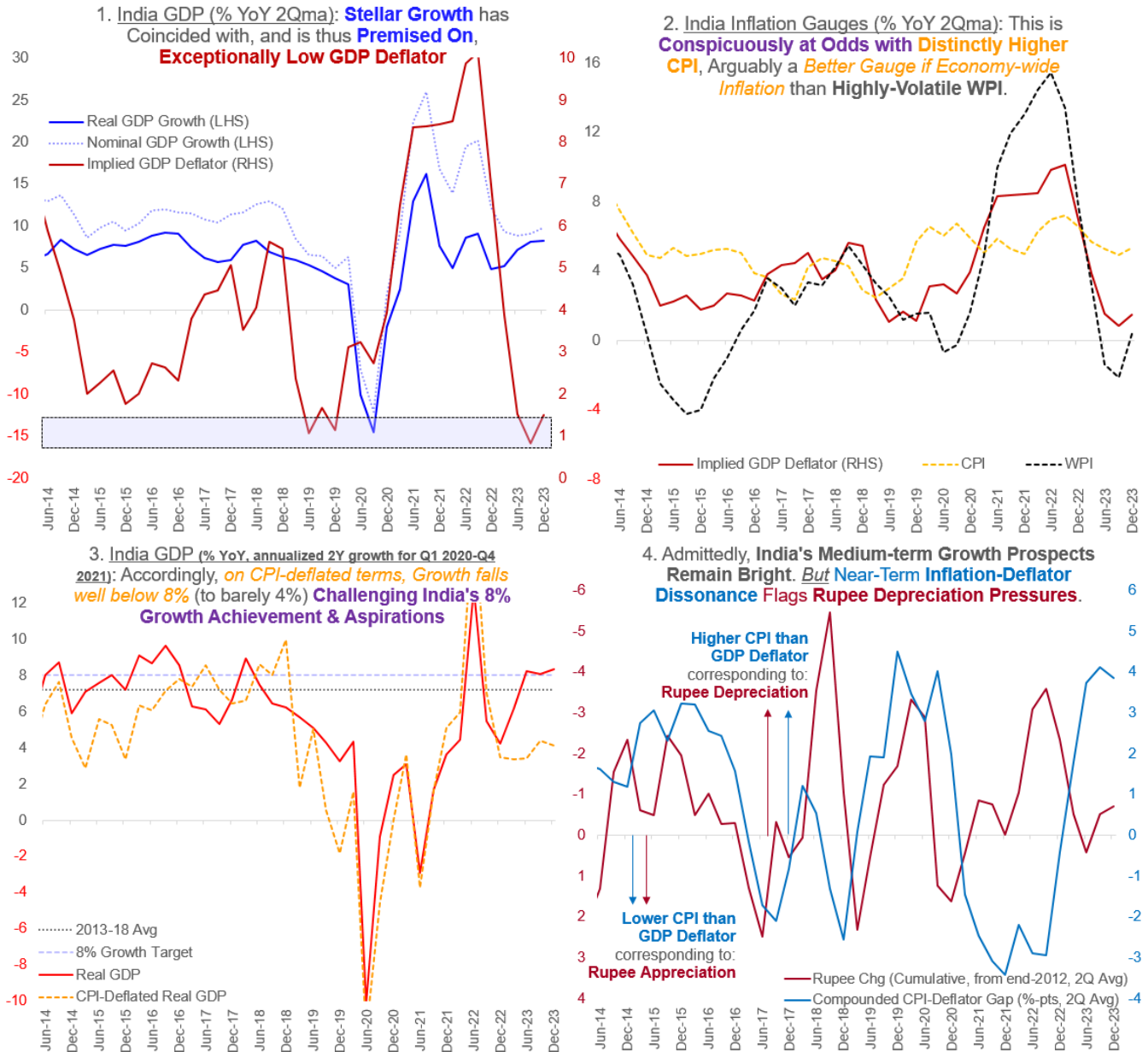


India's Awkward Growth-Inflation Proposition



Sources: Bloomberg, Mizuho Bank

1. Stellar Growth Awkwardly Premised on Stumbling Inflation

- After a solid run of 8+% GDP growth for three quarters running, **sustaining 8% economic momentum** is now a **convenient encapsulation of India's high-growth ambitions**.
- **But** beneath the glitzy headline, and *beyond justifiable grouse about uneven growth drivers*, is the **awkward proposition of 8+% growth clip for Q2-Q3 2023 requiring exceptionally low inflation**.
- To be precise, **implied GDP deflator has average 1.0-1.5%**, which is not just *exceptionally low*, but arguably neither *realistically nor sustainable*.

2. Removed from Inflation Reality

- In fact, the **implied GDP deflator**, which ought to be a measure of economy-wide inflation, is **divorced from the lived reality of materially higher (5-6% consumer) inflation**.
- Admittedly, the *GDP deflator falls between CPI and WPI*, with the latter averaging -1% for the corresponding period, *ostensibly lending a veneer of legitimacy* to real GDP computations.
- But **counter-intuitive WPI deflation**, from the quirks of dis-proportionately heavy commodity and energy and food weights, is **not reflective of far higher inflation in India's downstream industries and services**. So, *referencing off highly volatile WPI is, especially in this case, outright misleading*.

3. Challenges 8% Achievement & Aspiration

- In which case, **any serious tyre-kicking must grapple with GDP growth barely clearing 4%** when **backed out from CPI-based deflator**; which is **notably more representative than WPI-influenced deflator measures**, *although not as robust as input-output based deflators*.
- The *true* underlying growth momentum may admittedly be between the two.
- Regardless, inevitably, and rather inconveniently, this **lowers the current underlying (real) growth run rate**; with less flattering implications for growth potential and welfare.
- Moreover, not only is **growth achievement challenged**, but **so are wider economic aspirations**; as the *8% growth ambitions is now a relatively raised bar*.

4. Earnings Optimism is Nominal, But Rupee Depreciation Pressures are Real

- So **something has got to give** as *squaring the awkward deflator dissonance* requires pressure relief.
- Arguably, **Indian equity market bulls** are by and large **unfettered**. Simply because **earnings are nominal** and *higher inflation with price pass-through does not compromise optimism*.
- **But** the same cannot be said for the **rupee**. Fact is, higher underlying inflation (than accounted for in GDP) will have **negative bearing on rupee** once incorporated belatedly (as lower effective growth).
- What's more, **PPP effects** could also **tend to dampen relative rupee valuations**. And a look at *CPI-GDP deflator divergence squares with potential for rupee downside*.
- **Higher underlying inflation vis-à-vis growth** suggest *upward pressure yields*, with a tendency for *higher term premium* if there is evidence of stickier and more elevated underlying inflation. Although RBI policy vis-à-vis global monetary policy could offset.

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