February 2014

CRISIL Economy First Cut

Inflation cheers, industry still in tears

Overview: Index of industrial production (IIP) fell by 0.6% in December, marking a third consecutive month of contraction. While electricity production grew strongly, mining growth remained weak and manufacturing output fell by 1.6% on a year-on-year basis. During the third quarter of 2013-14, industrial output was 1.1% lower than a year ago. On the positive side, retail inflation as measured by CPI-combined, fell to a 24-month low of 8.8% in January. Food inflation at 22-month low of 9.9% led the decline in headline inflation. Inspite of weak demand, CPI inflation excluding food and fuel edged up to 8.1% in January from 8.0% in the previous month.

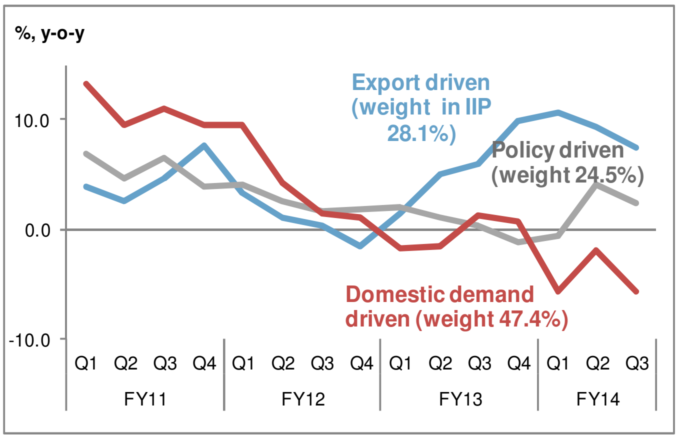
IIP: Domestic demand drags down industrial growth

Manufacturing sector's weak performance this year (-0.6% during April-December 2013) is driven by a sharp slowdown in industries that are mostly dependant on domestic demand (Figure 1) such as food & beverages, radio, TV & communication apparatus, motor vehicles & trailers, furniture manufacturing, and office machinery. Despite the boost to rural incomes from an above-normal monsoon, private consumption growth is estimated to have slowed down to 4.1% in 2013-14 from 5.0% in the previous year. The same is reflected in output of consumer goods, which has contracted in 7 of the last 9 months, dragged down by high interest rates, high inflation and slow income growth. At the same time, investment demand has also stagnated due to slow pace of policy reforms, weak consumption growth and political uncertainty prior to elections. According to advance estimates, fixed investments grew at a mere 0.2% in 2013-14. Mirroring investment standstill, capital goods output has fallen by 0.5% on a year-on-year basis from April-December, despite a very weak base.

In contrast, export-driven manufacturing industries such as textiles, leather products, refined petroleum, chemicals and other transport equipment have shown sustained high growth in the year so far, benefiting from a weak rupee and rising global demand. In Q3, 2013-14, output of export oriented industries grew at 7.4% (Figure 1).

Policy led sectors – mining and electricity – have also been growing since Q2, 2013-14, after contracting in the second half of last fiscal year. Mining ban in Karnataka was lifted in mid-2013 and resolution of mining issues is underway. In 2014-15, mining output is likely to improve as firms obtain relevant clearances and resume production. The low base of the last 2 years will provide further boost to mining growth in the coming fiscal.

Figure 1: Domestic demand weighs on IIP



Note: The above chart is a breakdown of IIP; the weights add up to 100%

Source: Central Statistical Office (CSO), CRISIL Research

Table 1: Sectoral Growth (y-o-y %)

				April - Dec	
	Weight	Dec-12	Dec-13	FY13	FY14
General	1,000.0	-0.6	-0.6	0.7	-0.1
Mining	141.6	-3.1	0.4	-1.8	-1.8
Manufacturing	755.3	-0.8	-1.6	0.6	-0.6
Electricity	103.2	5.2	7.5	4.6	5.6
Use-based classification					
Basic	355.7	2.2	2.4	2.6	1.3
Capital	92.6	-1.1	-3.0	-10.1	-0.5
Intermediates	265.1	-0.2	4.5	1.6	3.0
Consumer Goods	286.6	-3.6	-5.3	2.7	-3.0
-Durables	53.7	-8.1	-16.2	3.7	-12.9
-Non durables	233.0	-0.5	1.6	1.8	5.7

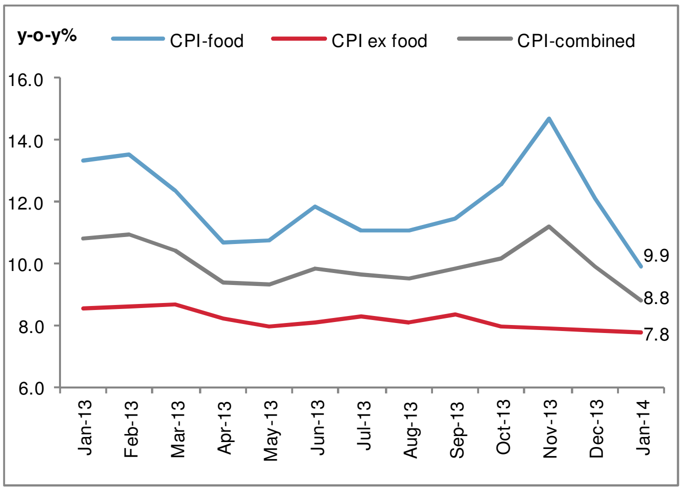
Inflation: Retail inflation falls to a 24-month low

CPI inflation fell to 8.8% in January – a drop of 2.4% in just two months from a record 11.2% in the November 2013. Inflation in vegetables fell sharply to 21.9% in January and further correction in vegetables prices is expected in the coming months. While this will help the food inflation to ease further, non-food inflation remains sticky close to 8%.

To lower CPI inflation to 8% by January 2015, in line with the recommendations of the Urjit Patel committee report, the Reserve Bank of India hiked the repo rate by 25 bps to 8% on January 28, 2014. We expect CPI inflation to moderate and average 8.5% during 2014-15, down from around 10% this fiscal. Food inflation is likely to moderate as healthy reservoir levels and expected normal monsoons in 2014 would help increase supply of food articles. In addition, rate hikes undertaken during the current fiscal will help lower non-food inflation with a lag during 2014-15.

We believe that achieving 8% inflation by January 2015 is feasible if the recent downward momentum in food inflation continues and non-food inflation moderates. However bringing down CPI inflation to 6% by January 2016 will require sustaining food inflation in the range of 7 to 8% from the average of 11.1% in the last two years as well as lowering non-food inflation to around 4-5% from the average of 8.7% since January 2012. A firm commitment to lowering CPI inflation to this level will imply little room for monetary policy loosening in the next fiscal year, despite weak domestic demand.

Figure 2: High non-food inflation remains a concern



Source: CSO, CRISIL Research

Table 2: Inflation statistics

y-o-y %		Jan-13	Jan-14	April-January FY13	April-January FY14
CPI-combined	General	10.8	8.8	10.1	9.8
	Food	13.3	9.9	11.7	11.6
	Fuel and Light	8.4	6.5	8.6	7.6
	Housing	10.3	10.2	11.4	10.5
	Clothing, Bedding and Footwear	10.9	9.2	10.9	9.3
	Miscellaneous	6.9	7.1	7.3	6.9
CPI-Rural	General	10.8	9.4	10.0	9.7
	Food	13.1	10.7	11.5	11.6
	Fuel and Light	7.8	7.0	7.9	7.6
	Clothing, Bedding and Footwear	11.3	9.7	10.9	9.6
	Miscellaneous	6.7	7.3	7.3	6.6
CPI-Urban	General	10.7	8.1	10.3	9.7
	Food	13.8	8.2	11.9	11.6
	Fuel and Light	9.5	5.6	9.7	7.7
	Housing	10.3	10.2	11.4	10.4
	Clothing, Bedding and Footwear	10.3	8.3	11.1	8.9
	Miscellaneous	7.2	6.9	7.4	7.2

Source: Ministry of Commerce & Industry, CSO, CRISIL Research

Analytical Contacts:

Vidya Mahambare
Principal Economist, CRISIL Research
Email: vidya.mahambare@crisil.com
Phone: +91 22 3342 8038

Neha Duggar Saraf
Junior Economist, CRISIL Research
Email: neha.saraf@crisil.com
Phone: +91 22 3342 8350

Anuj Agarwal
Economic Analyst CRISIL Research
Email: anuj.agarwal@crisil.com
Phone: +91 22 33423280

Media Contacts:

Manasi Apte
Manager, Communications and Brand Management
Email: manasi.apte@crisil.com
Phone: +91 22 334 21832

Jyoti Parmar
Communications and Brand Management
Email: jyoti.parmar@crisil.com
Phone: +91 22 334 21835

Our Capabilities

Making Markets Function Better

Economy and Industry Research

- Largest team of economy and industry research analysts in India
- Coverage on 70 industries and 139 sub-sectors; provide growth forecasts, profitability analysis, emerging trends, expected investments, industry structure and regulatory frameworks
- 90 per cent of India's commercial banks use our industry research for credit decisions
- Special coverage on key growth sectors including real estate, infrastructure, logistics, and financial services
- Inputs to India's leading corporates in market sizing, demand forecasting, and project feasibility
- Published the first India-focused report on Ultra High Net-worth Individuals
- All opinions and forecasts reviewed by a highly qualified panel with over 200 years of cumulative experience

Funds and Fixed Income Research

- Largest and most comprehensive database on India's debt market, covering more than 15,000 securities
- Largest provider of fixed income valuations in India
- Value more than Rs.53 trillion (USD 960 billion) of Indian debt securities, comprising outstanding securities
- Sole provider of fixed income and hybrid indices to mutual funds and insurance companies; we maintain 12 standard indices and over 100 customised indices
- Ranking of Indian mutual fund schemes covering 70 per cent of assets under management and Rs.4.7 trillion (USD 85 billion) by value
- Retained by India's Employees' Provident Fund Organisation, the world's largest retirement scheme covering over 60 million individuals, for selecting fund managers and monitoring their performance

Equity and Company Research

- Largest independent equity research house in India, focusing on small and mid-cap companies; coverage exceeds 125 companies
- Released company reports on all 1,442 companies listed and traded on the National Stock Exchange; a global first for any stock exchange
- First research house to release exchange-commissioned equity research reports in India
- Assigned the first IPO grade in India

About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research

CRISIL Research is India's largest independent and integrated research house. We provide insights, opinions, and analysis on the Indian economy, industries, capital markets and companies. We are India's most credible provider of economy and industry research. Our industry research covers 70 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 4,500 primary sources, including industry experts, industry associations, and trade channels. We play a key role in India's fixed income markets. We are India's largest provider of valuations of fixed income securities, serving the mutual fund, insurance, and banking industries. We are the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today India's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgments and forecasts with complete objectivity. We leverage our deep understanding of the macroeconomy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. We deliver our research through an innovative web-based research platform. Our talent pool comprises economists, sector experts, company analysts, and information management specialists.

Disclaimer

CRISIL Limited has taken due care and caution in preparing this Report. Information has been obtained by CRISIL from sources, which it considers reliable. However, CRISIL does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. CRISIL Limited has no financial liability whatsoever to the subscribers / users / transmitters / distributors of this Report. The Centre for Economic Research, CRISIL (C-CER) operates independently of and does not have access to information obtained by CRISIL's Ratings Division, which may in its regular operations obtain information of a confidential nature that is not available to C-CER. No part of this Report may be published / reproduced in any form without CRISIL's prior written approval.

CRISIL Privacy Notice

CRISIL respects your privacy. We use your contact information, such as your name, address, and email id, to fulfil your request and service your account and to provide you with additional information from CRISIL and other parts of McGraw Hill Financial you may find of interest.

For further information, or to let us know your preferences with respect to receiving marketing materials, please visit www.crisil.com/privacy. You can view McGraw Hill Financial's Customer Privacy Policy at http://www.mhfi.com/privacy.

Last updated: May, 2013

CRISIL Limited
CRISIL House, Central Avenue, Hiranandani Business Park,
Powai, Mumbai – 400076. India
Phone: +91 22 334 23000 | Fax: +91 22 334 28088
www.crisil.com

CRISIL Ltd is a Standard & Poor's company