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PROLONGED SLOWDOWN

Oct IIP shrinks 3.8%; CPI at 40-month high

FE BUREAU
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RETAIL INFLATION SCALED a 40-month peak of 5.54% in November and industrial production contracted by as much as 3.8% in October, stoking the fear that the country may be in for an extended period of intense economic slowdown.

Official data released on Thursday showed the output of both consumer durables and capital goods contracted by 18% and 21.9%, respectively, in October, the sharpest plunge in the current IIP series (since April 2012), amply reflecting a collapse in both consumption as well as investments. Although the October performance of IIP was still better than the previous month when it had hit an eight-year low of -4.3%, it nevertheless recorded the second-biggest decline in the current series.

Double whammy
(% change, y-o-y)

Source: MoSPI

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Oct IIP shrinks 3.8%; Nov inflation 5.54%

Of course, unfavourable base effect played a part in pushing up retail inflation and driving down industrial production. At 10.01% in November, food inflation scaled an over-five-year peak and was the biggest driver of headline inflation even though core inflation remained almost unchanged at 3.6%.

Given that the base for both food inflation and headline retail inflation remains damaging, at least until March 2020, price pressure in the economy will likely persist in the coming months as well. Conversely, policy-makers can take some solace in the fact that the base effect for IIP remains relatively favourable from November onwards, at least until March-April 2020.

Inflation breached the RBI's medium-term target of 4% for a second time in the past 15 months. Given the persisting upside risks to inflation, the monetary policy committee (MPC) will likely opt for an extended pause in the repo rate cut in its next policy meeting in February 2020 even though it may retain its accommodative stance. The MPC already surprised the markets by refraining from another round of policy rate cuts in December despite growth concerns, and its future course also hinges on the government's Budget plans.

All the three major sectors of IIP · manufacturing, mining and electricity · shrank for a second time since November 2012. Five of the six used-based categories, barring intermediate goods, too, saw contraction. However, a sharp 22.2% rise in intermediate goods somewhat bridled the fall in the headline IIP. Capital goods output recorded its tenth straight month of fall in October, mirroring a collapse in investments and an early revival is unlikely despite a massive corporate tax cut recently.

The drop in consumer durables output just worsened to 18% in October, against 9.9% in the previous month, indicating persisting weakness in urban demand. Importantly, even non-durables output shrank by 1.1%, against a fall of 0.4% in September (when it had contracted for the first time since November 2018), mirroring rural distress.

Manufacturing shrank 2.1% in October, against 4% in the previous month when it had recorded its worst performance in the current series. Mining crashed by 8%, against 8.6% in September, which was its sharpest fall since May 2013. Electricity output contracted 12.2% in October, against a fall of 2.6% in the previous month.

Commenting on the IIP, DK Pant, chief economist at India Ratings, said: "These numbers clearly suggest that the festival season could not arrest the declining growth momentum of the industrial sector resulting in manufacturing sector clocking de-growth for the third consecutive month in November 2019. This is unprecedented as the new series of IIP with 2011-12 as base year so far has not witnessed such consecutive months of de-growth either in the manufacturing, electricity or the industrial sector as a whole."

Aditi Nayar, principal economist at ICRA, said although overall core inflation remained unchanged at 3.6%, some of its components such as health, personal goods and education continue to be above 5% while recreation and housing are above 4%. "Given that the base effect will be unfavourable in January and February too, we may expect inflation to be in the region of 4.5-5% in the coming months too even when prices of vegetables moderate when the next crop comes in January-March 2020," she added.