

Economy

Industrial production

IIP growth at 3.7%; policy rates may remain unchanged

Following a sharp dip, the manufacturing sector growth improved 3.3% in Jan 2011 on the back of a stronger sequential rise of 3.3%. Overall IIP growth, inclusive of manufacturing, mining and electricity at 3.7% YoY was backed by stronger support from electricity generation which grew 10.5% with mining at 1.6% and manufacturing at 3.3%. While capital goods sector contracted 18.6% YoY in Jan 2011 it was more than compensated by stronger performance from consumer goods at 11.3%. Metal products, machinery, transport equipment and other manufacturing segments grew at -3.4%. The small rise from Dec 2010 lows in IIP growth is in line with our view that the worst over, but it is unlikely to be substantially better going forward. We believe the less than long term average growth and recent easing of food inflation will prompt RBI to keep policy rates unchanged in its March 2011 monetary policy announcement.

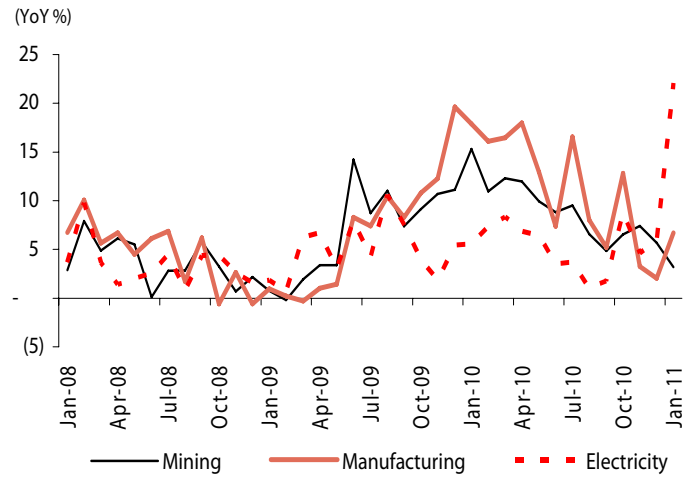
- **Manufacturing growth picks up to 3.3% from the Dec low of 2%:** Following the sharp dip manufacturing sector growth improved 3.3% in Jan 2011 on the back of a stronger sequential rise of 3.3% than long term average. The 17 sector disaggregation however shows considerable dispersion: Steep contractions of 34.4% YoY in metal products & parts (ex machinery), 22.2% in wood & wood products and 6.8% YoY in machinery & equipments and steep 772.6% YoY bounce in jute & other vegetable fibers, 39% in other manufacturing industries and 27% in leather products.
- Overall IIP growth, inclusive of manufacturing, mining and electricity at 3.7% YoY was backed by stronger support from electricity generation which grew by 10.5% compared to mining at 1.6% and manufacturing at 3.3%. Critical thing however is the fact that coal production for the month has been weak at -1.2% and has remained subdued at 0.8% for FY11 YTD. Since a major part of electricity generation comes from thermal sources weak coal production and high electricity generation are inconsistent.
- User based classification shows that while capital goods sector contracted 18.6% YoY in Jan 2011 it was more than compensated by stronger performance from consumer goods at 11.3%. We finally see strong recovery in consumer non-durables at 6.9% even as durables continued with robust growth of 23.3%. Basic and intermediate goods at 7.6% and 7.9% respectively showed steady growth.
- **Big Four contracted 3.4% YoY:** A break-up of the manufacturing sector shows that the "Big four" sectors comprising metal products, machinery, transport equipment and other manufacturing, weighing 24% in the manufacturing index, grew at -3.4%. Large volatility in these components was behind the volatility in the IIP growth numbers for FY11. The "other" sectors weighing 76% in manufacturing index have shown continued improvement with a growth of 7.3% in Jan 2011.
- **Outlook –Dec was possibly the worst, but growth to remain sub-par:** The small rise from Dec 2010 lows in IIP growth is in line with our view that the worst print is possibly behind us, but is unlikely to be substantially better, going forward. The key issue is that manufacturing sector inflation has continued to fall to 3.7% (Jan 2011) while inflation for raw material components has remained high (20-25%), thereby causing severe margin pressure. The combination of rising costs, implications from high oil prices and rising rates are the risk factors for future growth.
- **Monetary policy – Expect no rate hike in the forthcoming policy announcement:** We believe the combination of less than long term average growth and recent easing of food inflation will prompt RBI to keep policy rates unchanged in the March 2011 monetary policy announcement.

Exhibit 1: IIP growth summary

	Wt in IIP (%)	YoY (%)		YTD (Apr-Nov%)	
		Jan-10	Jan-11	FY10	FY11
Sectoral					
Mining	10.5	15.3	1.6	9.5	7.1
Manufacturing	79.4	17.9	3.3	9.9	8.6
Electricity	10.2	5.6	10.5	5.7	5.3
User Based					
Basic goods	35.6	11.5	7.6	6.6	6.5
Capital goods	9.3	57.9	(18.6)	16.1	12.3
Intermediate goods	26.5	22.2	7.9	13.4	9.1
Consumer goods	28.7	0.4	11.3	5.9	7.1
Durable	5.4	28.2	23.3	23.2	21.6
Non-durable	23.3	(7.0)	6.9	0.4	1.4
General	100.0	16.8	3.7	9.5	8.3

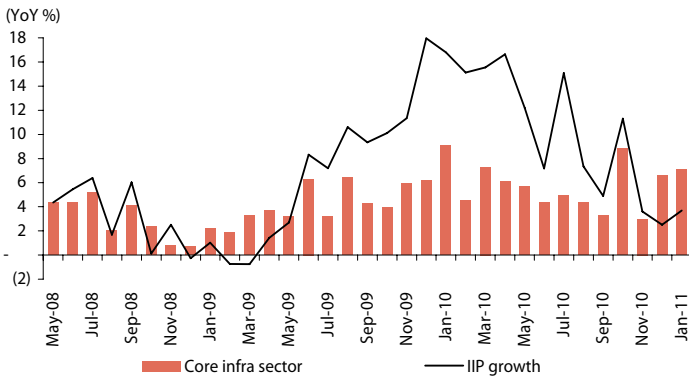
Source: CSO, Centrum Research

Exhibit 2: IIP growth improves on the back of rebound in electricity generation



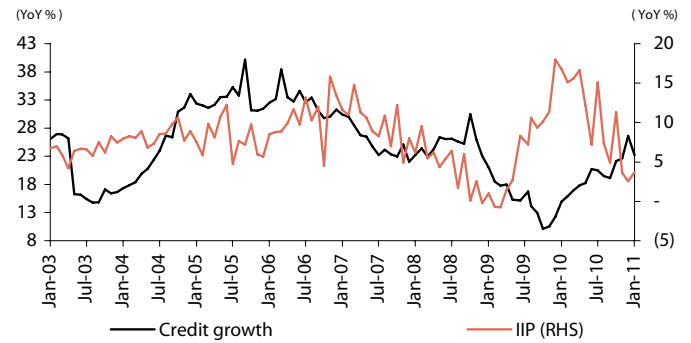
Source: CSO, Centrum Research

Exhibit 3: IIP & core sector growth



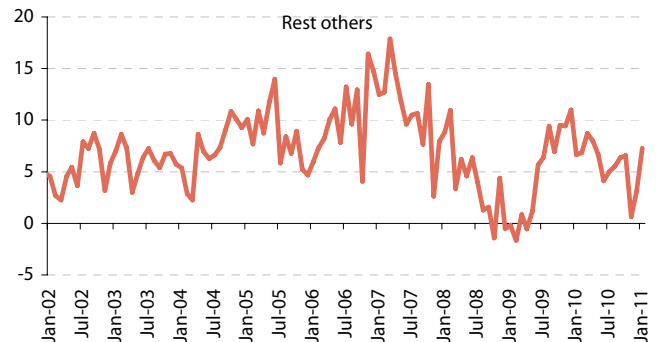
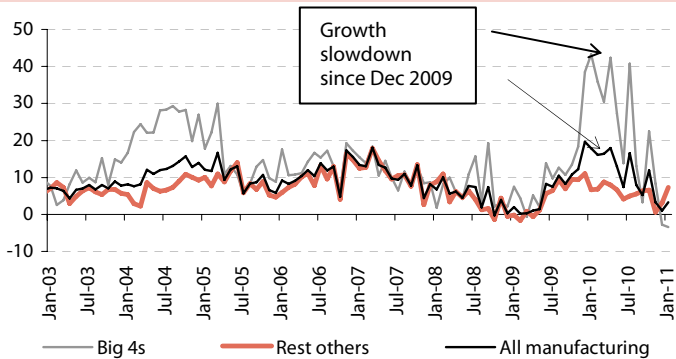
Source: CSO, Centrum Research

Exhibit 4: Abnormal inverse trend in credit and IIP growth



Source: Bloomberg, CSO, Centrum Research

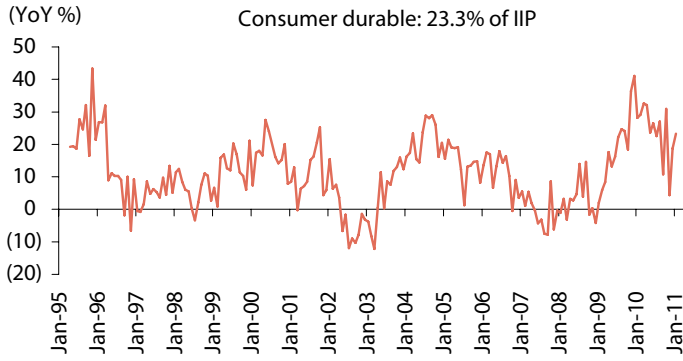
Exhibit 5: Manufacturing: Big 4s contracted by 3.4% YoY in Jan 2011 after abnormal growth, rest others weighing 76% picked up at 7.3%



Big 4s (24% weigh in manufacturing) include Metal products, Machinery, Transport & parts & Other manufacturing; Rest others include the balance 13 sectors (weigh 76%)

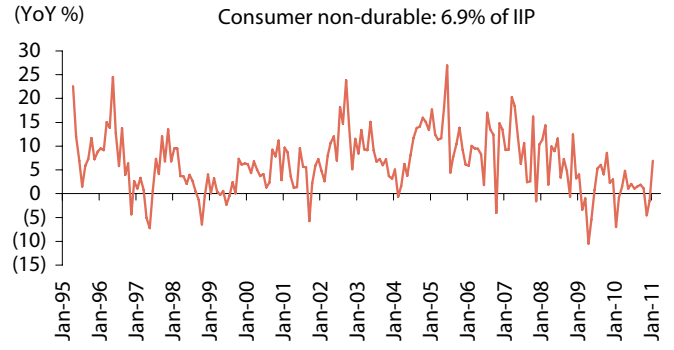
Source: CSO, Centrum Research

Exhibit 6: Consumer durables



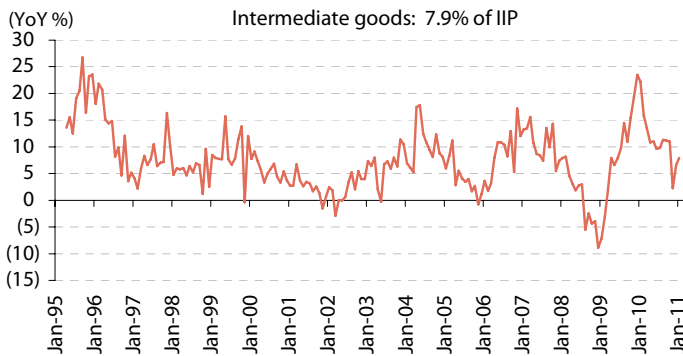
Source: CSO, Centrum Research

Exhibit 7: Non-durables growth picks up finally



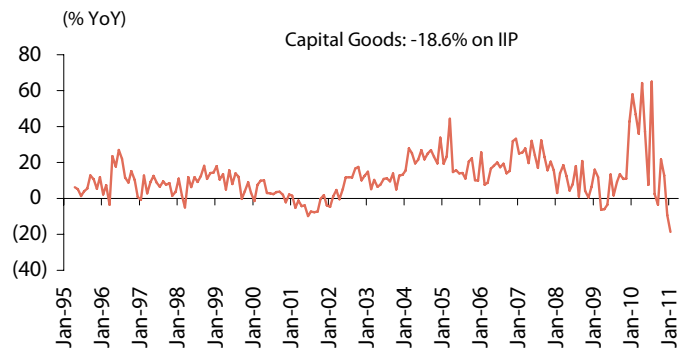
Source: CSO, Centrum Research

Exhibit 8: Intermediate goods



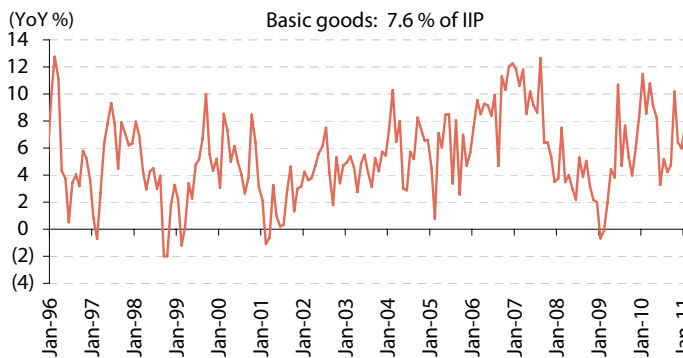
Source: CSO, Centrum Research

Exhibit 9: Capital goods: Growth contraction at 18%



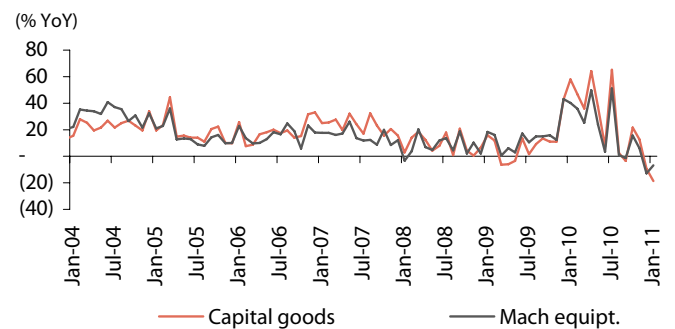
Source: CSO, Centrum Research

Exhibit 10: Basic goods



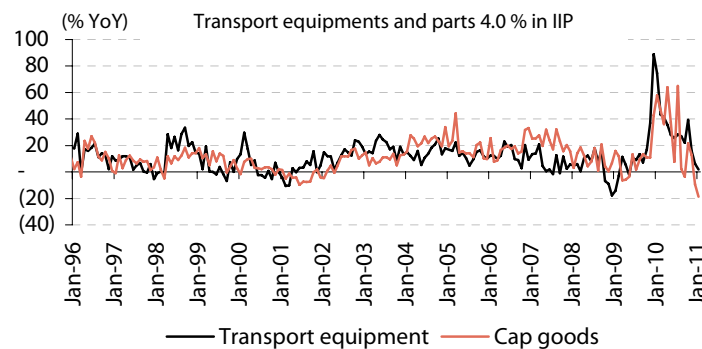
Source: Bloomberg, Centrum Research

Exhibit 11: Machinery equipment and capital goods



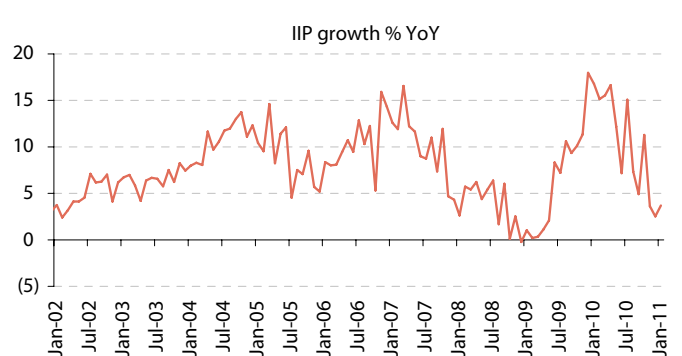
Source: Bloomberg, CSO, Centrum Research

Exhibit 12: Transport equipment



Source: Bloomberg, Centrum Research

Exhibit 13: IIP growth remains below LT average of 7%



Source: Bloomberg, CSO, Centrum Research

Exhibit 14: Sectors' IIP growth (YoY %)- 2 digit classification

Sector and user based performance	Weight (%)	YoY %		YTD (YoY %)	
		Jan-10	Jan-11	FY10	FY11
Manufacturing products					
Food	9.1	(3.4)	7.9	(6.3)	11.6
Beverages, Tobacco etc	2.4	1.4	0.2	(0.8)	(2.8)
Cotton Textiles	5.5	9.8	10.9	4.6	10.3
Wool, Silk and man-made fibre textiles	2.3	4.9	5.1	11.1	(0.0)
Jute and other vegetable fibre Textiles	0.6	(89.3)	772.6	(21.8)	21.5
Textile Products	2.5	6.8	11.4	10.2	4.5
Wood/wood products; Furniture etc	2.7	14.2	(22.2)	9.1	(14.5)
Paper & paper products and publishing & allied	2.7	8.8	12.1	2.8	8.4
Leather and leather products	1.1	(2.8)	27.0	0.7	12.9
Basic chemicals & chemical (ex petroleum & coal)	14.0	2.3	4.6	10.3	2.2
Rubber, plastic, petroleum and coal	5.7	25.9	11.2	15.6	11.0
Non-metallic mineral	4.4	17.4	3.2	9.0	6.1
Basic metal and alloys	7.5	12.0	12.5	5.4	8.8
Metal products/parts (ex machinery & equipment)	2.8	35.2	(34.4)	4.4	13.1
Machinery & equipment (ex transport)	9.6	40.2	(6.8)	18.3	10.2
Transport equipment & parts	4.0	74.6	1.9	23.5	21.6
Other manufacturing	2.6	10.4	39.0	6.8	23.7
Manufacturing	79.4	17.9	3.3	9.9	8.6
Mining	10.5	15.3	1.6	9.5	7.1
Electricity	10.2	5.6	10.5	5.7	5.3
General	100.0	18.0	1.6	9.5	8.3
User Based					
Basic goods	35.5	11.5	7.6	6.6	6.5
Capital goods	9.7	57.9	(18.6)	16.1	12.3
Intermediate goods	26.4	22.2	7.9	13.4	9.1
Consumer goods	28.4	0.4	11.3	5.9	7.1
Durables	5.1	28.2	23.3	23.2	21.6
Non-durables	23.2	(7.0)	6.9	0.4	1.4

Source: CSO, Centrum Research

Appendix A

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