STCI
Primary Dealer Ltd

Indian Economy - Fortnightly Update

Economic data released in fortnight 1-Dec-10 to 14-Dec-10:

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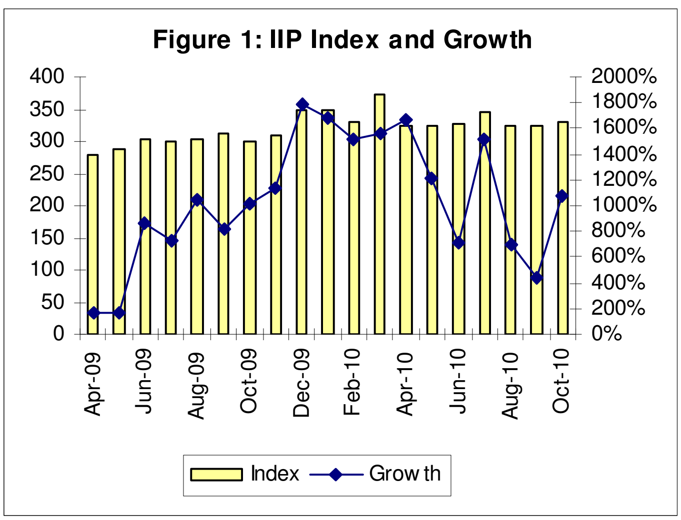
- IIP for Oct-10 at 10.8%
- WPI Inflation for Nov-10 at 7.48%
- Exports in Oct-10 grew by 21.3%

IIP for Oct-10 at 10.8%

IIP Index in Oct-10 was at 331.5, implying a growth of 10.8%, higher than growth rate of 10.1% noted in Oct-09. In Sep-10, the growth rate was 4.4%.

IIP growth for Oct-10 again surprised markets with an upwards jump after two months of decelerating growth pattern. IIP growth was expected to be better in Oct-10 tracking sudden rise in core goods index released a fortnight earlier (refer Fortnightly Update, 2 Dec 2010). But still the increase in IIP was higher than market expectations. The median market expectations were around 8.5-9% as per several newswire polls.



Source: CSO

Average growth is a better indicator of the growth pattern in industry as it looks at growth over a longer period of time. Growth rate in the period Apr-Oct 2010 was at 10.5%, higher than 6.9% in Apr-Oct 09 (Table 1). As growth rate in FY 2010-11 periods remains higher than FY 2009-10, it indicates the overall industrial activity is robust as compared to the previous year.

The previous IIP numbers have again been revised on account of new WPI-inflation series. IIP is a volume index and measures the quantity of goods produced. However, in the 287-item index, there are 33 items for which the data is calculated in value terms, which need to be converted into a volume-based index. The key items of the IIP that are reported in value terms include machinery, machine tools, and ship-building, which have a large weight in the index. Hence, if inflation is lower as per the new series, the output will be higher when values are converted into quantities.

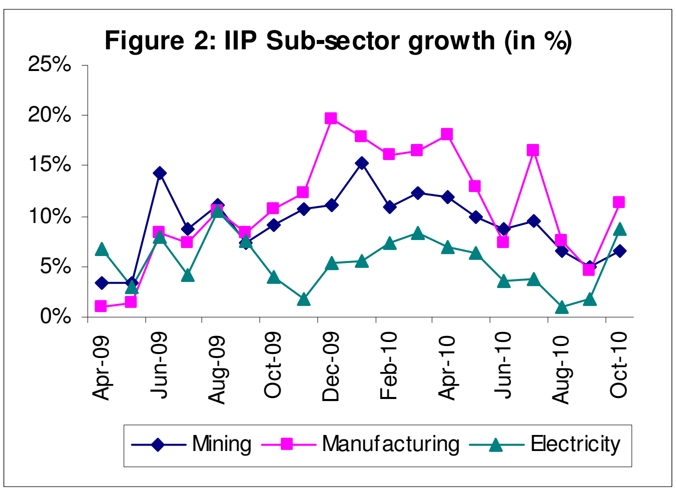
This is indeed the case as WPI inflation based on 2004-05 series is lower than the inflation in 1993-94 series. Earlier, CSO revised the data from Apr-08 onwards using new WPI inflation series. This time, it has revised the series from April-05 onwards. Comparing the two indices, one sees IIP based on 2004-05 WPI inflation series is higher than 1993-94 series in most of the months.

Sector-wise growth: Except mining, growth in the other two sub-sectors grew at a faster pace in Oct-10 compared to Oct-09. In Apr-Oct period, growth rate in Mining and Manufacturing was higher in Apr-Oct 10 compared to Apr-Oct 09 period. Electricity growth was lower compared to Apr-Oct 09 period. (Table 1)

Table 1: IIP Sector-wise Growth (in %)

	Oct-09	Oct-10	Apr-Oct 09	Apr-Oct 10
Mining	9.1	6.5	8.2	8.3
Manufacturing	10.8	11.3	6.8	11.2
Electricity	4.0	8.8	6.3	4.6
IIP	10.1	10.8	6.9	10.5

Source: CSO



Source: CSO

Manufacturing sector constitutes nearly 80% of the IIP Index. Hence, further analysis of manufacturing sector is important and it is divided into seventeen sub-sectors.

In Oct-10 we see double digit growth in nine industries compared to eight industries in Sep-10. The growth rate of sectors like Transport Equipment and Parts, Leather Products, Metal Products etc is noted at 39.5%, 26.0% and 19.5% respectively. Jute, and wood products sector witnessed a contraction in growth rates.

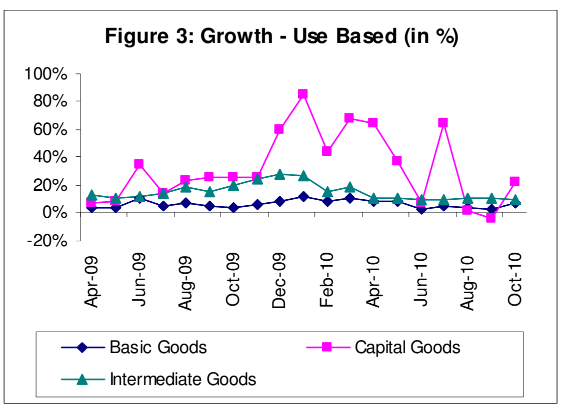
Transport equipment and parts includes items like passenger cars, motor cycles, locomotives etc. It has grown in double digits since Jun-09. Most of the items included in this sector either form a part of capital goods (locomotives, ship building etc) or consumer durables sector (cars, motor cycles etc.) Therefore, there is a linkage between Transport equipment, capital goods and consumer durables sector. This is a trend we have been seeing for many months now with a rise in production in transport equipment leading to a rise in capital goods and consumer durables industry.

Use-based classification: In use-based classification, we see higher growth in capital goods and consumer durables sector (as discussed above) in Oct-10 compared to Oct-09 (Table 2). In Apr-Oct period also, we see higher growth rate in capital and consumer durable goods compared to Apr-Oct 09 period.

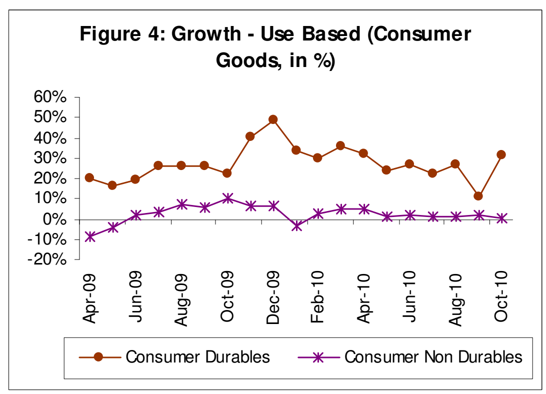
Table 2: IIP - Use Based Classification Growth (in %)

	Oct-09	Oct-10	Apr-Oct 09	Apr-Oct 10
Basic Goods	4.0	7.7	5.8	5.8
Capital Goods	25.4	22.0	19.8	27.7
Intermediate Goods	20.2	9.5	15.1	10.4
Consumer Goods	13.9	9.6	7.3	8.3
Consumer Durable Goods	22.2	31.0	22.4	24.8
Consumer Non-Durable Goods	10.6	0.1	2.3	1.7

Source: CSO



Source: CSO



Source: CSO

Use-based analysis highlights a few issues:

- Capital goods growth has again surged after contracting in Sep-10 at -4.4%. The index marginally declined from 567.6 in Sep-10 to 559.3 in Oct-10. Hence, the increase is also because of base effect but overall one sees a rise in production of a large number of capital goods. CSO points out that high growth was seen in capital goods like well/off shore platforms, ship building and repair, electric generators and turbines. Again, the volatility in these items is difficult to comprehend as their production does not change suddenly. Volatility in capital goods index remains unusually high.

- Consumer durables growth continues to remain in double digits since May-09. In 2009, this sector grew tracking fiscal stimulus measures giving more income in the hands of public. In 2010, it has been growing tracking higher economic growth. From Sep-10 to Dec-10, we should see sustained rise in this index because of festival season and low interest rates. The index has increased from 624.4 in Sep-10 to 680.1 in Oct-10. CSO points out that high growth was seen in Scooter and mopeds, alarm time pieces, motor cycles, television receivers and passenger cars. All these items are high purchase items in festival season.

- The growth in consumer non-durables has again dipped after showing some increase in Sep-10. The index has declined from 278.5 in Sep-10 to 270.5 in Oct-10. In times of strong economic growth and strong consumer demand, one should see persistent growth in this sector as well.

Summing up: IIP growth for Oct-10 is higher than expectations and is in line with the growing Indian economy. GDP for Q2 2010-11 marked a growth rate of 8.9% and government agencies are revising the growth trajectory upwards. The industrial data released in August and September showed that may be industrial activity is slowing but October data again shows a sharp rise. It was also being felt that industry may not drive growth as it was slowing but October data has reversed the trend. But again, it is just one data point and we need to watch out for future data to understand the underlying trend. RBI has tightened monetary policy since Mar-10 and that should also have some impact on industrial growth.

Though, just to reiterate the quality of the data remains a major concern. The data is still based on base year 1993-94 whereas demand patterns have changed since then. The consumer durable goods that are now in demand (like mobile phones, DVD players etc.) are not in IIP data series. Hence, growth in consumer durables could just be higher if we include the items in demand today.

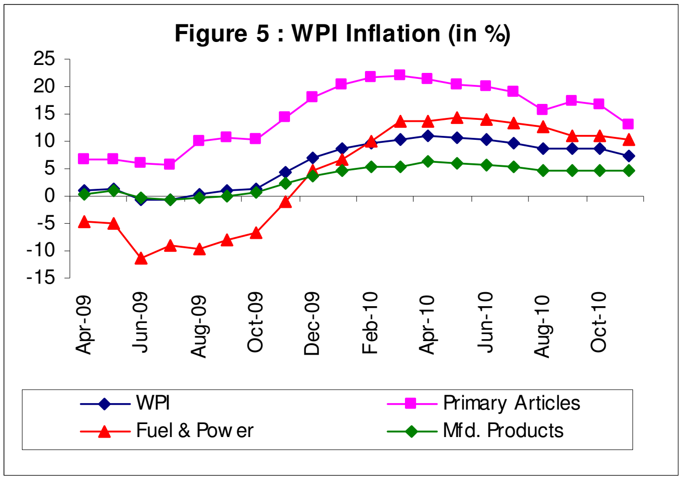
WPI Inflation for Nov-10 at 7.48%

WPI index increased from 141.7 in Oct-10 to 142.3 in Nov-10. This implied inflation for Nov-10 at 7.48% (y-o-y), in line with market expectations. For the month of Sep-10, the inflation was again revised upwards from 8.62% to 8.93%.

Table 3: WPI Monthly Inflation at a Glance

	Index		Rate of Inflation (YoY in %)	
	Oct-10	**Nov-10**	**Oct-10**	**Nov-10**
Primary Articles	181.2	182.6	16.69	13.00
Food Articles	180.1	180.2	14.13	9.41
Non-food articles	161.4	167.7	22.21	23.22
Fuel Products	148.1	148.6	10.99	10.28
Manufacturing Products	128.0	128.4	4.76	4.56
Core Inflation	69.2	69.3	5.07	5.32
WPI Inflation	141.7	142.3	8.58	7.48

Source: Commerce Ministry



Source: Commerce Ministry

Sector wise analysis

Primary Articles: The index for primary articles increased from 181.2 in Oct-10 to 182.6 in Nov-10. This implies primary articles inflation at 13.00% in Nov-10, lower than 16.69% noted in Sep-10. Despite a sharp rise in index, the inflation is lower on account of base-effect. Primary Articles is further divided into two sub- groups: Food Articles and Non-food articles.

- **Food articles:** The index for Food Articles increased marginally from 180.1 in Oct-10 to 180.2 in Nov-10. This implies food articles inflation for Nov-10 at 9.14%. Food article inflation has come in single digits for the first time since May-09. The index increased due to higher prices of meat items like fish, beef & buffalo meat and pork along with poultry items like egg and chicken. Other items like tea (4%), barley maize, gram and fruits & vegetables also increased. However, the prices of pulses like urad, moong, arhar and masur declined along with food grains like bajra, jowar and wheat.

  Till October, we saw no respite from rising food prices. However, we see some moderation in prices in November atleast in terms of overall food inflation. Kharif production also starts to come in this period and we are seeing some impact of the robust Kharif production leading to lower food prices. Over a long term, India needs to augment supplies of food items substantially. With rising incomes, demand for both, food and protein-rich food is going to rise putting upwards pressure on prices. Food price inflation will remain in India unless measures to correct supply side shortages are addressed with urgency.

- **Non-food articles:** The index for non-food articles increased significantly from 161.4 in Oct-10 to 167.7 in Nov-10. This implies non- food articles inflation for Nov-10 at 23.22%. This is the highest rate of non-food inflation in the time series since 2004-05. Index increased due to higher prices of raw materials like logs & timber, rubber, jute and silk. Prices of oilseeds like sunflower, safflower, nigerseed also rose along with flowers However, the prices of groundnut seed, linseed and cotton seed declined.

Prices continue to surge in this category. It has been in the range of about 15-18% for the past 6 months and has now touched 23%. These items are intermediate goods used in production of final goods. A rise in prices of these items leads to a spiral of rising prices in other items. A rise in prices of oilseeds leads to rise in price of cooking oil which then leads to a rise in prices of all the other manufactured food items prepared by cooking oil (we indeed see this linkage working in discussion on manufactured items inflation below).

Fuel Group: The index for Fuel Group Articles increased from 148.1 in Oct-10 to 148.6 in Nov-10. This implies fuel group inflation for Nov-10 at 10.28%. The fuel group index increased as prices of following items increased - light diesel oil, aviation turbine fuel, petrol, naphtha and furnace oil.

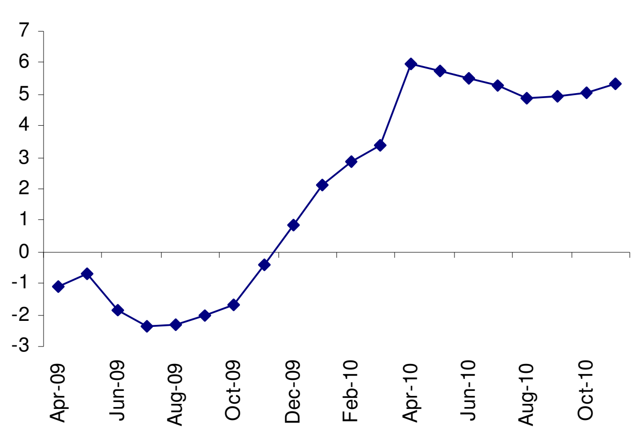
There will be an upward price pressure in the items under this group. As oil prices touch $ 90 per barrel, prices of both regulated and non-regulated fuel items will increase. Government is mulling to raise price of diesel as Oil marketing companies are incurring losses.

Manufactured Products: The index for Manufactured Products has increased from 128.0 in Oct-10 to 128.4 in Nov-10. This implies manufactured products inflation for Oct-10 at 4.56% lower than 4.76% in Oct-10. Within Manufactured Products, indices increased compared to Sep-10 levels in all the sub-sectors except wood and leather products.

Prices rose sharply in manufactured food products and paper products categories. In food products, prices of tea leaf, sunflower oil, salt, sugar etc rose. Prices of oil items like sunflower oil, vanaspati and ghee also rose tracking rise in prices of oilseeds shown above. In paper products, prices of paper cartons, kraft paper, newsprint etc. rose.

- **Core Inflation:** Core inflation index has risen from 69.2 in Oct-10 to 69.3 in Nov-10. This implies core inflation for Nov-10 at 5.32%, higher than 5.07% in Oct-10. RBI has been focusing on this measure of inflation for its monetary policy actions.

Figure 6 : Core Inflation (in %)



Source: Commerce Ministry

Summing up: Inflation has declined by more than 1% compared to Sep-10 levels. The new series shows inflation had reached its peak in May-10 at 10.6% and headline figure has declined since then. However, WPI index continues to rise and is at its highest in the time-series. Hence, the lower inflation numbers are because of base-effect. We witness some moderation in prices of food articles which is a positive development (provided the trend continues). Prices of non-food articles keep rising leading to a rise in prices of manufactured food items. Fuel group inflation is likely to increase tracking rise in global oil prices. Core inflation also has been rising gradually.

Despite this moderation in inflation, household inflation expectations continue to rise. As monetary economics shows that managing inflationary expectations is critical in lowering the overall inflation. RBI has been conducting Households survey to measure inflationary expectations. The latest survey for Sep-10 shows that around 70% of respondents expect prices to rise by a higher rate than current inflation. The survey also shows that expectations are mainly formed on the basis of food prices. Hence, as far as inflation expectations are concerned they continue to be revised upwards.

We expect inflation to ease going forward on account of base effect. Leading policymakers expect inflation to ease to 6.5% levels by Dec-10. However, it looks unlikely unless there is a significant decline in prices of food articles. We expect inflation to be around 7-7.5% % in Dec-10 and around 6.5% in Mar-11.

RBI Policy ahead: RBI's monetary policy review is scheduled on December 16, 2010. It now has all the major domestic economy data to frame the policy in the upcoming review. There have been five major data releases from the previous monetary policy - IIP for Sep-10 and Oct-10, WPI Inflation for Oct-10 and Nov-10 and GDP for Q2 2010-11. Meanwhile Finance Ministry also released the Mid-Term review of Indian economy raising the growth projections upwards and expecting inflation to ease to 5.5-6% levels by Mar- 2011. Though, despite lower reported inflation, households continue to expect inflation to be higher than current rate.

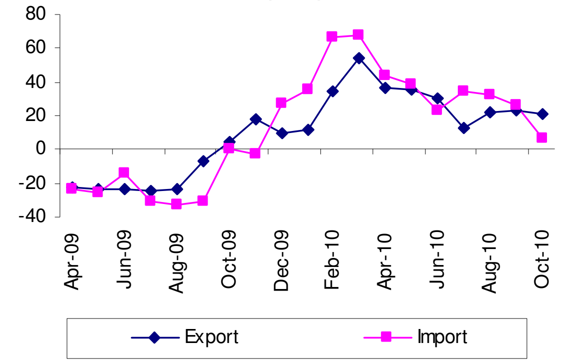
On the global economy front, tremendous uncertainty persists. Federal Reserve's QE2 has not led to lowering of yields as expected and yields have actually risen. US Congress has allowed certain tax cuts to continue providing fresh round of fiscal stimulus to the ailing US economy. But this stimulus has further raised concerns over worsening US debt and deficit position. Federal Reserve is going to have its monetary policy meeting on 14 December 2010 and we will get more cues from the FOMC statement. In Euroarea, markets are nervous over future trajectory of policies and whether other economies will come under pressure after bailout of Greece and Ireland.

Given this economic situation, RBI is expected to pause in the December 2010 review. In Nov-10 policy, RBI gave a forward guidance that given current economic situation, it does not see any further rate increases in future. RBI will prefer to wait and evaluate the effectiveness of monetary transmission. RBI has raised policy rates five times since Mar-2010. As monetary policy works with a lag, RBI would like to see the overall impact on economy. Banks have started raising both deposit and credit rates recently and this will have impact on economy the going forward. Again, inflation will continue to form the basis of the policy review. Overall, RBI will continue to frame its policies under periods of exceptionally high uncertainty.

Exports in Oct-10 grew by 21.3%

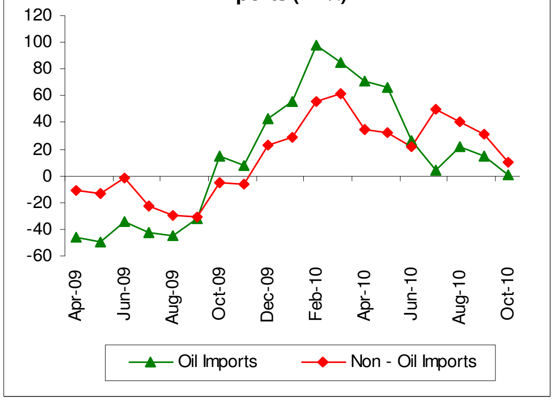
Commerce Ministry released export-import data for Oct-10. Exports were at $18.0 bn (grew by 21.3% YoY) and imports were at $ 27.7 bn (grew by 6.8% YoY). Within imports, oil imports were at $8.4 bn (grew by 0.3%) and non-oil imports at $ 19.3 bn (grew by 9.9%). The trade deficit was at $ 9.7 bn.

Figure 7: Growth in Exports and Imports (in %)



Source: Commerce Ministry

Figure 8: Growth in Oil and Non-Oil Imports (in %)



Source: Commerce Ministry

In Oct-10 export volumes declined slightly compared to Sep-10 levels. Import volumes increased in Oct-10 compared to Sep-10. This led the trade deficit to widen from $ 9.1 bn in Sep-10 to $ 9.7 bn in Oct-10. Within imports, oil imports have increased from Sep-10 levels and non-oil imports have declined marginally. This decline in non-oil imports is surprising given the strong performance of Indian economy. With Indian economy growing at nearly 9% levels, one should see a rise in non-oil imports. But as it is just a one month number, we need to see the data releases for the next few months.

Overall, external sector trends remain volatile and uncertain in line with the global uncertainty. Like September, October data provided relief as trade deficit did not widen significantly as seen in previous months. Higher trade deficit leads to widening of current account deficit and is seen as a headwind for Indian economy going forward. Hence, this data will be keenly watched.

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