MOTILAL OSWAL FINANCIAL SERVICES

EcoScope
The Economy Observer

# How did we get it so wrong in FY24?

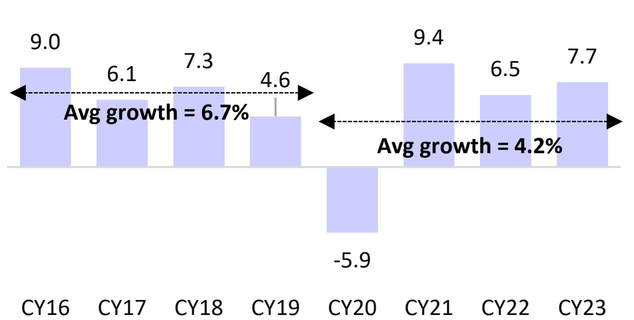
## Some lessons from the recent past for FY25

- **In this note, we discuss – with the benefit of hindsight – the possible factors explaining better-than-expected real GDP growth in FY24. In our view, four factors explain a large part of this outperformance: 1) lower deflator pushing real growth higher, even when nominal growth moderated; 2) no fiscal drag as fiscal spending, led by capex, grew decently in FY24, amid deficit consolidation; 3) strong growth in credit, pushing the credit-to-GDP growth ratio to a 17-year high; and 4) a 47-year low household net financial savings (HHNFS) in FY23, leading to an unfavorable base for household spending in FY24, which was exaggerated by a likely pick-up in HHNFS.**
- **As we enter FY25, one of these factors will reverse (deflator), some will moderate (fiscal spending and credit growth) and the last one (household spending growth) will improve. Accordingly, it explains the unanimous projection of a moderation in real GDP growth to 6.5-7.2% in FY25 from 8.2% in FY24. In any case, India's economic growth in the post-pandemic period (FY21-FY24), especially considering a modest fiscal and monetary stimulus, has not been particularly weak compared to other major economies, and it is unlikely to change in FY25.**

India's real GDP grew by a stunning 7.7% in CY23, following 6.5% growth in CY22. It implies a CAGR of 4.2% in the past four years (CY20-CY23), compared to 6.7% in the four-year period preceding the pandemic (CY16-CY19). This reduction in real GDP growth – by as much as 37% (and 2.5 percentage point [pp]) – may look really bad *(Exhibit 1)*; however, a comparison with other major emerging and advanced economies may put it in the correct perspective *(Exhibit 2)*.

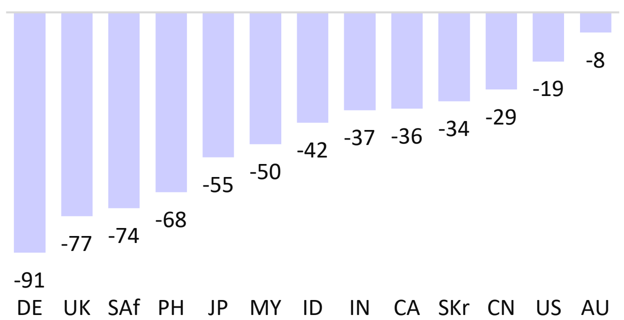
The deterioration in real GDP growth was as much as 42% in Indonesia (to 3.0% per annum in the post-Covid period, from 5.1% in the pre-Covid period), 68% in the Philippines (to 2.1% from 6.6%), 50% in Malaysia (to 2.4% from 4.9%) and as much as 74% in South Africa (to 0.2% from 0.9%). Not only this, real growth fell by as much as 91% in Germany (to 0.2% from 1.8%), 77% in the UK (to 0.4% from 1.9%) and 55% in Japan (to 0.3% from 0.7%).

**Exhibit 1: India's real GDP growth strengthened to 7.7% YoY in CY23…**




Calendar year data arrived at using quarterly data

**Exhibit 2: …and its performance has not been bad in the post-Covid period vis-à-vis other nations**




Pre-Covid = CY16-CY19; Post-Covid = CY20-CY23
Source: CSO, CEIC database, MOFSL

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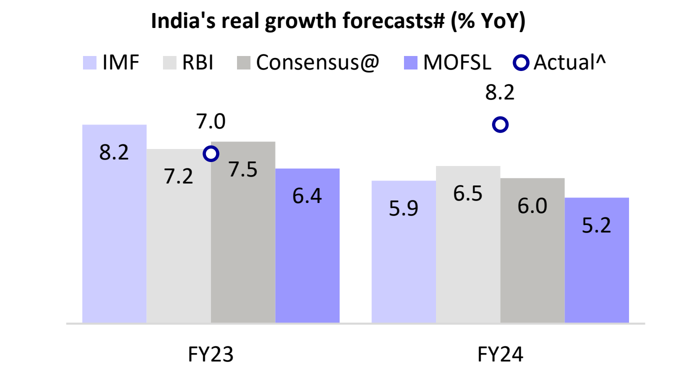
The decline in India's real growth is certainly not bad and actually lower than many other nations.

It is not that India has been the best-performing economy in terms of growth. China's real GDP growth averaged 4.7% in the post-Covid period vs. 6.6% in the pre-Covid period (a downgrade of 29%), it worsened by 34% in South Korea (to 1.9% from 2. 8%), 36% in Canada (1.4% from 2.3%), 19% in the US (to 2.0% from 2.4%) and only 8% in Australia (2.3% from 2.5%). Of course, this data is massively influenced by policy support in respective economies, but since the Indian government did not stimulate as much as several other major economies, the decline in India's real growth is certainly not bad and actually lower than many other nations.

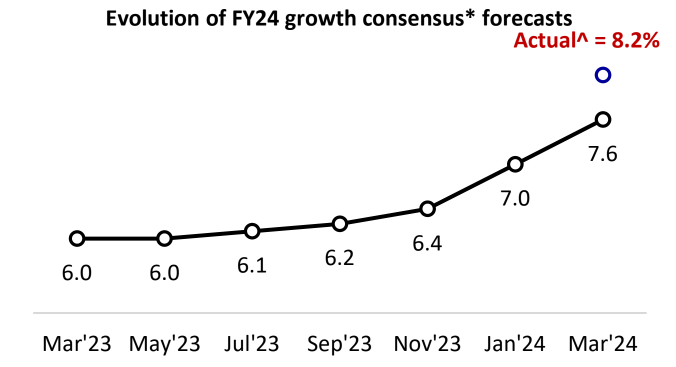
In fact, India's FY24 growth came as a huge pleasant surprise to almost the entire analyst community. Based on provisional data, real GDP grew 8.2% YoY in FY24[1] (revised up from 7.3% estimated in Jan'24), better than 7% in FY23 (revised from 7.2%). The market consensus was 6% growth in FY24 at the beginning of the year (based on the 81st round of the RBI's survey of professional forecasters conducted during Mar'23), our forecast was 5.2% (in Mar'23), and the RBI's projection was 6.5% (as per the monetary policy statement on 6th Apr'23). 2023-24 was supposed to be the first normal year, with negligible pent-up demand impact from the pandemic, and thus, the growth was expected to moderate. In contrast, it picked up, and turned out to be faster than any forecast on the street *(Exhibits 3 and 4)*.

**Exhibit 3: India's FY24 growth projections began with 6%…**




#At the start of the year: Mar'22 for FY23 and Mar'23 for FY24
@Consensus is based on RBI's bi-monthly SPF

**Exhibit 4: …but actual growth beat all forecasts till the end**




* Based on FY24 growth projections in 81st to 87th round of SPF
^Provisional estimate
Source: RBI, CSO, IMF, MOFSL

How did we get it so wrong? With the help of hindsight, we discuss four possible reasons for the surge in FY24 growth? This exercise also helps us draw some lessons and likely implications for FY25.

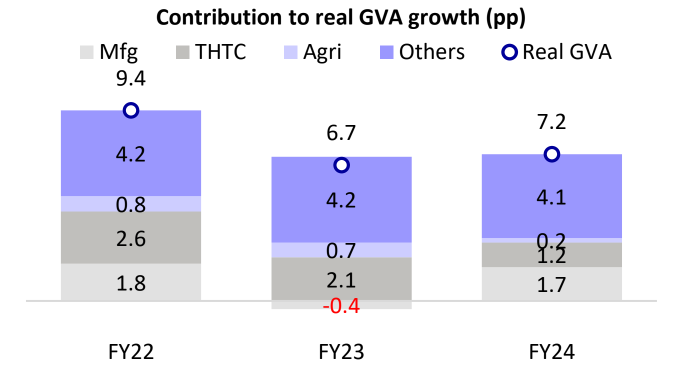
Before we proceed, one must note that headline GDP estimates in India are derived from bottom-up GVA estimates. Therefore, we must understand the higher-than-expected growth in real GVA, before we dig deeper into GDP data.

The manufacturing sector added 1.7pp to real GVA growth in FY24, from a 0.4pp contraction in FY23, creating a delta of more than 2pp last year

## Four factors supporting better-than-expected growth in FY24

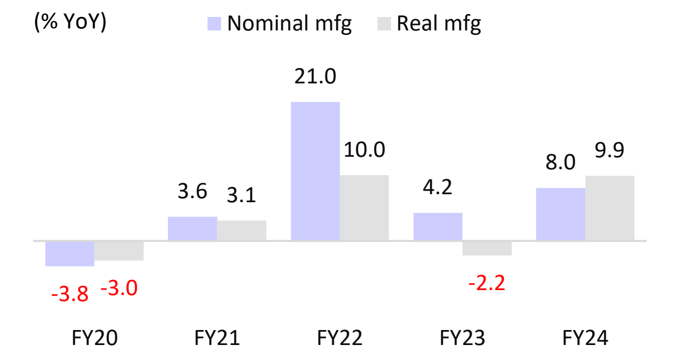
*Firstly*, it is very clear that the manufacturing sector was the primary force behind higher GVA growth in FY24. The real growth in the manufacturing sector was 10% in FY24, compared to a decline of 2.2% in FY23, which means that it added 1.7pp to real GVA growth in FY24, from a 0.4pp contraction in FY23, creating a delta of more than 2pp last year *(Exhibit 5)*. Interestingly, this higher contribution can be largely attributed to the price impact (or lower deflator), as the improvement in nominal manufacturing growth was modest – at 8.0% from 4.2% in FY23 *(Exhibit 6)*.

**Exhibit 5: India's manufacturing sector produced a delta of >2pp to real GVA growth in FY24…**




Others include mining & quarrying, electricity, construction, financial services and other services

**Exhibit 6: …as low deflator pushed real manufacturing growth much higher**




Source: CSO, MOFSL

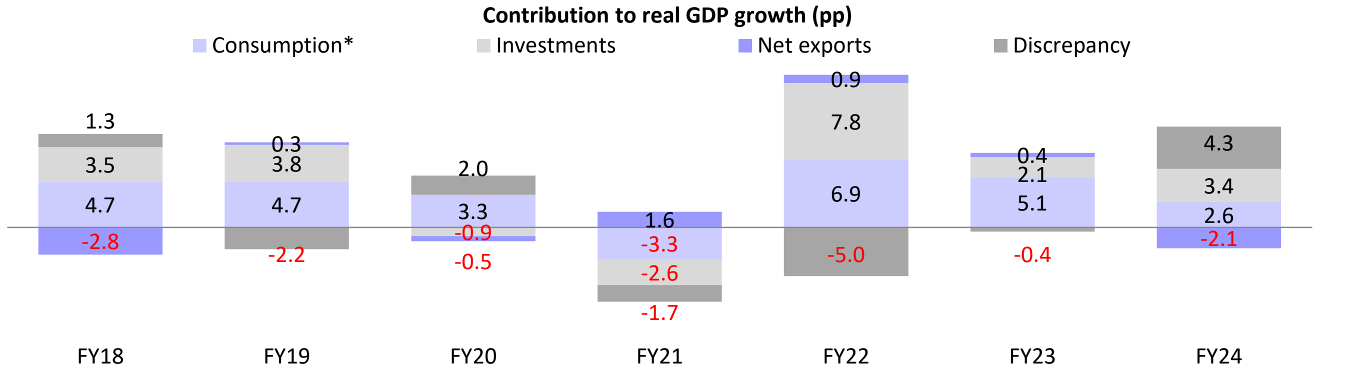
A large part of this strong contribution from the manufacturing sector was offset by very weak farm activities and slow growth in "Trade, Hotels, Transport and Communication" (THTC), and thus, the pick-up in real GVA growth in FY24 was not as high as the real GDP growth. The combined contribution from all other components was broadly unchanged in FY23 and FY24.

Similarly, it is well known that a very strong growth in 'net indirect taxes' is responsible for even higher real GDP growth; nevertheless, it must be distributed between consumption, investments and foreign trade. Details suggest that the contribution of real investments to real GDP growth increased to 3.4pp from 2pp in FY23, which was at least partly supported by lower prices, which must have helped push real growth higher (notably, nominal investments growth actually moderated to 10.6% vs. 17.4% last year). At the same time, however, final consumption expenditure (private + government), added only 2.6pp to real GDP growth in FY24, about half of 5.1pp added in FY23. Further, while nominal net imports of goods & services (or say, current account deficit [CAD] for simplicity) improved considerably last year, they worsened sharply in real terms.

Discrepancies, thus, contributed as much as 4.3pp to real GDP growth in FY24, compared to (-)0.4pp in FY23

All-in-all, the combination of consumption, investments and foreign trade implied a real GDP growth of 3.8% in FY24, down from 7.1% in FY23. Discrepancies, thus, contributed as much as 4.3pp to real GDP growth in FY24, compared to (-)0.4pp in FY23 *(Exhibit 7)*. It does not mean that real GDP growth is overestimated, but that it is difficult to allocate it more accurately into consumption and/or investments at this stage. It is possible that either consumption and/or investment growth is revised higher, as FY24 data is revised with more data sources. However, we must note that discrepancies were extraordinarily large in FY22 as well, for which final estimates are now available and no more revisions are pending.

**Exhibit 7: Contribution of various components to real GDP growth (pp)**



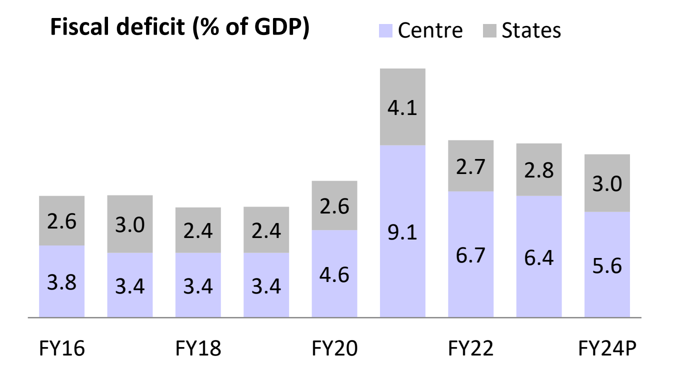

* Private + Government

Source: CSO, RBI, MOFSL

Real fiscal spending is estimated to have increased at a six-year high rate of ~10% YoY last year, adding 1.5pp to real GDP growth, the highest in at least the last 12 years

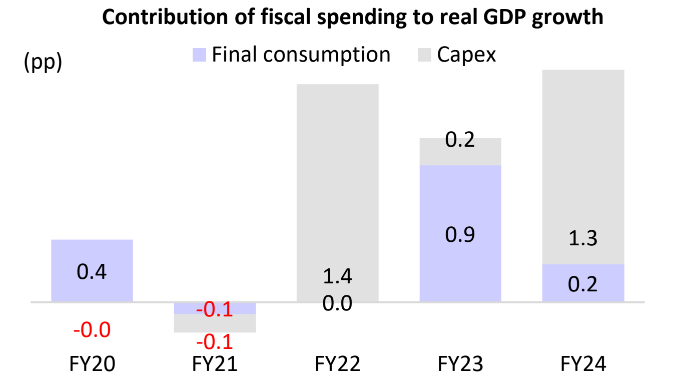
*Secondly*, it must be noted that while the central government narrowed its fiscal deficit from 6.4% of GDP in FY23 to 5.6% of GDP in FY24, our estimates suggest that states' aggregate fiscal deficit widened to ~3.0% of GDP last year, from about 2.8% of GDP each in the previous two years (FY22 and FY23). The combined fiscal deficit, thus, was ~8.6% of GDP in FY24, compared to 9.2% of GDP in FY23 *(Exhibit 8)*. Notwithstanding fiscal deficit consolidation, real fiscal spending (consumption and investments) is estimated to have increased at a six-year high rate of ~10% YoY last year, adding 1.5pp to real GDP growth, the highest in at least the last 12 years (since the new base data began in 2011-12). Although the contribution of government revenue spending (or consumption) to real GDP growth fell sharply last year, it was entirely offset by very high growth in fiscal capex *(Exhibit 9)*. Our estimates suggest that fiscal capex grew 25.7% YoY in real terms, as it grew 26.7% in nominal terms and the deflator (assumed as the aggregate investment deflator) growth was only 1% last year. This was largely supported by huge growth of 27% YoY in states' capex, amounting to ~88% of budget estimates (BEs), compared to an average of less than 80% in the past decade.

**Exhibit 8: India's combined fiscal deficit narrowed in FY24 vs. FY23…**




States' fiscal deficit based on our study of 20 states

**Exhibit 9: …however, there was no drag from the fiscal spending on GDP growth**




Fiscal capex are our estimates (using aggregate investment deflator)

Source: CSO, RBI, Union/State Budgets, MOFSL

Such strong bank credit growth with weak nominal GDP growth meant that the ratio of the two variables surged to 1.7x last year, the highest in the last 17 years

*Third*, we grossly underestimated credit growth last year. Bank credit grew 16.39% YoY (excluding HDFC Ltd. impact) in FY24, following 15% YoY growth in FY23. This was much higher than 10-12% growth we had projected. Such strong bank credit growth with weak nominal GDP growth meant that the ratio of the two variables surged to 1.7x last year, the highest in the last 17 years *(Exhibit 10)*. As explained in another **report**, personal credit (a part of household debt) has been the primary contributor to higher bank loan growth last year *(Exhibit 11)*. Within that, non-housing loans have increased at the fastest pace. Such high growth in household borrowings supported their spending growth, but also contributed to lower HHNFS.

**Exhibit 10: Bank credit growth to nominal GDP growth ratio was at 17-year high in FY24**

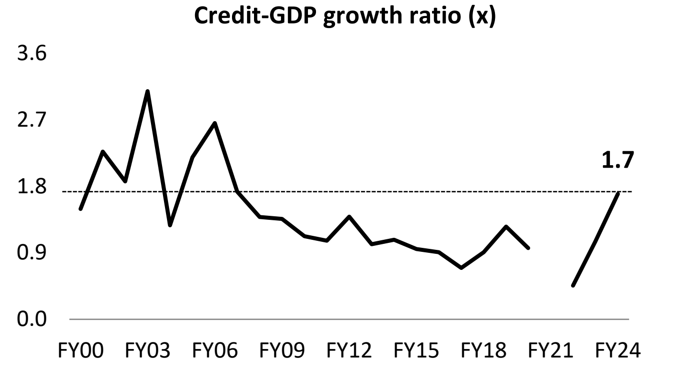
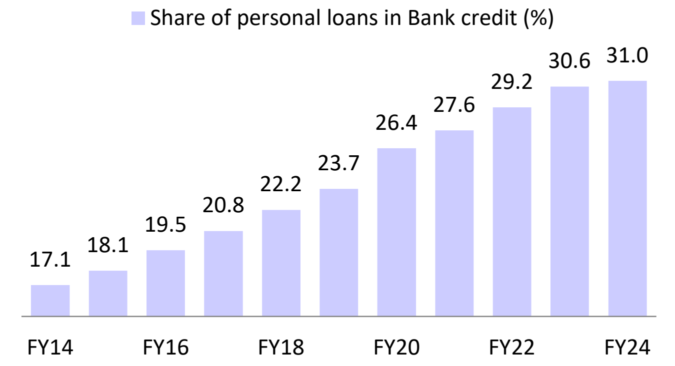



**Exhibit 11: Share of personal/consumer loans continued to increase in bank credit**




Source: CSO, RBI, IMF, MOFSL

*And finally*, although FY24 forecasts were prepared in 2022 or early 2023, one of the key data on household savings were published in two parts in Sep'23 (on household financial savings) and Feb'24 (on physical savings, and thus, household total savings). In contrast to our **forecast** of 6% of GDP, HHNFS dropped faster to a 47-year low of 5.3% of GDP in FY23 (from 7.3% of GDP in FY22). Household total savings were also at a six-year low of 18.4% of GDP, very close to a 25-year low of 18% of GDP in FY16 *(Exhibit 12)*.

A fall in HHNFS by 1pp of GDP leads to an increase in PFCE by about 2pp or a growth of 8pp in physical savings

Although savings are not estimated directly as the difference between income and consumption in India, they are effectively similar. A fall in HHNFS by 1pp of GDP leads to an increase in PFCE by about 2pp or a growth of 8pp in physical savings (or some combination of both). Lower-than-expected HHNFS in FY23 not only boosted household spending (consumption + investments) growth but also led to an unfavorable base for FY24. Therefore, although nominal growth of 8.5% YoY in personal final consumption expenditure (PFCE) in FY24 looks really low and was lower than the GDP growth of 9.6%, we must analyze it in the context of an average growth of 16.5% in the previous two years (FY22-FY23), the same as that in nominal GDP growth. A fall in real growth in PFCE to just 4% YoY last year (almost half of real GDP growth), compared to an average of 9.2% in the previous two years (vs. 8.3% GDP growth), also looks really bad, but it is affected by a high base. This becomes more convincing since our **calculations** suggest that, notwithstanding the halving of PFCE growth, the pick-up in HHNFS was only marginal – to 5.7% of GDP in FY24, from a 47-year low of 5.3% of GDP in FY23 *(Exhibit 13)*.

**Exhibit 12: Household savings fell to six-year low at 18.4% of GDP in FY23…**

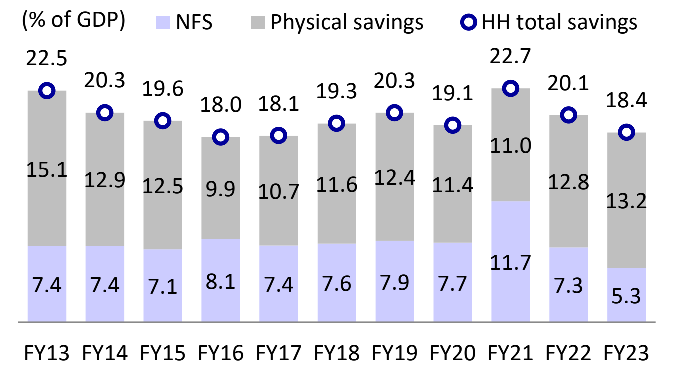
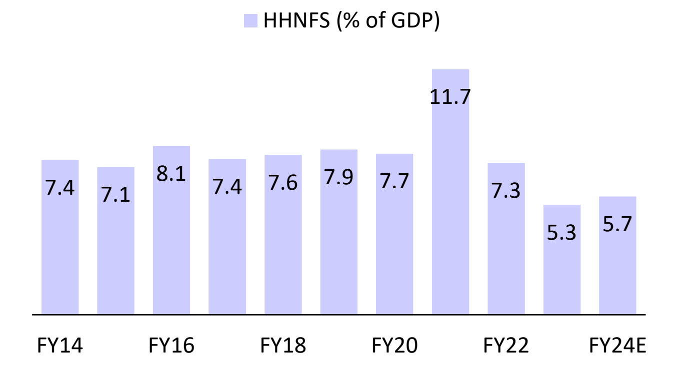



**Exhibit 13: …and it appears that HHNFS improved in FY24E, but still much lower than in earlier years**




Source: CSO, RBI, various national sources, MOFSL

Although the market underestimated real GDP growth in FY24, it over-projected nominal GDP growth.

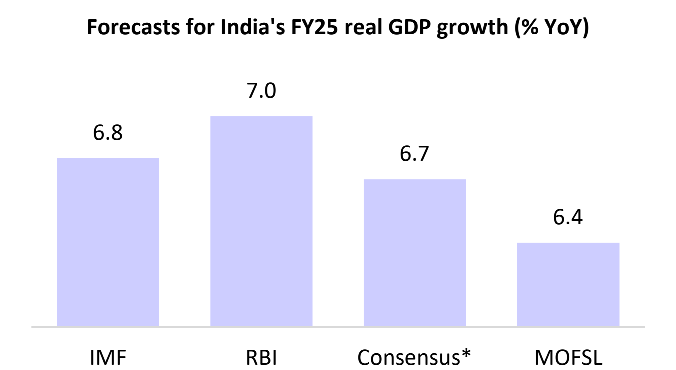
Notably, although the market underestimated real GDP growth in FY24, it over-projected nominal GDP growth. The RBI's SPF does not collect data on nominal GDP growth; however, the market consensus was likely around 10% (since they forecasted CPI and WPI inflation at 5.3% and 2.6%, respectively). In stark contrast, we expected it at ~7.5% in FY24. As per the provisional estimates, nominal GDP grew by 9.6% YoY in FY24, but it was supported by a downward revision – to 14.2% from 16.1% – in FY23 (published at end-Feb'24). Without such downward revision in FY23, nominal GDP growth (at INR295.4t) would have been 8.4% YoY in FY24, not very far from our non-consensus forecast of ~7.5% at the beginning of the year.

## What are the lessons for FY25?

India's real GDP growth is unanimously anticipated to moderate in FY25 vs. FY24, and the rate of moderation is also in a narrow range – from 1pp to 1.5pp

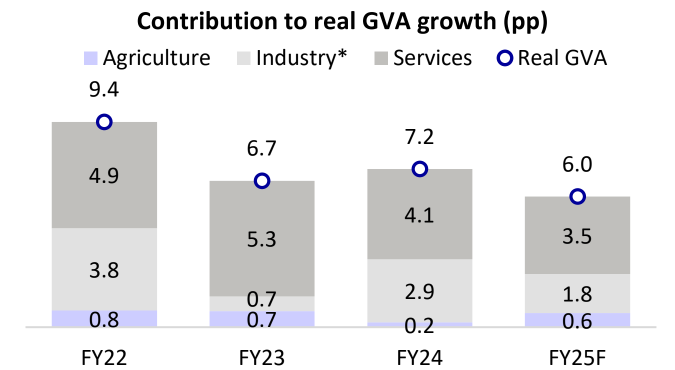
To start with, unlike FY24, the growth projections for FY25 are not too varied. The market consensus is 6.7% growth for FY25 (based on the 87th round of RBI's SPF conducted during Mar'24), our forecast is 6.4% (in Mar'24), and the RBI's projection is 7.0% (as per the monetary policy statement on 5th Apr'24). In the recent versions, the market consensus (based on 88th round of RBI's PSF conducted during May'24) forecast for FY25 real GDP growth is raised to 6.8% and the RBI's projection is revised to 7.2% (as per the monetary policy statement on 7th Jun'24). So, India's real GDP growth is unanimously anticipated to moderate in FY25 vs. FY24, and the rate of moderation is also in a narrow range – from 1pp to 1.5pp *(Exhibit 14)*.

**Exhibit 14: FY25 growth projections by various agencies are not very different from each other**




Based on Mar-Apr'24 surveys/forecasts
*RBI SPF 87th round conducted during Mar'24

**Exhibit 15: We expect real GVA growth to drop below 6% this year**




Source: CSO, RBI, IMF, MOFSL

Notably, although there is not much difference in the market consensus and our forecasts for real GDP growth, we expect real GVA to grow 6% this year, much slower than the market consensus of 6.6% (the RBI does not share its GVA growth projections). The consensus forecasts are not available for all GVA sub-components; however, given below are the explanations for our projections *(Exhibit 15)*.

There are three key reasons: 1) weak real manufacturing growth led by the normalization in manufacturing GVA deflator, 2) weaker growth in construction sector, and 3) slower growth in the services sector led by the deflator and fiscal spending. These three forces will be partly offset by the agricultural sector, which, led by normal monsoon and favorable base effect, could grow at a much faster pace this year.

Just like lower deflator helped push real GVA growth higher in FY24, a normalization toward 4% will reverse those gains in FY25.

Please note that just like lower deflator helped push real GVA growth higher in FY24, a normalization toward 4% will reverse those gains in FY25. We have projected higher nominal growth in all GVA components (including manufacturing and construction sectors), except community, social & personal services (which includes fiscal spending). Therefore, nominal GVA growth is expected to improve to 10.6% YoY in FY25, from 8.5% YoY in FY24 *(Exhibit 16)*.

In addition, fiscal spending growth is likely to moderate sharply this year, even though the deficit consolidation could be similar to last year. Assuming the Center's fiscal deficit target of 5.1% of GDP in FY25 and states' aggregate deficit remains unchanged at 3.0% of GDP (vs. their target of 3.2%), the combined fiscal deficit will come down to ~8% of GDP in FY25, compared to 8.6% of GDP in FY24 and 9.2% in FY23. Aggregate spending growth, however, is budgeted to moderate in nominal terms this year, which means a faster deceleration in real terms, as the deflator normalizes.

**Exhibit 16: We expect nominal growth to improve in FY25F, though normalization in deflator could pull real growth**

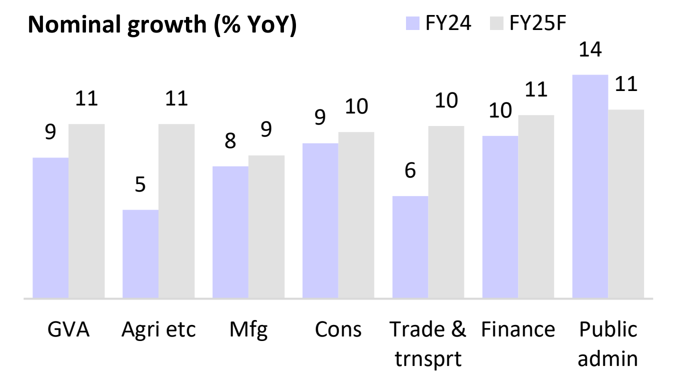
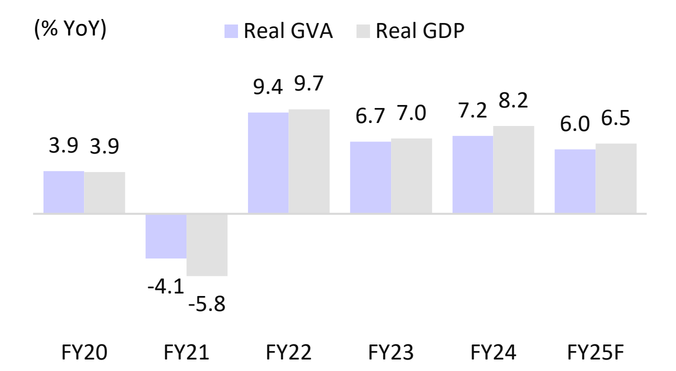



**Exhibit 17: Divergence between GVA and GDP growth could continue in FY25 as well**




Source: CSO, RBI, IMF, MOFSL

The gap between GVA and GDP growth will likely remain large in FY25 (at 0.5pp), like in FY24 (at 1.0pp).

One of the similarities between the two years would be the role of net indirect taxes (NIT). Since GDP estimates are arrived at using GVA estimates, NIT is the difference between the two. Like last year, the central government's indirect taxes are expected to grow decently, but subsidies are budgeted to decline this year *(Exhibit 17)*. Therefore, the gap between GVA and GDP growth will likely remain large in FY25 (at 0.5pp), like in FY24 (at 1.0pp).

## Conclusion: India's growth remains solid

Overall, there is no doubt that FY24 was an exceptional year for India's economy, wherein its growth was much better than anticipated, and retail inflation remained contained. It is, however, very important to understand the likely reasons for this outperformance to make an informed judgment about its sustainability. Based on hindsight, a very strong growth in FY24 was driven by a combination of lower deflator, decent fiscal spending growth amid deficit consolidation, much strong credit growth, and very low HHNFS in FY23, leading to an unfavorable base for household spending in FY24, which was exaggerated by a likely pick-up in HHNFS.

As we enter FY25, one of these factors will reverse (deflator), some will moderate (fiscal spending and credit growth) and the last one (household spending growth) will improve. With the wholesale price index (WPI) likely to normalize towards 4%, pushing GVA/GDP deflator to similar levels, the boost from the lower deflator will be missing this year. Similarly, unlike the 27% growth in fiscal capex last year, it is budgeted to grow only ~10% in FY25. Moreover, while credit growth may continue at a decent pace, as the banks' balance sheets are very strong, the RBI may try to curtail the fastest growing segment of unsecured consumer loans, which may restrict the overall credit growth in the economy. To offset them, just like there was an unfavorable base for household spending in FY24, it will turn favorable in FY25.

Whether it moderates to 6.5 or 7% remains to be seen, but in any case, India's growth has remained solid in the post-pandemic period.

In our view, three of these four factors will be missing in FY25, which explains the unanimous projections of a moderation in real GDP growth to 6.5-7.2% in FY25 from 8.2% in FY24. Now, whether it moderates to 6.5 or 7% remains to be seen, but in any case, India's growth has remained solid in the post-pandemic period.

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|---|---|
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