



Index of Industrial Production June 2010: Moderation to Single Digit Growth after Gap of Eight Months

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The Index of Industrial Production (IIP) expanded by 7.1% in June 2010 in year-on-year (y-o-y) terms led by a 7.3% expansion of manufacturing, a 9.5% growth of mining & quarrying and a low 3.5% growth of the electricity sub-sector. The pace of IIP expansion decelerated considerably relative to the growth of 11.3% witnessed in May 2010, reflecting the waning of the favourable base effect.

The rate of IIP growth in June 2010 was also slower than the growth of 8.3% in the same month in the preceding fiscal year, which had marked the start of the Indian industrial recovery. Relative to the pace of growth in June 2009, mining & quarrying and electricity displayed sharply slower growth in June 2010.

Manufacturing, which dominates the IIP index with a weight of nearly 80%, displayed an expansion of 7.3% in June 2010, which was somewhat slower than the 8% growth displayed by the sector in June 2009. This suggests some moderation of domestic demand and fading of the boost derived from inventory restocking; basic goods displayed low growth in June 2010, although the demand for consumer durables remained robust.

Manufacturing growth remained uneven and concentrated in a few categories in June 2010. Five categories accounting for 45.48% of the manufacturing index contributed to 6.1% of the 7.3% growth in the manufacturing sector in June 2010. Four sub-categories with a combined weight of 13.67% in the IIP index contracted in June 2010, as compared to two categories in May 2010.

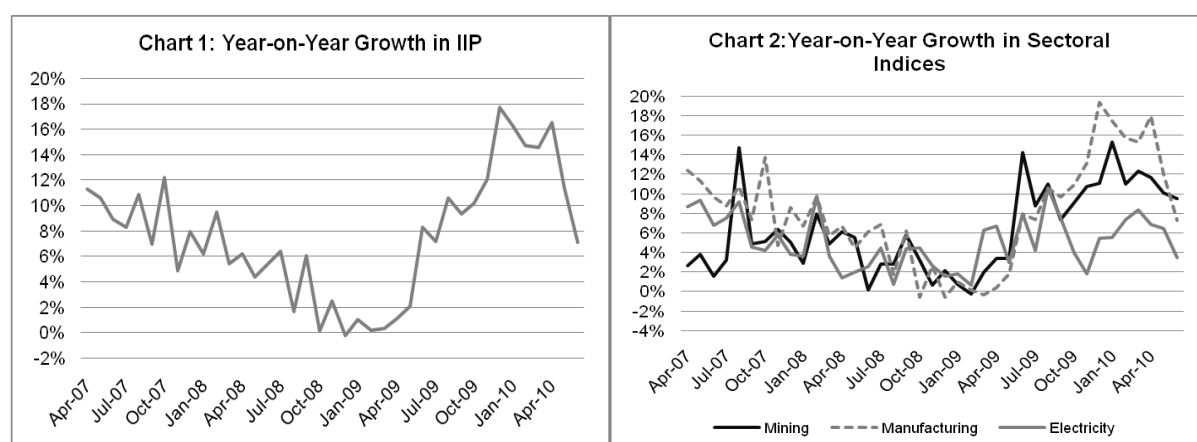
In terms of the use-based classification, IIP growth in June 2010 was led by consumer durables and intermediate goods. The pace of expansion of all sectors except consumer durables decelerated for the second consecutive month. In line with expectations, growth of capital goods declined sharply in June 2010, albeit to a healthy 9.7%.

Basic goods expanded by 3.4% in June 2010, sharply lower than the 8.2% growth witnessed in May 2010. Intermediate goods too displayed some moderation in the pace of growth, which slowed to 8.7% in June 2010 from 10.1% in May 2010.

Consumer non-durables expanded by a low 1.3% in June 2010, similar to the 1.4% growth witnessed in May 2010. In addition to the higher market penetration of these products reflecting in lower growth rates, demand for consumer non-durables is likely to have been dampened by the double-digit inflation prevailing since February 2010.

	Weight	May	June	May	June	April-June	
		2009	2009	2010	2010	2009	2010
IIP	100.0%	2.1%	8.3%	11.3%	7.1%	3.8%	11.7%
Mining	10.5%	3.4%	14.2%	10.1%	9.5%	7.0%	10.4%
Manufacturing	79.4%	1.8%	8.0%	12.0%	7.3%	3.4%	12.4%
Electricity	10.2%	3.0%	8.0%	6.4%	3.5%	5.9%	5.6%
Use-Based Classification							
Basic	35.6%	3.8%	10.7%	8.2%	3.4%	6.3%	6.9%
Capital	9.3%	-3.6%	13.4%	34.2%	9.7%	1.3%	37.9%
Intermediate	26.5%	6.6%	7.9%	10.1%	8.7%	7.5%	9.8%
Durables	5.4%	13.2%	16.2%	23.7%	27.4%	15.7%	27.9%
Non-Durables	23.3%	-5.5%	0.7%	1.4%	1.3%	-5.1%	2.4%

Source: Central Statistical Organisation (CSO)



Source: CSO

Sectoral Growth

Manufacturing expanded by 7.3% in June 2010, sharply slower than the growth of 17.9% and 12.0% in April 2010 and May 2010, respectively, reflecting the waning of the favourable base effect. Additionally, a sharp slowdown in the pace of growth of machinery & equipment (other than transport equipment) has contributed to the decline in the pace of manufacturing growth since April 2010.

Similar to the trend seen in the past few months, manufacturing growth remained uneven and concentrated in a few categories. Continuing the trend displayed in the first two months of the fiscal year, wood & wood products, furniture & fixtures and beverages and tobacco & related products contracted in June 2010. Additionally, basic metal & alloy industries and leather & leather & fur products also displayed a contraction during this month.

The five categories with the highest contribution to the manufacturing growth are enumerated in Table 2. These categories, accounting for 45% of the manufacturing index, contributed to 6.1% of the 7.3% growth in the manufacturing sector in June 2010.

With a weight of nearly 10% in the IIP index, machinery & equipment (other than transport equipment) remained the highest contributor to manufacturing growth, despite the sharp deceleration in its pace of growth over the past three months; the growth of this category slowed to 24.7% in May 2010 and further to 9.5% in June 2010 from 54.4% in April 2010.

Transport equipment & parts expanded by a robust 24.6% in June 2010 as compared to healthy growth of 12.3% in June 2009. This sector has displayed high growth in excess of 24% since the beginning of the current fiscal year, reflecting the favourable trends in passenger and commercial vehicle production indicated by the data released by the Society of Indian Automobile Manufacturers (SIAM).

Metal products & parts (except machinery & equipment) expanded by 62.1% in June 2010, sharply higher than the pace of growth displayed in the preceding two months. Although this partly reflects a favourable

base effect, with the sector having contracted by 7.5% in June 2009, the growth performance in June 2010 was remarkable.

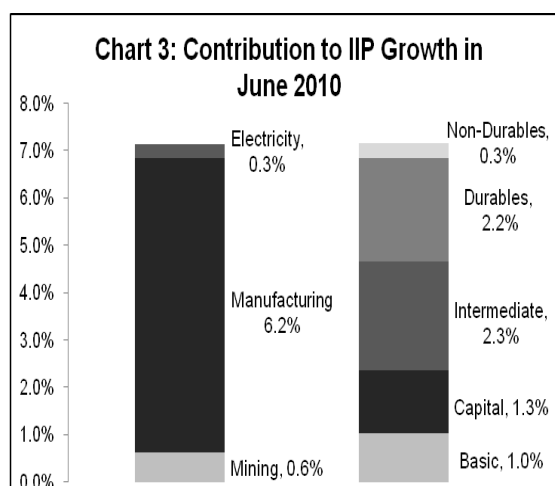
Basic chemicals & chemical products (except products of petroleum & coal), with a weight of 14% in the IIP index, expanded by a low 3.8% in June 2010, while rubber, plastic, petroleum & coal products expanded by a healthy 12.6% in the same month. Both these categories have displayed a decline in the pace of growth over the previous two months.

Sector	Weight	Growth		Contribution to Manuf. Growth
		June 2009	June 2010	
Machinery and Equipment (other than Transport Equipment)	9.57	12.9%	9.5%	1.8%
Transport Equipment & Parts	3.98	12.3%	24.6%	1.7%
Metal Products & Parts (except Machinery & Equipment)	2.81	-7.5%	62.1%	1.1%
Basic Chemicals & Chemical Products (except products of Petroleum & Coal)	14.00	4.8%	3.8%	0.8%
Rubber, Plastic, Petroleum and Coal Products	5.73	7.6%	12.6%	0.8%
Others	43.27	7.6%	2.7%	1.2%
Manufacturing	79.36	8.0%	7.3%	7.3%

Source: CSO

As in the case of the overall IIP index, manufacturing growth in June 2010 at 7.3% was lower than the 8.0% growth witnessed in June 2009. The pace of manufacturing growth moderated despite a turnaround in exports, which displayed a substantial 30% growth in June 2010 in y-o-y terms to reach US\$ 17.7 billion. Contrastingly, exports had declined by 29% in June 2009.¹

The pace of growth of the mining sub-index declined in June 2010 to 9.5% from a revised growth of 10.1% in May 2010. Growth in June 2010 was sharply slower than the 14.2% growth in the same month in the preceding year. Electricity generation expanded by 3.5% in June 2010 -- lower than the 6.4% growth witnessed in May 2010. This marks the lowest pace of growth in y-o-y terms since December 2009.



Source: CSO

Use-based Classification

In terms of the use-based classification, IIP growth in June 2010 was led by the 27.4% growth of consumer durables and 8.7% growth of intermediate goods.

Following a marginal 1.3% growth in the first quarter (Q1) of 2009-10, capital goods displayed robust expansion of 37.9% in Q1, 2010-11. Although capital goods expanded by a healthy 9.7% in June 2010, it was considerably lower than the 34-70% pace of growth in the past six months. The aforementioned decline in growth of machinery & equipment (other than transport equipment) is likely to be a factor behind the slowdown in growth of capital goods in June 2010. However, the 57% growth of commercial vehicles in that month (as per data released by SIAM) would have buoyed the growth of this sector to an extent. Growth of capital goods is expected to improve in July 2010, following a favourable base effect with low 1.7% growth in July 2009. In subsequent months, the strength of private investment sentiment in light of the likely rise in interest rates, following the monetary tightening being undertaken by the RBI, is likely to determine the trajectory of growth of capital goods.

After displaying a healthy growth in excess of 8% over the preceding six months, basic goods expanded by a sharply lower 3.4% in June 2010. Although intermediate goods expanded by a healthy 8.7%, the pace of growth was lower than the double-digit growth witnessed over the past 10 months. These trends suggest that the benefits derived from inventory restocking over the past few months are likely to have faded and

¹ Provisional data released by the Ministry of Commerce and Industry, Government of India (GoI)

that some moderation in domestic demand may be on the anvil, even though the demand for finished durable products remained healthy in June 2010.

The pace of growth of consumer durables improved to 27.4% in June 2010 from a healthy 23.7% growth in May 2010. The growth performance displayed by this sector is remarkable, given the 16.2% growth in June 2009. Growth was boosted by the 25% growth of passenger vehicles, 34% growth of two- and 30% growth of three-wheelers in June 2010 (according to data released by SIAM). The pace of growth of consumer durables is likely to moderate in the coming months, following an adverse base effect; consumer durables have displayed expansion in excess of 20% since July 2009. The transmission of monetary tightening to higher interest rates is also likely to dampen consumer demand to some extent.

Consumer non-durables expanded by a low 1.3% in June 2010, similar to the 1.4% growth witnessed in May 2010. With an average growth of 2.4%, this category has displayed the lowest pace of growth from amongst the use-based categories in the Q1, 2010-11, which is likely to be a result of the double-digit headline inflation over this time period. Nevertheless, the low growth is an improvement relative to the contraction of 5.1% in Q1, 2009-10.

Outlook

Lead indicators such as production of passenger and commercial vehicles remain healthy. The favourable monsoon rainfall so far in 2010 has boosted the outlook for the *kharif* output. Higher agricultural incomes as well as the anticipated cooling of food prices are expected to improve consumer demand. However, trends in growth of basic and intermediate goods point towards some inherent moderation in domestic demand. Additionally, higher interest rates are likely to dampen consumer demand in the coming months. In particular, the pace of growth of consumer durables is expected to moderate substantially, following an adverse base effect.

Notwithstanding the contraction witnessed in July 2010, the pace of growth of non-food bank credit remains strong at over 20% in y-o-y terms, suggesting a robust pipeline of planned investments. Nevertheless, the expected increase in interest rates may impact the pace of capacity expansion over the coming months.

The outlook for exports remains uncertain in the near term, following concerns regarding the pace and sustainability of economic growth in the advanced economies, which form a key market for Indian exports. Uncertainty regarding the trajectory of global growth is also expected to result in continuing volatility in the exchange rate of the rupee relative to the currencies of India's major trading partners. This may affect the level of orders being placed for Indian manufactured products and weakness in export growth would dampen the pace of Indian industrial growth in the coming months.

Overall, we expect that manufacturing growth is likely to have remained moderate at 7-8% in July 2010. Electricity generation is expected to have expanded by a low 4.3% in July 2010 according to data released by the Central Electricity Authority. Mining growth may have decelerated, following heavy rainfall in large parts of the country in July 2010. With the waning of the favourable base effect and the uncertainty in exports, the IIP index is expected to have expanded by 7-7.5% in July 2010.



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