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FY2025 GDP growth unlikely to cross 6.5%

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India's initial Q2 FY2025 GDP and GVA numbers were quite disappointing, with the year-on-year (YoY) growth printing at a seven-quarter low each of 5.4% and 5.6%, respectively. This was well below our estimate of 6.5-6.6%.

The negative surprise was largely on account of the industrial segment, which witnessed a significantly sharper-than-expected slowdown. On one hand, excess rains in August-September 2024 temporarily weighed down on mining output and electricity demand. Further, an adverse base and weak demand impacted manufacturing GVA growth in the quarter. Additionally, services GVA growth dipped, while continuing to exceed the 7.0% mark. In contrast, agricultural GVA growth recorded an expected uptick to a five-quarter high of 3.5% in Q2 FY2025 from 2.0% in Q1 FY2025.

On the expenditure side, private consumption growth slowed to 6.0% in Q2 FY2025 from 7.4% in Q1 FY2025, despite a low base. We remain circumspect about the Q1 print and believe that it may be revised downwards when the Q3 FY2025 data is released in February 2025. Additionally, investment activity curiously slowed down to 5.4% in Q2 FY2025 from 7.5% in Q1 FY2025, despite the turnaround in Government capex.

Looking ahead, we believe that growth likely bottomed out in Q2 FY2025, and the trajectory is set to improve in the next two quarters, aided by an uptick in Government capex, rural demand, and the dissipation of the transient impact of heavy rains.

Following the YoY contraction of 14.7% in April-October FY2025, the Centre needs to incur a considerable capex of Rs. 6.4 trillion in the remaining five months of the fiscal to meet the FY2025 RBE of Rs. 11.1 trillion. This implies a substantial YoY growth of ~61% during this period, which does seem unlikely to be achieved. While we expect the FY2025 target to be missed by at least Rs. 1.0 trillion, the YoY GoI capex growth in H2 FY2025 would still be quite high, boosting GDP growth in this period. A similar trend is expected to play in terms of the capex growth for the state governments.

Additionally, ICRA remains optimistic about the rabi crop, considering the favourable impact of high reservoir storage and the ensuing La Nina conditions on sowing and crop yields, even as the low inventory levels of DAP and the possibility of a warmer-than-normal winter pose a concern. Further, farm cash flows from a healthy kharif output are likely to provide a fillip to rural demand in the second half of the fiscal, the green shoots of which are visible. For instance, ICRA has revised the outlook for the wholesale volume growth for the 2W industry upwards to a robust 11-14% in FY2025, led by steady replacement demand and an improvement in rural demand on the back of a healthy monsoon precipitation.

Simultaneously, urban consumption is likely to remain uneven in H2, amid the adverse impact of sustained elevated food inflation levels on the budgets of the low- and middle-income households, which would continue to impact low-ticket and discretionary consumption. Notably, ICRA has revised the outlook for the wholesale volume growth for the PV industry in FY2025 downwards to a meagre 0-2%.

Additionally, the deceleration in the non-housing personal loan growth will weigh on urban consumption to some extent. Moreover, ICRA remains watchful of the impact of geopolitical and tariff-related developments on commodity prices and external demand.

On balance, ICRA expects the GDP growth in H2 FY2025 to print appreciably above the levels seen in the initial data for Q2 - primarily led by the lower-than-expected print for the just-concluded quarter. We have, therefore, revised our forecast for the full-year expansion to ~6.5% from 7.0%.

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