India's double deflation issue

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India's GDP to auto-correct

As global commodity prices plummeted, the divergence between output and input inflation soared

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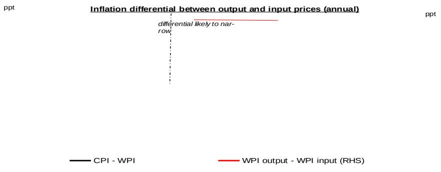

Source: CEIC, HSBC estimates

The impressive rise in manufacturing was not supported by volume indicators

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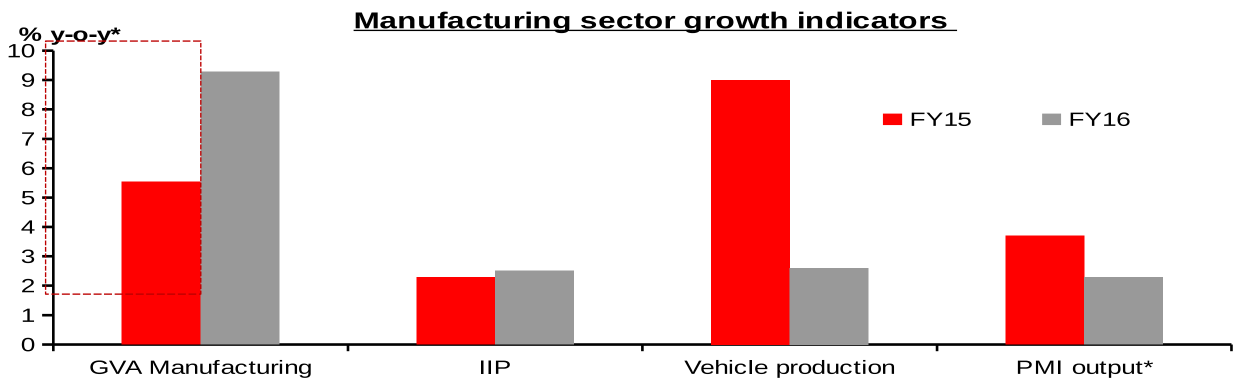

Source: CEIC, HSBC estimates

Double-deflating the data suggests that manufacturing growth in FY15 could have been exaggerated by 120bp

Manufacturing sector	Output	Input	GVA (output - input)	Output	Input	GVA
	INR bn, constant prices			*% y-o-y*		
	single deflation			***single deflation***		
FY15 (official)	75204	58533	16671	3.1	2.5	**5.5**
	double deflation			***double deflation***		
FY15 (HSBC est)	75,204	56,425	18,778	3.1	2.8	**4.3**

Source: CEIC, HSBC estimates

NB: In calculating double deflation estimates, we deflate nominal output by the official output deflator and nominal input by our calculated input deflator

Over the next several quarters, the divergence between output and input prices could normalise

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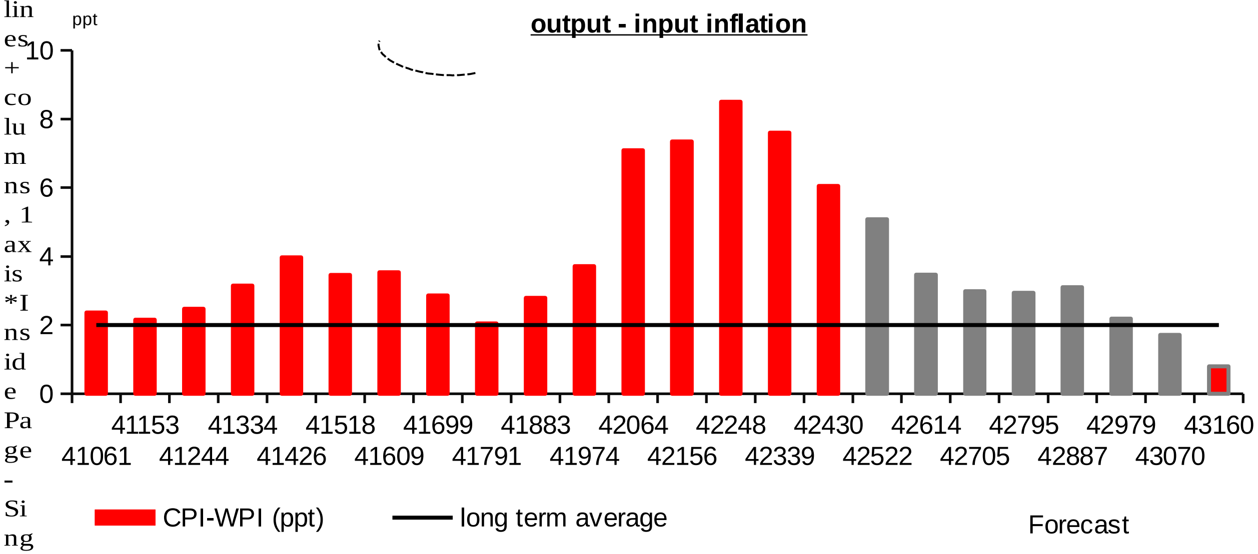

Source: CEIC, HSBC estimates

This has happened before; relative price movements exaggerated manufacturing growth post the GFC, only to correct shortly after

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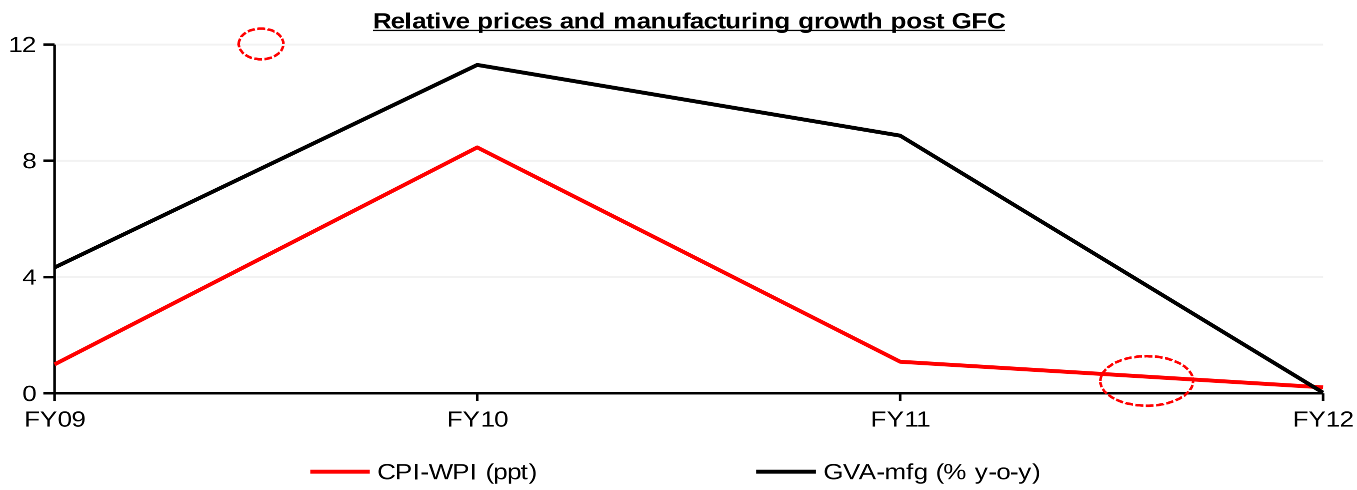

Source: CEIC, HSBC estimates

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Summary

India’s new GDP series seems to exaggerate the economy’s true growth rate. However, this overestimation is likely to narrow over the next few quarters.

We find that the practice of ‘single deflation’ instead of ‘double deflation’ during a period of falling commodity prices and sticky output inflation, artificially exaggerated growth prints.

We estimate that real manufacturing growth may have been overestimated by 450bp in FY16 as the divergence between output and input prices soared.

We also believe that this divergence has peaked and will normalise over the next six quarters.

During this period, the overestimation in India’s manufacturing growth should narrow. Users of GDP data should not read weaker manufacturing growth prints as renewed weakness on the ground.

Rather, calculated growth will finally begin to converge towards true values.