

Industry

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After recording 7.7, 9.0 and 9.1 per cent growth in Q1, Q2 and Q3: 2004-05, the industrial sector clocked 7.4 per cent growth in Q4: 2004-05 on a year on year (Y-o-Y) basis (Fig I.1). Industrial growth in 2004-05 has been better than expected against a backdrop of controlled inflation, the bottoming out of the soft interest rate regime, and high foreign exchange reserves. Further, industrial growth for the first two months of this fiscal is also encouraging. The Index of Industrial Production (IIP) for April-May 2005 grew at 9.6 per cent.

This buoyancy is also noticeable in the latest round of our Business Expectations Survey (BES), which shows that the Business Confidence Index (BCI), has jumped from 136.0 in October 2004, to 143.1 in April 2005. This is the highest level that the BCI has attained since December 1995.

The impetus provided by the 2005-06 Budget to rural infrastructure, irrigation etc. should add to the positive outlook. Of late, investment spending particularly by corporate entities has also picked up.

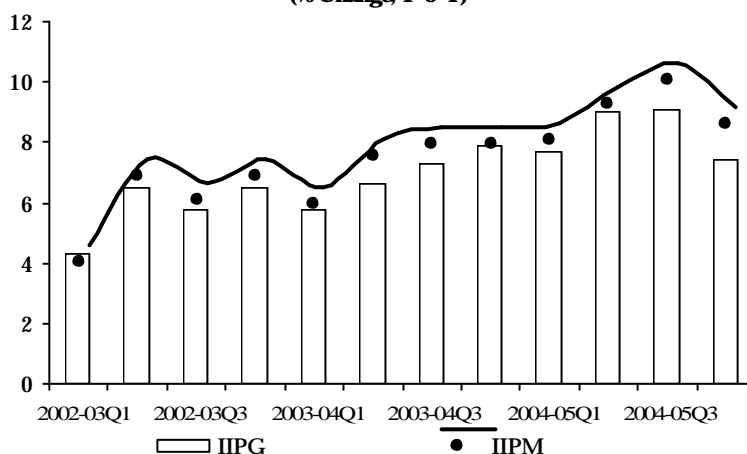
In the short term, the external downside risk comes from the volatility in international oil prices.

Trends in output

Industrial output in 2004-05 recorded the second highest annual rate of growth (8.2 per cent as measured by the IIP, which covers manufacturing, mining and electricity) in the last 10 years, next only to the double-digit annual growth rate of 1995-96. This is 1.2 percentage points higher than the growth

recorded in 2003-04. As in 2003-04, industrial growth in 2004-05 is once again mainly driven by manufacturing sector growth, which grew by 9.0 per cent in 2004-05 compared to 7.4 per cent growth in 2003-04 (Table I.1). Interestingly, with the exception of November 2004 and February 2005, manufacturing growth each month in 2004-05 was higher than the corresponding month in 2003-04. The sector's excellent run continues this fiscal: it posted an impressive 10.5 per cent growth during April-May 2005.

Fig I.1: Trends in Industrial Growth IIPG & IIPM
(% Change, Y-o-Y)



Contrary to the robust growth shown by industry in general and manufacturing in particular, infrastructure displayed a rather lacklustre performance in 2004-05 and through the first two months of 2005-06 as per available data. The overall growth of infrastructure industry at 4.9 per cent during April-May 2005 is exactly the same as was observed for the whole of financial year (FY) 2004-05 (Table I.2). Yet, coal and cement stand out for

Table I.1: Index of Industrial Production (% Change, Y-o-Y)

Year	General	Manufacturing	Mining & Quarrying	Electricity	Basic Goods	Capital Goods	Intermediate Goods	Consumer Goods	Consumer Durable	Consumer Non-Durable
1994-95	9.1	9.1	9.8	8.5	9.6	9.2	5.3	12.1	16.2	11.2
1995-96	13.1	14.1	9.7	8.1	10.8	5.4	19.3	12.8	25.8	9.8
1996-97	6.1	7.3	-1.9	4.0	3.0	11.4	8.1	6.2	4.6	6.6
1997-98	6.6	6.6	7.0	6.6	6.8	5.8	8.0	5.5	7.8	4.9
1998-99	4.1	4.4	-0.8	6.4	1.7	12.7	6.1	2.2	5.6	1.1
1999-00	6.6	7.2	1.0	7.3	5.5	7.0	8.8	5.7	14.2	3.2
2000-01	5.1	5.4	3.7	4.0	3.7	1.7	4.7	8.0	14.6	5.9
2001-02	2.7	2.9	1.3	3.1	2.6	-3.4	1.6	6.0	11.5	4.1
2002-03	5.8	6.0	5.8	3.2	4.8	10.5	3.9	7.1	-6.3	12.0
2003-04	7.0	7.4	5.3	5.0	5.5	13.6	6.4	7.2	11.6	5.8
2004-05	8.3	9.0	4.4	5.2	5.5	13.6	6.0	11.6	14.3	10.7
2004-05*	7.9	8.1	7.2	6.7	5.4	11.6	12.7	5.3	10.0	3.8
2005-06*	9.6	10.5	3.2	6.8	7.0	18.9	2.1	16.5	19.2	15.6

* April- May

having achieved six per cent plus growth in FY 2004-05.

The growth of cement output was mainly driven by ongoing infrastructure projects such as the National Highway Development Programme (NHDP) and construction activity in the housing/ commercial sectors. Cement consumption went up in 2004-05 in the eastern (16.3 per cent), western (7.6 per cent) and central (9.1 per cent) regions, but fell in the northern (by 1.2 per cent) and southern (by 1.4 per cent) regions. Demand usually goes up during April-May every year as construction picks up before the monsoon. However, figures

for April-May 2005-06 do not show any seasonal increment in demand.

The demand prospect for cement industry both in near and medium term is expected to remain robust. Firstly, the buoyancy witnessed in construction activity continues to show no signs of slowing down and secondly the widening of roads envisaged under NHDP III programme is soon expected to be a reality. Recently National Highway Authority of India (NHAI) has invited tenders for four-laning of six sections of national highways covering a total of 368 km and worth Rs 1,687 crore, with the last date being June 30. The six

Despite shocks such as the Tsunami, a deficient monsoon and volatile oil prices in 2004-05, the industrial sector continues to have an excellent run

Table I.2: Growth of Infrastructure Industry (% Change, Y-o-Y)

Sector	Weights	2003-04	2004-05	April-May 2004-05	April-May 2005-06
Crude petroleum	4.17	0.7	1.8	8.8	-1.2
Petro. products	2.00	8.2	4.3	13.6	-6.9
Coal	3.22	5.1	6.3	5.1	9.7
Electricity	10.17	5.1	5.2	6.8	6.7
Cement	1.99	6.1	6.6	6.9	5.0
Steel	5.13	9.8	5.1	9.6	7.6
Total	26.88	6.1	4.9	8.2	4.9

sections include Indore-Khalghat 80 km stretch in MP worth Rs 472 crore; Lucknow-Sitapur 75 km stretch in UP worth Rs 322 crore; Ranchi-Hazaribagh 75 km stretch in Jharkhand worth Rs 318 crore; two in Maharashtra worth Rs 380 crore; and a 48 km stretch between Agra and Bharatpur worth Rs 195 crore.

Growth in coal output has been largely an outcome of increased demand from the power sector, which consumes about 76 per cent of total coal output. Coal shortage has become a persistent problem of late and coal import at 28.1 million tonnes witnessed 19.2 per cent growth during 2004-05. Hearing alarm bells, the Department of Industrial Policy and Promotion (DIPP) proposes to raise the cap for coal and lignite sector to 100 per cent. Even for captive mining of the two fuels, the cap is proposed to be raised from 74 per cent to 100 per cent. Present rules permit up to 50 per cent FDI through the automatic route with a rider that foreign investment in public sector undertakings (PSUs) should not exceed 49 per cent.

Electricity generation grew by 5.2 per cent in 2004-05 and has shown further improved performance by clocking a 6.7 per cent growth in the first two months of this fiscal. The Central Electricity Authority (CEA) has set a target of generating 621.5 billion KWH, which translates into a growth of 5.8 per cent, for 2005-06. However, the real issue is not growth per se in electricity generation, but the increasing mismatch between power demand and supply. Shortages as a percentage of requirement crawled up from 7.1 per cent (2003-04) to 7.3 per cent (2004-05), before soaring to an astonishing 20.5 per cent in March 2005. In response, the Central government decided to do away with the in-principle Planning Commission approval and a pre-Public Investment Board (PIB) clearance for setting up power projects. All projects up to Rs. 500 crore no longer require PIB approval and are to be directly processed by the power ministry for seeking the Cabinet Committee on Economic Affairs' (CCEA's) nod. Projects

between Rs. 500 crore and Rs. 1,500 crore will be cleared in eight weeks by the CCEA.

The steel sector did not fare very well in 2004-05 (5.1 per cent growth as compared to 9.8 per cent growth in 2003-04), but has already clocked 7.6 per cent growth during April-May 2004-05. Although demand for steel has been guided both by domestic and export demand, the build up of inventory during April and May 2005 in Europe and North America has softened the export demand and consequently steel prices in the international market. A ripple effect of this softening was witnessed in the domestic market as well recently when domestic producers reduced steel prices (ranging between Rs. 500 to Rs. 2000 per tonne). In the short term, steel industry prospects appear to be good. Even though China is gradually increasing domestic steel production capacity, it is expected to remain a net importer of steel for a few more years. According to the International Iron and Steel Institute (IISA), while world steel consumption is expected to touch around 37-47 million metric ton (mmt) in 2005, as compared to 2004, steel consumption in China alone is expected to increase by 17-27 mmt. Although the growth in global steel consumption is expected to decline (from 7.7 per cent in 2004 to 4.9 per cent in 2005), domestic producers appear to be still optimistic about the medium/ long term, particularly in view of the domestic demand and are in the process of enhancing capacity. According to a steel ministry report, domestic steel demand is expected to increase to 55-60 million tons by 2011-12 and further to 100 million tons by 2020.

The biggest capital expenditure plans are those of the state-owned Steel Authority of India (SAIL) at Rs. 25,000 crore and Tata Iron and Steel Company (Tisco) at Rs. 23,000 crore. Bhushan Steel & Strips will be spending Rs. 3,200 crore for backward integration. Similarly, Jindal Steel & Power plans to expand its capacity at a cost of Rs. 3,050 crore, while Essar Steel is looking at a Rs. 4,400 crore expansion and acquisition

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plan. Most expansion plans are large in relation to the existing size of the steel companies. Tisco's capital outlay in terms of expansion will be equivalent to 195 per cent of its assets.

Corporate Sector Performance

The corporate sector, as in 2003-04, has once again registered a robust growth in 2004-05. Net sales, which increased by 12.8 per cent in 2003-04, have done even better in

line, the advantage on this account is dwindling for two reasons. Firstly, there are signs of reversal in the interest rate regime from soft to neutral/ hard, of late. Secondly, having already reaped the advantage of swapping expensive debt with lower cost during past few years, opportunities have narrowed on this account now.

Across the sectors, both non-metallic minerals and metal and metal products are way ahead of other sectors in terms of the bot-

Table I.3: Corporate Sector Performance (Growth Rates)

Item	2003-04	2004-05
Net Sales	12.8	22.7
Other income	35.5	-9.1
Interest	-8.9	-1.2
Gross profit (PBDT)	24.2	27.3
Depreciation	11.2	9.6
Tax	15.3	22.6
Net profit (PAT)	35.6	37.2

Corporate Sector Performance (Industry wise growth)					
	No of Co.	Net Sales		PAT	
		2003-04	2004-05	2003-04	2004-05
Manufacturing	1645	14.2	22.5	66.7	40.7
Food Products	179	6.8	9.0	86.2	79.5
Beverages & Tobacco	18	8.2	16.3	9.2	40.6
Textile	238	9.1	13.6	119.1	63.1
Chemicals	447	11.0	20.8	33.8	2.9
Non Metallic Minerals	115	30.3	17.1	133.9	113.0
Metal & Metal Products	164	29.0	43.3	1399.7	142.7
Machinery	258	10.3	19.0	38.4	90.4
Transport Equipment	102	27.2	24.3	68.9	39.2
Miscellaneous	93	14.7	16.7	69.8	46.5

Source: Prowess, CMIE (Sample size 2784 companies)

2004-05 registering 22.7 growth (Table I.3). Sectors across a wide spectrum of activity - beverages and tobacco, textiles, chemicals, machinery, metal and metal products - have witnessed excellent growth in sales.

Corporate sector profitability improved in 2004-05: profit before depreciation and tax (PBDT) increased from 24.2 per cent in 2003-04, to 27.3 per cent in 2004-05. However, profit after tax (PAT), did even better, increasing from 35.6 per cent to 37.2 per cent for the same period. Though lower interest cost continues to be a factor in enabling companies to improve the bottom

tom line. Both sectors recorded triple digit growth in 2004-05 on top of an equally superlative performance in 2003-04. Machinery and food products also registered huge growth in their bottom line in 2004-05.

Prospects 2005-06

Though industrial sector growth in 2004-05 (and subsequently in the first two months of 2005-06) did not indicate output slowdown, a blip in February 2005 IIP data raised some doubts in few quarters about the sustainability of current industrial expansion. It is worthwhile to examine the issue.

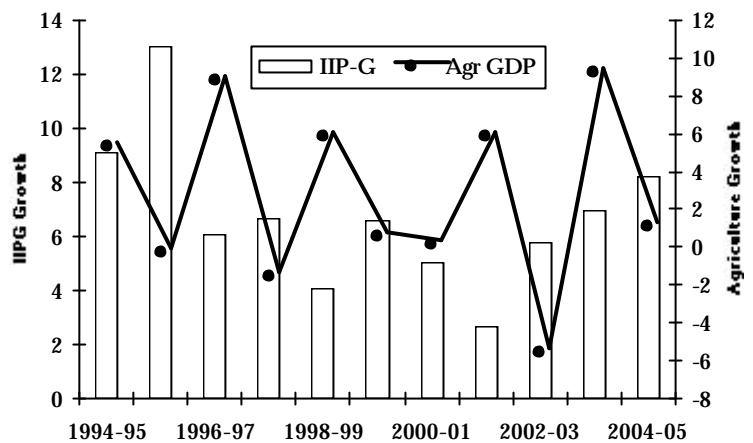
Agricultural growth is often cited as a driver of industrial growth. Although there appeared to be a mismatch between agricultural and industrial growth during 2004-05 with the latter surging while the former declined to 1 per cent, the pattern seems to be consistent with the longer term experience that agricultural growth affects industrial growth with one period lag (Fig I.2). The year 2003-04 saw a sharp rise in agricultural sector output and may have supported growth of industry in 2004-05.

There are other drivers of industrial output as well. An important one, of late, is export performance. Exports in 2004-05 hit record levels. In each of the past three years merchandise exports have increased by more than 20 per cent per year, taking the value of exports in 2004-05 to US\$ 79.6 billion. Although a part of the growth in export value is from higher commodity prices, the rise in exports in 2004-05 was a major driver of industrial growth.

Another important change in the economy that is influencing overall demand is the inflow of funds under the invisible account of external transactions. The net invisibles under private transfers (mainly remittances from abroad) and 'miscellaneous services' (software exports and BPO earnings) amounted to a little more than Rs. 104,000 crore and Rs. 22,500 crore respectively in 2003-04. The two components together amounted to less than Rs. 4,000 crore in 1990-91 or 70,000 crore in 2000-01. These are large gains and in 2003-04, the increase in net receipts under the two heads was about Rs. 22,000 crore. Put another way, five per cent of agriculture and allied sector GDP in 2003-04 amounted about Rs. 22,000 crore. Thus, a decline of five per cent growth in agricultural GDP could have been offset almost entirely by the rise in remittances and miscellaneous receipts. The consumption demand for industrial products would have been sustained by the rise in service sector income, despite the drop in rural income due to poor agricultural performance.

One more factor that appears to have

Fig I.2: Agricultural Growth and Industrial Growth (% Y-o-Y)



sustained the growth of demand for industrial products in recent years, despite poor agricultural growth, is the expansion in credit. The expansion in household credit in the form of consumer credit and housing finance may be insulating the demand for industrial output to some extent from the vagaries of income shocks. Innovations in the financial sector have the ability to provide such a cushion at least in the short term.

Some indication of sources of growth in industrial output can also be discerned from the break up of industrial output into sub-categories. The drivers of industrial output growth since 1993-94 have been consumer durables and the capital goods sector. The IIP for consumer durables more than tripled between 2004-05 and 1993-94; more than doubling (an increase of 128 per cent) for capital goods. Therefore, consumption spending was more conspicuous than capital spending in the loosely termed 'reform period'. As noted above, in 2004-05, the consumer durables IIP registered 14.3 per cent growth over the previous year, clearly buoyed by the growth of the automobile segment. But the surprising element in industrial growth was the rise in the output of the non-durables segment. Here textile products, 'beverages, tobacco and tobacco products', and 'other manufacturing' appeared to be the key components experiencing relatively high growth. Export demand has played an important role in driving this growth.

Besides these factors, which are expected to contribute towards sustainability of the industrial growth, even the Union Budget proposals of 2005-06, with the exception of few irritants (e.g. the Fringe Benefit Tax), are expected to help industrial activity consolidate in this fiscal. Moves to improve FDI inflows and a focus on improving infrastructure have given a fillip to the investment climate in general. Further, the monetary policy announced by the RBI for 2005-06 continues to be guided by the objectives of provision of adequate liq-

uidity for meeting credit growth, and of supporting investment and export demand.

Thus, on the whole, factors affecting industrial performance indicate that the current buoyancy in industrial growth is likely to be sustained in coming months. Yet the volatile nature of international oil prices and the fast-emerging infrastructure bottlenecks (with infrastructure industries growth being unable to keep pace with growth in the manufacturing sector) are down-side risks.

Thus, on the whole, factors affecting industrial performance indicate that the current buoyancy in industrial growth is likely to be sustained

Box I.1: Industrial Output: Use based Classification

Use based classification of industrial data shows capital and consumer goods to be the key drivers of industrial growth. During FY 2004-05 capital goods grew by 13.3 per cent, growing by 18.9 per cent (Table I.1) in the first two months this fiscal. The creditable performance of the capital goods sector in 2004-05 is indeed impressive, as it is attained on a high, 13.6 per cent growth base in 2003-04. Even more creditable is its consistent performance throughout FY 2004-05. With the exception of November 2004 and January and February 2005, the capital goods sector recorded double-digit growth in each month of FY 2004-05. This growth is led by the machinery and equipment segment, the dominant segment of the capital goods index (with 63.6 per cent weight in the CGI).

While the machinery and equipment segment grew by 16.0 per cent in 2004-05, the transport equipment grew by just 3.9 per cent. At a more disaggregated level, production of tractors went up by 35 per cent. Hydraulic machines, cooling towers, material handling equipment, control panels, computer system and peripherals - all witnessed growth ranging between 27 to 50 per cent. Even capital goods import recorded a handsome 22 per cent growth in 2004-05. Thus, higher domestic production, coupled with rise in imports, clearly suggest buoyant investment activity in the economy.

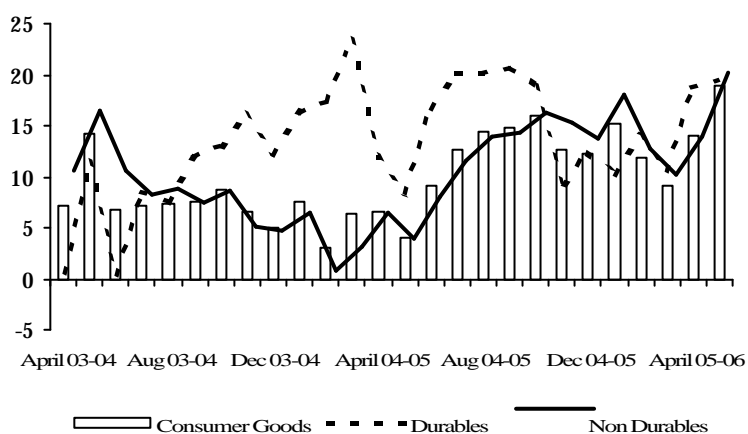
The production of consumer goods in FY 2004-05 increased by 11.5 per cent on a Y-o-Y basis, compared to 7.2 per cent during FY 2003-04 (Table I.1). This increased impetus in growth has not slackened even this fiscal. Consumer goods recorded a growth of 16.5 per cent for April-May 2005-06. A break up of the consumer goods sector into consumer durable and consumer non-durable indicates that the upturn in 2004-05, unlike 2003-04 has been witnessed both in consumer durable as well as in non-durable segments (Fig I.3).

While consumer durables showed 14.3 per cent growth in FY 2004-05, consumer non-durable clocked 10.6 per cent growth for the same period. Barring two months (May and December 2004), consumer durable showed double digit growth throughout FY 2004-05, ranging from 10.3 per cent to 20.6 per cent. The performance of consumer non-durables has been equally spectacular. With the exception of the first three and the last month, this segment registered double digit growth in all the remaining months of FY 2004-05 (Fig I.2). Some of its high performing components are refrigerators,

television, washing machines, motorcycles, and window air conditioners. In fact, window air conditioners and televisions recorded a phenomenal growth of over 40 per cent. The key segments driving the growth of consumer non durables are biscuits, edible oil, coffee, soft drinks, cotton hosiery cloth, hair oil, Indian made foreign liquor, detergents, rubber footwear and writing instruments. The growth momentum of both consumer durable and non-durable segments is continuing in this fiscal as well. The latest available data shows that while consumer durables grew by 19.2 per cent during April-May 2005-06, consumer non-durable grew at the rate of 15.6 for the same period.

Growth in the basic goods sector, at 5.5 per cent in 2004-05, is exactly same as 2003-04. The continued boom in the housing sector, coupled with spending on infrastructure projects such as NHDP, has kept the growth of the basic goods sector steady. The main segments driving growth are phosphatic fertilizer, carbon black, aluminium wire rods, HR sheets, sponge iron in addition to cement, wire ropes and washed coal. However, basic goods segments like acetic acid, ethylene, pig iron, structurals, electric sheets, aluminium extrusions etc., registered either low or negative growth in 2004-05.

Fig I.3: Monthly growth of Consumer durable & Non durable (% Change, Y-o-Y)



The intermediate goods sector recorded 5.8 per cent growth during FY 2004-05. This is 0.6 percentage points lower than the growth attained in FY 2003-04. Growth in the intermediate goods sector continues to be modest this fiscal as well, on a Y-o-Y basis this sector recorded a growth of 2.1 per cent in the period of April-May 2005.

However, aided by the growth in passenger cars, utility vehicles and two wheelers, the auto ancillary segment of the intermediate goods sector witnessed an excellent growth of 29.3 per cent during FY 2004-05. The growth story of this segment is far from over. In fact, several American and European vehicle manufacturers have revealed plans for stepping up sourcing of auto components from India. For instance, General Motors intends to source components worth a billion US dollars in the next three to four years, as compared to the current US\$ 120 million (Rs. 523 crore). Thus bolstered by growing overseas and domestic demand, auto components manufacturers are revving up their investments and have plans to invest about Rs. 4,355 crore on capacity expansion in the current year according to Auto Component Manufacturers Association.

The other notable drivers of growth for intermediate goods sector during FY 2004-05 were corrugated boxes, synthetic resins, reactive dyes, viscose staple fibre, adhesive, ball & roller bearings, valves, storage batteries etc. On the other hand, some of the prominent intermediate goods segments that witnessed negative growth are azo dyes, filament yarn, nylon tyre cord power, high explosive and PVC pipes and tubes.

Box I.2: Industrial Output: Two Digit Level Classification

Turning towards the two-digit classification, as many as 15 of the 17 industry groups showed positive growth in FY 2004-05 (up from 12 in 2003-04), (Table I.4). Textile products (including apparel) showed the highest growth of 19.2 per cent in 2004-05, followed by 16.9 per cent in other manufacturing and 16.0 per cent in machinery and equipment. The performance of textile products in 2004-05 and subsequently in the first two months this fiscal suggests that apprehensions about the adverse impact of dismantling the quota regime, on the textile industry in India, were premature.

Food products for the second consecutive year witnessed negative growth. However, in the first two months of this fiscal this sector seems to have turned the tide and recorded 6.0 per cent growth. The other sector to have witnessed negative growth in 2004-05 was wood and wood products; its dismal performance continues this fiscal. On the contrary, sectors such as non-metallic minerals and transport equipment, which registered a very low growth during FY 2004-05, have significantly improved during the first two months of this fiscal. On the whole, data at two-digit level suggests the broadening and deepening of economic activity across various industrial sectors.

Table I.4: Growth of Industry at 2-Digit Classification (% Change, Y-o-Y)

2 Digit Industries	Weights	2003-04	2004-05	April-May 2004-05	April-May 2005-06
Food products	11.4	-0.5	-0.9	-19.7	9.4
Beverages etc	3.0	8.5	10.8	12.6	6.5
Cotton textiles	7.0	-3.1	7.4	9.3	8.4
Wool, silk etc	2.8	6.8	7.0	36.5	-8.1
Jute	0.7	-4.2	3.7	-1.7	-3.5
Textile products	3.2	-3.2	19.2	7.2	27.9
Wood	3.4	6.9	-12.2	-8.2	-4.3
Paper & Paper Products	3.3	15.6	9.7	4.8	10.0
Leather	1.4	-3.9	6.9	9.9	13.8
Basic Chemicals	17.6	8.6	14.4	25.0	12.7
Rubber & petroleum	7.2	4.4	2.4	7.7	1.7
Non-metallic minerals	5.5	3.7	1.5	-1.4	7.0
Basic metal	9.4	9.2	5.4	-3.6	15.0
Metal products	3.5	3.7	5.8	1.2	7.1
Machinery and equipment	12.1	15.8	16.0	24.3	15.4
Transport equip & parts	5.0	17.1	3.9	-0.9	13.1
Other manufacturing	3.2	7.7	16.9	7.8	10.4