What the Q1 GDP numbers say

With improved revenues, government must increase expenditures to push consumption and investment

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India's GDP data for Q1 of 2021-22 was released by the National Statistical Office (NSO) on August 31, 2021. Real GDP growth at 20.1% in Q1 of 2021-22 is largely because of the contraction of 24.4% in the corresponding quarter of the first COVID-19 year, that is, 2020-21. Even with this high growth, the magnitude of real GDP fell short of the corresponding level in 2019-20 by a margin of ₹3.3 lakh crore. A growth rate of 32.3% was required in Q1 of 2021-22 for achieving the same level of real GDP as in Q1 of 2019-20.

Annual growth prospects

The Indian economy would have done better in Q1 of 2021-22 had its performance not been beset by the adverse impact of COVID-19's second wave which largely affected the months of April and May 2021. The Q1 2021-22 output and GDP growth data reflect a strong base effect since the corresponding levels of Q1 of 2020-21 were significantly adversely impacted by the first wave of COVID-19. While the economic impact of the first wave was more severe, the health impact of the second wave was more serious. This occurred because of the difference in the nature and scope of lockdowns in the two waves.

An interesting issue is to utilise the Q1 national income data to formulate views on how much additional growth would be required for the Indian economy in the remaining three quarters of the current year in order to clock the annual growth of 9.5% as forecast by both the Reserve Bank of India and the International Monetary Fund. We estimate that an average growth of 6.8% in the remaining part of the year would enable the Indian economy to meet this target. This should easily be feasible in Q2 since there would still be the benefit of a base effect, considering a contraction of 7.4% in Q2 of 2020-21. The task would become relatively more demanding in Q3 and Q4 considering that the real GDP growth was positive at 0.5% and 1.6%, respectively, in the corresponding quarters of 2020-21.

Workers use machinery at a coastal road project construction site in Mumbai. • AP

The largest segment of GDP viewed from the demand side is private final consumption expenditure (PFCE). Its average share over the last three years (2018-19 to 2020-21) was 56.5%. In Q1 of 2021-22, PFCE grew by 19.3%, which is marginally below the overall GDP growth. At the same time, it is notable that the contraction in PFCE in the corresponding quarter of 2020-21 was relatively larger at 26.2%. Thus, if PFCE were to reach back the 2019-20 level, it should have grown by 35.5% in this quarter. The recovery in private consumption demand is lagging behind the overall GDP growth. Since private consumption depends largely on income growth and its distribution, it would be useful to focus on further supporting income and employment levels for the MSMEs and informal sectors of the economy which have a higher propensity to consume.

On the demand side, noticeable positive outcomes in Q1 of 2021-22 came from exports and to some extent, from investment as reflected by gross fixed capital formation (GFCF). Exports grew by 39.1% over a contraction of 21.8% in Q1 of 2020-21. This differential is reflected in a positive growth of 8.7% over the export level in the corresponding quarter of 2019-20. In the case of GFCF, the base effect was quite large. Despite a growth of 55.3% in Q1 of 2021-22, its magnitude was still 17.1% lower than the corresponding level in Q1 of 2019-20. The only demand segment which contracted even with reference to Q1 of 2020-21 was government final consumption expenditure (GFCE). This contraction was by a margin of (-) 4.8%.

The output side

The performance of the economy when viewed from the output side largely points to the adverse impact of COVID-19's second wave which dragged the performance of the key service sector – namely trade, transport, storage et al. This sector grew by 34.3% in Q1 of 2021-22 as compared to a contraction of 48.1% in Q1 of 2020-21. However, relative to its level in Q1 of 2019-20, the output of this large service sector was significantly lower by 30.2% in Q1 of 2021-22. Though public administration, defence and other services showed a growth of 5.8% in Q1 of 2021-22 over Q1 of 2020-21, they actually reflected a contraction of 5.0% as compared to Q1 of 2019-20.

The key positive news came from the agricultural sector which showed a growth of 4.5% in Q1 of 2021-22, in continuation of annual growth of 3.6% in 2020-21. Given agriculture's positive growth in all the quarters of 2020-21, further contribution from this sector to the overall growth may not be expected. Its average weight to the overall output is also low at about 15%. It is the high weight manufacturing sector and the two substantive service sectors – trade, transport et. al and financial, real estate et al. – which will have to support growth in the remaining part of the year. Construction and electricity, gas, water supply and other sectors have already started showing a robust recovery. These may respond further to the government's emphasis on expanding investment in infrastructure.

Fiscal prospects

The government's intervention in the economy is reflected by the performance of GFCE on the demand side, and the public administration, defence and other services sector on the output side. In both cases, as noted earlier, the growth in Q1 of 2021-22 was less than desirable given the improvement in the Centre's tax revenue performance. Fiscal data of the Controller General of Accounts released on August 31, 2021 shows that the Centre's gross tax revenues (GTR) grew sharply by 83.1% in April-July of 2021-22 over the corresponding period of 2020-21 and by 29.1% over the corresponding period of 2019-20. The Centre's fiscal deficit in the first four months of 2021-22 amounted to only 21.3% of the budgeted target as compared to the corresponding average level of 90% over the last four years. Clearly, a significant policy space is opening up for the government to raise its demand and its contribution to output in the remaining part of the current fiscal year. Attempts should be made either to bypass or at least curb the adverse impact of COVID-19's likely third wave. Given the fiscal room, both the coverage of vaccination and the pace of investment in health infrastructure should be accelerated within the strategy of expanding the overall infrastructure investment. As revenues improve, expenditures can be increased. There is no need to reduce the fiscal deficit below the budgeted level of 6.8% of GDP.

Even a growth rate of 9.5% in the current year will mean that over two years, the Indian economy had an annual growth rate of 1.1%. The real test will come in 2022-23. Will the Indian economy get back to a higher growth path of 7%? We need a faster rate of growth to make up for the loss of output in the previous two years from the trend rate. We must lay the foundation for a faster growth in this year itself.

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