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IIP, CPI data pour cold water on green shoots

Factory output shrinks, retail inflation accelerates in economic headache

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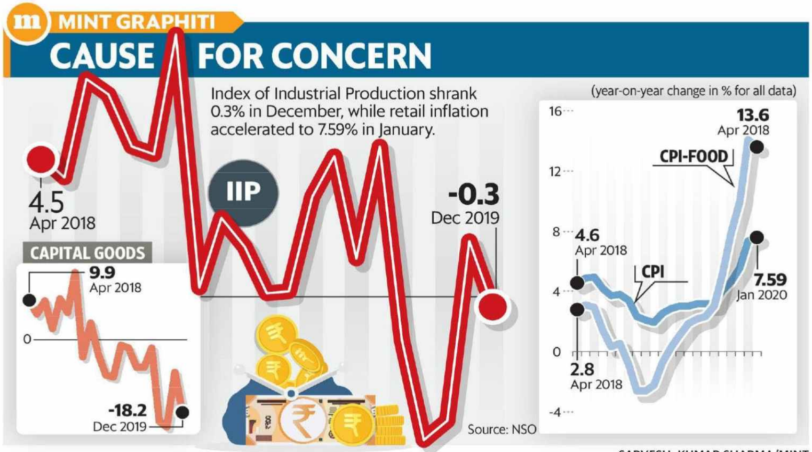
Factory output contracted in December and retail inflation shot up to a 68-month high in January, data released on Wednesday showed, a day after the government cited seven economic indicators to claim that the economy was recovering.

The National Statistical Office (NSO) on Wednesday said that the index of industrial production (IIP) shrank 0.3% in December from a 1.8% expansion a month ago, while retail inflation accelerated to 7.59% in January from 7.35% in the previous month.

On Tuesday, finance minister Nirmala Sitharaman claimed that the economy is on the mend, relying on seven indicators, including IIP and the Purchasing Managers' Index, to show that green shoots have started to emerge in the economy.



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The contraction in factory output does not bode well for the economy as global headwinds, including the coronavirus epidemic, already pose significant challenges to companies, said Rumki Majumdar, an economist at Deloitte India.

"The large outbreak of the coronavirus in China can adversely impact India as China is one of the largest trading partners," she said. "With several factories being closed down in China temporarily, the electronics and auto industry in India will likely be hit because of their dependence on Chinese imports of components and raw materials."

In 2002-03, when the SARS epidemic broke out, India's total trade with China was a paltry $4.8 billion, which has since expanded more than 18 times to touch $87 billion in 2018-19.

India's economic growth is estimated by NSO to hit an 11-year low of 5% in 2019-20 on the back of sluggish consumption and investment demand. The International Monetary

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Fund has projected growth to recover to 5.8% in 2020-21.

The IIP data came as a surprise as most economists expected that it would remain positive for the second straight month in December, after contracting for three consecutive months from August to October. Six infrastructure sectors, which constitute 40% of IIP, turned positive in December growing at 1.3% after a gap of four months, data released by the industry department last month showed.

The contraction in IIP was led by manufacturing (-1.2%) and electricity (-0.3%) sectors, while mining (5.4%) registered robust growth on the back of improved performance of Coal India Ltd.

Among use-based items, both consumer durables (-6.7%) and consumer non-durables (-3.7%) registered sharp contraction, while capital goods (-18.2%), which signifies investment demand in the economy, shrank for the 12th month in a row.

The items that registered the steepest decline in December include printed circuit boards (-69.7%), separators including decanter centrifuge (-63.3%), bars and rods of alloy and stainless steel (-54%) and electric and non-electric meters (-54%).

Factory output of printed circuit boards (-69.7%), and separators (-63.3%) shrank the most in December

Double-digit food inflation (13.6%) in January kept retail inflation above the central bank's tolerance level for the second month in a row.

The pick-up in core inflation to 4.1%, driven by various services, may also lead to a prolonged pause from the Reserve Bank of India (RBI).

"Regardless of the level of the CPI (Consumer Price Index) inflation, the stance of monetary policy is likely to be retained as accommodative, for as long as the MPC (monetary policy committee) considers the output gap to be negative," said Aditi Nayar, principal economist at ICRA Ltd. "The timing and magnitude of the next rate cut will depend on how quickly inflation appears to be reverting towards 4%."

RBI last week left policy rates unchanged for the second time, citing evolving growth-inflation dynamics. It had cut policy rates by 135 basis points in 2019.

The central bank sharply raised projection for retail inflation to 6.5% for the fourth quarter of FY20 from 4.7-5.1% earlier and pegged it at 5-5.4% for the first half of FY21 compared with 3.8-4% earlier.

The central bank has projected GDP growth for 2020-21 at 6%, in line with the projection in the Economic Survey, which pegged it in the range of 6-6.5%.