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India Econ Flash

July industrial production below expectations – Slows to 7%

Industrial Production Growth — Forecasts and Actual (Percent)

| Event | Actual | Citigroup Forecast | Consensus | Previous Data (Jun) | Previous Data(May) |
|---------------------------|--------|--------------------|-----------|---------------------|--------------------|
| Jul Industrial Production | 7.1 | 8.7 | 9.6 | 9.0 | 10.9 |

Source: CSO, Bloomberg, and Citi.* June Industrial production revised downward from 9.8% to 9%.

- **July Industrial production slows to 7%** - below expectations and the 13.2% growth last July. Excluding the Oct'06 aberration, this was an 18 month low, with the deceleration in growth across all sectors with the interest sensitive sectors worse off. On a cumulative basis, growth during April-July was 9.6% v/s 11.1% last year. While we expect industrial growth to remain in single-digits in the coming months, better agriculture coupled with a relatively benign monetary policy outlook prompts us to maintain our 9.3% GDP estimate.
- **Key Highlights:** (1) **Manufacturing** growth slowed to 7.2% with a contraction seen in transport equipment, metal products, paper and food products, while the growth in wood products seemed more realistic at 20% v/s 100% since earlier. (2) Though overall consumer goods rose 5.3%, the deceleration in **consumer durables** seen since a year has taken a turn for the worse with a contraction seen in the last two months. (3) **Capital goods** growth remained at double-digit levels at 12.9% but lower than 20% average seen earlier. (4) Interestingly, the buoyancy in **electricity** – a key input – continued with growth up 7.5%
- **Monetary Policy Implications:** We maintain that the moderation in credit from 30%+ to 23.1% (below the RBI's target of 24.5% for FY08) coupled with benign inflation will result in a pause in policy rates with the next move down. This should limit further downside to the rate-sensitive sectors.
- **FY08 GDP estimate of 9.3% unchanged:** Due to the higher rate environment, our current estimates have incorporated a deceleration in industrial activity from 11% in FY07 to 10% in FY08. While this may appear aggressive, given that the sowing of summer crop is higher this year, agriculture could offset further negative surprises in industry. We are thus maintaining our 9.3% GDP estimate for FY08. Key risk to the outlook is a US recession and a snap poll.

KEY DATA REVISIONS for June

Mining revised from 3.6% to 1.5%

Manf revised from 10.6% to 9.9%

Consumer Goods Prodn revised from 4.2% to 1.7%

Consumer durables prodn revised from 0.6% to -3.9%

Trends in Industrial Production (% YoY)

| | WTS | Feb-07 | Mar-07 | Apr-07 | May-07 | Jun-07 | Jul-07 | Jul-06 | Apr-Jul FY08 | Apr-Jul FY07 |
|---------------------------------|------------|-------------|-------------|-------------|-------------|------------|------------|-------------|--------------|--------------|
| Sectoral Classification | | | | | | | | | | |
| Mining | 10.5 | 7.5 | 8.0 | 2.6 | 3.6 | 1.5 | 4.9 | 5.1 | 3.1 | 4.0 |
| Manufacturing | 79.3 | 12.0 | 16.0 | 12.4 | 11.7 | 9.9 | 7.2 | 14.3 | 10.3 | 12.3 |
| Electricity | 10.2 | 3.3 | 7.9 | 8.7 | 9.4 | 6.8 | 7.5 | 8.9 | 8.1 | 6.1 |
| General | 100 | 11.0 | 14.8 | 11.3 | 10.9 | 9.0 | 7.1 | 13.2 | 9.6 | 11.1 |
| Use-based Classification | | | | | | | | | | |
| Basic goods | 35.5 | 10.7 | 11.9 | 8.6 | 10.2 | 9.1 | 9.0 | 10.0 | 9.3 | 9.2 |
| Capital goods | 9.7 | 18.0 | 18.1 | 10.9 | 22.9 | 30.0 | 12.9 | 18.3 | 19.2 | 20.3 |
| Intermediate gds | 26.4 | 13.3 | 15.3 | 10.6 | 8.4 | 8.5 | 4.7 | 10.7 | 8.0 | 10.7 |
| Consumer gds | 28.4 | 7.4 | 15.8 | 14.7 | 9.9 | 1.7 | 5.3 | 16.8 | 7.9 | 10.5 |
| Durables | 5.1 | 1.8 | 3.8 | 2.4 | 3.5 | -3.9 | -3.2 | 16.1 | -0.3 | 15.2 |
| Non-durables | 23.3 | 9.3 | 20.2 | 18.7 | 12.3 | 3.8 | 8.4 | 17.1 | 10.8 | 8.8 |

Source: CSO

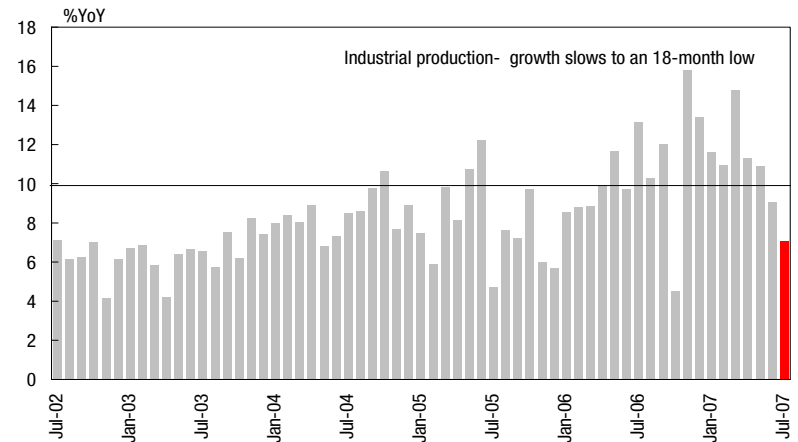


Charting Trends in Industrial Production

Industrial Production – Slows to 18-month low (excl Oct anomaly)

- Industrial production slowed to 7.1%yoy in Jul07, down from 9% the previous month and 13.2% in July06. On a cumulative basis, growth during Apr-Jul FY08 is down to 9.6%, from 11.1% during the same period last year
- The slowdown in growth is primarily a result of higher interest rates. While we expect growth to remain in the single-digit range over coming months, the moderation in credit growth coupled with benign inflation will likely result in a pause in policy rates, which should limit further downside to growth

Monthly trends in Industrial Production (%YoY)



Sectoral Trends

- Trends in the **auto sector** continue to reflect the impact of higher interest rates, with both CV and two-wheeler sales posting a contraction in July. Our autos analyst has also highlighted intense competition in the passenger car business as a key risk to growth
- In the **construction** industry, cement dispatches rose 11.3% in Jul07. However, numbers are not strictly comparable given that sales in July06 were impacted by seasonal factors

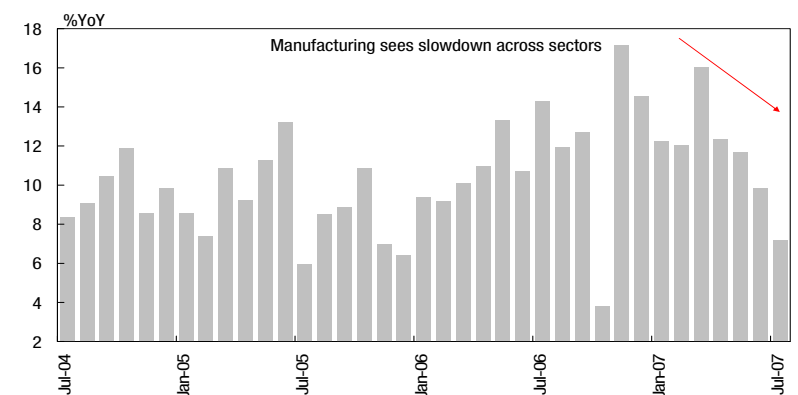
Sectoral Trends (%YoY)

| | Feb-07 | Mar-07 | Apr-07 | May-07 | Jun-07 | Jul-07 | Apr-JulFY08 | Apr-JulFY07 |
|----------------------|-------------|-------------|-------------|-------------|------------|------------|-------------|-------------|
| CV sales | 22.3 | 10.9 | 9.1 | 0.3 | 4.5 | -1.4 | 46.9 | 3.1 |
| Two-wheelers sales | 4.9 | -0.2 | -4.0 | -7.4 | -8.1 | -7.5 | 19.1 | -6.8 |
| Car Sales | 37.2 | 6.0 | 8.4 | 4.8 | 11.1 | 10.4 | 22.9 | 8.7 |
| Cement Dispatches | 6.3 | 6.2 | 6.0 | 10.7 | 4.6 | 11.3 | 11.1 | 8.1 |
| Diesel consumption | 1.3 | 11.6 | 8.5 | 1.0 | 19.9 | 14.0 | 6.6 | 10.8 |
| Infrastructure index | 7.5 | 10.0 | 6.7 | 8.7 | 5.3 | | 8.2 | 6.9 |
| Overall IP | 11.0 | 14.8 | 11.3 | 10.9 | 9.0 | 7.1 | 9.6 | 11.1 |

Manufacturing – Wood Products finally see a slowdown

- The manufacturing sector has been impacted by higher rates, with growth slowing to 7.2%yoy in Jul07, down from double-digit levels earlier in the year. On a cumulative basis, however, growth remains in the double-digit range, +10.3% during Apr-JulFY08, from 12.3% last year.
- On a sectoral basis, 13 of the 17 industry groups showed positive growth, with trends led by basic metals and alloys (+17.5%), and jute and fibre textiles (+16.1%). Interestingly, growth in wood products, which has been extraordinarily high (100%+) over recent months, slowed to 21% in Jul¹.

Monthly trends in Manufacturing (%YoY)



Source: NCAER, CSO, Citi, SIAM, Oil and Gas Monitor

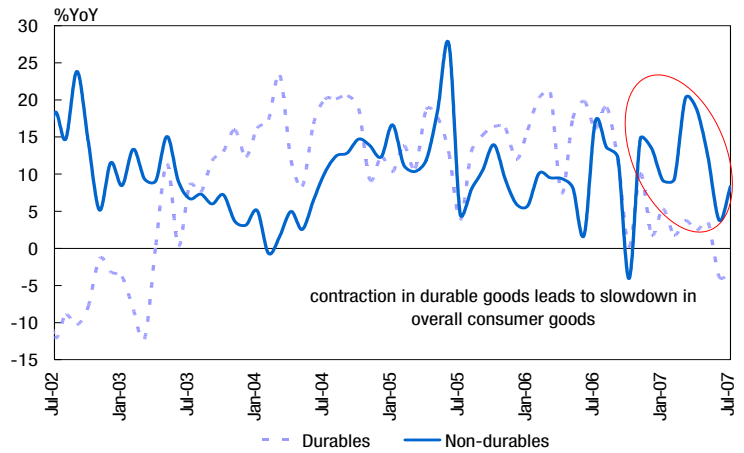
¹ See <https://www.citigroupgeo.com/pdf/SAP08145.pdf> for details



Consumer Goods – contraction in durables weighs on growth

- Consumer goods comprise non-durables and durable goods. Durables include two-wheelers, autos, and transport equipment. The contraction in durable goods for the second month in a row has largely been a result of higher rates coupled with a strong base effect.
- Consumer non-durables include tea, sugar, wheat and cigarettes. Production in this segment has been healthy- up 8.4% in Jul-07, albeit slower than the 17% growth seen in Jul06.

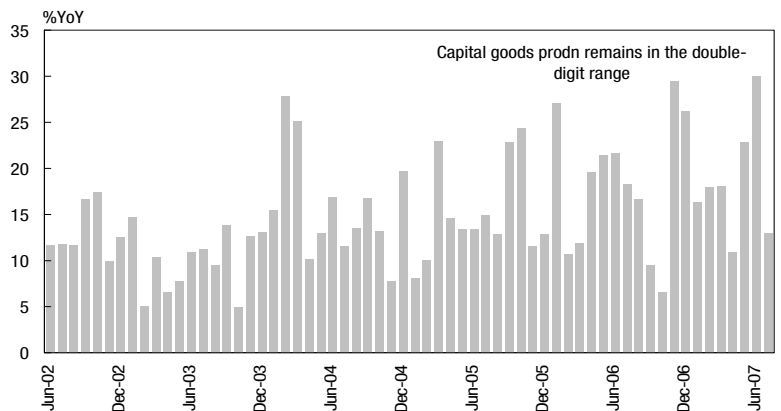
Monthly trends in Consumer Goods (%YoY)



Capital Goods – Slower, but still in double-digit range

- Capital goods production was up 12.9% in Jul07, down from the 20%+growth seen earlier in the year. On a cumulative basis, growth during Apr-Jul FY08 remained strong, up 19.5% vs. 20.3% last year.
- Although there has been some slowdown, we expect the sustained thrust on infrastructure coupled with strong order books of capital goods to result in sustained growth in capital goods production.

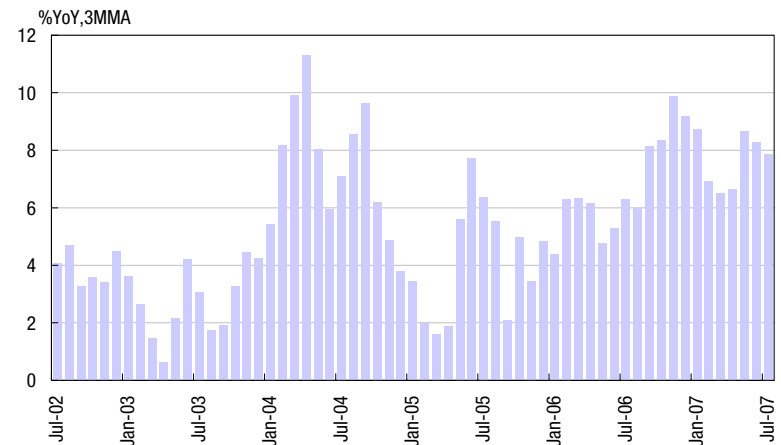
Monthly Trends in Capital Goods (%YoY)



Electricity – Trends remain buoyant

- Trends in electricity remain strong and continue to report buoyant growth up 7.5% in July 07 v/s 8.9% last year.
- Given the power deficit in the country, coupled with government measures to bridge the deficit, we expect the current uptrend in this sector to continue.

Trends in Electricity



Source: CSO



Appendix: Manufacturing Classification – Detailed Breakdown

Break-Up of Manufacturing (% YoY)

| | Wts | Mar-07 | Apr-07 | May-07 | Jun-07 | Jul-07 | Jul-06 | Apr-Jul FY08 | Apr-Jul FY07 |
|---------------------------------------|-------------|-------------|-------------|-------------|------------|------------|-------------|-----------------|-----------------|
| Manufacturing | 79.4 | 16.0 | 12.4 | 11.7 | 9.9 | 7.2 | 14.3 | 10.3 | 12.3 |
| Food Products | 9.1 | 23.7 | 55.0 | 24.8 | 1.3 | -4.1 | 26.9 | 19.7 | 0.4 |
| Beverages, Tobacco & Related | 2.4 | 4.8 | 12.2 | 6.5 | 9.8 | 6.7 | 11.8 | 7.3 | 12.6 |
| Cotton Textiles | 5.5 | 21.2 | 10.5 | 6.9 | 8.1 | 5.1 | 14.3 | 6.7 | 12.1 |
| Wool, Silk, Manmade fibres | 2.3 | 12.6 | 2.0 | 10.9 | 5.0 | 6.9 | 2.7 | 5.9 | 6.4 |
| Jute, Vegetable, and Fibre Textiles | 0.6 | -37.0 | 17.7 | 40.4 | 35.2 | 16.1 | -5.1 | 26.2 | -2.1 |
| Manf of Textile Prod | 2.5 | 11.9 | 7.1 | 9.9 | 14.6 | 3.6 | 28.1 | 5.3 | 17.8 |
| Wood, Wood Products | 2.7 | 113.9 | 92.2 | 132.8 | 103.9 | 21.1 | 26.4 | 72.1 | -5.5 |
| Paper, Prod, Printing, Pub. | 2.7 | 4.8 | 0.3 | 0.0 | 2.3 | -4.6 | 7.3 | 0.0 | 10.7 |
| Leather and Leather Products | 1.1 | -11.1 | 14.7 | 5.7 | 7.7 | 4.2 | -3.9 | 7.5 | -8.5 |
| Basic Chemicals ,Chemical Products | 14.0 | 14.3 | 10.8 | 5.9 | 4.3 | 11.7 | 9.6 | 7.5 | 10.5 |
| Rubber, Plastic, Petro, Coal Products | 5.7 | 16.4 | 14.1 | 9.4 | 9.3 | 6.4 | 9.2 | 10.0 | 9.2 |
| Non-Metallic Mineral Products | 4.4 | 9.2 | 10.0 | 6.7 | 4.0 | 9.2 | 13.3 | 7.3 | 14.5 |
| Basic Metal and Alloy Industries | 7.5 | 23.3 | 18.0 | 21.1 | 21.1 | 17.5 | 20.0 | 19.4 | 20.6 |
| Metal Products and Parts | 2.8 | 47.5 | 3.4 | 8.4 | -7.7 | -5.1 | 6.7 | -1.3 | 1.9 |
| Machinery and Equipment | 9.6 | 11.4 | 19.2 | 22.8 | 18.6 | 7.7 | 15.8 | 14.9 | 14.3 |
| Transport Equipment and Parts | 4.0 | 11.9 | 5.5 | -0.1 | 0.8 | -3.0 | 22.8 | 0.3 | 21.0 |
| Other | 2.6 | -21.1 | -5.4 | -5.0 | 32.5 | 11.9 | 15.9 | 8.5 | 26.1 |
| Mining | 10.5 | 8.0 | 2.6 | 3.6 | 1.5 | 4.9 | 5.1 | 3.1 | 4.0 |
| Electricity | 10.2 | 7.9 | 8.7 | 9.4 | 6.8 | 7.5 | 8.9 | 8.1 | 6.2 |
| General | 100 | 14.8 | 11.3 | 10.9 | 9.0 | 7.1 | 13.2 | 9.6 | 11.1 |

Source: CSO

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