GDP

Edelweiss
Ideas create, values protect

Slowdown realities

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Siddhartha Sanyal
+91-22-4040 7505
siddhartha.sanyal@edelcap.com

Growth set to slow down; FY10 GDP growth forecast at 6.0%

- We expect a GDP growth rate of 6.0% during FY10E. Our FY09 growth forecast has also been revised down to 7.4% from 7.8% earlier. At 6%, the FY10 GDP growth will be the lowest since FY03.

	FY09E	FY10E
Real GDP	7.4	6.0
Agriculture+	3.5	3.0
Industry*	6.0	3.8
Services	9.2	7.9

Source: Edelweiss research

'+: including allied activities like forestry and fishing.

': including construction.*

- Our projection of growth slowdown is against the backdrop of a rapid deterioration of the global economic scenario. Several advanced economies are almost certain to face recession in CY09. Business and consumer confidence indices are at multi-year lows, indicating no possibility of a quick turnaround in either consumer spending or industrial activity. Weakening demand is also depressing prices of several commodities.

- In India, investment activities, particularly corporate capex, have taken a backseat in recent quarters and are unlikely to improve, at least for the bulk of FY10. Discretionary consumption demand is likely to stay muted as well. Non-discretionary consumer demand, however, is likely to be largely unaffected and will provide GDP some resilience.

Slowdown across sectors

- We expect a modest 5.4% growth in manufacturing in FY09E and a further fall to ~3% in FY10E. Overall index of industrial production (IIP) is estimated to grow at ~5.1% and ~3.3% during FY09 and FY10, respectively.

- Our projection is factoring in further intensification of slowdown in construction activities with base case expectations of 8.5% and 5.0% for FY09E and FY10E, respectively. This is a sharp slowdown for the construction sector from the average rate of ~10% over the past 10 years. Despite fears of a sharp drop in corporate capex and weak demand for housing, we believe risks of further downside to these projections are limited as a sizeable part of construction activities are driven by the government (e.g., roads, rail roads, bridges, tunnels, pipelines, ports, runways, hydro-electric and power projects, etc).

- As regards the services sector, we believe the growth rate will dip from the current double-digits to ~9.2% in FY09E and further to ~7.9% in FY10E. Amongst larger components of services, 'banking, real estate, and business services' is likely to slowdown markedly from the current 12% plus level to ~9% in FY09E and further to ~6.5% in FY10E. Our estimates implicitly assume slowdown in trade, transportation, hotels and restaurants, among others, to the levels of the most recent low growth phase of FY1999-03. Communication (weight ~5% in overall GDP), however, is likely to stay strong. The social and community services segment (~14% of GDP) is likely to hold steady as well, as it is driven largely by government activities.

- Agriculture remains a potential source of uncertainty. In FY03, the year with the worst economic activities in the recent past, overall GDP growth dipped to 3.8%. During that year, growth in services and industry was relatively resilient at 7.5% and 7.1%, respectively. However, the big shock came in the form of a sharp decline in agriculture (-7.2%). We have implicitly assumed trend growth rate of ~3% for agriculture in FY10. However, an assumption of zero growth in GDP instead of ~3% can bring down the overall GDP growth to ~5.5%.

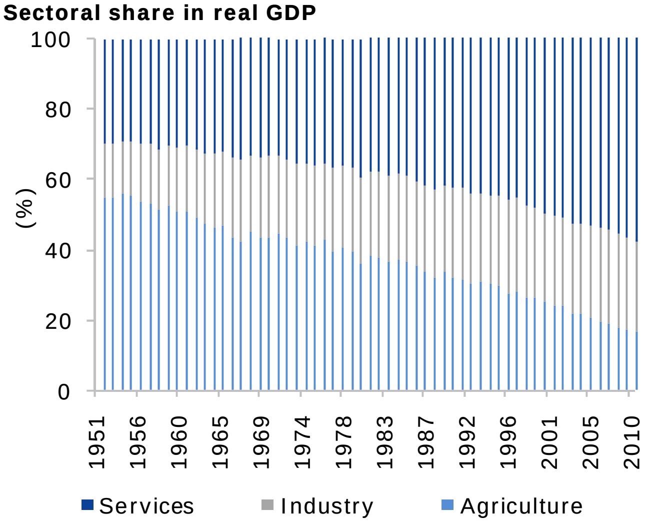
Policy response to focus on supporting growth

- Amidst slowing growth, softening inflation, and scarcity of lendable resources, we expect continued monetary accommodation by the Reserve Bank of India (RBI). We expect:

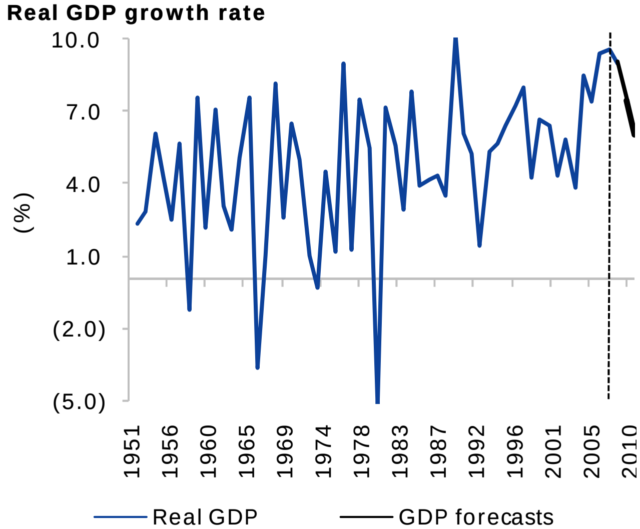
  1. The cash reserve ratio (CRR) to be reduced to ~3% by H1FY10E from the current 5.5%.
  2. The repo and reverse repo rates will be brought down to 6% and 5%, respectively.
  3. The scarcity of capital for commercial credit is likely to induce reduction of the statutory liquidity ratio (SLR) by 2-3 percentage points.

- We believe the government is set to overshoot its market borrowing target by at least INR 400bn in the current fiscal. During FY10, the government is likely to step up expenditure further to combat growth slowdown. Market borrowing requirements are likely to stay high.
- RBI will accommodate the government's market borrowing by way of unwinding of bonds under the Market Stabilisation Scheme (MSS). Total outstanding bonds under MSS are ~INR 1,650 bn as at October 2008 end. Nevertheless, the reduced SLR norm will be an additional impediment for the government's borrowing programme.
- The large government borrowing will require additional subscription from the banking system. The enhanced liquidity requirement will largely be provided by the RBI through open market operations (OMO).
- In the extreme situation, RBI may start financing deficits of the government, temporarily violating the Fiscal Deficit and Budgetary Management (FRBM) Act.
- At this moment, amidst heightened economic uncertainty across the globe, outlook for GDP growth in FY11 is relatively less clear. However, with the likelihood of resumption of stability in financial markets and continued monetary and fiscal stimulus across the globe including India, FY11 holds promise of a turnaround in overall economic performance.

Sectoral share in real GDP



Real GDP growth rate



Source: CSO, Edelweiss research

Naresh Kothari	Co-Head Institutional Equities	naresh.kothari@edelcap.com	+91 22 2286 4246
Vikas Khemani	Co-Head Institutional Equities	vikas.khemani@edelcap.com	+91 22 2286 4206
Shriram Iyer	Head Research	shriram.iyer@edelcap.com	+91 22 2286 4256

Recent Research

Date	Company	Title
06-Nov-08	**Inflation**	Stays flat
04-Nov-08	**Economy Release Calendar**	November
04-Nov-08	**Indicator Release**	Trade deficit softens on lower imports
04-Nov-08	**Vistas**	Inflation: From dizzying heights to ground zero

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	94	59	14	8	187

* 10 stocks under review / 1 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	75	65	47

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period