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The Mirage of an Industrial Production Revival

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Jayanta Dey/Reuters

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India's industrial production in October rose by a whopping 8.21% from a year earlier, far above the market expectation, according to the index of industrial production released Wednesday.

This is being hailed in some quarters as a sign that India's economy has turned the corner. This reading, however, should not be construed as a reversal of fortune that sets India on its way to recovery. Far from it, actually. The devil, as they say, is in the details.

To begin with, the October number is reflective of pure "base effect" that skews the comparison with year-earlier data.

It is important to note, in this connection, that India's festival period started in November while it took place in October last year. Since production for the festival period tends to ramp up a month ahead of the festivities, festival-related production took place in September 2011 and in October this year. So the index in October 2011 was 158.3, down by nearly 4% from the month before.

Not surprisingly, with an index value of 171.3 in October this year, industrial production grew at its fastest pace since June 2011. More importantly, this one month masks the anaemic growth in previous months. In fact, in five of the seven months between March and September, the index contracted – a clear indication of manufacturers' reacting to falling demand by curtailing production and using up inventory. This is reflected in gross domestic product data.

An important component in the demand side of GDP data is changes in inventory levels. If there is accumulation in inventory, this component rises; if there is a drawdown, this component decreases. For two consecutive quarters, inventory levels have been falling and inventories, as of the third quarter of 2012, are lower by 40.5 billion rupees compared with the first quarter of 2012. With November being the festival period in India, it is not a surprise that manufacturers were on production overdrive in anticipation of meeting festival demand.

However, anecdotal evidence suggests that consumers did not loosen their purse strings to the extent anticipated, perhaps because they have been hurt by high inflation and high interest rates. In fact, during November, sales of passenger cars contracted by 8.25% from a year earlier while total passenger vehicle sales grew by 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 — exports in dollar terms contracted during eight of the last nine months — India's manufacturing is expected to face heavy weather in the future.

The slowdown is also reflected in the changing pattern of bank credit. A fairly large number of construction projects are currently on hold because of the paralysis in the government's policy-making apparatus and various obstacles like environmental and land issues. The only reason credit growth is holding up is because of the rising working-capital requirements of the various companies. With investment-related corporate borrowing down to a trickle and tight-fisted domestic consumers reducing their purchases of durables such as houses, banks are now forced to tread the risky path of increasing unsecured credit, either through personal loans or credit cards, to grow their loan books. Unsecured loans are typically riskier and carry a higher likelihood of default. In October, the growth rate of personal loans was as high as 23% on an annual basis compared with growth of only 9% a year earlier. Credit card loans jumped by 17%, compared with a rise of 5% in October last year. In contrast, growth in housing loans fell to 12% from 17% while consumer durable loans contracted by as much as 17% from a year earlier.

On the positive side, despite the politicians' best efforts to derail the economy, foreign direct investment in multi-brand retail finally is secure. Some financial sector reforms are also on the way, reports suggest. This may improve business sentiment going forward, which may get reflected in a pick-up in investments. But it is still not time to say that manufacturing in India is finally out of the woods. We need to watch this data for at least another two months to arrive at such a conclusion.

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