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India's factories lose festival lift

By Kunal Kumar Kundu

NEW DELHI - India's industrial production growth rate for November 2012 plunged, the euphoria of a major uptick in October giving way to a more sobering reality.

As represented by the Index of Industrial Production (IIP), growth contracted by 0.12% year-on-year as against Reuters expectation of a 0.7% year-on-year expansion and compared with 8.34% growth in October '12 (revised upward from the first estimate of a growth of 8.21% year-on-year). Industrial production had grown 6.01% year-on-year during November 2011.

As was suspected, India's IIP for last October was a mere flash in the pan as it benefited from low base effect related to the festival period. More importantly, it masked the anaemic growth in the previous months. During five out of the seven months between March and September 2012, the index actually contracted - a clear indication of the manufacturers reacting to falling demand by curtailing production and using up the inventory. This is reflected in the GDP data.

An important component in the demand side GDP data (as is reflected in GDP at market price) is change in inventory. In the case of inventory accumulation, this component rises, while in the case of inventory drawdown this component decreases. For two consecutive quarters, inventory levels have been falling, and the inventory as of the third quarter 2012 is lower by 40.5 billion rupees (US$740 million) compared with the first quarter of 2012. With October being the festival period in India, it is not a surprise that the manufacturers were on production overdrive to build up inventories in anticipation of meeting festival-induced demand.

However, consumers did not loosen their purse strings to the extent anticipated (being clearly done in by high inflation and high interest rates). During November, sales of passenger car contracted by 8.25% compared with November 2011, while total passenger vehicle sales grew less than 4% during November.

More importantly, reflecting the overall economic slowdown, sales of medium and heavy commercial vehicles declined by more than 33% during November. With external demand also faltering what with exports in dollar terms contracting during eight out of last nine months (March '12 - November '12) despite a weak domestic currency, India's manufacturing caved in again. Manufacturing (which has a weight of 75.5% in the IIP) grew at a mere 0.28% annual rate compared with growth of 6.59% recorded during November 2011 and 9.83% in October 2012.

On the positive side though, the three-month moving average data for November registered an annual growth of 2.41%, which is more than double the 1.07% growth recorded in the same month a year previously.

What is a major cause for concern is the continuous slowdown of the capital goods sector. In November, it contracted by 7.7%. Overall, during six out of the seven months of the current fiscal year (to March), this sector recorded negative growth. As a result, for the period April-November 2012 it contracted by a remarkable 11.1%, compared with a contraction of only 1% for the same period in the previous financial year.

The sharp slowdown is a manifestation of a large number of projects (both green and brown field) being currently on hold because of policy paralysis and various obstacles such as environmental and land issues. Delay in land acquisition has resulted in substantial time over-run for the Navi Mumbai airport project. Corruption perception and other hurdles (including land acquisition) have led to both time and cost over-runs of the Asian Genco projects. Gas-based power plants in Gujarat are stuck because of dispute between National Thermal Power Corporation and Reliance Industries Ltd. The list is endless.

Despite this, the only reason credit growth is holding up is because of rising working capital requirement of the various corporate houses, especially the oil marketing companies, which are bleeding due to a rising subsidy burden while the government has so far refused to pay its own share of oil subsidy.

With investment-related corporate borrowing down to a trickle and tight-fisted domestic consumers reducing their demand for consumer durables, houses and so forth, the banks are now forced to tread the risky path of increasing unsecured loans (personal loans, credit card loans etc - which have a higher probability of default) to their overall loan portfolio for sake of growth of business.

Hence, in November 2012, personal loans grew 19.1% on an annual basis as against 13.4% growth during the same month a year previously. Even credit card loans jumped by 25.7% as compared to only 3.7% a year ago. On the other hand, growth in consumer durable loans contracted 7.8% compared with the same period in the previous year.

What the November IIP number also reveals is that small and medium-sized enterprises (SMEs) are facing a difficult operating environment, when one compares and contrasts the Purchasing Managers' Index (PMI) survey data and the IIP data. It is important to note here that while the PMI survey relates to the bigger manufacturing units, IIP data covers both big and small units.

While the November PMI data showed a major uptick (seasonally adjusted manufacturing PMI rose from 52.87 to 53.70, output PMI rose even faster to 55.40 from 52.69) the contraction in November IIP data brings forth the difficulties faced by SMEs. This is not a surprise though. While high inflation and falling demand erodes their margin, higher risk perception means they are operating under a much higher interest rate environment.

Given this and the fact that inflation is unlikely to ease off substantially as the government is committed to raise administered prices of oil and oil products, raising prices of electricity etc, the Reserve Bank of India will likely shift focus from inflation to growth (which continues to remain weak), and it is quite likely that the central bank might make the first easing move during the monetary policy meeting on January 29.

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