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FLASH
India GDP growth accelerates

1 September 2014

India's GDP growth for the first quarter (April-June) of the Indian fiscal year (Q1 FY2015) surprised positively at 5.7%, compared to 4.6% in the previous quarter. This is the fastest pace in 10 quarters. While the recovery will take time given a number of short-term challenges, this figure comes as an additional sign that the Indian economy has bottomed out and is now heading towards a higher, more sustainable growth rate in the next two to three years.

GDP GROWTH SURPRISES POSITIVELY

India's Q1 FY2015 GDP growth surprised positively at 5.7%, the highest growth rate in two and a half years. This improvement in GDP was industry led, as it rebounded to 4.2% from negative levels in the previous two quarters. This is thanks to strong export growth as well as a pick-up in both investment at 7% and government spending at 8.8% due to the May general elections.

Agriculture growth stood at 3.8%, reflecting the healthy winter harvest. The services sector, which represents 58% of GDP, improved modestly but remained below expectations at 6.8%.

Private consumption remained flat at 5.6% on a year-on-year basis but fell from 8.2% on a quarterly basis, partly due to continuing high inflation. In the meantime, exports continued to play a key role, achieving double-digit growth, as external demand was healthy and the Indian rupee (INR) remained stable.

(YoY%)	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
Agriculture	4.0	5.0	3.7	6.3	3.8
Industry	(0.4)	2.6	(0.4)	(0.2)	4.2
Service	7.2	6.3	7.2	6.4	6.8
Overall GDP	**4.7**	**5.2**	**4.6**	**4.6**	**5.7**

Source: CSO, Axis Capital, 30 August 2014

GROWTH REVIVAL UNDERWAY, BUT SHORT-TERM CHALLENGES REMAIN

In the short term, industrial activity momentum may slow, as the sharp rebound in Q1 FY2015 was partly due to the late monsoons, which enabled construction and mining activities to continue for longer in the quarter. Meanwhile, below-average monsoons may weigh on agriculture growth as well as on rural incomes, which could ultimately hit domestic consumption. Weaker agricultural production may also maintain pressure on inflation, spurring the Reserve Bank of India to keep rates high for longer, in line with its disinflationary glide path targeting inflation of 8% by January 2015 and 6% by January 2016.

Lastly, the government seems determined to meet its ambitious fiscal deficit target of 4.1% of GDP in the current fiscal year. This may result in spending cuts later in the year, given that slightly over 60% of the fiscal deficit target has already been used in the first four months. Consequently, fiscal and monetary policies may not be directly supportive of economic expansion in the coming quarters, which could result in a short-term moderation of growth.

POLICY EXECUTION WILL BE KEY TO LONG-TERM, SUSTAINABLE GROWTH

While the inflation targeting policy may limit the pace of growth in the short term, it lays the foundations for solid growth in the medium to long term. As inflation cools, real incomes should improve, boosting domestic consumption and encouraging higher investment and ultimately leading to a virtuous growth cycle.

As the government led by Narendra Modi celebrated its first 100 days in office, its ability to maintain the pace of reforms, support the revival in capital expenditure and improve project execution will be critical in guiding India towards a higher, more sustainable growth rate in the next two to three years.

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* BNP Paribas Investment Partners Asia Limited, 30/F Three Exchange Square, 8 Connaught Place, Central, Hong Kong.
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