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Indian factory output maintains weakness
By Kunal Kumar Kundu

NEW DELHI - India's latest official industrial production (IP) data, released last week for February 2013, showed, as anticipated, the 2.36% growth rate in industrial production recorded in January 2013 was an aberration.

Yet, the umpteenth time, officials jumped at some isolated bit of good news to herald that a "change is round the corner".

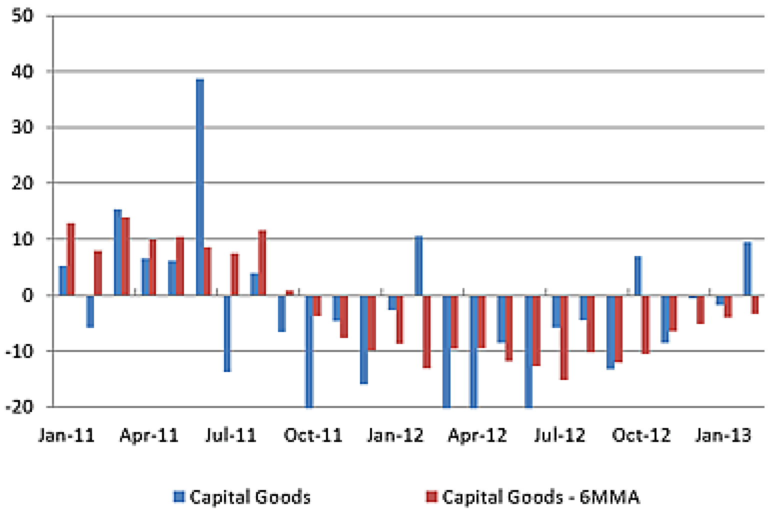
India's IP barely inched up in February, growing at 0.57% annualized rate as against 4.29% recorded for the same month a year ago. Hence, for the eleven-month period April-February, industrial production increased at a mere 0.89% annualized rate, compared with 4.31% growth during the same period in the previous year.

A bigger question is whether IP has bottomed out and is on its way to recovery as is claimed in some quarters. So far, there's no indication to that effect. While the IP growth remained positive at an annualized rate, it contracted by as much as 3.1% on a monthly basis as against a contraction of 1.4% during the same period in 2012.

Within the IP, manufacturing, which has 75.5% weightage in the index, contracted 1.3% on a monthly basis although the annualized growth rate was 2.19%. And the only reason manufacturing showed a decent growth was sudden jump in capital goods production.

Capital goods production recorded a strong 9.5% annualized growth in February; it accounted for nearly 94% of the growth recorded by the manufacturing sector. But for capital goods production, IP would have shrunk in February.

Unfortunately, capital goods data is notorious for its extreme volatility, and there's no reason to believe that there's a sudden reversal of fortune for this sector. This sudden spurt may well be the result of clubbing up of production data and the impact of a lower base. If we take the six-month moving average data to strip off the volatility, there was actually a 3.3% annualized contraction in February, the 17th straight month of contraction.

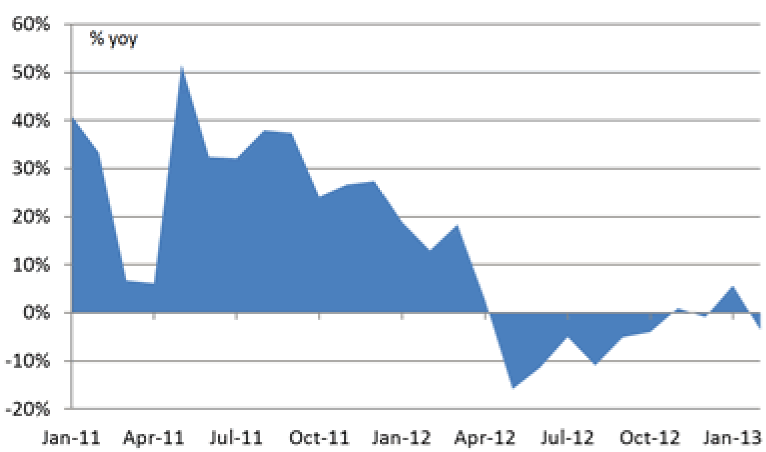


Source: CEIC Data, author's calculation

Investment is showing no signs of picking up. The euphoria that was generated after the government announced a series of policy measures from September 2012 onwards has slowly died down with hardly any of the announcements bearing fruit. Issues related to land acquisition continue to be the biggest impediment against investment and the much discussed and debated Land Acquisition Bill continues to be debated with virtually no end in sight.

Availability of coal continues to be the biggest challenge for large power projects. India's peak power problem has been rising and industrial production has been suffering due to acute power shortages - an issue that has repeatedly been highlighted by HSBC Markit during the release of its monthly manufacturing PMI data for India.

India's non-oil imports have been shrinking for some time now - clearly indicating the weakness in the investment cycle. In fact, despite the publicly stated desire (of both Prime Minister Manmohan Singh and Finance Minister P Chidambaram) to remove obstacles in the way of many of the projects stuck at various levels, hardly anything has moved beyond the discussion stage thus far, though we have been regularly told that major announcements would be made soon.



Source: CEIC Data

Given the current political uncertainty and the increasing probability of general election taking place this year rather than next, it is quite unlikely that the investment cycle will revive any time soon. Hence the positive growth in IP is no signal of industrial production bottoming out. Business would rather wait for the election outcome before committing money in the domestic market.

Indeed, Indian businesses seem to be more comfortable investing abroad than at home. According to Reserve Bank of India data, Indian companies in February invested close to US$1.65 billion in various overseas markets. In January, the investment was even higher, at $3.3 billion. This compares highly favorably as compared to investments made by Indian companies in India.

Jindal Steel and Power recently announced investment to the tune of $2 billion in a power plant in Africa, while the the Birla family has said it will $750 million across the world to increase its companies' aluminum capacity.

For the time being, therefore, investment-led growth is unlikely to materialize. However, increased spending on various populist measures (read social sector spending) as elections near will likely see some consumption-led growth coming back as rural spending will likely get a boost.

That, however, will only mean another bout of price increases even before the current level of inflation gets a chance to moderate to comfortable levels.

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