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Economy

Poor mfg output pulls IIP into negative territory

Economy Update

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- **IIP growth for Oct 2011 at -5.1% came significantly lower than our expectation of -1.5% and consensus -0.5%. With this the IIP growth has fallen close to the Jan 2009 low of -5.3%**
- **Surprise came from -6%yoy for mfg sector vs our expectation of -1.6%. Max contraction in cap goods sector at -25.5% followed by intermediate goods sector at -4.7%**
- **Consumption sector also slowing along with investments. Notably while durables grew 0.3% (despite festival season), non-dur prod has been contracting over Sep and Oct 2011**
- **Today's IIP data has strengthened our take on possible accommodative monetary policy actions on Dec 16 and the coming months**

Sharp cracks in mfg prod pull IIP growth in negative territory

The index of industrial production (IIP) growth for Oct 2011 at -5.1% came significantly lower than our expectation of -1.5% and consensus -0.5% led by a sharp 6%yoy decline in manufacturing and 7.2% decline in mining output. With this the IIP growth has fallen close to the Jan 2009 low of 5.3%. The surprise for us came from -6%YoY for manufacturing sector vs our expectation of -1.6%. On seasonally adjusted basis the decline in IIP index has been steep at 4.2% mom and 14% over March 2011. These are much higher than our expectation of -0.5% and -6.8% respectively. What is surprising is that the raw data on IIP also show 3.1% mom contraction, which is atypical for October month.

The industry group 'Medical, precision & optical instruments, watches and clocks' has shown the highest growth of 30.8%, followed by 18.4% in 'Office, accounting & computing machinery' and 15.3% in 'Radio, TV and communication equipment & apparatus'. On the other hand, the industry group 'Electrical machinery & apparatus n.e.c.' has shown a negative growth of 58.8% followed by 12.1% in 'Machinery and equipment n.e.c.' and 11.4% in 'Rubber and plastics products'.

Capital goods sees sharp decline @ -25.5%

User based data show that the decline in IIP growth has been pervasive with maximum contraction in capital goods sector at -25.5% followed by intermediate goods sector at -4.7%. These have weighed over the manufacturing sector performance which contracted 6% YoY. Ex capital goods the IIP growth YOY was still a contraction of -1.1%

Some of the important items of capital goods showing high negative growth during Oct 2011 include 'Cable, Rubber Insulated' [(-) 82.9%], 'Cement Machinery' (-74.6%), 'Insulated Cables/Wires all kind' (-38.2%), 'X-ray equipment' (-35.8%) and 'Plastic Machinery including Moulding Machinery' (-32.3%). However, some important items of the capital goods are also showing significant growth. These are: 'Conductor, Aluminium' (46.6%), 'Boilers' (45.8%), 'Heat Exchangers' (35.5%) and 'Machine Tools' (31.4%).

Consumption sector also sees slowdown

It is getting increasingly evident that growth slowdown or contraction is not just an aberration, it is strongly cyclical. Importantly, this is happening at a time when fiscal leeway to prop up growth is low and is on a fiscal consolidation mode. The key thing to notice is that consumption sector is also slowing along with investments. Notably while durables production grew 0.3% (despite festival season), non-durables production has been contracting over Sep and Nov 2011. Sharper contraction in investments is a leading indicator for a much weaker overall GDP growth outlook.

Negative surprises in IIP to translate into Q3 topline disappointments

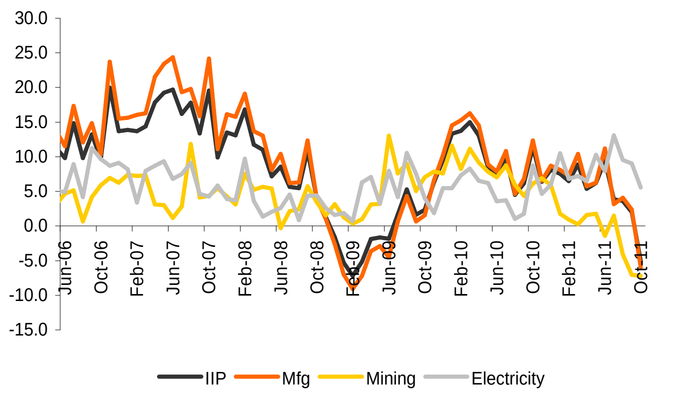
From the market stand point, the negative output growth surprises will likely impact both earnings growth outlook and multiples. We believe, what might surprise the market are disappointments on topline growth, which may continue to feed into weakening net profits. This sets out the backdrop for Q3FY12 results, in our view. Drifting of IIP growth to contraction zone would also imply that the weakening bias on INR/USD will sustain beyond 53; at the moment we maintain an outer limit of 55. Today's IIP data has strengthened our take on possible accommodative monetary policy actions on Dec 16 and the coming months

Mfg growth lowest in last two years

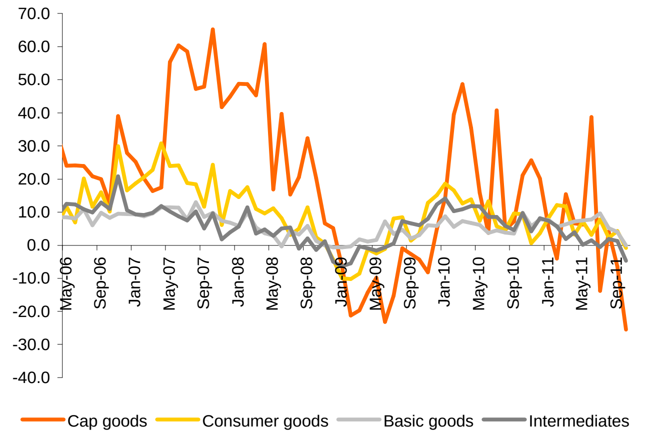
% yoy	General	Mfg	Mining	Electricity	Cap goods	Cons goods	Durable	Non-durable	Basic goods	Intermediates
Oct-06	9.7	10.3	5.9	9.7	12.6	10.2	23.2	3.8	8.2	11.0
Oct-07	19.5	24.2	4.3	4.3	65.2	24.3	39.4	15.5	9.8	9.6
Oct-08	3.9	3.8	3.4	4.4	20.2	2.3	11.8	-4.4	1.3	-1.4
Oct-09	2.3	1.6	7.1	4.0	-4.3	3.4	7.2	0.4	3.0	6.1
Oct-10	11.4	12.4	6.1	8.8	21.0	9.4	14.3	5.1	9.8	9.7
Oct-11	-5.1	-6.0	-7.2	5.6	-25.5	-0.8	-0.3	-1.3	-0.1	-4.7

% mom	General	Mfg	Mining	Electricity	Cap goods	Consumer goods	Durable	Non-durable	Basic goods	Intermediates
Oct-07	5.0	4.5	9.2	5.4	-0.8	7.1	17.9	0.7	6.5	2.2
Oct-08	-1.6	-3.4	6.8	5.5	-9.9	-1.7	0.5	-3.3	2.0	-1.3
Oct-09	-0.9	-2.5	8.9	2.0	-11.5	0.3	2.1	-1.1	3.0	-1.8
Oct-10	3.9	2.5	10.7	9.0	-0.1	0.1	2.2	-1.9	9.2	3.0
Oct-11	-3.3	-5.8	10.5	5.6	-20.4	-4.9	-6.7	-3.0	5.0	-3.1

IIP grows below expectation led by fall in Mfg & Mining



..capital goods and intermediate sees maximum decline



Source: CSO, Emkay Research

Industrial production (Base=2004-05)

% yoy change	Oct-11	Oct-10	Sep-11	YTD FY12	YTDFY11
IIP	-5.1	11.4	2.0	3.5	8.7
General					
Mfg	-6.0	12.4	2.4	3.7	9.4
Mining	-7.2	6.1	-7.1	-2.1	7.0
Electricity	5.6	8.8	9.0	8.8	4.5
Use based					
Cap goods	-25.5	21.0	-6.5	-0.3	17.2
Consumer goods	-0.8	9.4	4.3	3.9	9.1
Durable	-0.3	14.3	9.2	4.5	15.7
Non-durable	-1.3	5.1	-0.2	3.3	3.9
Basic goods	-0.1	9.8	4.0	5.8	5.4
Intermediates	-4.7	9.7	1.3	0.5	8.6

Source: CSO, Emkay Research

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