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Indian output still weak

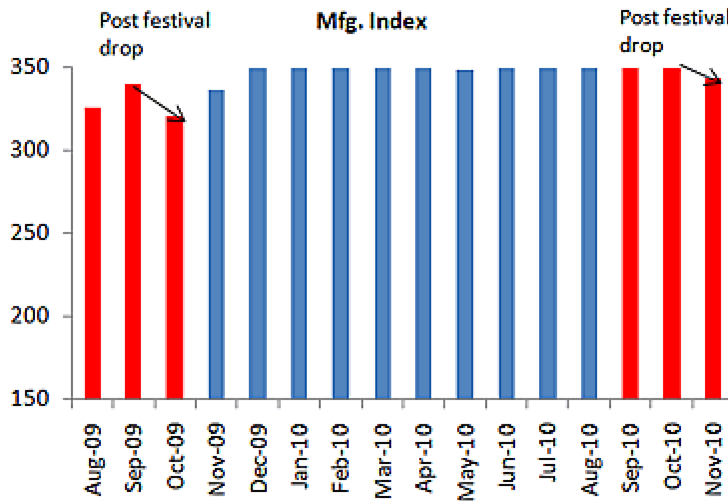
By Kunal Kumar Kundu

India's October industrial production (IP) number released on Wednesday showed a growth of a mere 2.7% on a year-on-year basis (and way below the consensus number), the lowest growth recorded since May 2009, when the year-on-year growth was only 1.7%.

Coming on the back of 11.3% growth recorded in the previous month, this was a major shocker for the market. However, it is important to note that both these growth numbers were exaggerated either way because of the fact that the festival period in India does not always fall on the same month.

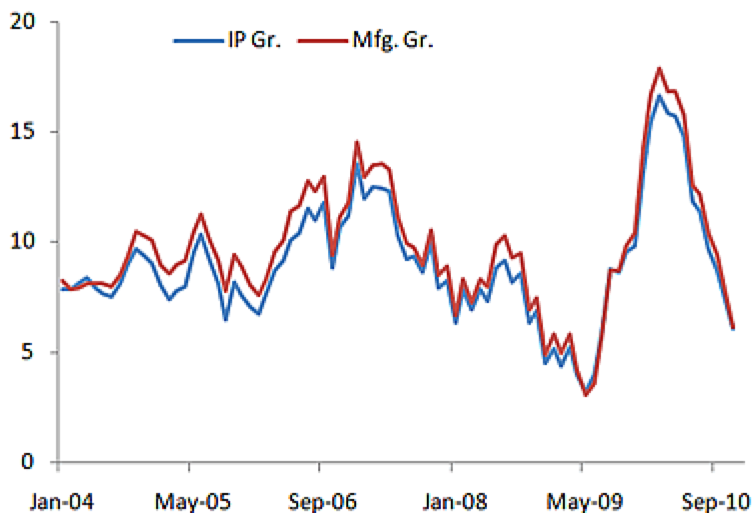
In 2009, Diwali was in middle of October and hence production was cranked up in September and the first week of October. Post that, output fell. With manufacturing accounting for about 80% of IP, it is not a surprise that IP would fall. Hence the index rose in September and slumped on October.

In 2010, however, Diwali was in early November and hence production was cranked up in the whole of October. In this case, the index rose in October and dropped in November. This led to an exaggerated year-on-year growth number.



Source: Ministry of Statistics & Programme Implementation

This notwithstanding, the slowdown in IP, which started from March 2010, continues. This is visible from the year-on-year growth rate of the three-month moving average (3-MMA) data.



Source: Ministry of Statistics & Programme Implementation

Within manufacturing, consumer durables (which account for about a third of manufacturing) declined by 6% in November 2010 as against a 2.3% growth in the same month a year earlier. The average growth of 0.7% in non-interest sensitive consumer non-durable segment during the April-November 2010 as compared to a 1.2% growth recorded in the year-earlier period is a cause for concern.

Apart from manufacturing, mining and electricity output also slowed down on a year-on-year basis. Even the infrastructure sector output slowed down in November, as it grew by only 2.3% year-on-year, much slower than an 8.6% growth (revised upward) recorded in October. It is important to note here that the infrastructure sector accounts for 26.7% of India's industrial output.

The slowdown in IP notwithstanding, it is significant that this data was released on the backdrop of a substantial uptick in food inflation (weekly data) to 18.3% in end-December, its highest in more than a year. The monthly inflation data as is revealed by the Wholesale Price Index (WPI) recorded a 7.48% year-on-year growth in November and I expect it to cross 8% when data for December is released.

With the government lacking arsenal to fight inflation (which is the worst form of taxation on the poor), the Reserve Bank of India (RBI) is expected to raise interest rates in its next review to cool off inflation. While the initial expectation was a 50 basis points (bps) rise in both the repo rate and the reverse repo rate, the indication of a slowdown in IP is likely to result in changing the stance to a 25 bps hike, even more so because the global condition continues to remain weak.

The fact that RBI is worried about inflation (which is overtaking growth concerns) was clear from the recent statement of the RBI governor, Duvvuri Subbarao, who said that a pause in its tightening cycle should be interpreted as a comma and not a full stop. Clearly, he is not done with the tightening cycle.

The fact of the matter is that inflation remains and will continue to remain a major concern for India going forward (see Indian inflation waiting to strike , Asia Times Online, December 23, 2010). I have been maintaining that with the expectation of rate hikes, a lot of demand has been preponed, more so with the banks and other lending institutions unwilling to pass on the rate hike to their customers initially.

Not surprisingly, the interest sensitive consumer durable segment has been growing fast so far. But with 4.3% growth rate in November (the lowest growth rate since January 2009), the picture is no longer as rosy. And with the interest rates on a northward trajectory and rising it is likely to act as a dampener going forward.

Clearly the aggressive monetary stance is now taking effect (with a lag). Going forward, as actual lending rates go up and inflation remains at an elevated level, domestic demand will slow down. I, therefore, expect the IP growth to moderate from here onward.

While during the April-November period, IP grew by 9.5% as compared to 7.4% for the same period in the previous year, I expect IP growth for the full fiscal year to June 30 2011 to close at around 9% at best.

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