September IIP; investment cycle getting hampered..

The industrial growth for the month of September 2011 came in at 1.8%, lower than consensus estimate of 3% and lower than the revised 3.6% growth in Aug'11. **Major negative came from the Capital goods index, which de-grew by 6.8% for the month. In spite of a volatile trend witnessed in Capital Goods Index, the lower lows and lower highs made in last 3-months and the growth consistently coming at sub-IIP rate, signal muteness in capital formation going forward - -which also is evident from the order inflows for capital goods, engineering and Infra companies (as notified to Exchange) which registered a de-growth of 20% q-o-q and 21% y-o-y for Q2FY12.** The 3-mma of IIP stood at 3.1% as against 6.9% y-o-y and 5.6% on m-o-m.

Independent of the Capital Goods impact, the IIP grew at 3.6% Vs 3.5% in Aug'11 –apparently protected by consumer durables, which grew by 8.7% -stocking prior to festive season being the major drive, hence sustainability remains doubtful.

Manufacturing growth has been moderating since Apr'11 but since last 2 months the moderation seems to generalize. Services PMI contracted for consecutive 2 months (49.8-Sep'11 & 49.1-Oct'11), trade deficit at 4-yr high for Oct'11 at ~$20bln, Indirect tax collections down 2.5% for Oct'11 and gross-indirect tax collections down 0.6% for Oct'11. The October PMI manufacturing came at 52.0 indicating moderate rise in output and business on the back of festive season. Reading from the PMI data, irony of the situation is that festive season in Oct'11 results in modest rise in output coupled with rise in input and output prices (sustained inflation levels!). For October month we expect the IIP to come at ~1.3%.

Manufacturing index subdued

The growth for the manufacturing sector came in at 2.1% as against 4.1% in the month of Aug'11 and 6.8% in previous year. Manufacturing index accounts for 76% of total IIP. In terms of industries, fifteen (15) out of the twenty two (22) industry groups in the manufacturing sector have shown positive growth (for Aug'11 it was 12 of 22 in positive zone). The industry group 'Radio, TV and communication equipment apparatus' has shown the highest growth, at 25%, followed by 19% in 'other transport equipments' and 16.6% in n 'Office, accounting & computing machinery'. On the other hand, the industry group ''Electrical machinery & apparatus'' has shown a negative growth of 27.7% followed by 8.2% in ''Furniture; manufacturing'.

Electricity shines, fall in mining continues

The Mining segment has been confronted with piles of worries: ban in mining in certain parts of the country and heavy rainfalls relative to last year affecting production. As a result the, the mining segment has shown de-growth of 5.7% as against 4.3% in previous year and -4.1% in previous month. With the blanket ban in all mining operations in Karnataka, being enforced from Aug'11, the worries seem unending. On the other hand, Electricity segment has shown a strong growth of 9.0% as against 1.8% in previous year and 9.5% in previous month.

Exhibit 1: IIP Trend

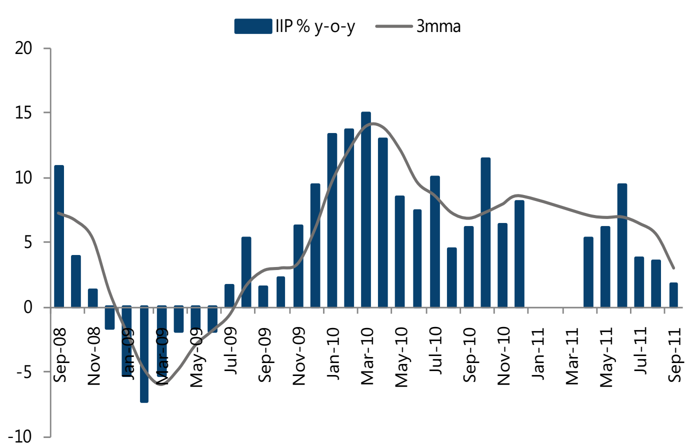
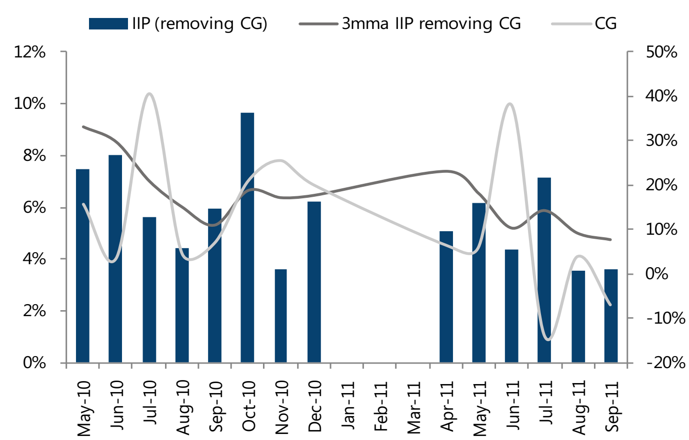


Exhibit 2: IIP Trend (removing Capital Goods)



Source: Office of Economic Advisor, MSFL Research

Capital goods: capital formation getting hampered?

Growth in capital goods segment came at-6.8% as against 7.2% in previous year and -3.9% in previous month. However the YTD growth for capital Goods remains at 4.5%, hence the sub-YTD growth since last three months confirms moderation. Though the recent numbers for the Capital goods have come on the extreme sides (outliers), hence making the IIP analysis more biased and noisy. But the recent trend, despite of noise have made lower lows and lower highs, indicating muteness in capital formation going forward. Reasons being manifold- starting from high interest rates which though directly tends to be inelastic to investment decisions but its prolongness tends to negatively impact business confidence and also the expectations of changing demand, added to that is the pending clearances for many large infrastructure and power projects being mired in bureaucracy.

Assertive of the above assumptions is the subdued growth in order inflows for capital goods, engineering and Infra companies as notified to Exchanges. The Q2FY12 order-book inflows saw a de-growth of 20% q-o-q and 21% y-o-y at ₹ 400bln.

Consumer goods up ahead of festive season

Basic goods showed a lower than average growth number at 4.5% in Sep'11. The consumer goods came strong in spite of negative growth witnessed in consumer non-durables (-1.3% in Sep'11 vs 2.8% in Aug.), driver being the seasonal affect of pre-stocking of durables ahead of festive season. As a result consumer durables grew at 8.7% Vs 4.6 in Aug'11. The intermediate goods grew at 1.5% Vs 4.6% last year and 1.3% in July'11.

Exhibit 3: Sectoral classification of IIP growth (y-o-y)

IIP - Component Based	Weight	Sep-11	Aug-10	Aug-11	YTD12	YTD11
Manufacturing	75.5	2.1	6.8	4.1	5.4	8.8
Mining	14.2	-5.7	4.3	-4.1	-1.0	7.2
Electricity	10.3	9.0	1.8	9.5	8.4	6.3
IIP Total	**100.0**	**1.8**	**6.2**	**3.6**	**5.0**	**8.2**
IIP - Use Based						
Basic Goods	45.7	4.5	3.5	5.2	6.9	4.7
Capital Goods	8.8	-6.8	7.2	4.1	4.5	25.2
Intermediate Goods	15.7	1.5	4.6	1.9	1.2	11.8
Consumer Goods	29.8	3.5	9.6	2.2	7.5	10.5
- Consumer Durables	8.5	0.0	14.2	5.5	5.2	15.9
- Consumer Non-Durables	21.3	-1.3	5.9	-0.6	3.6	3.8
IIP Total	**100.0**	**1.8**	**6.2**	**3.6**	**5.0**	**8.2**

Source: CSO, MSFL Research

Exhibit 4: Trend across the board

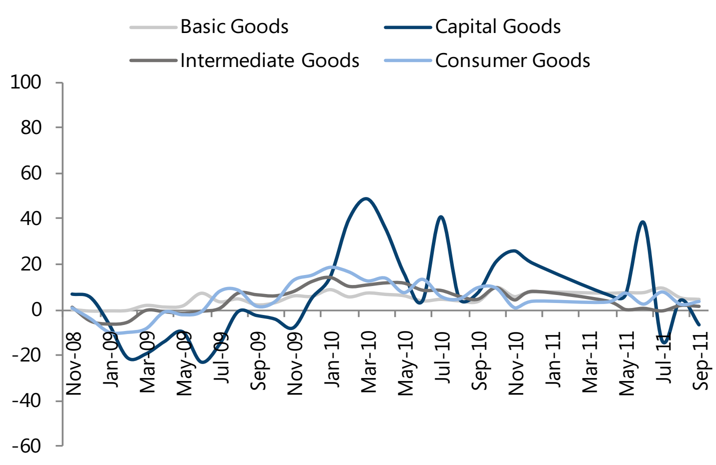
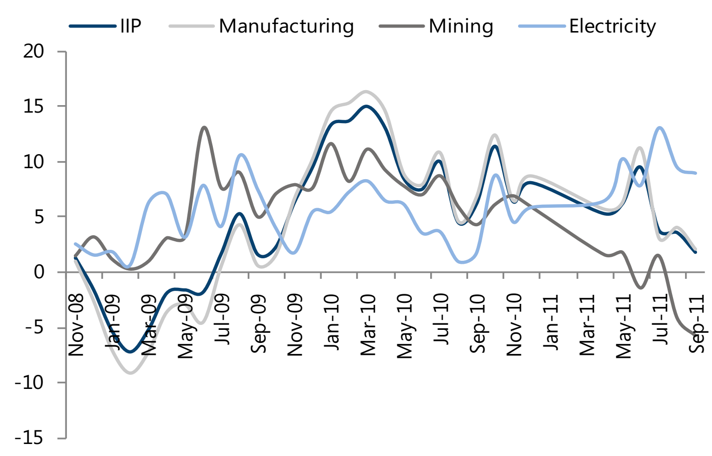


Exhibit 5: Electricity gets a strong push



Source: Office of Economic Advisor, MSFL Research

Aug IIP revised downwards

The IIP growth of Aug'11 has been revised downwards to 3.6% from the earlier 4.1% and for June'11 has also been revised upwards to 9.5% from 8.8%. Manufacturing and mining have witnessed change in their IIP as regards to component based index. However, for used based index, the entire sector has witnessed changes.

Exhibit 6: Revision in IIP Growth

	Quick Estimates	Revised Estimates
IIP (General)	4.1	3.6
Component Based		
Manufacturing	4.5	4.1
Mining	-3.4	-4.1
Electricity	9.5	9.5
Use Based		
Basic Goods	5.4	5.2
Capital Goods	3.9	4.1
Intermediate Goods	1.3	1.9
Consumer Goods	3.7	2.2
- Consumer Durables	4.6	5.5
- Consumer Non-Durables	2.8	-0.6

Source: Office of Economic Advisor, MSFL Research

Outlook

Last three series of IIP data, signals a moderation in output, which given the monetary tightening in view of taming inflation and global slowdown, comes in expected lines. Given the reduced government revenues, muted export growth and services PMI signaling contraction, the present domestic condition indicates of moderation getting generalized. The WPI data for October would be a key data to watch for however the continued rise in primary and fuel articles should keep the number for Oct in the higher end. The PMI manufacturing data for October also signals a rise in input prices and output prices in the wake of festive season. Having said that, the risks to growth getting hampered are significant now (especially on the investment side and the increased risk of surpassing fiscal deficit is not helping- target=4.6% Vs consensus=5.5%). The key therefore remains in supporting growth by rebalancing demand from consumption driven Govt. spending to investments (public/private). Henceforth, given that the transmission of previous hikes is still in-process, the probability of a further rate hike is miniscule.

Exhibit 7: Classification Manufacturing Products

	Weights	Sep-11	Aug-11	YTD12	YTD11
Food products	7.3%	8.6	11.5	16.0	7.0
Tobacco products	1.6%	12.8	(20.3)	-1.0	2.1
Textiles	6.2%	(1.9)	(2.3)	-2.1	6.7
Wearing Apparels; dressing and dyeing fur	2.8%	(8.1)	(13.1)	-6.0	3.7
luggage's, hand bags, saddlery harness & footwear; tanning and dressing of leather products	0.6%	10.0	5.2	7.0	8.0
Wood and wood products	1.1%	2.4	(0.6)	-3.5	-2.2
Paper & paper products	1.0%	5.1	0.8	5.7	8.5
Publishing, printing & reproduction of media	1.1%	8.4	6.4	9.0	11.2
Coke, refined petroleum products & Nuclear fuels	6.7%	2.8	8.6	5.4	-0.2
Chemicals & chemical products	10.1%	(6.0)	(3.9)	-0.6	2.0
Rubber & plastic products	2.0%	(1.8)	(1.6)	-1.3	10.6
other Non-metallic mineral products	4.3%	0.4	6.4	2.3	4.0
Basic metal	11.3%	10.4	11.1	14.3	8.8
Fabricated Metal products except machinery & equipments	3.1%	11.8	12.2	14.1	15.3
Machinery and equipments	3.8%	(3.8)	(0.7)	-2.1	29.4
Office, accounting & computing machinery	0.3%	16.6	(26.8)	13.2	-5.2
Electrical machinery and Apparatus	2.0%	(27.7)	(4.8)	-3.8	2.8
Radio, TV and communication equipment apparatus	0.99%	25.0	12.5	5.1	12.7
Medical, precision & optical instruments, watches and clocks	0.57%	11.8	(9.7)	-2.7	6.8
Motor vehicles, trailers & semi-trailers	4.06%	5.7	8.1	13.7	30.3
Other transport equipment	1.83%	19.0	12.1	17.6	23.1
Furniture; manufacturing n.e.c.	3.00%	(8.2)	3.0	0.1	-7.5

Source: Office of Economic Advisor, MSFL Research

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