ICRA

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Signs of improvement in investment activity

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Investment activity improved somewhat in Q2 FY2025 after the election-led lull in Q1 FY2025, even as excess rainfall during August-September 2024 likely weighed on construction activity in the quarter.

As anticipated, new project announcements witnessed a healthy rebound to Rs. 6.7 trillion in Q2 FY2025 from a multi-quarter low of Rs. 2.2 trillion in Q1 FY2025, registering a quarter-on-quarter (QoQ) expansion of 207%. This was in sync with the historical trends, wherein new proposals picked up sharply in Q2 after the lull seen during the Parliamentary elections. The QoQ increase in cost of announcements in Q2 FY2025 was much stronger by the private sector (to Rs. 5.2 trillion from Rs. 1.1 trillion) than by the Government (to Rs. 1.5 trillion from Rs. 1.1 trillion).

Further, project completions improved to Rs. 1.0 trillion from Rs. 0.7 trillion in Q1 FY2025. However, this was only half of the average completion cost of Rs. 1.8 trillion seen over the last 10 quarters, which may partly reflect the impact of the heavy monsoon rainfall in Q2 FY2025.

Encouragingly, the Government of India's (GoI's) capex expanded by ~10% in Q2 FY2025 after having contracted by a sharp 35% in Q1, which is likely to augur well for the GDP growth in that quarter. To meet the FY2025 BE (Rs. 11.1 trillion), the GoI needs to incur capex amounting to Rs. 7.0 trillion during H2 FY2025, implying a sharp expansion of ~52%, relative to the corresponding period of FY2024 (Rs. 4.6 trillion), which appears quite challenging. With an average run rate of ~Rs. 1.16 trillion per month during H2 FY2025 (vs. Rs. 0.76 trillion/month in H2 FY2024), ICRA thinks the FY2025 capex target is likely to be missed by at least Rs. 0.5 trillion.

Simultaneously, the aggregate capital outlay and net lending of 22 states (Rs. 1.7 trillion; -4.3% YoY) was tepid during April-August FY2025, owing to the General Elections and heavy rainfall in some states. With a lull expected for a few weeks in Q3 FY2025 in the election-bound states of Haryana and Maharashtra, we expect the capital spending by the states to also undershoot the capex target set for FY2025.

Notably, housing activity weakened in Q2 FY2025, with home sales and new project launches contracting by double digits in the quarter. After reporting a low single-digit growth in Q1 FY2025, the area sold in the top seven cities contracted sharply by 14.7% YoY in Q2 FY2025, to an eight-quarter low of 144.4 million square feet (msf). Additionally, new launches in top seven cities fell to a 12-quarter low in Q2 FY2025. With the onset of the festive season, launches are expected to pick up in Q3 FY2025. Additionally, the decadal low inventory and YTS levels would also push developers to augment their launch pipeline.

Interestingly, steel and cement, which are crucial inputs for construction, witnessed divergent trends in Q2 vis-à-vis Q1; the year-on-year (YoY) growth in the consumption of the former slowed to 11.6% in Q2 FY2025 from 14.8% in Q1 FY2025, while remaining in double digits, and that in the output of the latter inched up (to 3.0% from 0.4%), albeit remaining weak in low single digits.

Overall, ICRA maintains that private capex remains contingent on demand conditions, which would influence the pace of capacity additions over the next few quarters. Given this, and the weakening housing activity, Government capex remains crucial to support investment demand and growth. The required exceptionally high YoY growth in the Government capex during H2 FY2025 augurs well, although we do suspect a modest miss in the FY2025 capex targets may be on the cards.

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