Industrial Downturn

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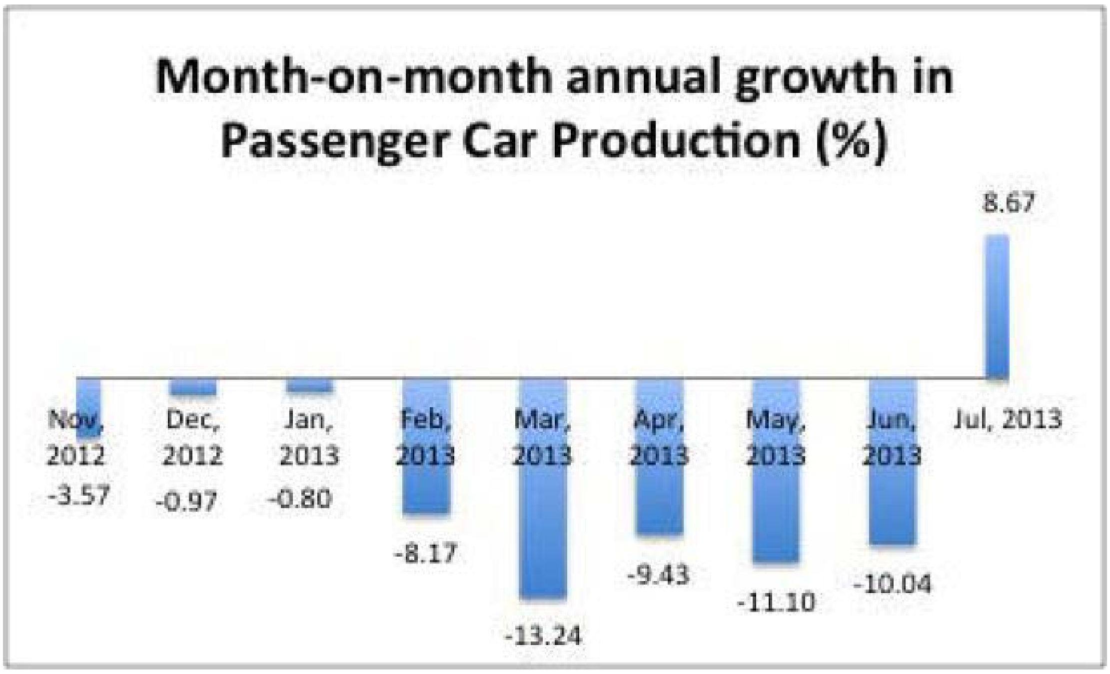
Indian industry is in the midst of a serious downturn. The Index of Industrial Production, the lead indicator of industrial production trends in the registered factory sector, contracted 2.2 per cent in June 2012, after a 2.8 per cent decline in May. What is worrying is that this recessionary trend is affecting key manufacturing sectors, including the once rapidly growing passenger car industry.

According to the Society of Indian Automobile Manufacturers (SIAM), July was the ninth consecutive month when sales of passenger cars reportedly fell relative to the corresponding month of the previous year. Over the last financial year (2012-13) as a whole, car sales fell (by 6.69 per cent) for the first time in a decade. The reliability of these sales estimates is questionable, but they are indicative of a trend. Production figures point to a positive 8.7 per cent growth in the passenger car industry in July. But that seems to be merely the adjustment after months of production declines, of which some were sharp (Chart).



This deceleration in growth seems part of a medium term trend. Between 2005-06 and 2010-11, which covers most of India's high growth era, passenger car sales grew at a scorching 15.2 per cent per annum. That had fallen to 4.7 per cent in 2011-12, before collapsing last financial year. Not surprisingly, manufacturers are responding to the recession. Maruti Suzuki has reportedly asked some of its temporary workers at a Manesar plant to go on indefinite leave while Toyota Kirloskar is not renewing contracts of temporary employees. Some time back Maruti Suzuki India suspended production for a day at its Gurgaon plant, which is capable of delivering upwards of 3000 units every day.

There are many reasons why this trend in the passenger car industry must be disconcerting for the government. The industry was in a sense the poster child of reform, delivering not just high growth performance, but also significant foreign investment, new products, better technology, some exports and competition that kept prices down. So the setback in this industry is far more significant than a sector-specific downturn. Rather that downturn has something to say about the sustainability of India's high growth story.

This is especially true because of the stimulus that drove manufacturing production and construction during India's high growth years. Retail credit that went to finance housing investment, automobile purchases and durable consumption boomed during those years with the ratio of bank credit to GDP rising from around 20 to more than 50 per cent. It was this private debt financed expansion in demand that was an important explanation of the boom. In the case of the passenger car industry too, the principal factor driving demand and sales was access to credit. Being a commodity that has resale value and can therefore serve as collateral for the loan financing its purchase, the automobile is a prime candidate for debt finance. With banks keen to lend, middle class consumers who might have had to wait to accumulate adequate purchasing power, were now free to obtain credit and acquire the commodity immediately. Thus, after housing, the area in which personal loans have increased substantially is for purchases of automobiles, resulting in a rapid increase in vehicle ownership. This factor was principally responsible for the explosion in demand, sales and production.

A corollary of this is that the decline in demand must partly be because the credit-driven growth in sales is proving difficult to sustain. The problem with a credit boom is that it feeds on itself. Periods when the economy is booming boosts confidence, leading to excess credit provision by lenders convinced that default is unlikely. This leads to an expansion of the universe of borrowers to an extent where the proportion of potential defaulters or subprime borrowers exceeds some critical level. When either evidence of overexposure or signs of rising default emerge, the retreat of overexposed lenders can be sudden. That is possibly happening in India, where a host of other indicators like inflation, a rising current account deficit and a weakening rupee are sapping confidence. This tendency can be cumulative, since slowing growth is accompanied by rising default.

In sum, what the experience in the automobile sector could be pointing to is that the confidence required to keep growth going is waning. It is widely accepted after the 2008 crisis that growth and accumulation under a neoliberal regime ride on bubbles, facilitated by excess liquidity and credit in the system. In India, as in many other emerging market economies, the liquidity needed to drive incremental bank lending was ensured by large inflows of foreign capital into the economy. Though this process of liquidity infusion has not dried up, the confidence to ride on that liquidity to pump credit in the system seems to be on the decline. Moreover, in its effort to address the rupee's decline the Reserve Bank of India is seeking to mop up rupee liquidity. This together with the increase in automobile prices that the rupee depreciation entails is likely to worsen the recession in the passenger car market in the days to come. That could intensify the industrial downturn.

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