Industry

Industry remains in the doldrums with neither output nor gross capital formation showing any sign of revival. Various attempts have been made by the government to try and improve sentiment and revive animal spirits but have not borne fruit as yet. The political uncertainty caused by the impending general elections is expected to weigh hugely on sentiment and cast a dampener on the sector for the remaining part of this fiscal and possibly, the first quarter of the next fiscal as well. The only hope is that the pick-up in global growth might provide an export-led stimulus to the sector.

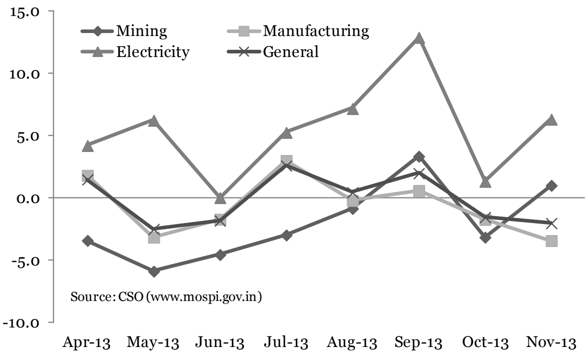
The general belief (hope?) that growth in industry had been bottomed out and things would start looking a lot better in the second half of the current fiscal have, unfortunately, been belied. The latest index of industrial production (IIP) for November, 2013 (-2.1%) shows we are nowhere near recovery.

A word on the IIP. The index of industrial production (IIP) with 2004-5 as base (compiled monthly) is the principal indicator for industrial activity in the country. The existing IIP series is based on 399 products/ product groups which are further aggregated into three broad groups: mining, manufacturing, and electricity. The IIP as an index reflects both the level of production and growth. An examination of the trend in the IIP numbers suggest the weakness may continue in the coming months as well, as industrial production has been declining on a month-on-month basis for four out of the last six months, reflecting sustained weakness.

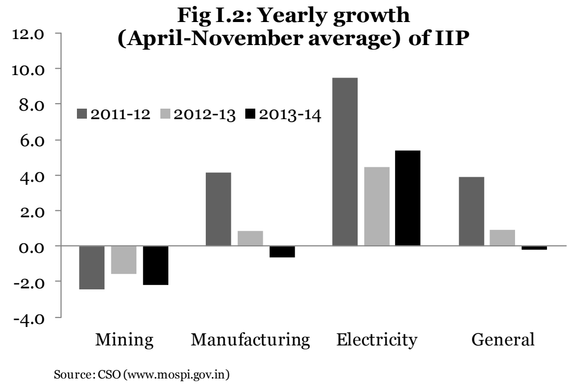
In November, while electricity generation grew 6.3 per cent month-on-month, growth in the manufacturing sector declined to -3.5 per cent on a month-on-month basis, the steepest decline after March, 2012 (Figure I.1). Due to a low base effect, the mining sector exhibited one percent growth in November 2013 despite policy bottlenecks. Any hope that the manufacturing sector will witness a turnaround soon is likely to be misplaced as credit flow to the sector will also slow down as banks start deleveraging to reduce their credit-deposit ratio.

Sustained slowdown in industrial production in the second quarter of FY14 has implications for gross domestic product (GDP) growth. Quarterly GDP growth numbers in India are estimated using the monthly index of industrial production and industrial value-added contributes 19 per cent of Indian GDP. Sluggish growth in developed markets coupled with weakness in the services sector, could manifest itself in "deeper macro stress" and lead to significant deceleration in GDP growth.

Fig I.1: Monthly growth of IIP



Average sectoral performance for the April-November period shows a precipitous decline in the yearly growth of manufacturing and the general index (Figure I.2). Mining has been a laggard, throughout this period, reflecting deep rooted policy uncertainties. The manufacturing sector, after recording a high growth of as 4.1 per cent growth in 2011-12, has also slumped, falling to a low of 0.8 per cent in 2012-13 and further to -0.6 per cent for the April-November 2013 period (Y-o-Y). The general index too declined, reflecting overall sectoral deceleration.



What explains the steady decline in industrial growth since 2010-11? A number of factors played spoilsport. The boost to demand given by monetary and fiscal stimulus following the international financial crisis saw consumption grow at an average of over 8 per cent annually between 2009-10 and 2011-12. However, it also resulted in strong inflation and an equally powerful monetary response that eventually contributed to slow down in consumption as well as investment demand. Moreover, corporate and infrastructure investment started slackening since 2011-12 as a result of structural bottlenecks. The global slowdown and uncertainties about fiscal policy in the United States also impacted sentiment.

Manufacturing bears the brunt of any decline in investment. Unfortunately, both the data on Gross Fixed Capital Formation (GFCF) and Capital Goods sector (use-based classification of IIP) shows a downturn. The series of hikes in the RBI's repo rates contributed to raising capital costs for industry. Small and medium enterprises have been particularly hard hit.

GFCF growth, an indicator of investment activity by industry, has fallen over the period (April-September, y-o-y) from as high as 16.2 per cent in the first quarter of 2011-12 to as low as -0.6 per cent in the same period, 2012-13 (Table I.1).

The slight uptick to 0.7 per cent in the current fiscal is not big enough to counter the sharp slowing down of corporate investment.

Capital goods output has also shown a downward drift to negative territory,

IIP: Use-based classification

On a use-based classification, basic goods registered a growth of 0.7 per cent during April-November, 2013-14, down from 2.8 per cent during the comparable period, 2012-13 (Table I.2). On a year-on-year basis, the April-November 2013-14 period saw a big drop in consumer durables output to -12.6 per cent, signaling tighter demand conditions and steep moderation in production. However, the growth of capital goods production, which was -11.3 per cent during 2012-13, improved to -0.1 per cent in 2013-14, reflecting revival in the pattern of investment demand during the period. Intermediate goods too show some sign of revival, with growth up to 2.7 per cent in the April-November 2013 period. The consumer non-durable segment saw a surge in demand to 6.3 per cent in April-November, 2013-14, up from 2.2 per cent in the comparable period, 2012-13.

IIP Growth across sub-sectors (2-digit classification)

The IIP data for 22 sub-groups, disaggregated at the 2-digit level of National Industrial Classification (NIC), 2004 shows diverse performance across industries in April-November period 2013-14 (Table I.3). Overall, 11 out of the 22 industry groups in the manufacturing sector show positive growth. Prominent among these are wearing apparel (32.3%), electrical machinery (26%), chemical & products (9.9%), refined petroleum products (6.6%), leather products (6.4%), other transport equipment (6.4%), textiles (3.8%), tobacco products (3.4%) publishing, printing (2%) and other non-metallic mineral products (1.5%). All these segments, specially the wearing apparel segment, have recorded impressive growth, reflecting the positive impact from the demand-side as well. However there are some worrisome signs - negative growth in food products and beverages, machinery and equipment, metal and metal products, all of which have relatively higher potential for labour absorption. In the consumer durable sector, there are several products that have registered steep negative growth. Noticeable among them are: Fabricated metal products (-7.5%), Office machinery (-17.3%), Radio, TV and communication equipment & apparatus (-25.1%) and Medical, precision & optical instruments, watches and clocks (-7.0%). Wearing apparel has shown a positive growth of 32.3 per cent during April-November 2013-14. The automobile sector is passing through a challenging phase and recorded a negative growth (-7.6%) in 2013-14.

Infrastructure: Performance of the eight core industries

Infrastructure industries are an important constituent of overall industrial activity.

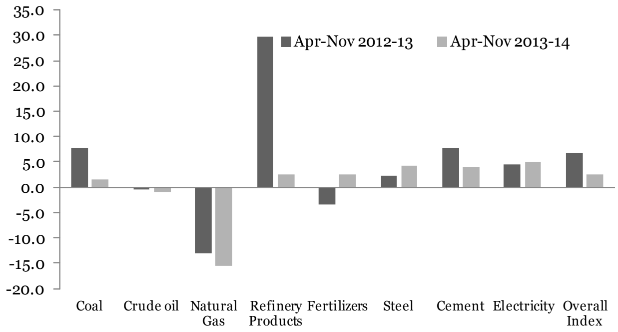
The eight infrastructure industries (crude oil, petroleum refinery, coal, electricity, cement, steel, natural gas, and fertilisers), with a combined weight of 37.9 per cent in the IIP, registered a growth of 1.7 per cent during April-November, 2013-14, way behind the growth rate achieved during the same period of the previous year (6.7%).

Among the components of the core sector, coal, refinery products, fertiliser, steel, cement and electricity registered a positive growth but (except electricity) less than that achieved in the same period of the previous fiscal.

Coal, with a weight of 4.38 per cent, registered a growth of 1.5 per cent during April– November, 2013–14 compared with 7.8 per cent during the same period of the previous fiscal (Figure I.3). Prevailing uncertainty and controversies relating to allocation of coal blocks could be the reason for the decline in coal production in the country.

Crude oil production continued to suffer registering –0.9 per cent growth in April–November, 2013–14 compared with -0.5 per cent growth recorded during the same period of the previous fiscal. The growth rate of natural gas production recorded a

Figure I.3: A glance on the cumulative growth of the eight core industries



Source: Office of the Economic Adviser, GoI

steep decline of –15.6 per cent in April–November 2013-14 compared with –13.1 per cent growth in the same period of 2012–13. Petroleum refinery production (weight 5.94%) recorded a growth of 2.5 per cent during April–November, 2013-14. However, this is much below the growth rate recorded in the same period (29.7%) of 2012-13.

Fertilizer production registered a negative growth of 2.5 per cent during April–November 2013–14 as against a growth of -3.4 per cent during the same period of the previous fiscal.

Steel production grew 4.3 per cent, higher than the growth rate of the previous year (2.2%). However, cement production dipped, recording a growth of just 4 per cent during April–November, 2013–14, down from almost 8 per cent growth in the same period a year back.

Electricity with the highest weight of 10.32 per cent, recorded cumulative growth of 5 per cent in April-November 2013-14, compared to 4.6 per cent growth in the same period of 2012–13. Question marks remain over the production of coal but with the government's special drive to improve the performance of the power sector, the electricity sector may improve in the coming quarters.

Concluding observations: Internal and external demand components

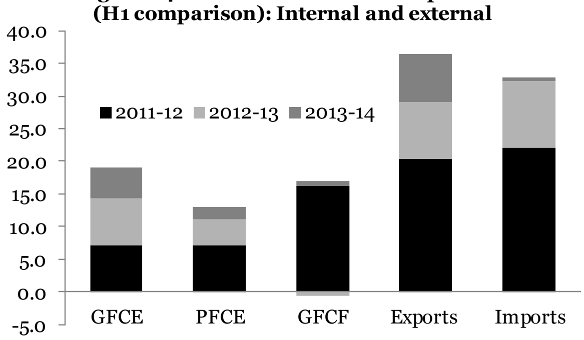
Analysis of the demand components (internal as well as external) shows a sustained fall in demand over the period.

The first-half (i.e. H1) comparison of growth rates for government consumption expenditure (GFCE), private final consumption expenditure (PFCE) and gross fixed capital formation (i.e., GFCF reflecting investment demand) reveals a distinct fall in growth rates from 2010-11 to 2013-14 (Figure I.4).

External demand components (i.e., export and import) show downward movement. This could well affect industry adversely.

To counter the adverse investment environment, FDI policy has been liberalised to allow FDI in more industries under the automatic route. Allowing FDI in multi-brand retail up to 51 per cent subject to specified conditions; increasing FDI limit to 100 per cent in single-brand retail, FDI up to 49 percent in civil aviation and power exchanges; FDI up to 49 percent in broadcasting sector are all initiatives worth mentioning. However, unless there is transparency and expediency with regard to application of policy, the impact will be limited.

Figure I.4: Growth of demand components (H1 comparison): Internal and external



Source: CSO (www.mospi.gov.in)

Table I.1: Decline in investment pulls down manufacturing activity and GDP growth (H1 Y-o-Y comparison)

	GFCF	IIP Capital Goods	IIP_MFG	CSO_MFG	GDP
2010-11	7.8	16.4	8.9	11.4	9.3
2011-12	16.2	4.6	5.5	5.2	7.0
2012-13	-0.6	-14.2	-0.3	-0.5	5.3
2013-14	0.7	-0.6	0.0	-0.1	4.6

Source: CSO (www.mospi.gov.in)

Table I.2: Use-based classification of IIP (April-November comparison)

	Basic goods	Capital goods	Intermediate goods	Consumer durables	Consumer non-durables
Weights	**(456.82)**	**(88.25)**	**(156.86)**	**(84.60)**	**(213.47)**
2011-12	6.3	-1.0	-0.5	5.2	4.9
2012-13	2.8	-11.3	1.8	5.2	2.2
2013-14	0.7	-0.1	2.7	-12.6	6.3

Source: CSO (www.mospi.gov.in)

Table I.3: Growth rate of IIP: 2-Digit Classification (April-November)

Industry descriptions*	Weight	2011-12	2012-13	2013-14
Food products and beverages	72.8	17.3	2.4	-3.0
Tobacco products	15.7	2.5	-8.4	3.4
Textiles	61.6	-2.8	7.3	3.8
Wearing apparel; dressing and dyeing of fur	27.8	-6.3	0.5	32.3
Luggage, handbags, saddlery, harness & footwear; tanning and dressing of leather products	5.8	4.5	6.7	6.4
Wood and products of wood & cork except furniture; articles of straw & plating materials	10.5	-1.1	-5.4	-0.2
Paper and paper products	10	5.8	0.9	0.9
Publishing, printing & reproduction of recorded media	10.8	15.4	8.1	2.0
Coke, refined petroleum products & nuclear fuel	67.2	4.8	7.3	6.6
Chemicals and chemical products	100.6	-0.2	3.2	9.9
Rubber and plastics products	20.2	-1.4	2.2	-2.8
Other non-metallic mineral products	43.1	4.1	1.6	1.5
Basic metals	113.4	11.6	1.8	-2.8
Fabricated metal products, except machinery & equipment	30.8	13.4	-0.6	-7.5
Machinery and equipment n.e.c.	37.6	-2.2	-2.8	-8.4
Office, accounting & computing machinery	3.1	5.7	-11.0	-17.2
Electrical machinery & apparatus n.e.c.	19.8	-17.3	-20.1	26.0
Radio, TV and communication equipment & apparatus	9.9	6.7	12.1	-25.1
Medical, precision & optical instruments, watches and clocks	5.7	6.5	4.4	-7.0
Motor vehicles, trailers & semi-trailers	40.6	12.5	-1.9	-7.6
Other transport equipment	18.2	16.1	-2.0	6.4
Furniture; manufacturing n.e.c.	30	-1.3	-6.1	-16.8

Source: CSO (www.mospi.gov.in)