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The US$2trn question: What's potential?

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Bottom line: Growth bottoming out, wait end-Feb for clarity

We await the release of a longer FY12 base GDP series at end-February to fully assess India's growth profile. The CSO today projected growth at 7.4% in FY15, up from 6.9% in FY14 in the new series. It reported December quarter growth at 7.5% and revised the June quarter to 6.5% from 5.7% in the FY04 series and September to 8.2% from 5.3% in the old series. Pronab Sen, chairman of the National Statistical Commission, has long maintained that the 2004-05 GDP data underestimated industrial growth. New GDP data continue to support our call that growth is bottoming out. We expect India to surpass Brazil and Russia in GDP this year to emerge as the second-largest BRIC economy after China (Chart 1). In our view, the US$2trn question is: what is the potential? We placed this at 7-7.5% in the old FY12 series. We will look to a longer-data series based on the FY15 methodology to re-estimate it. Only then can the RBI and the market determine if further rate cuts are required and by how much. Do read our India 2015 report here.

CSO estimates FY15 growth at 7.5% in new GDP series

The Central Statistical Organisation today projected growth at 7.4% in FY15 (far above 6.6% BAMLe), up from 6.9% in FY14 in the new FY12 GDP series (Table 1 and Exhibit 1). It reported December quarter growth at 7.5% and revised the June quarter to 6.5% from 5.7% in the FY04 series and September to 8.2% from 5.3% in the old series (Table 2). We will publish our FY16 growth estimates after greater clarity once the CSO releases its new GDP manual in end-February.

RBI policy depends on potential

Where does this leave the RBI? Monetary policy works on the gap between potential and actual growth rather than the actual growth rate itself. We placed potential growth at 7-7.5% in the old FY12 series. We will look to a longer-data series based on the FY12 methodology to re-estimate it, as the bulk of the higher growth has come from a methodological shift to value added from production in industry. It is only then that the RBI and market can determine if further rate cuts are required and by how much. As of writing, we retain our RBI call of 25bp rate cuts in April and June.

Why? GDP revised to meet international standards

The Central Statistical Organisation periodically revises the GDP series to upgrade to the latest methodology and capture a greater part of the economy. It has upgraded the GDP series to the 2011-12 base year from 2004-05 guided by the recommendations of the international guidelines on the 2008 System of National Accounts on Friday. Major changes include the following (do read our report here):

Corporate sector coverage: Extended by incorporation of annual accounts of companies as filed with the Ministry of Corporate Affairs (MCA) under their e-governance initiative, MCA21. Partnership firms covered under the Limited Liability Partnership Act have also been covered. For "manufacturing" enterprises, the MCA21 database has been used to supplement the information available in the Annual Survey of Industries.

Local government: Improved coverage of activities of local bodies – both rural and urban – and autonomous institutions, resulting in better coverage of government activities.

Informal sector: Incorporation of the results of the recent NSS Surveys, viz., the Unincorporated Enterprise Survey (2010-11) and the Employment-Unemployment Survey (2011-12), along with the adoption of an “Effective Labour Input Method” for unincorporated manufacturing and services enterprises, giving due weights to different categories of workers, i.e., owners, hired workers and helpers, for compiling the estimates of these enterprises.

What? Manufacturing share rises to 15.8%

The new GDP series has captured the changing structure of the Indian economy. The share of manufacturing has increased to 15.8% from 11.9% in the 2004-05 series. At the same time, share of trade services is down to 10.9% from 15.2% in the 2004-05 series. Except real estate and construction, the share of all other services has also fallen in the new series. The share of agriculture has increased marginally in the new series to 17.2% from 16.8%.

There is no significant change in the structure of GDP on the demand side. Savings and investment have slowed across the old and new series.

Why? Structural change driven by methodological advance

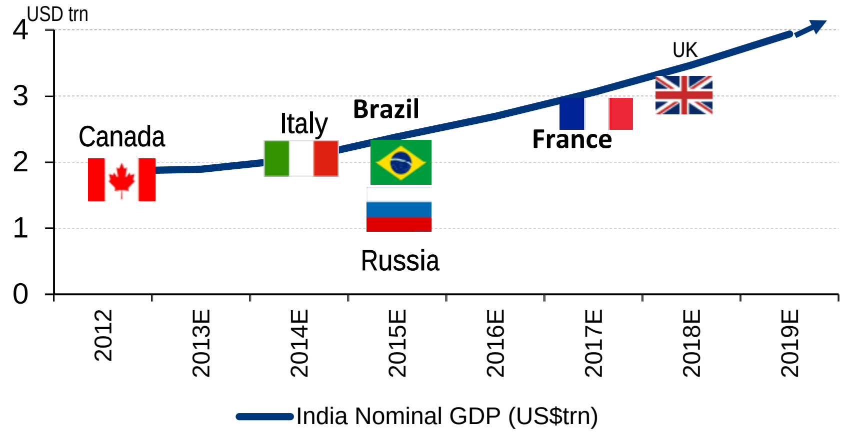
The main reasons behind this upward revision in growth include the following:

- The adoption of the MCA21 database has led to a higher share of mining and manufacturing in GDP and consequently a higher growth rate relative to the 2004-05 base year series. It is important to note that the share and growth rate of both of these sectors have been declining since FY12 as per the new series confirming the slowdown in these sectors in recent years.

- ‘Enterprise Approach’ is adopted in the new revision in place of establishment approach for mining and manufacturing. As a result, certain companies that were earlier being covered under the trade category are now correctly being reported under the mining and manufacturing category. This has resulted in a falling share of trade services.

- The growth rate for non-financial services has increased due to the use of sales/service tax as an indicator for nominal growth.

Chart 1: India should become 2nd largest BRIC economy after China in 2015



Source: BofA Merrill Lynch Global Research estimates.

Table 1: Growth has jumped 200bp in the new methodology

	Old weights (2004-05)	New weights (2011-12)	FY13	FY14	FY15E
Agriculture, Forestry and Fishing	16.8	17.2	1.7	3.7	1.1
Industry	15.6	20.6	5	5.3	6.5
Mining and Quarrying	2	2.6	0.5	5.4	2.3
Manufacturing	11.9	15.8	6.1	5.3	6.8
Electricity, Gas, Water & Other Utilities	1.8	2.2	2.3	4.8	9.6
Services	59.8	54.7	-4.4	8.1	9.8
Construction	7.2	7.6	5.9	2.5	4.5
Trade, hotels, transport, communication and services related to broadcasting	22.1	17.1	18.1	11.1	8.4
Financial, real estate & professional services	17	18	16.7	7.9	13.7
Public administration, defence and Other Services	13.4	12	9.4	7.9	9.0
GVA at basic prices	na	92.3	4.9	6.6	7.5

Source: BofA Merrill Lynch Global Research estimates, MoSPI

Table 2: India growing faster than China

	FY 14			FY 15E		
	Q1	Q2	Q3	Q1	Q2	Q3
Agriculture, Forestry and Fishing	2.7	3.6	3.8	3.5	2.0	-0.4
Industry	5.9	4.2	5.5	6.5	5.5	4.6
Mining and Quarrying	0.8	4.5	4.2	5.1	2.4	2.9
Manufacturing	7.2	3.8	5.9	6.3	5.6	4.2
Electricity, Gas, Water & Other Utilities	2.8	6.5	3.9	10.1	8.7	10.1
Services	8.9	9.7	8.3	8.1	9.8	11.7
Construction	1.5	3.5	3.8	5.1	7.2	1.7
Trade, hotels, transport, communication and services related to broadcasting	10.3	11.9	12.4	9.4	8.7	7.2
Financial, real estate & professional services	7.7	11.9	5.7	11.9	13.8	15.9
Public administration, defence and Other Services	14.4	6.9	9.1	1.9	6.0	20.0
GVA at basic prices	7.2	7.5	6.6	7.0	7.8	7.5

Source: BofA Merrill Lynch Global Research estimates, MoSPI

Exhibit 1: Advance Estimates of National Income and Expenditures on GDP, 2014-15 at constant (2011-12 Prices)

(₹ crore)

S.No	Item	2011-12	2012-13 (2nd RE)	2013-14 (1st RE)	2014-15 (AE)	percentage change over previous year 2012-13	2013-14	2014-15
	Domestic Product							
1	GVA at basic prices	8195546	8599224	9169787	9857672	4.9	6.6	7.5
2	Taxes on Products including import duties	886969	978603	1037006	1086552	10.3	6.0	4.8
3	Less Subsidies on Products	250503	297024	285687	287299	18.6	-3.8	0.6
4	GDP (1+2-3)	8832012	9280803	9921106	10656925	5.1	6.9	7.4
5	NDP	7923355	8301305	8872127	9529255	4.8	6.9	7.4
	Final Expenditures							
6	PFCE	5090822	5370768	5704132	6108497	5.5	6.2	7.1
7	GFCE	987220	1004155	1086121	1194560	1.7	8.2	10.0
8	GFCF	2971246	2962726	3050236	3176067	-0.3	3.0	4.1
9	CIS	214555	201262	158211	164328	-6.2	-21.4	3.9
10	VALUABLES	253033	261353	133975	171748	3.3	-48.7	28.2
11	Exports of goods and services	2143931	2286611	2453005	2475997	6.7	7.3	0.9
12	Less Imports of goods and services	2715554	2877291	2636313	2623615	6.0	-8.4	-0.5
13	Discrepancies	-113242	39476	-3768	-10656	0.4	0.0	-0.1
14	GDP	8832012	9280803	9921106	10656925	5.1	6.9	7.4
	RATES TO GDP							
15	PFCE	57.6	57.9	57.5	57.3			
16	GFCE	11.2	10.8	10.9	11.2			
17	GFCF	33.6	31.9	30.7	29.8			
18	CIS	2.4	2.2	1.6	1.5			
19	VALUABLES	2.9	2.8	1.4	1.6			
20	Exports of goods and services	24.3	24.6	24.7	23.2			
21	Less Imports of goods and services	30.7	31.0	26.6	24.6			
22	Discrepancies	-1.3	0.4	0.0	-0.1			
23	GDP	100.0	100.0	100.0	100.0			
24	GNI	8755188	9172925	9800813	10527936			
25	NNI	7846531	8193427	8751834	9400266			
Per Capita Income, Product and Final Consumption								
26	Population* (in million)	1220	1235	1251	1267	1.2	1.3	1.3
27	Per Capita GDP	72394	75148	79305	84111	3.8	5.5	6.1
28	Per Capita GNI	71764	74275	78344	83093	3.5	5.5	6.1
29	Per Capita NNI	64316	66344	69959	74193	3.2	5.4	6.1
30	Per Capita PFCE	41728	43488	45597	48212	4.2	4.8	5.7

* Relates to mid-financial year

Source: BofA Merrill Lynch Global Research estimates, MoSPI

APPENDIX: NEW GDP SERIES

The Central Statistical Organisation has revised the GDP series to the 2011-12 base year from 2004-05. The changes introduced in this comprehensive revision have been guided by the recommendations of the international guidelines on the subject, System of National Accounts, 2008. Major changes include:

- Comprehensive coverage of Corporate Sector both in manufacturing and services by incorporation of annual accounts of companies as filed with the Ministry of Corporate Affairs (MCA) under their e-governance initiative, MCA21. Partnership firms covered under the Limited Liability Partnership Act have also been covered. For the "manufacturing" enterprises, MCA21 database has been used to supplement the information available in the Annual Survey of Industries.

- Improved coverage of activities of local bodies – both rural and urban – and autonomous institutions, resulting in better coverage of government activities.
- Incorporation of the results of the recent NSS Surveys, viz., the Unincorporated Enterprise Survey (2010-11) and the Employment-Unemployment Survey (2011-12), along with the adoption of an "Effective Labour Input Method" for unincorporated manufacturing and services enterprises, giving due weights to different categories of workers, i.e., owners, hired workers and helpers, for compiling the estimates of these enterprises.

Apart from the above-mentioned major changes, specific changes have also been made in the following industries/sectors:

Agriculture, forestry and fishing
i. Segregation of crop and livestock production;

ii. Adoption of Agriculture Census (2010-11) and Livestock Census (2012);

iii. Revision of yield rates of meat & by-products of different livestock species based on a study conducted by National Research Centre on Meat, Hyderabad.

Mining & manufacturing
i. Estimation of value addition from extraction of sand through an indirect method, in accordance with its use in construction;

ii. "Enterprise Approach" adopted for mining and manufacturing activity using the MCA21 database to account for head offices, ancillary activities, etc. not covered under the "establishment approach".

Electricity, gas, water supply & other utility services
i. Utility services, including sewage, waste management, recycling and remediation activities, brought under the group "electricity, gas and water supply".

Construction
i. Study on the inputs in the Construction sector by Central Building Research Institute (CBRI), Roorkee;

ii. Incorporation of results of NSS All India Debt & Investment Survey, 2013.

Non-financial Services
i. Use of Consumer Price Indices-Rural, Urban and Combined, instead of the CPI-AL/RL/IW being used earlier;

ii. Use of Service Tax as an indicator for growth in the respective service(s).

Financial Services
i. Comprehensive coverage of the financial sector by inclusion of information from the accounts of stock brokers, stock exchanges, asset management companies, mutual funds and pension funds, as well as the regulatory bodies, SEBI, PFRDA and IRDA.

ACRONYMS

GDP: Gross Domestic Product
GVA: Gross Value Added
GNI: Gross National Income
NDP: Net Domestic Product
NNI: Net National Income
GNDI: Gross National Disposable Income
PFCE: Private Final Consumption Expenditure
GFCE: Government Final Consumption Expenditure
CFC: Consumption of Fixed Capital
GFCF: Gross Fixed Capital Formation
CIS: Changes in Stock
CE: Compensation of Employees
OS: Operating Surplus
MI: Mixed Income
ROW: Rest of the World

FORMULAE

1. GVA at basic prices = CE + OS/MI + CFC + Production taxes less Production subsidies
2. GVA at factor cost (earlier referred to as GDP at factor cost) = GVA at basic prices – Production taxes less Production subsidies
3. GDP **=** ∑ GVA at basic prices + Product taxes - Product subsidies
4. NDP/NNI = GDP/GNI – CFC
5. GNI = GDP + Net primary income from ROW (Receipts less payments)
6. Primary Incomes = CE + Property and Entrepreneurial Income
7. NNDI =NNI + other current transfers from ROW, net (Receipts less payments)
8. GNDI = NNDI + CFC = GNI + other current transfers from ROW, net (Receipts less payments)
9. Gross Capital Formation= Gross Savings+ Net Capital Inflow from ROW
10. GCF = GFCF + CIS + Valuables + "Errors and Omissions"
11. Gross Disposable Income of Govt. = GFCE + Gross Saving of GG
12. Gross Disposable Income of Households = GNDI – GDI of Govt. – Gross Savings of All Corporations

REMARKS ON THE FORMULAE:

1. Production taxes or subsidies are paid or received with relation to production and are independent of the volume of actual production. Some examples are:

- Production Taxes – Land Revenues, Stamps and Registration fees and Tax on profession;
- Production Subsidies – Subsidies to Railways, Input subsidies to farmers, Subsidies to village and small industries, Administrative subsidies to corporations or cooperatives, etc.

3. Product taxes or subsidies are paid or received on per unit of product. Some examples are:

- Product Taxes: Excise Tax, Sales tax, Service Tax and Import and Export duties;
- Product Subsidies: Food, Petroleum and fertilizer subsidies, Interest subsidies given to farmers, households etc through banks, Subsidies for providing Insurance to households at lower rates.

8. Other Current Transfers refers to current transfers other than the primary incomes.

9. Estimate of GCF derived from this formula is taken as the “firmer” estimate and the difference between this estimate and the sum of GFCF, CIS and valuables is taken as “errors and omissions.

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