

Drought fears cloud GDP recovery in Q1

Economy grows 6.1% to Rs8.31 trillion on spurt in govt spending, private consumption down to seven-year low

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The worst seems to be over for the Indian economy, with the government's statistics office announcing on Monday that the economy had grown by 6.1% in the first quarter of the current fiscal year, the best growth in the last three quarters. But analysts warned that the drought-like situation in the country may prove to be a dampener in the coming quarters.

Weak consumer spending and anaemic investment spending continue to be major concerns, though their drag on economic growth was more than offset by a big spurt in government spending through

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Quarterly performance of different sectors from Q1 2009 to Q1 2010.

GDP at factor cost

(Year-on-year growth in %)



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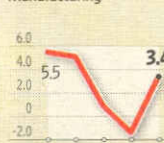
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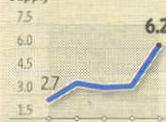
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Source: CSO

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Drought fears cloud recovery

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the two fiscal stimulus packages in December and February.

The country's gross domestic product (GDP) at the end of the first quarter of the current fiscal year was Rs8.31 trillion, compared with Rs7.83 trillion in the same period of 2008-09, raising expectations that the economy could meet the anticipated growth rate of 6%-plus for the year.

Data released by the Central Statistical Organisation on Monday indicated that the economy had a marginal recovery when compared with the preceding quarters. The GDP growth rate decelerated from 7.7% in the second quarter ended September to 5.8% in quarter ended December and then bottomed out at the same level in the fourth quarter ended March of 2008-09.

During the April-June quarter of 2009-10, while the farm sector grew 2.4%, industry and services sectors grew at 4.8% and 7.8%, respectively. While a higher growth in mining and electricity sectors led to strong growth in the industry sector, growth in services was led by banking and finance.

Consumption growth slowed to 2.8% in the quarter compared with 6.1% in the fourth quarter of 2008-09 largely due to a slump in the growth of private consumption, which fell to a seven-year low at 1.6% even as government consumption was up at 10.2%. Investment growth declined, marking the lowest growth since 2001-02 at 4.5%, down from the sustained

double-digit growth in the previous quarters. Though the first quarter growth rate is lower compared with the same quarter of the previous year when the economy grew at 7.8%, it signals a turnaround and bottoming out of the economy as in the previous two quarters of fiscal 2008-09, the economy grew at 5.8%.

While Planning Commission deputy chairman Montek Singh Ahluwalia said that the worst may be over and expected improved performance in the subsequent quarters, finance secretary Ashok Chawla predicted GDP growth rate of "6.5% or above" during the current fiscal.

With poor monsoon and the government declaring 278 out of India's 593 districts to be drought-hit, economists maintain India's battle against downside risks is far from over.

"Recovery will depend on how strong or weak is the impact of drought. The agriculture directly contributes 0.5% to 1% to GDP growth. If farm sector contracts by 4%, then it may shave off 1% from the GDP growth rate. However, it is the second and third round impact of the drought (through lowering of rural demand) which is more worrisome," said Pronab Sen, chief statistician of India. He said it is difficult to weigh the impact of drought as "we don't know what impact will it have on rabi crop as rabi output is larger than kharif output".

However, Sen added that because in the second quarter there is no farm output and the

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land under cultivation is taken into account in calculating farm growth, "farm output may contract by 10% in the September quarter". The next quarter will be crucial for the overall growth in FY10, he said.

Rohini Malkani, India economist with Citigroup, in an advisory agreed that growth will be affected by the drought, but maintained that the second-round effect of a drought on industry and services would be limited due to the Pay Commission arrears' payments in September and the employment guarantee scheme.

Sameeran Chakraborty, head of India research with **Standard Chartered Bank**, said the share of rural consumption has been declining and is being replaced by government spending. "The drought will have some impact, but that will be counter-balanced by industry doing better."

Sherman Chand, an economist with **Moody's Economy.com**, posed a counter view. "A sharp decline in farm output is expected to reduce demand for transport and storage services, and the supply for exports could also plummet.

Therefore, the drought could cause severe damages to the Indian economy, and all business sectors can yet to breathe a sigh of relief despite easing external concerns," Chand said in an advisory.

While Citigroup said it maintains its 5.8% growth forecast for the current fiscal, Chakraborty said the economy may register 6.4% growth during the same year.

Economists expect the shape of any recovery to be affected by how the Reserve Bank of India (RBI) deals with the classic dilemma of balancing growth and inflation. Sen feels inflationary pressure is apparent and wholesale inflation rate may accelerate and exceed RBI's comfort level of 4.5-5% by November, as the base effect peters away. "If the world economy recovers faster, then RBI may become aggressive in controlling inflation," he said.

Goldman Sachs in a report released on Monday said it expects WPI inflation to move to 6.5% by March, with risks on the upside due to higher food prices. "With growth and inflation expected to be higher, we now expect 300 bp (basis point) of tightening in policy rates in calendar year 2010."

Chakraborty said it is too early to take a call on RBI's response. "RBI's response will depend on how soon the economy recovers or how bad is the inflationary situation. If recovery is faster, it will fight inflation at a faster rate." He expects inflation to touch 6.5-7% by March-end.

PTI contributed to this story.