



Index of Industrial Production December 2009: Sharp Growth Signaling Investment Revival

Contacts:

Aditi Nayar

aditin@icraindia.com

+91-124-4545385

The Index of Industrial Production (IIP) expanded by a sharp 16.8% in year-on-year (y-o-y) terms in December 2009, substantially exceeding expectations and recording the highest growth rate since the base year was revised to 1993-94. The growth performance was aided by a favourable base effect with marginal contraction in the IIP index in December 2008. Nevertheless, the overall growth rate is remarkable. Growth in excess of 9% in five consecutive months points toward a sustained revival in industrial growth. Additionally, average growth for April-December 2009 at 8.6% is significantly higher than the growth of 3.6% in the same period in 2008.

The robust IIP growth performance in December 2009 was led by an 18.5% expansion in manufacturing, pointing towards healthy consumer demand, renewed exports and a revival of investment growth. However, growth was not broad-based, with the majority of the manufacturing growth on account of three categories, which account for just over one-third of the manufacturing index. Additionally, three manufacturing sub-categories displayed contraction in December 2009. IIP growth was supported by a 9.5% growth in the mining & quarrying sub-sector and 5.4% growth in the electricity sub-sector.

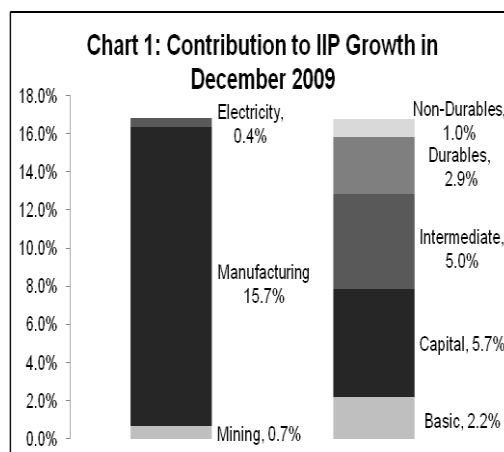
In terms of the use-based classification, growth was led by a sharp upturn in the growth of capital goods (38.8%) and continued improvement in the growth of intermediate goods and consumer durables relative to recent months. After displaying healthy double-digit growth for three consecutive months, the growth of capital goods surged to 38.8% in December 2009, suggesting a revival of investment, beyond infrastructure spending by the Central and State Governments and providing evidence that the industrial recovery is broadening beyond a consumption-fuelled upturn.

Consumer durables continued to display steep growth for the second consecutive month, improving to 46% growth in December 2009 in y-o-y terms from 38.4% in November 2009, thus emphasising the continued boost provided by consumption to the economic recovery. Intermediate goods displayed a high growth of 21.7%, pointing towards inherent revival as well as restocking of inventories.

Growth of basic goods improved to 7.5% in December 2009 from a revised growth of 5.7% in November 2009. The growth of consumer non-durables decelerated somewhat to 3.7% in December 2009 from a revised growth of 4% in November 2009. Nevertheless, the value of the consumer non-durables sub-index rose sharply for the second consecutive month in December 2009, in line with the trend in the previous years. Regardless, the average growth of consumer non-durables in the nine months ending in December 2009 is low at 1.8% as compared to the 6.8% growth in the corresponding period in 2008.

	Weight	December		April-Dec	
		2008	2009	2008	2009
IIP	100.0%	-0.2%	16.8%	3.6%	8.6%
Mining	10.5%	2.2%	9.5%	3.3%	8.6%
Manufacturing	79.4%	-0.6%	18.5%	3.7%	8.9%
Electricity	10.2%	1.6%	5.4%	2.7%	5.8%
Use-Based Classification					
Basic	35.6%	2.0%	7.5%	3.4%	6.1%
Capital	9.3%	6.6%	38.8%	8.4%	10.0%
Intermediate	26.5%	-8.9%	21.7%	-1.6%	12.6%
Durables	5.4%	-4.2%	46.0%	4.2%	24.7%
Non-Durables	23.3%	3.2%	3.7%	6.8%	1.8%

Source: Central Statistical Organisation (CSO)



Sectoral Growth

Manufacturing expanded by a sharp 18.5% in December 2009. While this partially reflected a favourable base effect, with contraction of 0.6% in December 2008, the growth momentum displayed was nonetheless remarkable. Additionally, the manufacturing index expanded by 11.6% in December 2009 in month-on-month (m-o-m) terms, a sharper growth as compared to the trend witnessed in the past years. The pace of manufacturing growth has increased steadily in the recent months, and the average growth of 8.9% in the period from April to December 2009 is substantially higher than the growth of 3.7% in the same months in 2008.

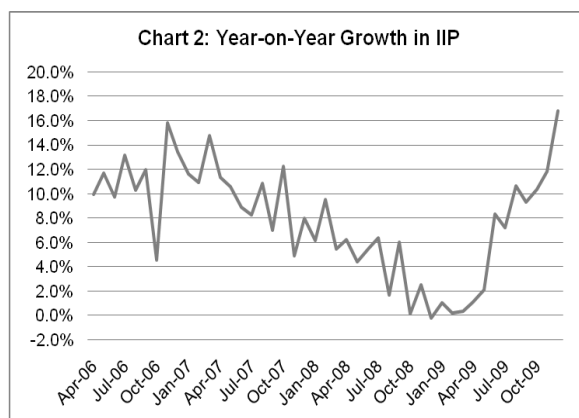
However, manufacturing growth is still not broad-based, with machinery & equipment, transport equipment & parts and basic chemicals & chemical products (excluding petroleum & coal), which comprise around 35% of the manufacturing index, accounting for the bulk of the 18.5% growth in manufacturing in December 2009. These three categories displayed dramatic growth rates of 44.6%, 82.2% and 29%, respectively, with transport equipment & parts and basic chemicals & chemical products having contracted by 17.8% and 9%, respectively, in December 2008. Additionally, three categories with a combined weight of 12.78% in the IIP index, namely food products, other manufacturing industries and leather, leather & fur products contracted during December 2009. These trends suggest that the eventual reversal of the excise cuts that were instituted by Government of India (GoI) as part of its fiscal stimulus packages in 2008-09 needs to be carefully calibrated to the sectors displaying sustained recovery in growth and demand.

While domestic consumer demand continues to drive manufacturing growth, exports too have displayed positive growth in y-o-y terms since November 2009 after sustaining a contraction for several consecutive months. Exports increased in m-o-m terms in November and December 2009; and are expected to have decreased marginally in January 2010.¹ Nevertheless, concerns remain regarding whether export demand will sustain in the medium term once fiscal stimulus packages are phased out by India's trading partners.

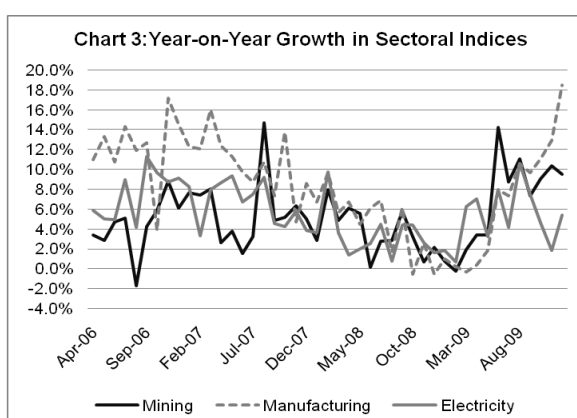
IIP growth was supported by a healthy growth of the mining sub-index although mining growth slowed marginally to 9.5% in December 2009 from a growth of 10.4% in November 2009. Nonetheless, the level of the sub-index in m-o-m terms increased considerably in December. Mining growth for the period from April to December 2009 at 8.6% is considerably higher than the 3.3% growth in the corresponding period in the previous year.

Growth of electricity generation improved to 5.4% in December 2009 from a low growth of 1.8% in November 2009; and the electricity sub-index expanded in m-o-m terms in December 2009. Electricity growth in the nine months period ending December 2009 at 5.8% is higher than the 2.7% growth in the same months of 2008, as is the case with the other sub-sectors. Data released by the Central Electricity Authority suggests that the growth momentum will continue at a similar pace in January 2010.

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



Source: CSO



Use-based Classification

IIP growth in December 2009 benefited from the high 38.8% growth rate displayed by capital goods, while the growth of intermediate goods and consumer durables too improved to 21.7% and 46%, respectively, in December 2009, aided by a favourable base effect, with contraction of 8.9% and 4.2% for these two sub-indices, respectively, in December 2008.

Capital goods expanded by 38.8% in December, sharply higher than the healthy growth rates displayed in the recent months and emerged as the largest contributor to IIP growth amongst the use-based industries. This remarkable growth performance comes on the back of a 6.6% growth rate displayed in December 2008, which while modest, represented the highest growth amongst the use-based categories in that month. Therefore, the upturn in capital goods growth in December 2009 cannot be ascribed to a benign base effect. With this impressive growth performance, average growth in April-December 2009 at 10% exceeded the 8.4% growth in April-December 2008. The value of the capital goods index surged substantially to the highest level since April 1994 and represented a growth of 41% in m-o-m terms, considerably higher than the trend witnessed in the previous years. These trends in growth of capital goods are likely to reflect a pick-up in the pace of infrastructure spending by the Central and State Governments, as the fiscal year draws to a close. Notwithstanding the improvement in bank credit off-take in recent months and pick-up in funds raised through external commercial borrowings (ECB), the growth displayed by capital goods is substantial in relation to credit growth and points towards a likely rise in disbursements in the remaining months of the fiscal year. Nevertheless, the high growth of capital goods emphasises a revival of investment sentiment and provides evidence that the industrial recovery is broadening beyond a consumption-fuelled upturn.

The growth of intermediate goods improved to 21.7% in December 2009. The average growth in the nine months ending December 2009 is healthy at 12.6% as compared to the contraction of 1.6% in the same months in 2008. Additionally, the level of the sub-index expanded for the third consecutive month. The impressive growth performance suggests an inherent demand for finished goods in addition to restocking of inventories as well as a favourable base effect, with contraction of 8.9% in December 2008. With the sub-index displaying contraction in January and February 2009, the base effect is likely to result in high growth in the coming months as well.

Growth of consumer durables increased further to a high 46% in December 2009, from a revised growth of 38.4% in November 2009, having sustained a contraction of 4.2% in December 2008. The y-o-y growth performance of December 2009 represents the highest growth rate recorded by consumer durables since the base year of the IIP index was revised to 1993-94. The average growth for the period from April to December 2009 is robust at 24.7%, as compared to the low 4.2% growth for the same period in the previous year, thus highlighting the continued boost provided by consumption to the industrial recovery. However, the consumer durables sub-index contracted in December 2009 and was considerably lower than the peak value of the index in September 2009.

In addition to buoyant consumer confidence and domestic consumer demand, led by the phased release of Pay Commission related arrears to the Central and State Government employees, the robust growth of consumer durables in y-o-y terms reflects a 9.3% growth in exports in December 2009. Additionally, the growth performance reflects a favourable base effect, with contraction of 4.2% in December 2008.

The growth of consumer durables is likely to moderate somewhat in the coming months. In particular, the extent to which the eventual reversal of the excise cuts has a negative impact on consumer demand

remains uncertain. With State Governments releasing arrears related to the Pay Commission in a phased manner to their employees, consumer demand is expected to retain some buoyancy over an extended period of time.

Basic goods displayed a growth of 7.5% in December 2009, higher than the revised growth of 5.7% displayed in November 2009. Average growth over the period from April to December 2009 at 6.1% is considerably higher than the 3.4% growth in the same period in 2008.

Growth of consumer non-durables slipped to 3.7% from a revised growth of 4% in November 2009 and the average growth in the period from April to December 2009 remains low at 1.8% as compared to 6.8% growth in the corresponding period in 2008; and is the only use-based category that has displayed lower growth in April-December 2009 as compared to the same period in 2008. However, the level of the sub-index expanded sharply in m-o-m terms in both these months, in line with the trend in the previous years after the harvesting of the *kharif* crop. While the base effect is favourable in the near term, with sustained contraction of the sub-index between February and May 2009, growth of consumer non-durables is likely to be crucially determined by rural income and demand based on the favourability of the upcoming *rabi* harvest.

Outlook

The growth in the manufacturing sub-sector is expected to remain robust in January 2010, although growth may slow down as compared to December 2009. Growth is likely to be led by continued buoyancy in consumer demand and a sustained level of exports, as suggested by initial estimates for January 2010, as well as a continued revival in investment sentiment and pick-up in credit off-take in the recent months. As a result, consumer durables, intermediate and capital goods are expected to display a healthy growth in January 2010, although growth may moderate somewhat relative to the high growth witnessed in December 2009. The pace of mining and electricity growth are likely to remain similar to the trends witnessed in December 2009.

With a favourable base effect on account of a marginal 1% growth of the IIP index in January 2009, IIP growth is expected to remain in excess of 13% in January 2010.

ICRA Limited

An Associate of Moody's Investors Service



CORPORATE OFFICE

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon—122002
Tel.: +(91 124) 4545 300; Fax: +(91 124) 4545 350

REGISTERED OFFICE

Kailash Building, 11th Floor; 26, Kasturba Gandhi Marg; New Delhi—110001
Tel.: +(91 11) 2335 7940-50; Fax: +(91 11) 2335 7014, 2335 5293
Email: info@icraindia.com Website: www.icra.in

Branches: **Mumbai:** Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 o **Chennai:** Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 o **Kolkata:** Tel + (91 33) 2287 0450, 2240 6617/8839, 2280 0008, Fax + (91 33) 2287 0728 o **Bangalore:** Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 o **Ahmedabad:** Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 o **Hyderabad:** Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 o **Pune:** Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 2553 9231

© Copyright, 2009, ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.