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With weak manufacturing hurting GDP, can services be the saviour?

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GDP may grow at 4.2% in Q2, says SBI report

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India's industrial output in September was dismal to say the least. The Index of Industrial Production (IIP) contracted for the second consecutive month to 4.3%. September data was way below *Bloomberg*'s consensus estimate of a 2.5% contraction. In fact, there was a broad-based slowdown across all components of IIP.

Needless to say, with IIP contracting further, India's gross domestic product (GDP) reading for the September quarter is likely to be much worse than anticipated. It should be noted that the country's GDP slipped to a multi-year low of 5% in the June quarter. "The sequential worsening in the performance of consumer durables and non-durables in September 2019 belies any hopes of a pre-festive restocking of inventories," rating agency Icra Ltd said in a note.

What's more, for the December quarter as well, the GDP print may not see the much-anticipated recovery. This is because high-frequency data for October showed that despite the government's measures to boost demand, sales hardly took off. And, one cannot be sure how long it would take for these measures to boost consumption demand.

In this scenario, where manufacturing clearly remains in the doldrums, can services do the heavy-lifting of containing falling GDP? Some economists expect the services sector to see faster improvement than manufacturing in H2 FY20.

"Manufacturing is likely to remain weak throughout the current fiscal year. On the services side, we are expecting better growth in finance, trade and public administration in the second half of this fiscal year, which could lift overall GDP growth," said Anagha Deodhar, economist at ICICI Securities Ltd.

According to independent research firm Capital Economics Ltd, there were signs that services sector activity was picking up. It added in a note to clients that since services account for a larger share of India's GDP than industry, there is a chance that the economy has recovered slightly in Q3.

While there is no harm in hoping that services will contain further deterioration in India's GDP growth, the fact remains that at least for now business confidence among service providers is muted.

A private survey conducted by IHS Markit thrice a year showed that India's manufacturers and service providers were downbeat on growth prospects in October. Companies in both sectors were not looking to invest in employment, expansion or research and development.

Besides, the latest data set could prompt the Reserve Bank of India to cut interest rates further, despite fears of inflation inching up. The clamour for stimulus in the form of personal income-tax cuts may also get louder.

But given the government's tight fiscal position and the threat of a ratings downgrade, more tax incentives may not be a possibility.

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WITH IIP shrinking further, India's GDP for second quarter is likely to be weaker than anticipated

ANALYSTS expect services sector to see a faster improvement than manufacturing, aiding overall growth

GIVEN THE poor data, there would be higher expectations of more interest rate cuts and tax stimulus

Slowdown pangs

India's gross domestic product growth has slumped to a multi-year low in the June quarter and is likely to decline further.

Source: Central Statistics Office, CEIC, Nirmal Bang Institutional Equities Research

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