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India's GDP growth slows to 2-year low of 5.4% in Q2, adding pressure on RBI to cut rates

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India's economy grew at its slowest pace in seven quarters, with gross domestic product (GDP) expanding just 5.4% year-on-year in the July-September quarter, well below the 6.5% expected by analysts. The slowdown, driven by weaker manufacturing and private consumption, marks a sharp decline from the 6.7% growth recorded in the April-June period.

Manufacturing, a key driver of economic activity, grew only 2.2% in the latest quarter compared to a robust 7% growth in the previous one. Economists attribute the slump to rising inflation, weak real wage growth, and high borrowing costs, all of which have dampened urban consumption.

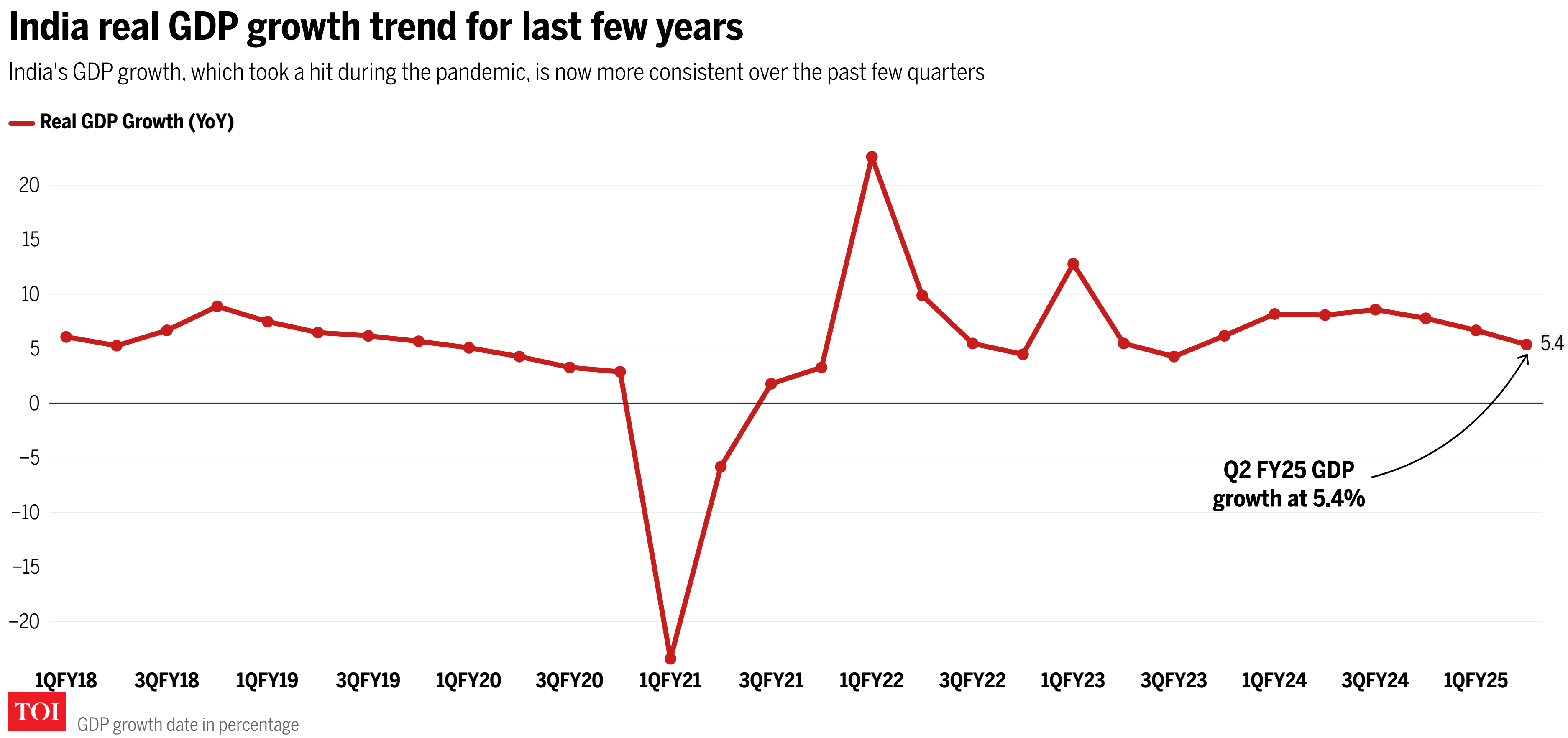
Why it matters

- The latest data highlights mounting challenges for India's economy, raising concerns about the sustainability of its recent growth momentum.
- Consumer crunch: Private consumption, which accounts for 60% of GDP, slowed to 6% growth compared to 7.4% in the prior quarter, reflecting weakened demand for both durable and non-durable goods.

- Policy pressure: The Reserve Bank of India (RBI), which has maintained its benchmark repo rate at 6.5% since May 2020, now faces mounting calls to cut rates to stimulate demand and investment.
- Political stakes: Prime Minister Narendra Modi's government, which recently pledged increased spending to address uneven growth and joblessness, faces added pressure ahead of crucial fiscal and political milestones.

Zoom in

- The slowdown is most evident in manufacturing, a sector that has long been seen as central to India's ambitions of becoming a global economic powerhouse. "The manufacturing sector appears to have taken the maximum beating," said Upasna Bhardwaj, Chief Economist at Kotak Mahindra Bank. She noted that disappointing corporate earnings are consistent with the subdued growth figures.
- The gross value added (GVA), a more stable indicator of economic activity, grew 5.6% year-on-year, down from 6.8% in the previous quarter, further underscoring the widespread deceleration across sectors.
- Rural vs urban dynamics: While rural demand showed signs of recovery, thanks to a strong monsoon that boosted agricultural output by 3.5% (up from 2% in April-June), urban consumption lagged.
- Economists blame this on factors such as: *Rising food prices, which erode disposable income; high borrowing costs that deter spending on big-ticket items; weak wage growth in urban areas, limiting purchasing power.*



What they're saying

- Upasna Bhardwaj, Kotak Mahindra Bank: "The sharply lower-than-expected GDP figures reflect the highly disappointing corporate earnings data. The manufacturing sector appears to have taken the maximum beating."
- Harry Chambers, Capital Economics: "We expect growth to remain subdued over the next few quarters as household consumption moderates and investment growth eases in an environment of still-high interest

rates."

- Aditi Nayar, ICRA: "In light of the recent spike in CPI inflation, we anticipate a status quo from the RBI's monetary policy meeting next week. However, a February 2025 rate cut may be on the table if the next two inflation prints recede."
- Sakshi Gupta, HDFC Bank: "The softer economic growth stemmed from lower manufacturing, electricity and mining growth in the second quarter. On the demand side, consumption growth slowed probably due to a moderation in urban demand."
- Garima Kapoor, Elara Securities: "Amid sluggish consumption growth owing to moderating real income growth and the effect of concentrated and heavy rains, demand drivers remained weak in Q2 FY25."
- Radhika Rao, DBS Bank: "The outcome reflects a miss in domestic-oriented as well as external-driven segments. This quarter likely marks the bottom of the cycle and we count on a modest recovery in the second half as few of these constraints are expected to even out."

The big picture

- India's economy, while still one of the fastest-growing major economies globally, is navigating headwinds from both domestic and global factors:
- Domestic constraints: Inflation, hovering around 6%, has squeezed disposable incomes and dented consumer confidence. Slowing urban demand and tepid corporate investments are further compounding the issue.
- Global risks: Export-oriented sectors have struggled amid weakening global demand and rising geopolitical tensions, particularly with ongoing uncertainty around US-China relations.
- The latest growth data increases pressure on the RBI to reconsider its current monetary stance. While the central bank has maintained its repo rate at 6.5% to curb inflation, bond yields fell after the GDP data release, signaling market expectations of a potential rate cut.

Between the lines

- The slowdown poses a political challenge for the Modi government, which has promised ambitious growth targets and development programs. Rising food prices and joblessness have already emerged as key voter concerns, underscoring the need for swift economic interventions.
- While India's status as a high-growth economy remains intact, the latest data is a stark reminder of the vulnerabilities that come with its scale and complexity.
- However, chief economic advisor V Anantha Nageswaran said that second quarter GDP growth at 5.4 per cent is disappointing but maintained that overall growth projection for FY25 at 6.5 per cent is "not in danger".
- Harry Chambers, Assistant Economist at Capital Economics, warned that while growth may remain subdued, the economy is not heading toward a major downturn. "The economy is not going to crater," he said, emphasizing resilience in certain sectors.

What's next

- Economists are divided on the path forward. While some expect a pick-up in growth during the second half of the fiscal year, others caution that the recovery could be modest and uneven.
- One thing is certain now: The RBI's next monetary policy decision on December 6 will be closely watched.
- Bond markets reacted swiftly to the weaker-than-expected GDP data, with yields falling as investors priced in the possibility of a rate cut. The RBI, which has held its benchmark repo rate steady at 6.50% since May 2020, faces a delicate balancing act between fostering growth and containing inflation.
- "Post-today's print, there is a high probability of an RBI rate cut in December," said Gaura Sen Gupta, an economist at IDFC First Bank.
- Although others see rate cuts as more likely in early 2025, contingent on inflation retreating towards the central bank's 4% target. Analysts expect the central bank to hold rates steady in the short term while evaluating inflation trends. However, if inflation eases further, a rate cut as early as February could be on the horizon.

(With inputs from agencies)