increase in other personal loan segments.
- ASCBs incremental credit growth has turned positive in Nov'20 and grew by 0.3% (YTD) as on 06 Nov'20, compared to 0.8% growth during the corresponding period of last year. We believe, going forward Emergency Credit Line Guarantee Scheme (ECLGS) would play a major role in the sequential improvement in the bank credit. Banks have sanctioned Rs 2.03 lakh crore, out of which Rs 1.48 lakh crore has been disbursed till Oct'20 under the scheme.

IMPROVED CORPORATE EARNINGS – FOCUS ON COST CUTTING

- Corporate, in the listed space, reported improved earnings in Q2FY21, as compared to Q2FY20, post a drag in Q1FY21 courtesy Covid-19 and its aftermath.
- While analyzing more than 3000 listed entities, excluding BFSI and telecom, we observed around 11% de-growth in top line and around 7% growth in EBIDTA. PAT too grew by around 6% in Q2FY21 as compared to Q2FY20. Sectors such as Edible Oil, Packaging, FMCG, Pharma, Cement, Steel, Consumer Durable etc. reported better number in key parameters. It is pertinent to mention that corporates are now focusing on all means of cost cutting including on wage bill. We can see sectors such as Cement, Consumer durable reduced their employee expenses by 6% and 5% respectively in Q2FY21 as compared to Q2FY20.

Short-term Consumer Leverage

Item	Incremental Credit (Rs Crore)					
	FY20	Jun'20 over Mar'20	Jul'20 over Mar'20	Aug'20 over Mar'20	Sep'20 over Mar'20	Oct'20 over Mar'20
Credit Card Outstanding	19832	-10508	-6703	-3261	-2454	2113
Other Personal Loans	119332	-24945	-4467	5099	17449	37805
Advances against Fixed Deposits (Including FCNR (B), NRRR Deposits etc.)	-3377	-18039	-17179	-16928	-16329	-18036
Advances to individuals against share, bonds, etc.	-931	469	1058	979	991	962
Consumer Leverage	134856	-53023	-27291	-14111	-343	22844

Source: RBI; SBI Research

Growth (%) in key parameters Q2FY21 vis-à-vis Q2FY20

Sector	No of cos.	Net Sales	Employee expenses	EBIDTA	PAT
Edible Oil	36	29	3	89	102
Packaging	53	11	8	90	179
Steel	120	11	-0.03	55	3
Tyres	10	10	5	65	45
Pharmaceuticals	150	10	7	20	-8
Agro Chemicals	20	9	6	33	-10
FMCG	82	7	13	34	25
Healthcare	34	5	-1	14	21
Cement	33	5	-6	38	73
Consumer Durables	46	4	-5	18	12
Non Ferrous Metals	31	2	-5	41	9

Source: Cline; SBI Research

Growth in revenue and employee expenses of listed entities Q2FY21 vis-à-vis Q2FY20 (sizewise)

Turnover	No of Companies	Revenue	Employee expenses
up to Rs 50 crore	1803	-4.3%	-11.5%
above Rs 50 crore to Rs 100 crore	320	-9%	-12%
above Rs 100 crore to Rs 250 crore	349	-7%	-8%
above Rs 250 crore to Rs 500 crore	213	-6%	-11%
above Rs 500 crore to Rs 1000 crore	172	-10%	-5%
above Rs 1000 crore	182	-11%	1%

Source: Cline; SBI Research

- ◆ Further, we observed small companies, turnover of up to Rs 500 crore, are more aggressive in cutting cost, where we saw reduction in employee cost by 10-12%. For example, a set of around 1800 small companies with turnover of up to Rs.50 crore, reported a 4.3% dip in revenue but reduced their employee expenses by 11.5%.

GOVERNMENT FINANCES IN OCT'20

- ◆ Government finances data released today show that fiscal deficit is 119.7% of the BE in Oct'20. Total receipts are around 31% of the total BE. Within revenue receipts which amounted to Rs 6.91 lakh crore (Rs 2.20 lakh crore BE), Government collected net tax revenue of Rs 5.75 lakh crore (35.2% of BE) and non-tax revenue of Rs 1.16 lakh crore (30.2% of BE) with tax revenue (particularly excise duty, customs, CGST) gaining traction in Oct'20. Disinvestment receipts are only Rs 6178 crore so far, way below the BE of Rs 1.20 lakh crore.
- ◆ Coming to expenditure side, total expenditure till Oct'20 is Rs 1.61 lakh crore (54.6% of BE). Though in Oct'20 the Government has maintained capital expenditure at the same level as in Sep'20, but it has reduced its revenue expenditure (particularly due to lower interest payments) to Rs 1.5 lakh crore in Oct'20 from Rs 2.0 lakh crore in Sep'20.

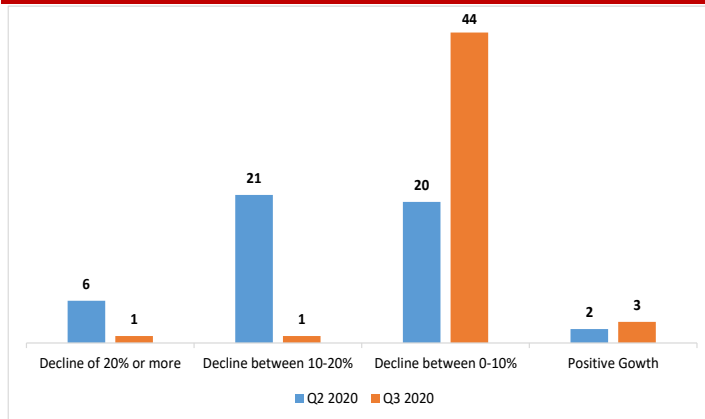
GDP GROWTH IMPROVED SIGNIFICANTLY IN ALMOST ALL COUNTRIES

- ◆ Till now GDP growth data for Q3 2020 has been released (including India) for 49 countries. Compared to Q2 2020, the GDP growth has improved significantly in Q3 2020. In Q2, 27 economies exhibited decline of more than 20% but in Q3 only 3 economies fell into this range. Most of the economies grew in the range of negative 0-10% in Q3 2020 (44 as compared to 20). The average decline of these 49 economies is 12.4% in Q3 2020 as compared to 5.6% decline in Q2.

GOING FORWARD

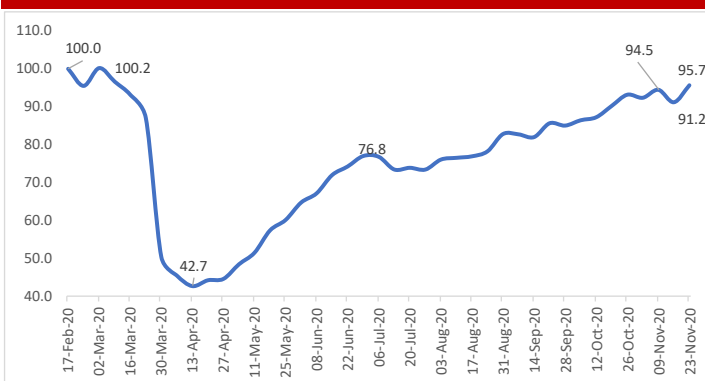
- ◆ Based on the current trends we believe that Q3 FY21 real GDP growth would be tad positive. The Q4 GDP growth would definitely be in positive territory. However, about the whole year growth one fact is certain that it will be in negative zone.

Number of Economies according to GDP Growth/Decline



Source: SBI Research

Business Activity Index



Source: SBI Research

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