PMI gives good news, but remains below trend

Given the plethora of good news—highest PMI since June and smart December automobile sales—it's not surprising the Sensex closed 421 points up. HSBC's manufacturing PMI came in at 54.2 over November's 51 and October's 52, though it remained below the long-term average of the past few years—even in April, PMI was 58. So though the data suggests the rebound in manufacturing activity will not be very strong, it certainly suggests it is not all doom and gloom, a point reiterated by the core sector data that came out just before the end of 2011. It is true there is no one-on-one correlation between PMI and IIP, but given the sharp volatility in IIP, and the data errors, focusing on PMI is probably a better bet. Between January and February 2011 when PMI rose, IIP fell; between March and April, when PMI rose marginally, IIP collapsed. Similarly, when PMI rose between September and October, IIP collapsed from a growth of 1.9% to negative 5.1%. The directional relationship between GDP and PMI, however, appears stronger, suggesting it is better to focus on trends rather than month-to-month fluctuations, but it makes sense to wait and see other data—the sharp fall in exports growth and the consistently lower credit growth each month suggests PMI may not be presenting the full picture.

What may turn things around, and probably moved the markets more, was the interview given by RBI Governor Duvvuri Subbarao where he said that if inflation was the main concern in 2001, it would be growth in 2012. "I think the balance between growth and inflation will shift in 2012," he told BBC, while adding that it was "difficult to say when that would take place, and it what shape it would roll out," A continued fall in the rupee, more so given the fact that European banks need to liquidate a large part of their $148 billion India investments (see European crisis comes home on Reflect page) in order to meet their capitalisation needs, could put more pressure on inflation and get RBI to wait a bit. The fact that the government's borrowing targets seem to be rising could also make RBI want to pause. The overall collapse in sentiment, especially given the government's inability to get legislation through and the need to show growth, however, could tip things in favour of a rate cut on January 24. Watch this space.