

6.8% FY13 growth: Cutting again... and again

6.9% September 2011 quarter real GDP growth

Actual:	6.9%
Previous:	7.7%
Consensus:	6.9%
BofA ML:	7.1%

Bottom line: 6.8% FY13 growth, 7% FY12 growth

- We continue to expect growth to slow on high rates and rising global uncertainties. It came off to 6.9% - broadly in line with our 7.1% forecast - in the September quarter from June's 7.7%. On our part, we cut growth further by 40bp to 7% in FY12 and 6.8% in FY13 pruning our construction and financials growth forecasts. It is not until mid-2012 that we expect growth to bottom out on rate cuts and base effects. If the US double dips, it will likely fall to 6% levels. (As of now, our US economist, Ethan Harris, sees a 40% chance of an US recession.) Given this backdrop of growth slowing and inflation peaking off, we are relieved that the RBI has finally begun to OMO (Rs1000bn by January BofAMLe) to cut the money market liquidity deficit and reduce undue pressure on interest rates. With inflation likely to come off to 7.2% by March, we expect Gov Subbarao to cut rates by 100bp from April onwards. Do read our latest growth downgrade report [here](#).

Why it matters? Inflation top off = 100bp rate peak off

- We continue to expect the RBI to cut rates to protect growth as inflation comes off. With inflation likely to slow to 7.2% by March, the RBI will likely cut policy rates by 100bp from April onwards. Can't it get more aggressive, clients ask, like 2008? Not unless a global recession pulls down oil prices. After all, mid-2012 will likely see a resurgence of inflation, in our opinion, with Delhi likely to hike administered fuel prices after the summer UP polls (Chart 1). This will likely push back further monetary easing to early 2013. With loan demand likely to slow to 17% levels by March, we expect lending rates to come off by 100-150bp in the April-September slack season. The 10y should settle at 8-8.5% levels by March with RBI OMO of Rs1000bn covering for our expected fiscal deficit overshoot to 6.1% of GDP (earlier 5.8%) from the 4.6% target.

Key Points: Watch real cash demand for bottoming out

- 6.8% FY13 growth:** Growth expectedly slowed to 6.9% - broadly in line with our 7.1% forecast - in the September quarter from 7.7% in June (Table 1). We have further cut growth by 40bp to 7% in FY12 and 6.8% in FY13. In particular, we have pruned our growth forecasts for construction and financials to account for rising domino effects of a slowing global economy on domestic sentiment. If the US double dips or the European crisis sets off a global recession, FY13 growth will likely fall to 6%, below FY09's 6.7%.
- Rural demand only bright spot:** Agriculture grew 3.6% (3% FY13 BofAMLe) in the September quarter on the back of a good autumn *khari* harvest. Early



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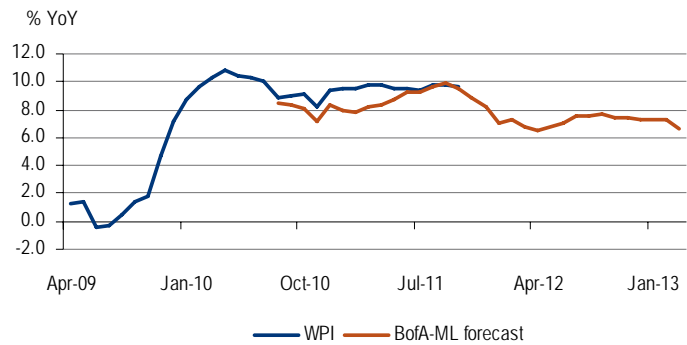
sowing leads also point to a good winter crop with the Indus, which waters the wheat fields in northern India, filled to the brim. Industrial growth expectedly weakened to 2.8% from 6.7% in June on higher rates. Services also decelerated to 8.7% from 8.9% in June. Do read our latest *rabi* report [here](#).

- **Mid-2012 bottom out:** We expect growth to slow to languish to 6.5-7% levels till mid-2012 (Chart 2). It will then likely bottom out to 7.5% levels in 2HFY13 on rate cuts and base effects.
- **Consumption-led, slowing capex:** We continue to expect domestic demand to be essentially sustained by consumer demand. We remain skeptical of any revival of capex till the G-3 stabilizes. On our part, we have built in a 1% of GDP drop in the investment rate in FY12-13, comparable to the 150-200bp cut seen during the Asian credit crisis, the dotcom bust or the Lehman collapse (Table 2). Given an incremental capital output ratio of about 4.5, a reduction in investment by 100bp of GDP impacts overall growth by 20bp. In 1HFY12, investment has grown 3.5% broadly in line with our expectations.
- **Real cash demand still falling:** Last, but not the least, how would we know if the economy has bottomed out? We track real cash demand - money in the pocket less inflation - as a key lead indicator. Since plastic money is essentially restricted to cities, cash demand serves as an excellent proxy for economic activity. Chart 3 shows that real cash demand has been slipping with rising interest rates hurting growth. We expect it to bottom out by the June quarter as lending rates come off.

Next up in India: Food inflation peaking off

India: Food inflation (November 19), Thursday, 1 December 2011

Chart 1: Inflation peaking off for now, but will rise again in 2H12



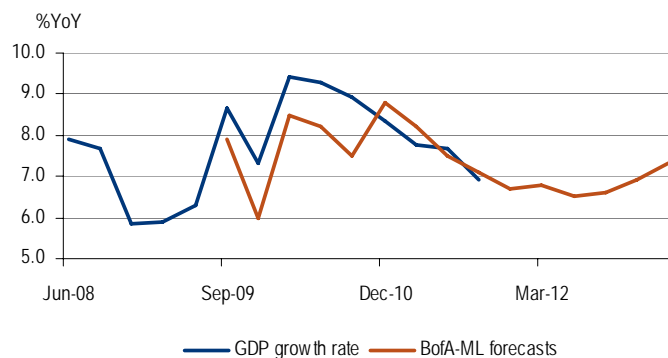
Source: Ministry of industry, BofA Merrill Lynch Global Research estimates.

Table 1: Slower 6.8% FY13 growth...

Item (%)	Weight	FY09	FY10	FY11	Q2FY11	Q2FY12	FY12	FY13
Agriculture and allied activities	16.8	-0.1	0.4	6.6	5.4	3.2	3.0	3.0
Industry	20.3	4.0	8.3	7.8	7.3	2.8	4.6	5.7
Mining and quarrying		1.3	6.9	5.8	8.0	-2.9	0.5	3.0
Manufacturing		4.2	8.7	8.3	7.8	2.7	4.0	6.0
Electricity, gas and water supply		4.9	6.4	5.7	2.8	9.8	8.0	6.0
Services	62.8	9.5	9.7	9.2	9.2	8.7	8.7	8.0
Construction		5.4	7.0	8.1	6.7	4.3	4.0	4.0
Trade, hotels, transport, storage and communication		7.5	9.5	10.3	10.2	9.9	10.0	8.0
Financing, insurance, real estate and business services		12.5	9.3	9.9	10.0	10.5	10.0	9.5
Community, social and personal services		12.7	12.1	7.0	7.9	6.6	7.0	8.0
Real GDP at Factor Cost	100	6.8	8.0	8.5	8.4	6.9	7.0	6.8

Source: CSO, BofA Merrill Lynch Global Research estimates

Chart 2: ... with a bottom out only in mid-2012



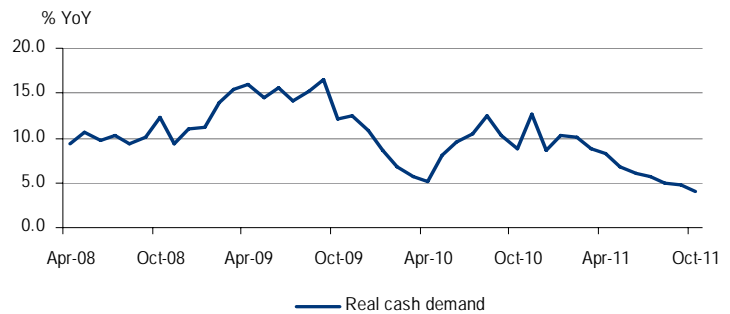
Source: CSO, BofA Merrill Lynch Global Research estimates

Table 2: 2% of GDP drop in the investment rate like past slowdowns

% of GDP	Asian crisis			Dotcom bust			2008 financial crisis		
	FY98	FY99	FY00	FY00	FY01	FY02	FY08	FY09	FY10
GCF	24.5	23.5	26.2	26.2	23.5	25.1	37.0	34.1	34.1
Agriculture	1.9	2.0	2.8	2.8	2.4	3.1	2.5	2.9	2.8
Mining	0.5	0.5	0.5	0.5	0.3	0.4	1.6	1.3	1.9
Manufacturing	10.3	9.3	9.1	9.1	6.5	5.4	13.8	8.8	10.5
Electricity, gas and water	2.0	2.0	1.7	1.7	1.7	1.7	1.9	2.0	1.9
Construction	0.6	0.6	0.5	0.5	0.7	1.3	2.6	1.9	2.0
Trade, Hotels and Restaurant	1.5	0.8	1.7	1.7	1.8	1.2	2.5	3.2	2.0
Transport, Storage and Communication	1.6	1.6	2.0	2.0	2.5	2.1	2.1	2.8	2.5
Financing, Insurance, Real Estate & Business (FI)	3.2	3.3	4.7	4.7	4.4	5.9	4.4	6.1	5.2
Community, Social and Personal Services	2.9	3.4	3.2	3.2	3.2	3.9	5.5	5.2	5.3

Source: CSO, BofA Merrill Lynch Global Research estimates

Chart 3: Falling real cash demand = slower growth



Source: RBI, BofA Merrill Lynch Global Research estimates

30 November 2011

Table 3: India story in numbers

	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Summary Data										
Nominal GDP (US\$ bn)	599.5	721.6	834.0	948.1	1,239.1	1,215.8	1,381.4	1,727.6	1,947.1	2,177.3
GDP per capita (US\$)	568	663	759	846	1,084	1,052	1,124	1,458	1,622	1,790
Population (millions)	1,072	1,089	1,106	1,122	1,138	1,154	1,170	1,185	1,201	1,216
Economic Activity										
Real GDP growth (% yoy)	8.5	7.5	9.5	9.6	9.3	6.8	8.0	8.5	7.0	6.8
Agriculture (% YoY)	10.0	0.1	5.1	4.2	5.8	-0.1	0.4	6.6	3.0	3.0
Industry (% YoY)	6.0	8.4	8.5	12.9	9.2	4.0	8.3	7.8	4.6	5.7
Services (% YoY)	8.8	10.2	11.2	10.1	10.4	9.5	9.7	9.2	8.7	8.0
Domestic demand growth (% yoy)	7.4	8.5	10.5	9.7	11.1	6.2	8.3	8.2	5.1	5.7
Real investment growth (% yoy)	13.6	18.9	15.3	14.3	15.2	2.7	7.3	8.6	3.9	3.6
Real consumption growth (% yoy)	5.4	4.9	8.5	7.7	9.2	7.9	8.7	8.0	5.7	6.7
Real private consumption growth (% yoy)	5.9	5.2	8.4	8.5	9.1	7.4	7.3	8.6	6.4	6.0
Real government consumption growth (% yoy)	2.6	3.6	8.9	3.7	9.5	10.7	16.4	4.8	2.3	10.5
Real export growth (% yoy)	9.6	27.2	25.9	21.8	5.2	13.4	-5.5	17.9	4.9	6.8
Real import growth (% yoy)	13.8	22.2	32.5	22.0	10.0	22.2	-1.8	9.2	7.4	6.8
Prices										
WPI inflation (% yoy, eop)	4.8	5.3	3.9	6.8	7.7	1.5	10.2	9.8	7.2	6.7
WPI inflation (% yoy, avg)	5.5	6.5	4.4	6.5	4.8	8.1	3.6	9.6	8.8	7.2
USD-INR (eop)	43.4	43.8	44.6	43.6	40.0	50.9	45.1	44.7	55.0	51.0
USD-INR (avg)	46.0	44.9	44.3	45.3	40.2	45.9	47.4	45.6	50.0	51.3
REER (% yoy, + dep)	3.2	-0.8	3.1	-1.8	7.1	-9.9	-3.1	7.7		
Monetary Sector										
Reserve money (% yoy)	18.3	12.1	16.9	23.9	31.0	6.4	17.0	17.2	17.0	17.0
M3 growth (% yoy)	16.7	12.0	21.1	21.7	21.4	19.3	16.8	16.0	17.0	17.0
Non-food credit (% yoy)	18.40	28.99	28.46	27.32	22.60	17.50	16.90	21.30	17.00	17.0
RBI policy rate - Reverses repo (%)	4.5	4.75	5.5	6	6	3.5	3.5	5.75	7.50	5.50
Repo rate	6	6	6.5	7.5	7.75	5	5	6.75	8.5	6.5
CRR	4.5	5	5	6	7.5	5	5.75	6	6	6
1-month interbank rate -Call rate (%)	4.62	4.65	5.60	7.22	6.07	7.06	3.24	5.25	7.50	5.50
Long-term yield (%)	5.2	6.7	7.5	8.0	8.0	7.0	7.8	8.0	8.5	8.5
PLR	10.25	10.25	10.25	12.25	12.25	12.25	11.75	13	14.75	13.25
External Sector										
Current Account balance (% of GDP)	2.3	-0.3	-1.2	-1.0	-1.3	-2.4	-2.8	-2.6	-3.1	-3.0
Current Account balance (US\$ bn)	14.1	-2.5	-9.9	-9.6	-15.7	-28.7	-38.4	-44.1	-60.0	-65.0
Trade Balance (US\$ bn)	-14.3	-28.0	-46.1	-59.3	-88.5	-118.4	-118.4	-130.4	-149.0	-165.0
Exports, f.o.b. (US\$ bn)	63.8	83.5	103.1	126.4	162.9	185.3	182.2	250.5	290.0	326.3
Imports, c.i.f. (US\$ bn)	78.1	111.5	149.2	185.7	251.4	303.7	300.6	380.9	439.0	491.3
Invisibles (US\$ bn)	27.80	31.23	42.00	52.22	75.73	89.92	79.99	86.2	89.0	100.0
Foreign direct investment (US\$ bn)	2.4	3.7	3.0	7.7	15.9	17.5	18.8	7.0	18.0	18.0
International reserves (US\$ bn)	113.0	141.5	151.6	199.2	309.8	251.9	279.1	304.8	323.5	354.5
Public Sector										
Consolidated Fiscal deficit (% of GDP)	-8.4	-7.4	-6.7	-5.7	-4.5	-10.0	-9.6	-7.6	-8.6	-8.6
Central Gov. Budget Deficit (% of GDP)	-4.5	-3.9	-4.0	-3.9	-2.9	-7.4	-6.3	-5.1	-6.1	-5.9
Central Gov. Revenues (% of GDP)	9.6	9.5	9.4	10.1	10.9	9.7	8.8	10.0	8.4	8.2
Debt Indicators										
Gross External Debt (% of GDP)	18.8	18.6	16.7	18.2	18.1	18.5	19.0	17.7	17.6	17.6
Gross Government Debt (% of GDP)	81.1	78.6	77.4	74.1	71.4	72.1	69.1	64.9	62.2	60.6
Savings - Investment Balance										
Savings (nominal - % of GDP)	28.2	32.4	33.5	34.6	36.9	32.2	33.7	33.7	33.7	32.7
Investment (real - % of GDP)	26.7	31.3	33.2	34.5	36.7	34.9	34.7	34.7	33.7	32.7

Source: Government of India, BofA Merrill Lynch Global Research estimates

Link to Definitions

Macro

Click [here](#) for definitions of commonly used terms.

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