



Index of Industrial Production July 2009: Encouraging Signals Pointing to an Impending Industrial Recovery

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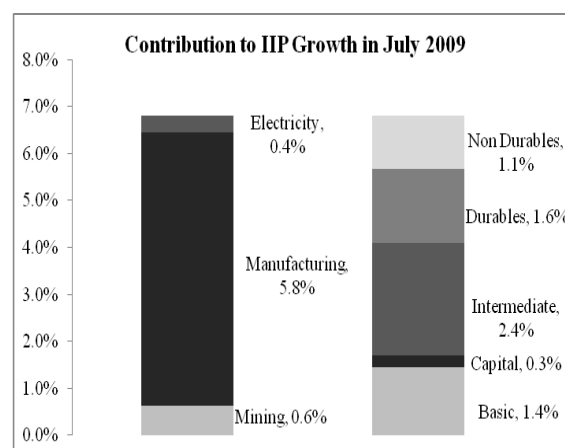
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The Index of Industrial Production (IIP) expanded by 6.8% in year-on-year (y-o-y) terms in July 2009, while growth for June 2009 was revised upwards from 7.8% to 8.2%. After continued low or negative growth since October 2008, the robust IIP growth for two consecutive months points to the likely start of an industrial recovery in India. While mining & quarrying and electricity grew by 9.9% and 4.2% respectively, IIP growth was underpinned by a strong 6.8% growth reported by manufacturing. In an encouraging trend, the number of sub-categories within manufacturing experiencing contraction decreased from five in June to two in July 2009. In addition to sustained domestic demand, manufacturing growth appears to have benefited from a revival in the volume of overall exports in month-on-month (m-o-m) terms since April 2009. However, the overall index and the three sub-indices of mining & quarrying, manufacturing and electricity, displayed some deceleration in July 2009 relative to the y-o-y growth achieved in the preceding month. The slackening of manufacturing growth from 7.8% in June 2009 to 6.8% in July 2009 suggests that the spurt in growth may be partly reflective of pent-up demand and restocking of inventories as well as of the increase in export demand brought about by the stimulus packages abroad.

In terms of the use-based classification, the IIP growth in July 2009 was led by intermediate and consumer goods. A marked deceleration in the growth of capital and basic goods during July lends credibility to the argument that pent-up demand was the driver of higher growth in June. Nevertheless, in an encouraging sign, all the five use-based categories displayed expansion for the second month in a row.

| IIP Growth | | | | | |
|---------------|--------|-------|-------|------------|-------|
| | Weight | July | | April-July | |
| | | 2008 | 2009 | 2008 | 2009 |
| IIP | 100.0% | 6.4% | 6.8% | 5.6% | 4.6% |
| Mining | 10.5% | 2.8% | 9.9% | 3.7% | 7.7% |
| Manufacturing | 79.4% | 6.9% | 6.8% | 6.0% | 4.3% |
| Electricity | 10.2% | 4.5% | 4.2% | 2.6% | 5.6% |
| Basic | 35.6% | 5.3% | 4.8% | 3.6% | 5.9% |
| Capital | 9.3% | 17.9% | 2.0% | 10.6% | 1.5% |
| Intermediate | 26.5% | 3.0% | 9.0% | 2.7% | 7.7% |
| Durables | 5.4% | 13.9% | 19.8% | 6.2% | 16.5% |
| Non-Durables | 23.3% | 3.4% | 5.0% | 8.5% | -2.3% |



Source: Office of the Economic Advisor, Government of India, Ministry of Commerce and Industry

Sectoral Growth

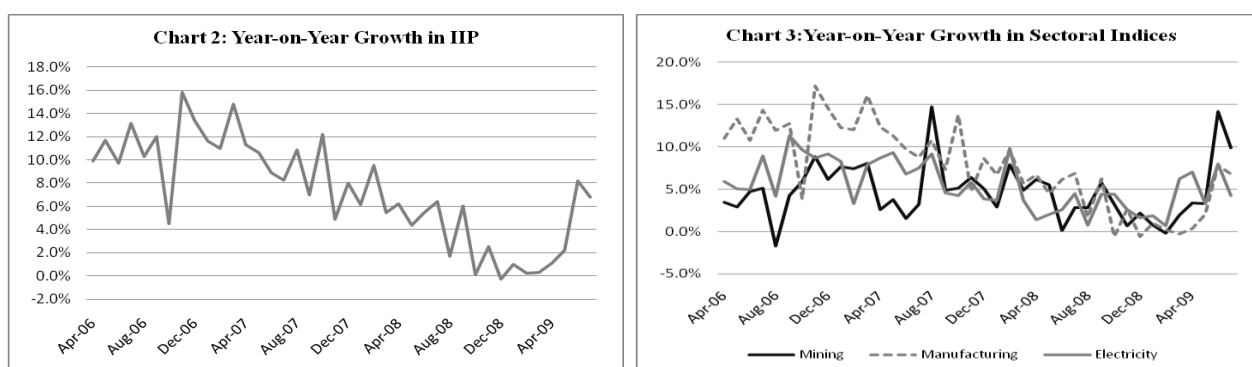
Manufacturing growth was robust for the second consecutive month in July 2009, and the number of sub-categories undergoing contraction fell to two that month from five in June; these two sub-categories were cotton textiles, and jute and other natural textiles, which have a combined weight of 6.1% in the IIP. Significantly, the protracted contraction in food products, which have a weight of over 9% in the total IIP, was stemmed in July, although the sub-category displayed a low 2.2% growth that month. Sectors such as manmade fibres, machinery & equipment, metal products and rubber, plastic, and petroleum & coal products, on the other hand, reported high growth in July 2009 over the same month in the preceding year. In addition to sustained domestic demand, manufacturing growth appears to have benefited from a recent revival in exports. While exports are continuing to display contraction in y-o-y terms, there has been a sequential increase in the volume of monthly exports from US\$10.7 billion in April 2009 to US\$13.6 billion in July 2009, with growth of 16% and 6% in m-o-m terms in June and July 2009, according to the provisional data released by the Ministry of Commerce, Government of India (GoI). This revival in the volume of exports is however likely to be partly reflective of the demand push delivered by the stimulus packages that India's trading partners have introduced. For instance, the 37.5% increase in passenger vehicle exports over the April-August 2009 period¹ is likely to be a consequence largely of programmes such as "cash-for-clunkers" introduced in several European countries.

Despite remaining robust, manufacturing growth decelerated from 7.8% in June 2009 to 6.8% in July 2009, raising some questions about the sustainability of the growth spurt. The manufacturing sub-categories such as metals & alloys, paper, wood products and textile products displayed sharply lower growth in July, suggesting that the high growth in June was partly reflective of pent-up demand and restocking of inventories, factors that may not sustain in the coming months.

¹ Source: Society of Indian Automobile Manufacturers

While electricity generation expanded in July relative to the preceding month, the y-o-y growth rate slowed from 8% in June 2009 to 4.2% in July 2009, reflecting an unfavourable base effect. Heavy rains over large parts of India in August and September suggest that improved hydroelectricity generation may facilitate growth of in the coming months.

Mining growth slowed from 14.9% in June 2009 to 9.9% in July 2009, but was significantly higher than the 2.8% growth displayed in July 2008, with the sector benefiting from the extended dry spell in 2009. This spike in mining growth provided a boost to the overall IIP growth in July 2009 relative to July 2008 (when 6.4% growth had been reported), which more than compensated for the marginally lower growth reported by manufacturing and electricity in July 2009 relative to July 2008. However, with August and September reporting heavy rains, mining growth may be lower in the coming months.



Source: Office of the Economic Advisor, Gol, Ministry of Commerce and Industry

Use-based Classification

In terms of the use-based classification, growth in the month of July 2009 was led by intermediate and consumer goods, while there was a marked deceleration in growth in capital and basic goods. Continuing with the robust growth witnessed in the previous quarter, intermediate goods expanded by 9% in July 2009, suggesting the building up of inventories drawn down previously. While the momentum from the same may not sustain going forward, the growth rates are nevertheless expected to remain healthy over the next two quarters, given the favourable base effect created by the sustained contraction in intermediate goods between August 2008 and February 2009.

At 19.8% growth in July 2009, consumer durables reported the fastest growth rate since June 2006, thereby extending the streak of double-digit growth witnessed in the previous quarter. In recent months, this sector has benefitted significantly from the Pay Commission related salary benefits accruing to Central and State Government employees, cuts in excise rates (as part of the Gol's fiscal stimulus packages), and softening of interest rates. This sector is expected to continue to display strong growth in the coming months as the second instalment of Pay Commission related arrears is released to Central Government employees.

Consumer non-durables expanded by 5% in July 2009, displaying the highest growth since November 2008. With monsoon rainfall having revived substantially in August and September, the outlook for the rabi harvest, and consequently, rural demand has improved, which in turn is expected to have a substantial bearing on the demand for non-durables. However, this sector tends to be extremely volatile, with spikes following several months of low growth. Nevertheless, growth in consumer non-durables is likely to be high going forward, given the favourable base effect; August 2009, with its unfavourable base effect, could however be an exception.

In contrast to the relatively higher growth displayed by intermediate and consumer goods in July 2009 relative to the preceding month, basic goods and capital goods showed lower growth, suggesting that the spike in June 2009 was caused by pent-up demand. Growth of basic goods in y-o-y terms decelerated from 10.6% in June 2009 to 4.8% in July 2009. After contracting for three successive months in y-o-y terms, capital goods had displayed a high growth rate of 13.3% in June 2009, but subsequently the growth rate decelerated sharply to 2% in July 2009. While this deceleration is partly attributable to an unfavourable base effect (17.9% growth in July 2008), the low growth displayed by capital goods in July 2009 does dampen the near-term outlook for industrial growth.

Outlook

In the coming months, manufacturing growth is likely to be positively impacted by sustained domestic demand driven by the Pay Commission benefits accruing to Central and State Government employees and by the continuance of the lower excise rates. Further improvement in the level of exports in m-o-m terms, which rose to US\$14.3 billion in August 2009, is also likely to buoy manufacturing growth. However, there could be some loss of momentum in the case of intermediate goods, and growth could be weak for basic and capital goods. Additionally, while higher monsoon rainfall is expected to benefit hydroelectricity generation, the same would also dampen growth of mining in the coming months. Overall, data for August 2009 is expected to show that the IIP expanded by 6-7% that month over the August 2008 level.

With the base effect turning favourable post-August 2009, the IIP growth rate is likely to appear robust in the coming months, obscuring other signals regarding the strength and sustainability of the economic recovery. Whether the Indian economy is able to withstand the impact of the inevitable withdrawal of the fiscal stimulus packages at home and abroad, and of the phasing out of Pay Commission arrears, will determine whether the recovery sustains over an extended period of time.



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