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The Imminent Danger of GDP Growth Under 5%

By Kunal Kumar Kundu

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A laborer worked at a factory near the western Indian city of Ahmedabad, Gujarat, Oct. 20, 21010.

India's September industrial production data released Monday showed an unexpected contraction of 0.37%. What is even worse is that the August growth rate was also revised downward by 0.37 percentage point to 2.29% from 2.66%.

This data is a big jolt since India's festival period has been in full swing and this generally tends to boost production as inventories are built up.

What is even more worrying is that the index value itself has been falling since March (with the exception of May), indicating that the worse may not yet be over of the economy.

Even if one accounts for the notorious volatility of production data, the downward trend — which indicates consumer fatigue — is clearly visible.

In fact, both the three-month and the six-month moving average exhibit this weakening trend. From April to September, the first six months of the current financial year, India's industrial production remained virtually stagnant (it grew by 0.1%) as compared to the same period in the previous year, when it grew 5.1%.

The industrial production data, as I have been saying for quite a few months now, continues to be at variance with India's Purchasing Managers Index data released by HSBC-Markit.

The PMI moved up from 52.78 in August to 52.80 in September and the index for output jumped from 52.74 to 53.20. Data above 50 indicates expansion while data below 50 indicates contraction.

It is important to note here that while the PMI is a survey based on data that mostly covers larger production houses while the official industrial production data encompasses data from the entire economy.

What this implies is that smaller manufacturers are clearly under stress as they struggle with high inflation, falling demand and, more importantly, the high cost of funds because of the perceived higher risk that they will default.

This becomes evident if you parse data from the Reserve Bank of India on lending the priority sectors – those areas that the government has deemed in need of preferential consideration.

Priority-sector lending overall rose 13.3% in September from a year earlier. But within that, lending to agriculture rose by 21.3%, the highest rate since January 2011, while lending to small and micro enterprises rose by 8.4%, the lowest-ever growth rate recorded. Within small and micro enterprises, disbursal to the manufacturing sector rose by just 7%.

A closer look at the disaggregated data on industrial production, not surprisingly, shows that manufacturing, which accounts for 75.5% of industrial production and approximately 15% of gross domestic product, contracted by 1.52% in September and by 0.4% from April to September.

In fact, manufacturing contracted during five out of the last seven months. What is even more worrying is that the production of capital goods continues to contract.

Capital goods, which include factories, machinery and tools, contracted by 12.2% in September. In fact, it contracted during 13 out of the last 15 months. For the first half of the current financial year, capital goods production contracted by as much as 13.7%.

For the economy, this is a clear danger signal. Not only is the slowdown continuing, the sharp and continuous decline in capital goods production spells bad news for future growth.

If this does not spur the government into action and to focus more on fiscal consolidation to free up more resources for capital investment, India maybe in the danger of recording economic growth of under 5%.

Kunal Kumar Kundu is senior economist at RGE India, based in New Delhi. The views expressed are his own.