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Economics Group

Special Commentary

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Indian Economy: Less to Fear from Global Slowdown

Real GDP Growth in India Downshifted a Bit in Q2 2015

Data that were released today show that real GDP in India grew at a year-over-year rate of 7.0 percent in Q2 2015, which was down from the 7.5 percent rate that was registered during the previous quarter (Figure 1). Moreover, the outturn was not as strong as most analysts had expected. The breakdown of GDP data into its demand-side components show that growth in real personal consumption expenditures (PCE) slowed a bit in the second quarter. That said, the 7.4 percent year-over-year growth rate in real PCE in Q2 2015 is still quite strong. Fixed investment spending was up 4.9 percent in Q2, which represents a modest acceleration relative to the first quarter. In contrast, real exports of goods and services were down 6.5 percent on a year-ago-basis in the second quarter. The deceleration in Indian economic activity in the second quarter appears to have more to do with external factors than with domestic ones.

Growth in domestic demand generally remained solid in Q2.

Figure 1

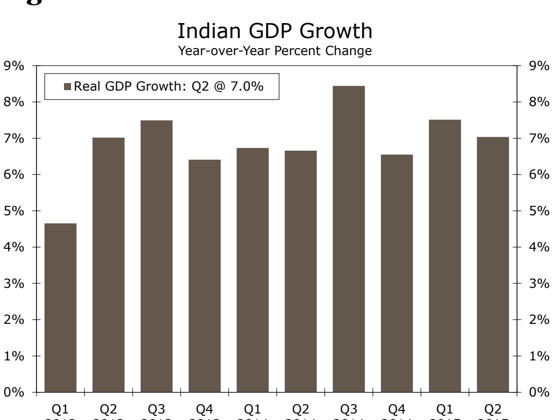
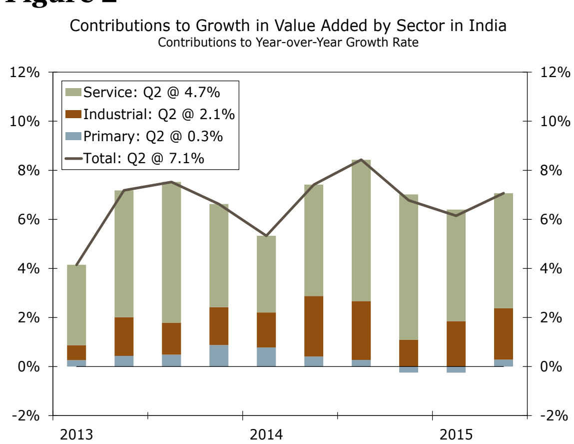


Figure 2



Source: CEIC and Wells Fargo Securities, LLC

Turning to the income side of the economy, real value added in the economy was up 7.1 percent in Q2 2015, which was stronger than the 6.1 percent growth rate that was registered in the first quarter.[1] The primary sector (i.e., agriculture, forestry and fishing), which accounts for about 17 percent of total value added in the Indian economy, made a small contribution to *growth* in value added in the second quarter (Figure 2). The industrial sector (i.e., manufacturing, mining, utilities and construction), which accounts for about one-third of total value added, contributed 2.1 percentage points to the overall 7.1 percent growth rate in value added. The service sector, which represents a bit more than one-half of total value added, accounted for two-thirds of *growth* in value added in Q2. In other words, the service sector was the main driver of Indian

[1] **In theory, growth rates in real GDP and real value added should be equal. They often are not, however, due to statistical discrepancies.**

economic growth in the second quarter. Moreover, the Indian service sector has been "punching above its fighting weight" for some time in terms of growth in value added in India. The relative orientation of the Indian economy toward services has generally served it well in the current environment of financial and economic volatility around the world, a topic to which we now turn.

India: Less Cyclically Sensitive than Most Developing Economies

Indian financial assets have generally "outperformed" their emerging market counterparts in recent months.

Financial markets in developing countries have clearly struggled this year. For example, an index that measures the trade-weighted value of the U.S. dollar versus the currencies of some important developing economies has risen sharply over the past few months (Figure 3).[2] A widely followed index of emerging market stocks is down 17 percent in local currency terms since late April, and it is off 23 percent in dollar terms over that period.[3] However, the Indian rupee is down only 4 percent or so vis-à-vis the greenback since mid-May and the Indian stock market (as measured by the S&P BSE 500 index) is essentially unchanged on balance over the same period. In other words, Indian financial assets have generally "outperformed" their emerging market counterparts in recent months.

Figure 3

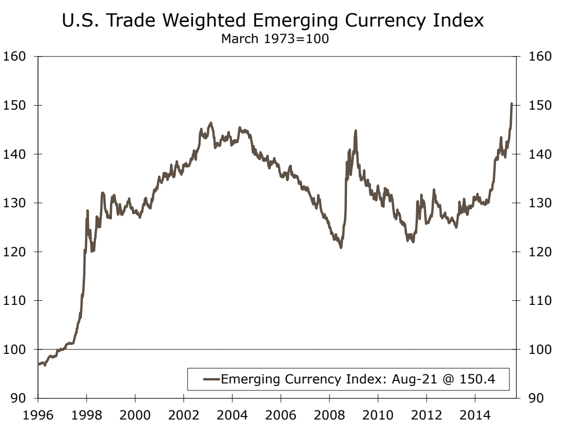
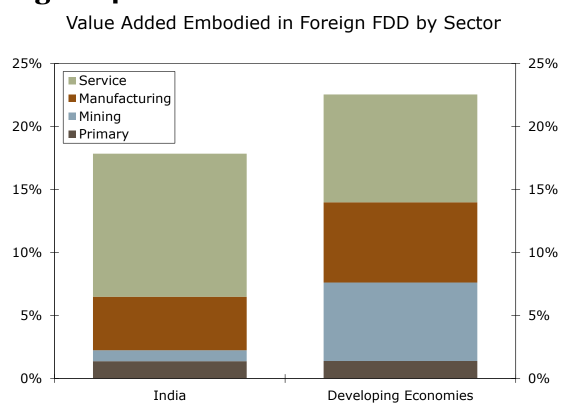


Figure 4



Source: Bloomberg LP, Organisation for Economic Cooperation and Development and Wells Fargo Securities, LLC

There may be a number of reasons for this general outperformance of Indian financial assets, but the structure of the Indian economy that was discussed previously probably plays a role. Whereas many developing economies have a fair amount of exposure to the global economy, India's exposure is more limited. As shown in Figure 4, the amount of value added in India that is attributable to final demand (i.e., final sales to consumers, businesses and the government) in foreign economies was about 18 percent in 2011 (latest available data). The comparable ratio for all developing economies was 23 percent. If growth is slowing in some important economies (e.g., China), then there would be less drag on the Indian economy than on the "average" developing country.

Service exports are more important to India than exports of industrial goods.

Moreover, the structure of Indian exports reduces the sensitivity of the Indian economy to foreign economic developments even further relative to the average developing country. About 1 percent of Indian value added is attributable to exports of the mining sector (Figure 4). In contrast, mining exports account for a sizeable 6 percent of value added in the average developing country with this ratio exceeding 8 percent in some large developing economies (e.g., Colombia, Indonesia, Malaysia and Russia) that are major producers of "hard" commodities.

Exports of manufactured goods account for 4 percent of value added in India but more than 6 percent in the average developing economy. This ratio is much higher in countries such as

[2] **The Fed's "Other Important Trading Partners" (OITP) index has risen more than 8 percent since mid-May.**

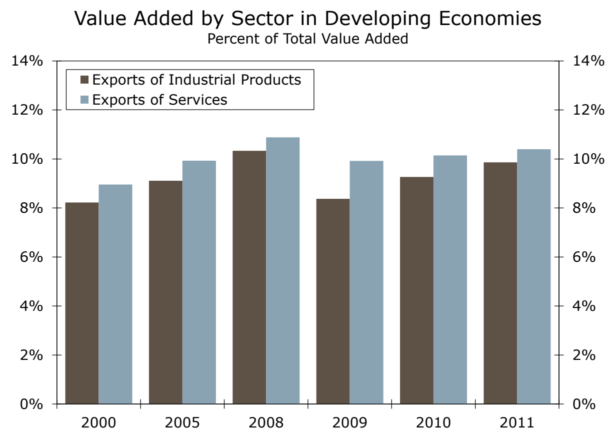
[3] **We refer to the MSCI emerging market indices.**

Vietnam (11 percent), Malaysia (17 percent) and Taiwan (18 percent). On the other hand, India derives more than 11 percent of its total value added from exports of services, whereas the comparable ratio for the average developing economy is less than 9 percent.

The industrial sector, which is a combination of the mining and manufacturing sectors, tends to be more cyclically sensitive than the service sector. As shown in Figure 5, the share of value added in all developing countries that is attributable to exports of industrial products swung from 10.3 percent in 2008 to 8.4 percent in the global recession year of 2009. The ratio in the service sector was more stable during that period.

The industrial sector tends to be more cyclically sensitive than the service sector.

Figure 5



Source: CEIC and Wells Fargo Securities, LLC

The bottom line is that the Indian economy should be less sensitive to a downshift in global growth than many other developing economies. Not only does final spending in foreign economies account for a smaller proportion of value added in India than it does in other emerging markets, but exports of services tend not to be as cyclically sensitive as exports of industrial goods. The year-over-year rate of real GDP growth in India slowed a bit in Q2 2015 relative to the previous quarter, and further deceleration could lie in store. That said, India likely has less to fear from a global economic slowdown than do some of its emerging market counterparts who are intensively involved in global trade in commodities and industrial goods.

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