

South Asia

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India's production strength a mirage

By Kunal Kumar Kundu

NEW DELHI - After two continuous months of contraction, India's Index of Industrial Production (IIP) for January finally gave some cause for cheer as it expanded by 2.36% annual rate, the fourth increase during the past 10 months of the current financial year 2012-13.

Even so, while this growth rate was higher than what was achieved in January 2012 (0.97%) and double what the market was expecting (a 1.2% annual growth rate), the overall growth rate for the period April-January was a mere 1% compared to the 3.4% achieved during the same period in the previous year.

As is their wont, the government spokespersons for the umpteenth time proclaimed that the worst for the economy is over. Planning Commission deputy chairman Montek Singh Ahluwalia, speaking to NDTV Profit, expressed his happiness at the number and said that, "the numbers fits in with the signals we have been getting ... have to see how fast the turnaround happens."

He also foresaw a turnaround in the economy earlier this year and trashed the 5% advance estimate of GDP growth released by India's Central Statistical Organization (CSO), stating that the CSO failed to see the green shoots that he and his team were able to see, only to resign to his fate once the third-quarter GDP data was released. The next couple of months' data will confirm whether what he is seeing is a green shoot or a withering weed.

If one takes a dispassionate view, there's no cause for euphoria. For one, India's PMI data has become notoriously unpredictable, and there's no reason to believe that the sharp rebound expected by the February manufacturing PMI (which increased to 54.2 from January's 53.2) may eventually materialize.

The PMI also showed a rebound in November and December while the manufacturing data actually showed a contraction. In contrast, January PMI showed a drastic decline while manufacturing expanded

for the first time in three months.

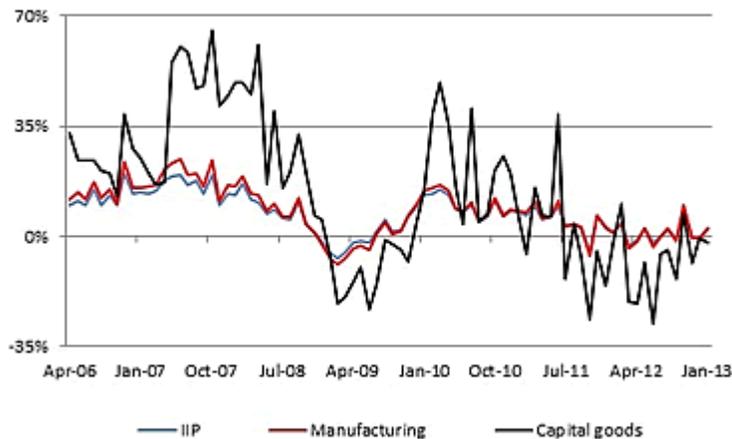


Source: HSBC Markit, MOSPI

India's domestic passenger car sales plummeted in February by 26%, the worst performance in 12 years. This was the fourth consecutive monthly drop as economic sentiments turned weak, fuel costs rose and finance cost at their peak.

According to the Society of Indian Automobile Manufacturers, February sales came in at 158,513 units, down from 213,362 units sold during February 2012. It is important to note that February this year will have one working day less than that of the previous year, which will also weigh on the overall manufacturing data for February.

Capital goods production continued to contract as production fell by a 1.8% annual rate to ratchet up declines in nine out of 10 months in the current financial year. For the entire 10-month period, it contracted a worrying 9.3%, compared to a 2.9% decline during the same period in the previous year. This fall, despite a low base effect, is a major cause for concern as clearly business sentiment is showing no encouraging signs of revival.



Source: MOSPI

One cannot also rule out the effect of fiscal drag as the fiscally challenged government has embarked on a severe austerity drive, which will put further pressure on overall sentiment for the next two months.

While the January data is unlikely to herald a spring, the retail inflation data released immediately after the release of the industrial production data ensured that the euphoria of a positive production data was short-lived, as the newly constructed CPI (used since January 2011) showed an increase of as much as 10.91%, the highest growth rate recorded.

There is, therefore, a possibility that official gauge of inflation (WPI or Wholesale Price Index) to be released on Thursday may actually show a reversal of the easing trend. However, given that high retail inflation has been caused by ever-increasing food inflation, core inflation may continue to remain benign.

The Reserve Bank of India will, therefore, be confronted with the dilemma of a slowing economy (despite the January uptick) and high inflation when it meets on March 19 to decide on monetary policy action. My sense is that the central bank will focus on core inflation and ignore the January increase as noise, and cut the policy rate by 0.25%, though their tone would continue to be cautious.

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