Will inflation, high rates dent Indian manufacturing?

REUTERS, *New Delhi*

India's manufacturing has had solid expansion for the past two years, but now high inflation, climbing interest rates and pinching crude prices threaten to cut the economy's pace of industrial growth.

The Reserve Bank of India (RBI), which stepped up its fight against inflation with a bigger-than-expected 50 basis point rise in interest rates on May 3, has vowed to battle price pressures even at the cost of some economic growth.

India is not alone in facing up to the reality that gross domestic product (GDP) growth is likely to be dented in the battle against inflationary pressures that have been building in Asia as the region leads the global recovery.

Below are some questions and answers about the state of manufacturing:

WHAT IS THE OUTLOOK FOR MANUFACTURING?

Most analysts expect industrial growth to slow in the current fiscal year, which ends in March 2012, to 7.5-8.0 percent but it could slip lower. For 2010-11, the pace has been estimated at around 8 percent and in 2009-10 it reached 10.5 percent.

The manufacturing growth could, however, pick up in March and April, based on the HSBC Markit Purchasing Managers' Index for those months.

However, analysts say the central bank's aggressive 50 bps hike and the likelihood of more increases in coming months will hamper manufacturing growth by raising the cost of borrowing funds and slowing robust domestic demand.

If manufacturing growth drops to about 6 percent this fiscal year, GDP expansion "could come down by about 0.4 percentage point," said N.R. Bhanumurthy, an economist at National Institute of Public Finance and Policy, a Delhi think-tank.

In a note after the interest rate hike, securities firm Nomura said focusing only on aggressive monetary tightening at a time growth indicators are already faltering "could choke growth with only a limited effect on taming inflation."

India's manufacturing output contributes about 16 percent to GDP.

HOW MUCH OF A WORRY IS INFLATION?

It is a significant worry. Although demand remains strong so far, "inflation is really a matter of concern and could affect the manufacturing sector in the short term and investments," said B. Muthuraman, vice president of Tata Steel. He noted that higher interest costs "will be an added burden."

Industry estimates show that raw material costs as a proportion of net sales rose to 52.9 percent in the March quarter, the highest in two years, for India's top 100 firms.

Average salaries have gone up 14-15 percent this year as firms had to raise wages, partly to offset almost double-digit rise in food and consumer prices, and to retain skilled labour.

In March, food inflation was 9.47 percent compared with year earlier while CPI rose 8.82 percent. That's lower than in March 2010, when food inflation was 16.65 percent and the CPI rise hit 14.86 percent.

HOW MUCH HAVE COSTS RISEN?

India's leading personal care and food products maker Dabur India said raw material costs in the March quarter were up 57.5 percent from a year earlier, and inflation would keep margins under pressure for the next six months.

Top coal miner Coal India raised prices in February by about 30 percent, putting pressure on most steel, paper and engineering firms.

Analysts say a sharp increase in prices of palm oil, copra, and sugar will impact the bottomline of consumer goods companies.

Profit margins are under severe pressure in tea, coffee, synthetic fibres, wood products, transport equipment and fuel segments, according to Nomura.

It said firms in these sectors have raised product prices and are trying to cut costs by steps such as leaving vacancies unfilled. But analysts say a bigger chunk of higher costs will be passed through to customers.

Some industries that face sluggish demand, such as steel and cement, are finding it difficult to raise prices despite a spike in the prices of raw materials such as pet coke and power.

WILL MONETARY TIGHTENING HAVE A LONGER-TERM IMPACT?

It could. Industry lobbies say more rate hikes might hurt companies' expansion plans, which would restrain increases in industrial output in future. If industries have capacity constraints but do not expand, imports will rise.

The manufacturing sector in Asia's other big engine of growth, China, also faces issues from a battle to tame inflation.

REUTERS

An employee works inside a metal workshop in Kolkata.

China to offset weak oil demand in Japan, US: Opec

AFP, *Vienna*

The Opec oil cartel on Wednesday held steady its forecast for world oil demand growth this year, saying rising consumption in China would make up for the uncertain outlook in the United States and in quake-hit Japan.

"World oil demand is forecast to grow by 1.4 million barrels per day (bpd) in 2011, broadly unchanged from the previous report," the Organisation of Petroleum Exporting Countries said in its latest monthly oil market report.

"The Japanese earthquake, along with economic uncertainty in the US, is keeping oil demand estimates in an adjustment mode and is imposing a downside risk for the year's forecasts," the cartel wrote.

"At the same time, China's economy is roaring ahead of all expectations, which has implications on the country's consumption. As a result of the offsetting demand trends, the risks look to be nearly balanced at the present time."

US economic growth has slowed sharply in the first quarter, mainly as a result of a drop in government spending, placing a major question mark over oil consumption in the world's largest economy, Opec said.

In Japan, the world's second-biggest economy, the devastating earthquake and ensuing deadly tsunami in March caused the country's oil demand to plunge by 0.2 million bpd in March, and it is forecast to worsen in April and May, Opec said.

China's economy, on the other hand, is roaring ahead and would likely offset any negative developments in the US and Japan.

"That said, it is too early to alter the existing forecast for world oil demand as risks are nearly balanced with regard to upward and downward movements," Opec wrote.

The cartel estimated that world oil demand increased by 2.1 million bpd to 86.67 million bpd in 2010 and would rise by a further 1.4 million bpd to 88.08 million bpd this year.

China's economy cools, limiting need for tighter policy

REUTERS, *Beijing*

China's inflation eased in April to 5.3 percent and other data, including for industrial output and loans, suggested the world's second-biggest economy may be cooling and there was less need for further aggressive monetary tightening.

Inflation was slightly higher than expected but lower than a 32-month high in March of 5.4 percent, underlining expectations that price pressures were peaking and would start to ease in the second half of 2011.

The annual growth rates for industrial output and retail sales eased more than expected, backing the view that the heady 10-percent plus pace of economic growth last year is calming.

Food prices, the main driver of overall inflation, fell 0.4 percent in April from March and were up 11.5 percent from a year earlier. Non-food prices rose 0.4 percent in April from March.

"The data suggests that previous measures to get a grip on lending and growth have had an impact," said George Worthington, chief Asia economist, IFR Markets, a unit of Thomson Reuters, in Sydney.

Several analysts said other data released on Wednesday, including figures that showed growth in money supply and outstanding bank loans were at a 29-month low, so the central bank could be approaching the end of its monetary tightening.

"The April economic indicators make it less likely that the central bank will raise required reserve ratios or interest rates. I believe the central bank will, at most, raise reserve requirements once in the coming two months," said Shao Yu, an economist with Hongyuan Securities in Shanghai.

The government aims to limit average inflation in 2011 to 4 percent. The central bank has raised interest rates four times since last October and banks' reserve requirements seven times, which has meant big banks have a record 20.5 percent in deposits tied up. Those funds could otherwise become loans.

Indeed, Wang Jian, a researcher with the National Development and Reform Commission, said policymakers may now become more concerned about an overly rapid slowdown in the economy.

They may look to cut, rather than raise, interest rates.

"The central bank will be very cautious about raising interest rates. In fact, I believe it may stop raising interest rates but cut interest rates in the second half of the year," Wang told Reuters in an interview.

Markets showed little reaction to the data.

TIGHTENING BITES

China's industrial output in April rose 13.4 percent from a year earlier, easing from a pace of 14.8 percent in March, the National Bureau of Statistics said. Output had been forecast in a Reuters poll to rise by 14.7 percent.

Retail sales rose 17.1 percent, lower than 17.6 percent forecast in a Reuters poll and weakening from 17.4 percent in March.

Chinese banks extended 739.6 billion yuan ($113.9 billion) in new yuan loans in April, more than market forecasts for 700 billion yuan, People's Bank of China figures showed.

M2 money supply growth of 15.3 percent was lower than forecasts of 16.5 percent and also marked the lowest pace in 29 months.

Outstanding yuan loans at the end of April were 17.5 percent higher than a year earlier, also the weakest pace in 29 months, adding to expectations that inflation, which usually lags money supply trends, may moderate.

"The economy is slowing, but not very seriously. It is still far from the warning line for the Chinese leadership. There is no room for the central bank to relax its monetary tightening," said Chen Gang, economist with CEBM in Shanghai.

But the possibility the central bank might resume issuance of 3-year bills, on top of other short term bills it issues, suggested it might opt for open market operations rather than outright rate rises or higher reserve requirements to manage monetary conditions, analysts said.

REUTERS

A customer looks at price tags in a supermarket in Hefei, Anhui province.

Asian century key to Australian boom

AFP, *Sydney*

The China-led mining boom that will help wipe out Australia's deficit within two years was the "first taste" of benefits set to flow from the "Asian century", Treasurer Wayne Swan said Wednesday.

Asia's insatiable demand for Australian iron ore and coal has helped build an economy dubbed "the wonder from Down Under", which avoided recession during the global slump and now looks able to return to surplus by 2012/2013.

Swan said the changing global balance of power towards Asia presented Australia with opportunities at least equal to any the country has seen before.

"In many ways the mining boom is just the first taste for us of the huge shift in the world's economic centre of gravity in Australia's favour," he said.

Swan said as the numbers of middle class people in Asia swelled, "the implications for high-value knowledge economies like Australia stretch well beyond the mining boom".

"As the emerging economies continue to develop, the growing cities which are now generating extraordinary demand for Australia's energy and mineral resources will be populated by an increasingly wealthy and upwardly mobile middle class, with incomes and tastes to match," he said.

"As we integrate more closely into this vast and swiftly expanding economic zone... more and more of our services industries will acquire the character of export industries. That is

Sri Lanka to sell $1b, minimum 10-yr eurobond-cbank

REUTERS, *Colombo*

Sri Lanka plans to sell a billion sovereign dollar bond this year with a tenure of 10 years or more to retire expensive debt and fund vital infrastructure projects, the island nation's central bank said on Tuesday.

The issue will be Sri Lanka's fourth eurobond offering since it first tapped international capital markets in 2007.

"It will be $1 billion and the tenure will be 10 years or even more," Dharma Dheerasinghe, the central bank's deputy governor, told Reuters in an interview. "We are in the process of writing to investment banks and other institutional investors and the road shows will be done in June."

This issue will be used to refinance expensive debt and fund infrastructure projects. Proceeds from earlier bonds were mostly used to pay for infrastructure projects during the last years of a quarter-century civil war that ended in May 2009 and after.

In September, Sri Lanka's issued a $1 billion, 10-year eurobond yielding 6.25 percent which received $6.33 billion in offers.

That followed two $500 million, five-year bond sales, the first in 2007 and the second in 2009. Sri Lanka wants to trim its long-term borrowing costs and cut its debt-to-GDP ratio to 67 percent by 2014 from last year's 81.9 percent.

"We could go to the market even earlier than October this year," he said.

INFRASTRUCTURE DRIVEN GROWTH

Sri Lanka has allocated about $6 billion to road, railway, port, airport, and power generation projects projects that are either underway or in the pipeline, hoping to keep its $50 billion economy growing sustainably at 8 percent or more.

Sri Lanka has forecast a record economic expansion of 8.5 percent this year, from last year's 32-year high of 8 percent, despite rising inflationary worries.

"We can achieve a growth between 8.2-8.5 percent this year as the economy has the capacity to expand more with the end of the war and we are underperforming in a number of sectors," Dheerasinghe said.

Sri Lanka's annual inflation jumped to a 27-month high of 9.8 percent in April from a year earlier and the annual average inflation hit a 19-month high in April, well above analysts forecast.

"Both annual average and point-to-point inflation will be below what it is now and the rise in inflation is purely due to supply constraints."

AFP

Toyota Motors President Akio Toyoda speaks at a news conference in Tokyo yesterday. Toyota said fourth quarter net profit tumbled 77 percent due to a strong yen and as it reels from the impact on production of Japan's biggest recorded earthquake and a tsunami.