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ECONOMY & GILT WATCH

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Q4 GDP Review
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Q4 GDP Growth: Agri & Services Fire Economic Engine

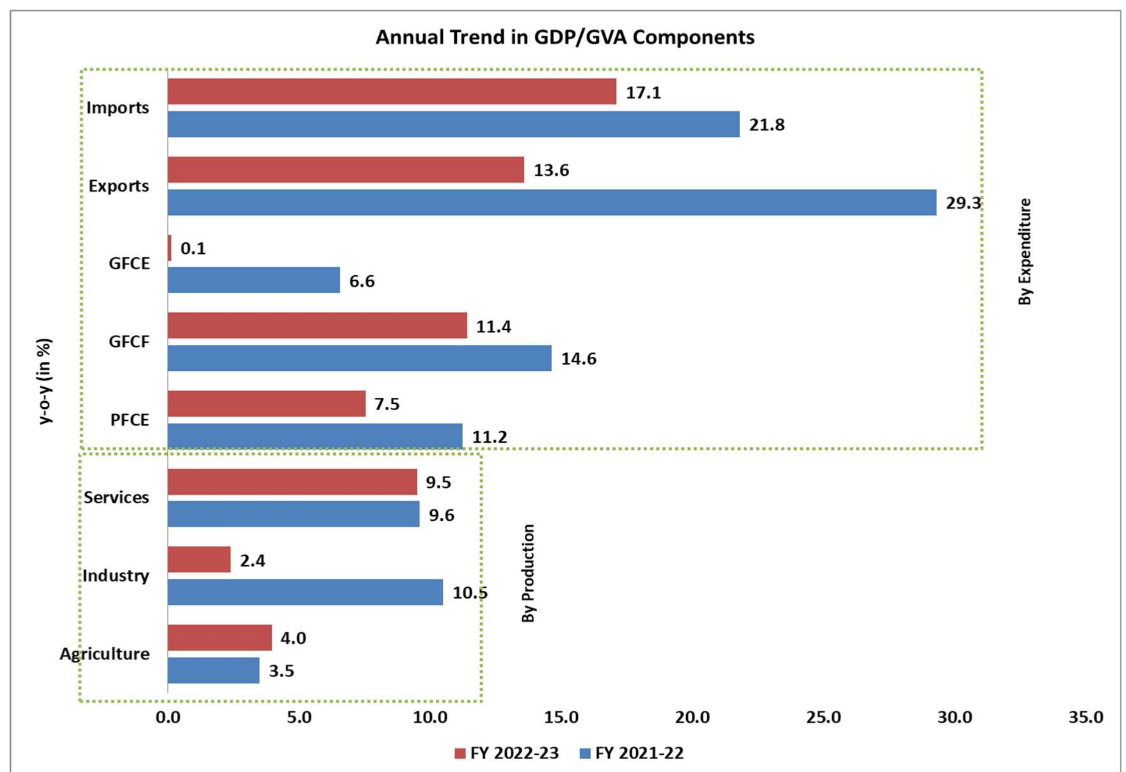
The fourth quarter GDP growth print, surprised on the upside, beating estimates by a wide margin boosted by a stronger show by the agriculture and services sector. The real GDP growth for Q4 FY 2023-24 came in at 6.1 per cent, while for the full financial year 2022-23, the real GDP growth stands at 7.2 per cent as against second advance estimate of 7 per cent released by the government (9.1 per cent for FY 2021-22). The headline GDP number came in strong despite expectations of global headwinds, non-seasonal rains and sharp rise in interest rates hurting domestic growth prospects. Production side numbers reveal continued weakness in the industrial sector, which posted a growth of only 2.4 per cent during FY 2022-23 as against 10.5 per cent in the previous year. On the other hand, services sector shone bright, registering y-o-y growth of 9.5 per cent, as against previous year's growth of 9.6 per cent. Agriculture sector's GVA grew by 4.0 per cent during FY 2022-23 as against 3.5 per cent in FY 2021-22. Expenditure side numbers revealed subdued private consumption momentum, and strengthening of capital formation. The nominal GDP for FY 2022-23 is estimated at Rs. 272.40 lakh crore, implying a y-o-y growth of 16.1 per cent during the year.

Quarterly Trends in Production & Expenditure

The quarterly trends, indicate a broad based recovery in economic activity, with all three sectors registering a sequential improvement in growth rates in Q4 as against Q3 of FY 2022-23. Agriculture sector GVA posted a y-o-y growth of 5.5 per cent, which is the highest growth seen in 12 quarters. The surprisingly strong growth registered by the agriculture sector is indicative of growing immunity of the agri production to erratic weather patterns. The services sector witnessed a robust growth of 7.4 per cent led by construction; trade hotels, transport, communication and financial real estate professional services. The industrial sector also witnessed a sequential improvement, growing by 4.7 per cent during Q4 FY 2022-23 as against 0.1 per cent in Q3 of FY 2022-23. Within industrial sector, growth was primarily led by electricity, gas , water supply & other utility, which posted y-o-y growth of 6.9 per cent in Q4. On the other hand, though manufacturing sector growth turned positive after two successive quarters of negative growth rate, the 4.5 per cent in Q4 of FY 2022-23 comes on a small base and needs to be seen with some caution.

The fourth quarter GDP benefitted from a surprisingly better than expected agri sector growth and continued spurt in the services sector

Expenditure side trends on the other hand reveal that economic growth in Q4 was largely driven by higher contribution of Gross Fixed Capital Formation (GFCF) to the overall GDP. During the quarter, GFCF's share in the quarter's GDP rose to 35.3 per cent which is unprecedented in the current series. Net exports which had been weighing on the GDP growth, also improved on back of sharp decline in the imports (with softening of commodity prices), thus easing the drag on the GDP growth for the quarter. The chink in the otherwise rosy GDP print is the Private Final Consumption Expenditure (PFCE), the share of which retraced to 55 per cent in Q4 vis a vis 61.6 per cent in Q3 FY 2022-23 (at constant price). However, past trends reveal that the PFCE generally remains on a weak footing in the last quarter of the year as savings take priority towards the end of financial year. For the entire fiscal, PFCE's share in GDP remained broadly flat at 58.5 per cent, while the y-o-y growth remained healthy at 7.52 per cent. This is corroborated by the strong performance of the services sector, which has led to increased consumption demand, mainly from the urban side. Rural demand though has witnessed slack over the previous quarter's, it is slowly regaining footing as indicated by rising wages for both agriculture and non-agriculture workers. Government Final Consumption Expenditure (GFCE) share in GDP declined to 9.9 per cent during FY 2022-23 from 10.6 per cent in FY 2021-22.



Monetary Policy Expectations

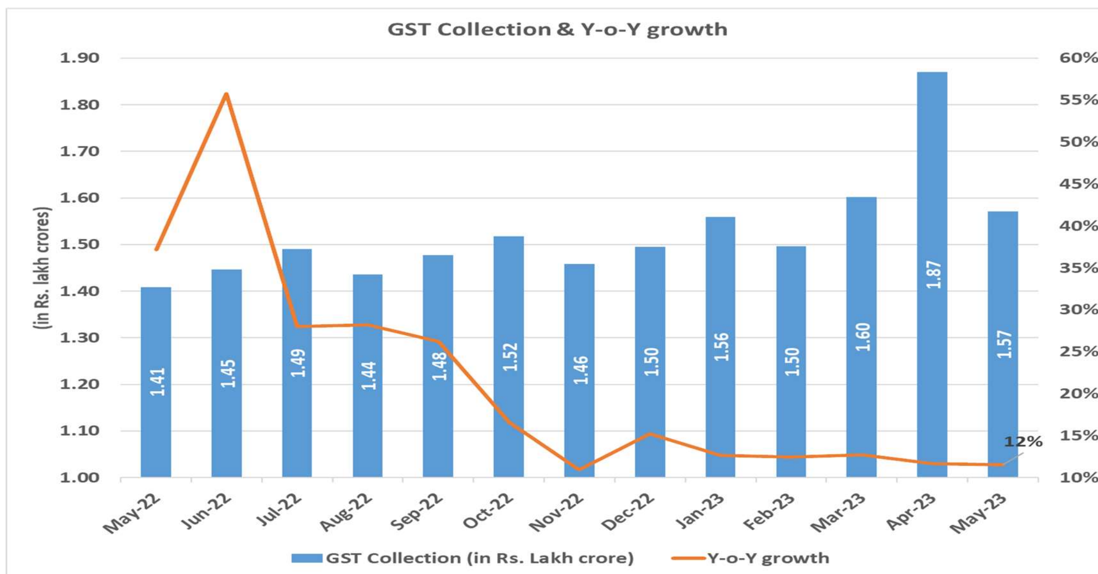
The GDP number though unexpectedly better than estimates, does not change the equation much from monetary policy perspective. A fairly healthy GDP print along with receding inflation will likely prompt RBI to maintain status quo on the policy rates as well as forward guidance as withdrawal of accommodation. The fact that economic activity is showing resilience despite headwinds, will give confidence to the central bank to maintain its focus on bringing inflation down further, even as there are upside risks to inflation emanating from international crude oil prices.

Macro Monitor

GST collection rises y-o-y, owing to an uptrend in domestic transactions and service imports

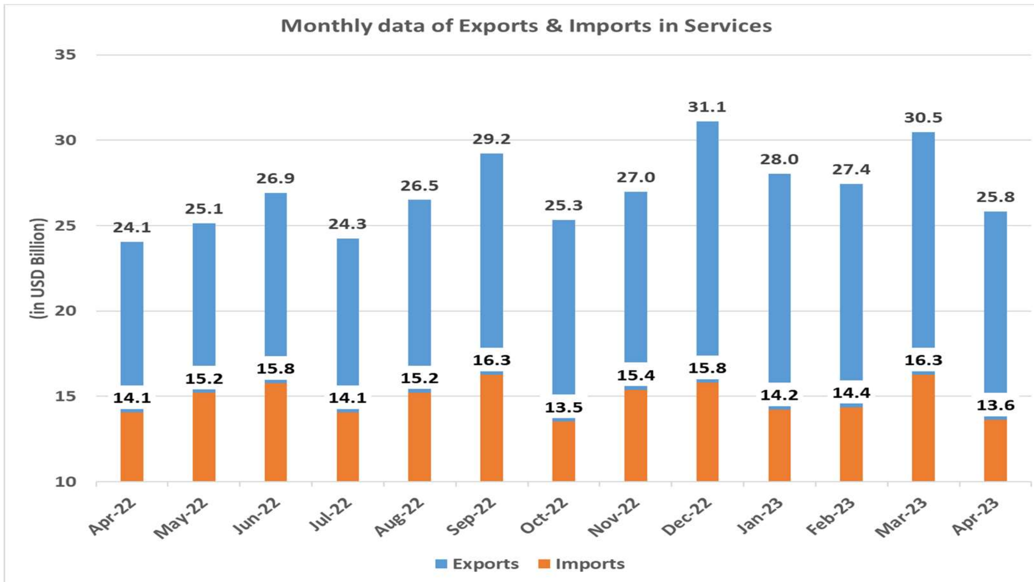
GST collection jumps by 12 per cent y-o-y to stand at Rs. 1.57 lakh crore for the month of May 2023. The recent growth trend aligns well with the Centre's projection of 12 per cent increment in GST collection during the current financial year.

The collections may go up further on the back of the announced demonetization, resulting into a jump in consumer purchases



Service exports go up, while imports record a decline

RBI's provisional monthly data shows that service exports grew 7.75 per cent as against the preceding year to $25.84 billion for the month of April 2023. Inversely, the service imports dropped by 3.1 per cent y-o-y to $13.63 billion in April 2023, witnessing a sequential fall in the crude oil prices, besides the persistence of global headwinds.



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The unemployment rate continues to be on the downward trajectory

As the economy recovers from the shadows of the pandemic, the unemployment rate exhibits a steady downward trend, recording a rate as low as 6.80 per cent for the January – March quarter of FY2023. While both, the male and the female labour force participation registered a growth, the worker-population ratio (WPR) also witnessed a slight increase as compared to the December quarter.

The unemployment rate was 6 per cent for men and 9.2 per cent for women in Q4FY23, as against 6.5 per cent and 9.6 per cent for men and women respectively, in Q3FY23

Fixed Income Outlook

Fundamental View

Shorter end of the curve is expected to remain in favour as liquidity makes a comeback in the system, while further rate hikes look improbable

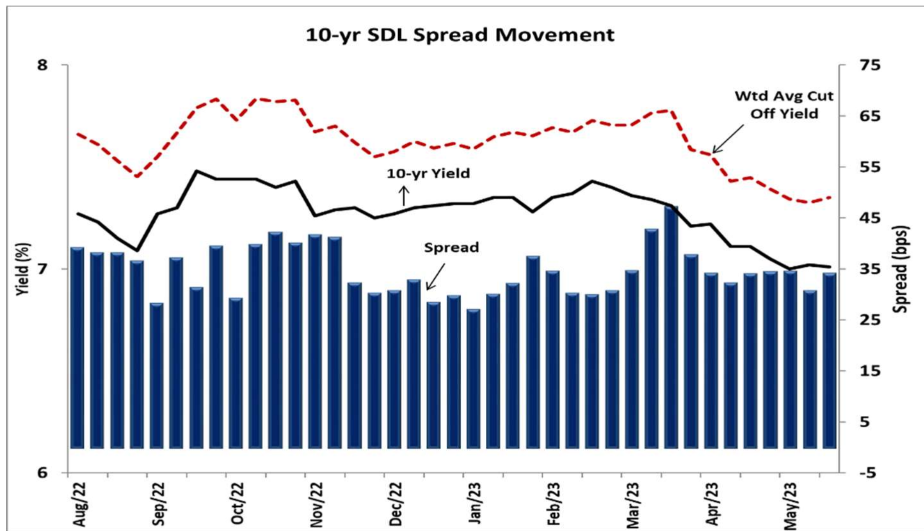
The feel good rally continues in the Indian bond market with the rally rotating between long end, belly of the curve and the short end of the curve. We would reckon short papers as the safe haven as of now (as liquidity comes back into the system and further hikes looking improbable at current juncture). Though we are expecting RBI to retain its stance as withdrawal of accommodation in the 8th June monetary policy review, a drop in phrase "withdrawal of accommodation" would mean that RBI stance has now shifted to neutral and this may spark a short term rally in 10 year bond. If this materializes, could take the yields to 6.90 or thereabouts quickly. As of now we find it difficult to form a view that a rate cut is on the cards in the current year. While we concur that the next rate action is a rate cut in all likelihood but we feel that it may not materialize in the current year given the robustness in growth. On the other hand, the weight of supply will start increasing on market in coming weeks. Due to this we are of the opinion that majority of the rally may be over and the current quarter could see 10 yr yield move in the range of 6.90%-7.15%.

SDL Overview

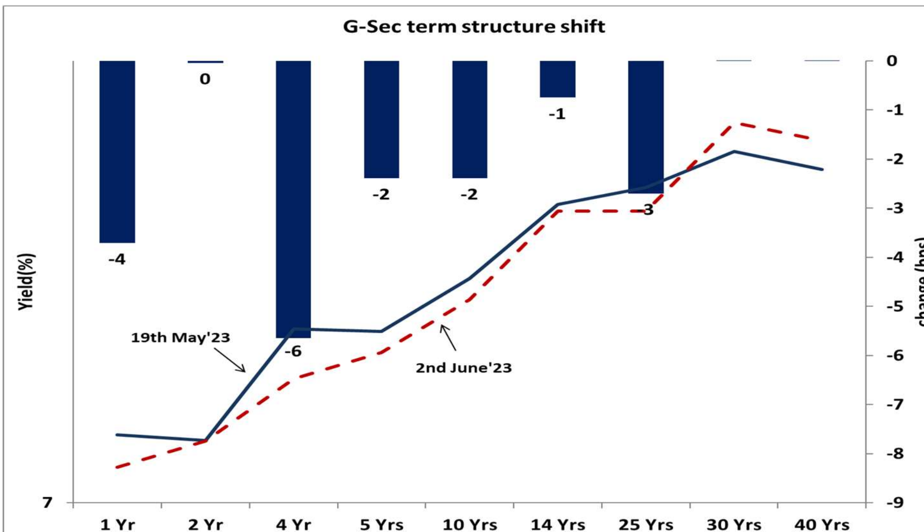
During last fortnight, 10 Yr State Loans traded in the broad range of 7.30%-7.37%, whereas the 10 Yr CG benchmark, remained in the range of 6.96%-7.03%. The latest SGS issuance was nearly 19 per cent higher than the, vis-à-vis their scheduled figure, partly reflecting the rise in supply of SGS (State Government Securities. However, the cumulative issuance of Rs 1,00,250 Cr so far this fiscal is ~32% below than the indicated level of Rs 1,32,250 Cr. The cut off for long tenure have remained lower than the 10 Year SGS suggesting robust demand for longer tenure papers from institutions like retirement funds and insurance companies, etc. However, we are expecting this trend to peter out towards the end of this Quarter, as evident from rising cut-offs of Longer tenure CG papers.

The spread between 10 year SGS and G-Secs (government securities) has widened to 34 bps from 32 bps in the previous fortnight and currently hovers in the band of 32 to 35 bps. We expect the spread between 10 yr SGS and CG to further widen and trade in the range of 35-40 bps and spread of Long End SGS vis-à-vis their CG counterparts to trade in the band of 30-35bps.

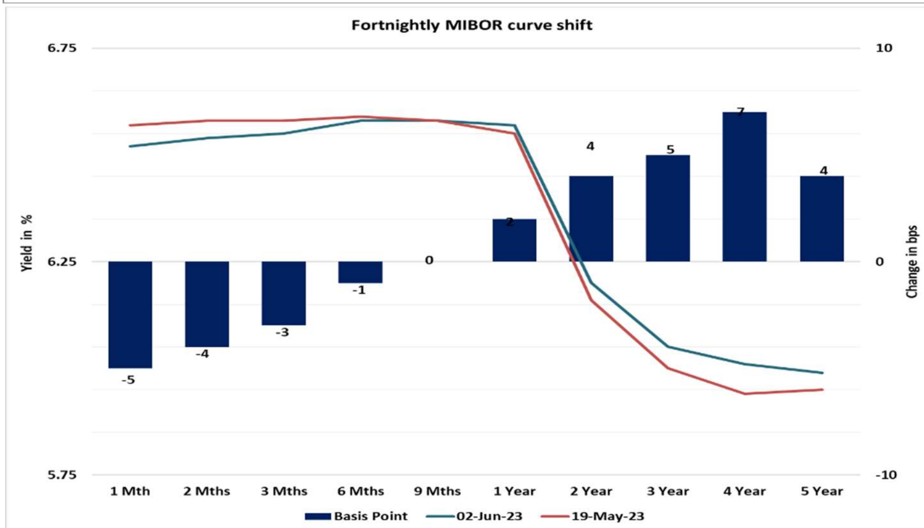
Spread Monitor



10-yr SDL spreads are expected to widen in the coming fortnight



G-sec term structure witnessed steepening during the previous fortnight



OIS rates traded largely flat in the previous fortnight

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