Growth Slows Sharply in Q2 FY25 Amid a Slump in Industries

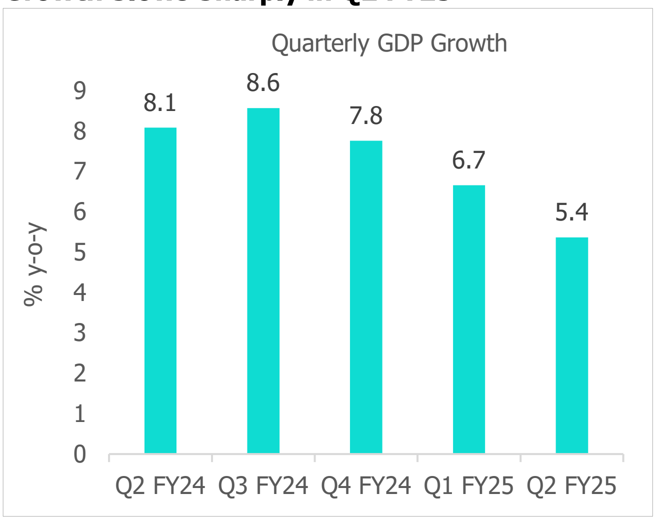
November 29, 2024 | Economics

The GDP growth in Q2FY25 moderated sharply to a seven-quarter low of 5.4%, down from 6.7% in the last quarter and much below the market expectations. The GVA growth came in at 5.6% in Q2 FY25. While the GDP growth was expected to moderate as being indicated by some of the high frequency macroeconomic indicators and weaker corporate performance, the quantum of deceleration is much sharper than expected.

In terms of the sectors, agriculture growth continued to recover, growing at 3.5% YoY in Q2, higher than the 2% growth witnessed last quarter. The services sector, too, maintained its broad momentum, growing at 7.1% YoY in Q2, marginally slower than Q1 growth. However, the industrial sector performed poorly, with all major subheads witnessing a slowdown. A prolonged monsoon this year impacted the mining sector in Q2 FY25. Additionally, the contraction in public capex further slowed construction activities. The manufacturing growth witnessed a steep slowdown in growth, growing at 2.2% YoY in Q2, much lower than the 7% YoY growth in the previous quarter. The slowdown in the manufacturing sector was on the expected line, reflecting the moderation seen in IIP data and corporate profitability. However, the quantum of slowdown was higher than expected.

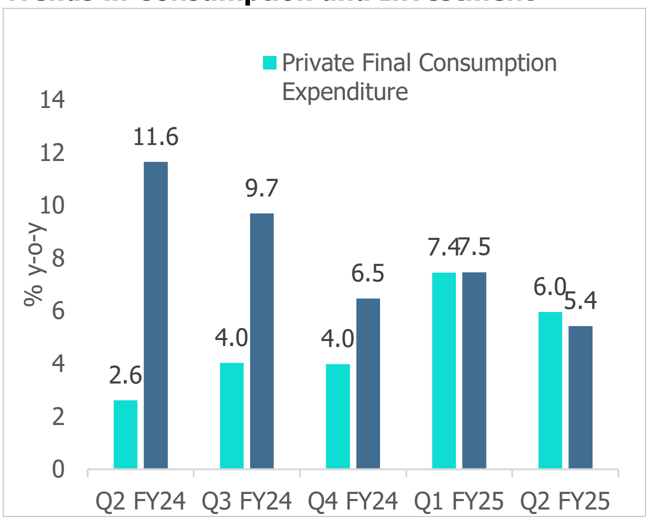
Within the services sector, trade, hotels, transport, communication and broadcasting services saw an improvement in growth compared to the previous quarter. However, the growth moderated in the financial, real estate and professional services to 6.7% compared to the previous quarter's growth of 7.1%. Growth in public administration services also slowed marginally to 9.2% in Q2 down from 9.5% in the previous quarter. A slower government spending could have impacted this sector.

Growth Slows Sharply in Q2 FY25



Source: MOSPI

Trends in Consumption and Investment



Source: MOSPI

On the expenditure side, the private final consumption expenditure moderated to 6% in Q2 FY25 from 7.4% in the previous quarter. However, it remained largely healthy. While there are signs of an ongoing recovery in the rural demand, urban demand continues to slow which is concerning. High food inflation and muted real wage growth continues to impact private consumption demand.

Growth by Expenditure (% y-o-y)

	Q3 FY24	Q4 FY24	Q1 FY25	Q2 FY25
Government Final Consumption Expenditure (GFCE)	-3.2	0.9	-0.2	4.4
Private Final Consumption Expenditure (PFCE)	4.0	4.0	7.4	6.0
Gross Fixed Capital Formation (GFCF)	9.7	6.5	7.5	5.4
GDP (at constant prices)	**8.6**	**7.8**	**6.7**	**5.4**

Source: MOSPI

There has also been a sharp moderation in investments as measured by Gross Fixed Capital Formation. The government's capex, which had been supporting growth so far, saw a moderation, with the Centre and consolidated State capex falling by 15% and 11%, respectively, in H1. Exports of goods and services grew by 2.8% YoY in Q2, slowing from 8.7% YoY growth witnessed last quarter. However, it was accompanied by a contraction in imports as well, which fell by 2.9% YoY in Q2. On the brighter side, the government's final consumption expenditure rebounded in Q2 as reflected by higher revenue spending.

Sectoral Growth (% y-o-y)

	Q3 FY24	Q4 FY24	Q1 FY25	Q2 FY25
Agriculture, forestry & fishing	**0.4**	**0.6**	**2.0**	**3.5**
Industry	**10.5**	**8.4**	**8.3**	**3.6**
Mining & quarrying	7.5	4.3	7.2	-0.1
Manufacturing	11.5	8.9	7.0	2.2
Electricity, gas, water supply & other utility services	9.0	7.7	10.4	3.3
Construction	9.6	8.7	10.5	7.7
Services	**7.1**	**6.7**	**7.2**	**7.1**
Trade, hotels, transport, communication & broadcasting	6.9	5.1	5.7	6.0
Financial, real estate & professional services	7.0	7.6	7.1	6.7
Public administration, defence and other services	7.5	7.8	9.5	9.2
GVA (at basic price)	**6.8**	**6.3**	**6.8**	**5.6**

Source: MOSPI

Way Forward

We expect GDP growth to pick up in the second half of the year as the government pushes up its capex spending. Agricultural production is estimated to be healthy and that should help further bolster rural consumption. Food inflation is also expected to moderate by the fourth quarter and that would be supportive of pick up in consumption. Beyond that urban consumption would be dependent on improvement in the employment scenario and real wage growth. Sustained momentum in consumption growth would be critical for private investment to pick up. The order book of capital goods companies and road development companies are showing a significant pick up in first half of the year and that bodes well for overall pick up in capex. However, weak growth in China and consequent flooding of markets like India would remain a deterrent for pick up in private investment. On the external front, while merchandise exports growth is likely to remain muted in midst of global uncertainties, we expect the momentum in services exports to continue. Overall, we expect GDP growth of around 6.8% in H2, taking our projection for FY25 to around 6.5%.

Contact

Rajani Sinha	Chief Economist	rajani.sinha@careedge.in	+91 - 22 - 6754 3525
Sarbartho Mukherjee	Senior Economist	sarbartho.mukherjee@careedge.in	+91 - 22 - 6754 3483
Mradul Mishra	Media Relations	mradul.mishra@careedge.in	+91 - 22 - 6754 3596

CARE Ratings Limited

Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Phone : +91 - 22 - 6754 3456 | CIN: L67190MH1993PLC071691

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