GLOBAL RESEARCH & ANALYTICS

Volume 17 | November 2012

ECONOMY

CRISIL Insights

Through the monthly CRISIL Insights Economy series, we offer incisive analysis of macroeconomic parameters of the country. In the November issue, we talk about the causes of poor industrial production in the country and the possible solutions.

Policy thrust imperative for industrial growth

Sustainable recovery of industrial growth is critical for raising India's GDP growth. It is also essential considering the spillover effect from industrial activity to services. Many modern industrial units outsource technical and business-related services such as marketing, logistics, technical and design support, data processing and advertising. With a large part of the GDP emanating directly from the services sector, a decline in services growth does not bode well for India's medium-term prospects. Hence, the policy thrust to boost industrial activity could give a fillip to India's growth.

The index of industrial production (IIP) rose by only 0.4 per cent between April and August 2012, on a y-o-y basis. In three out of these five months, industrial output contracted. A sharp fall of nearly 13 per cent in the output of capital goods during this period led to the stagnation in the IIP. In addition, the basic goods sector, which has a weight of 45 per cent in the IIP, expanded by mere 2.8 per cent during April-August 2012. The basic goods sector comprises mining, minerals and electricity.

An uncertain domestic investment climate appears to be the primary cause of poor industrial performance. In the 12 months up to August 2012, the capital goods output recorded a sharper contraction of 11 per cent, compared with the corresponding figure in 2009, in the aftermath of the Lehman collapse. The collapse of Lehman Brothers in late 2008 came as a shock to the global economy, which contracted 0.6 per cent in 2009. India's GDP growth fell to 6.7 per cent in 2008-09, from 9.3 per cent in the previous year. In contrast, while Standard & Poor's forecasts 2.7 per cent growth for the global economy in 2012, India's GDP growth is expected to slow to 5.5 per cent in 2012-13. India's current economic woes, including the falling capital goods output and sluggish expansion of mining and electricity output, therefore, could be attributed more to adverse domestic factors than global developments.

Monetary Policy	**Industrial Production**	**Inflation**
RBI reduces CRR, keeps repo rate unchanged at 8 per cent	Industrial output growth turns positive in August	Inflation surges to a 10-month high in September

BALANCE OF PAYMENTS

- Citing the possibility of tight liquidity conditions, the RBI slashed the Cash Reserve Ration (CRR) by 25 bps on 30 October. The move will inject liquidity of about Rs. 175 billion into the banking system.
- With the repo rate unchanged at 8.0 per cent, the reverse repo and the marginal standing facility (MSF) rates remained at 7.0 and 9.0 per cent, respectively.
- The RBI maintained the repo rate, citing persistent inflationary pressures. It expects inflation to ease towards the last quarter of the current fiscal, which may create room for a rate cut in early 2013.

INDUSTRIAL PRODUCTION

- Industrial output grew 2.7 per cent in August after contracting in the previous two months. Output of core industries grew 2.1 per cent.
- Manufacturing output rose 2.9 per cent in August driven by consumer goods. Mining and quarrying output grew only 2 per cent in August over a 5.5 per cent contraction in output a year earlier.
- Growth in capital goods and consumer goods sectors has slowed down due to a slowdown in investment and consumption in the economy. The recent policy actions are a step in the right direction, but their effect on industry will take time to materialise, in our view.

INFLATION

- WPI-based inflation rose to a 10-month high of 7.8 per cent in September, primarily due to a rise in fuel and non-food manufacturing inflation. A partial pass-through of high import costs is believed to have kept non-food manufacturing inflation at escalated levels.
- Revision of diesel prices resulted in fuel prices rising 11.9 per cent in September from 8.3 per cent in August. In contrast, food inflation fell to 7.9 per cent in September from double-digit levels earlier this year.
- The CRISIL Core Inflation Indicator (CCII) rose to 6.2 per cent in September from 5.9 per cent in the previous month. RBI's measure of core inflation (non-food manufacturing inflation) remained at 5.6 per cent in September.

Interest Rate	Rupee	Trade
10-Year G-sec yields unchanged at 8.3 per cent in October	Rupee averages to 53.0 per US$ in October	Trade deficit at a 16-month high in September

INTEREST RATE

- Net FII inflows of about US$ 1.5 billion into the debt market kept the yields unchanged during October despite increased borrowings of the government.
- Average yields on the 10-year G-sec and 1-year G-sec remained at 8.3 and 8.1 per cent, respectively, in October. On the month-end basis, the yields increased marginally to 8.4 and 8.2 per cent, respectively, over September.
- Liquidity pressures increased in the month as average LAF (volumes/borrowings) per day rose to around Rs. 687.4 billion in October, taking it closer to the 1 per cent limit of the net demand and time liabilities.

RUPEE

- In October the rupee reached a six-month high of 51.6 per US$ as the government announced more reform measures to attract foreign investment. The currency, however, again began to depreciate towards the end of the month and closed the month at 54.1 per US$.
- The rupee averaged at 53.0 per US$ in October, trading in the band of 51.6 to 54.1 per US dollar. On a y-o-y basis, the currency depreciation was at 7.6 per cent in October, compared with 14.7 per cent depreciation last month.
- Net FII inflows into the debt market stood at US$ 1.5 billion, the highest in 8 months, primarily due to relaxation in debt allocation norms.

TRADE

- Merchandise exports for September were valued at $23.6 billion, around 6.1 per cent higher than last year. On a cumulative basis, exports contracted by 6.7 per cent over April-September 2012.
- Merchandise imports grew for the first time in the past three months in September, led by an increase in oil imports. While oil imports registered a growth of 31 per cent, non-oil imports fell by 4.5 per cent during the month.
- Increase in imports and falling exports due to weak global demand resulted in a trade deficit of $18.8 billion in September, the highest in the past 16 months.

Source: CRISIL Research

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