ICRA
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INDEX OF INDUSTRIAL PRODUCTION JULY 2020

Industrial activity records tepid step-up in July 2020, contraction remains in double-digits

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Aditi Nayar
+91 124 4545 385
aditin@icraindia.com

Yash Panjrath
+91 124 4545 399
yash.panjrath@icraindia.com

Aarzoo Pahwa
+91 124 4545 873
aarzoo.pahwa@icraindia.com

Tiasha Chakraborty
+91 124 4545 300
tiasha.chakraborty@icraindia.com

HIGHLIGHTS

- The pace of contraction in the Index of Industrial Production (IIP) in year-on-year (YoY) terms recorded a tepid improvement to 10.4% in July 2020 from the revised 15.8% in June 2020. A modest sequential normalisation in capital goods, intermediate goods, infrastructure goods and consumer durables, was offset by a deflation of momentum in the pace of growth of consumer non-durables between these two months.

- The contraction of 10.4% posted by the IIP in July 2020, trailed our expectation of a 9.0% de-growth for that month, on account of a modestly weaker than anticipated performance of all the three sectors, namely mining, manufacturing and electricity.

- Despite continued improvements, capital goods and consumer durables underperformed the other use-based categories in July 2020, recording the deepest de-growths of 22.8% and 23.6%, respectively, in that month, reiterating that the discretionary portion of consumption and investment will recover from this crisis with a substantial lag.

- While consumer non-durables remained the only category posting a growth in July 2020, the pace of its expansion halved to 6.7% in July 2020 from 14.3% in June 2020, suggesting that restocking of inventory lost some steam.

- Electricity outperformed the other two sectors in July 2020, with a muted de-growth of 2.5%.

- Available indicators for August 2020 provide mixed cues, with a base effect-led improvement in sectors such as coal and rail freight, modest recovery in petrol consumption, port cargo traffic and GST e-way bills, juxtaposed with a worsening pace of contraction of electricity generation and diesel consumption, which may be a consequence of heavy rainfall in the second half of that month.

- Based on the available indicators, we foresee an easing in the pace of contraction of the IIP to 6-8% in August 2020.

OVERVIEW

After sharp improvements in May 2020 and June 2020, the pace of contraction in the industrial output in YoY terms recorded a tepid improvement to 10.4% in July 2020 from the revised 15.8% in June 2020 (refer Exhibit 1). The initial estimate for the IIP for July 2020 trailed our expectation of a 9.0% de-growth for that month, on account of a modestly weaker-than-anticipated performance of all the three sectors, namely mining, manufacturing and electricity. The extent of the YoY de-growth in the broader IIP (-10.4%) in July 2020 was sharper than the 9.6% contraction in the core sector output (refer Exhibit 2), which has a weight of 40.3% in the former.

Sectoral performance: While the contraction in manufacturing narrowed to 11.1% in July 2020 from the revised 16.0% in June 2020, it exerted the chief drag on the overall IIP performance in both these months. Moreover, the de-growth in mining eased to 13.0% in July 2020 from the revised 19.6% in June 2020, although this remained the worst affected sector for the second month in a row. Additionally, the contraction in electricity generation narrowed to a mild 2.5% in July 2020 from 10.0% in June 2020, outperforming the other sectors.

In terms of the sub-sectors of manufacturing, the production of 21 out of the 23 sub-sectors displayed a contraction in July 2020, in line with the trend in June 2020. Notably, 15 of the 23 sub-sectors (with a weight of 40.2% in the IIP), recorded an improvement in their YoY performance in July 2020 relative to the previous month. For instance, the output of tobacco products grew by 6.1% in July 2020, in contrast to contraction of 8.9% in June 2020 (refer Exhibit 3 and Exhibit 4). Moreover, the YoY contraction in the output of textiles and other transport equipment narrowed significantly to 14.8% and 25.3%, respectively, in July 2020 from 52.1% and 50.1%, respectively, in June 2020. Similarly, the contraction in output of wood and wood products, fabricated metal products and motor vehicles, trailers and semi-trailers narrowed to 26.6%, 12.7% and 31.4%, respectively, in July 2020 from 43.2%, 31.0% and 46.1%, respectively, in the previous month. In contrast, eight of the 23 sub-sectors (with a weight of 37.4% in the IIP), recorded a deterioration in their YoY performance in July 2020 relative to the previous month. For instance, the pace of expansion in the output of pharmaceuticals, medicinal chemical and botanical products (with a weight of 5.0% in the IIP) moderated to 22.0% in July 2020 from 34.8% in June 2020, suggesting a let up in the pace of restocking. Additionally, the performance of chemicals and chemical products (with a weight of 7.9% in the IIP) deteriorated to a contraction of 3.5% in July 2020 from a marginal growth of 0.2% in June 2020. Moreover, the YoY decline in the output of coke and refined petroleum products (with a weight of 11.8% in the IIP) widened to 17.2% in July 2020 from 13.8% in June 2020.

The recovery in the performance of mining was primarily led by coal (to -5.7% in July 2020 from -15.5% in June 2020), with a mild improvement in crude oil (to -4.8% from -6.0%) and natural gas (to -10.1% from -12.0%). Data released by the Central Electricity Authority (CEA) indicates that the YoY contraction of thermal electricity generation narrowed significantly to 2.2% in July 2020 relative to 17.1% in June 2020, even as the pace of expansion in hydroelectricity generation eased to 13.6% from 18.6%, respectively.

Use-based categories: Capital goods and consumer durables recorded the sharpest improvement in their YoY performance, with the pace of contraction narrowing appreciably to 22.8% and 23.6% (worst-performing category), respectively, in July 2020 from the revised 37.4% and 34.3%, respectively, in June 2020. Despite continued improvements, these two categories underperformed the other categories, with deepest YoY de-growths in July 2020, reiterating that the discretionary portion of consumption and investment will recover from this crisis with a substantial lag. The YoY decline in the output of infrastructure/construction goods eased to 10.6% in July 2020 from the revised 18.8% in June 2020. This benefitted from the narrowing in the pace of contraction in the production of steel (to -16.3% in July 2020 from -25.4% in June 2020), even as the performance of cement output (-13.4% from -6.8%) worsened in these two months. In addition, the pace of YoY de-growth in the output of intermediate goods nearly halved to 12.5% in July 2020 from the revised 23.0% in June 2020. Primary goods displayed the lowest improvement for the third consecutive month in July 2020, with the pace of YoY decline in the output narrowing to 10.9% in that month from 14.5% in June 2020. While consumer non-durables, which comprise of many essential items, remained the only category posting a growth in July 2020, the pace of its expansion halved to 6.7% in July 2020 from 14.3% in June 2020, suggesting that restocking of inventory lost some steam.

The contraction in the IIP in June 2020 was revised to 15.8% from the initial 16.6%. This was led by an upward revision in the case of intermediate goods (revised: -23.0% vs. initial: -25.1%), infrastructure goods (-18.8% vs. -21.3%), consumer durables (-34.3% vs. -35.5%) and consumer non-durables (+14.3% vs. +14.0%), but was partly offset by a downward revision in capital goods (-37.4% vs. -36.9%). In sectoral terms, manufacturing (revised: -16.0% vs. initial: -17.1%) and mining (-19.6% vs. -19.8%) have reported an upward revision for June 2020.

OUTLOOK

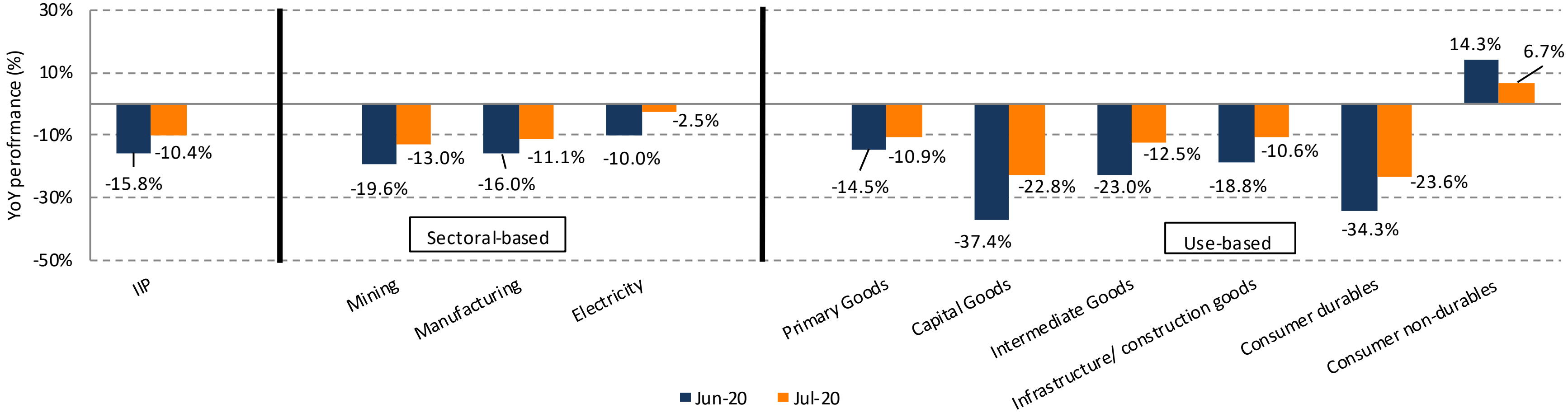
After displaying contraction for four consecutive months, Coal India Limited's (CIL) output recorded a five-month high 7.1% growth on a YoY basis, in August 2020 (-10.5% in August 2019). The turnaround relative to the 3.0% de-growth in July 2020 (-5.1% in July 2019), largely benefitted from the favourable base effect, as well as a mild improvement in the offtake levels. The improvement in the output of CIL, coupled with a low base (YoY stagnation in August 2019) may support the performance of mining in the just-concluded month.

Domestic electricity generation has witnessed a YoY decline for six months in a row, the pace of which worsened to 3.1% in August 2020 from the marginal 0.7% in July 2020, as per the tentative data released by the Central Electricity Authority (CEA). With heavy rainfall, the YoY demand for electricity declined in the second half of August 2020 (-5.5%), relative to the mild pickup in the first half (+1.5%) of that month, according to POSOCO data. Nevertheless, with a contraction in electricity generation from August-December 2019, this sector may continue to out-perform the rest of the IIP in the next few months, led by favourable base effects.

Moreover, the YoY contraction in the generation of GST e-way bills eased further to a muted 3.5% in August 2020 from 7.3% in July 2020.

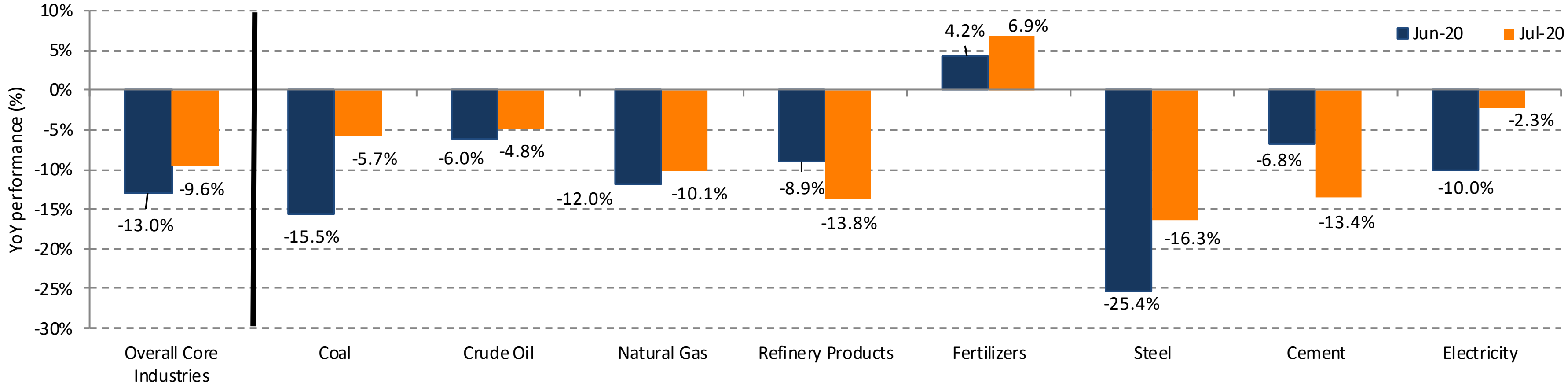
Over the next three months, while the base effect is favourable given the contraction in industrial output from August-October 2019, the impact of waning pent-up demand, as well as restocking ahead of the festive season remains to be seen. Moreover, a late withdrawal of monsoon rains could impact the mining and electricity generation activities in September-October 2020. Based on the sharp, albeit base effect-led turnaround in the performance of the output of CIL, the narrowing de-growth in generation of GST e-way bills, and the mild worsening in the contraction in electricity generation in August 2020, we are hopeful that the pace of contraction of the IIP could ease to 6-8% in August 2020.

Exhibit 1: Trend in YoY performance of IIP and its sub-components in June 2020 and July 2020



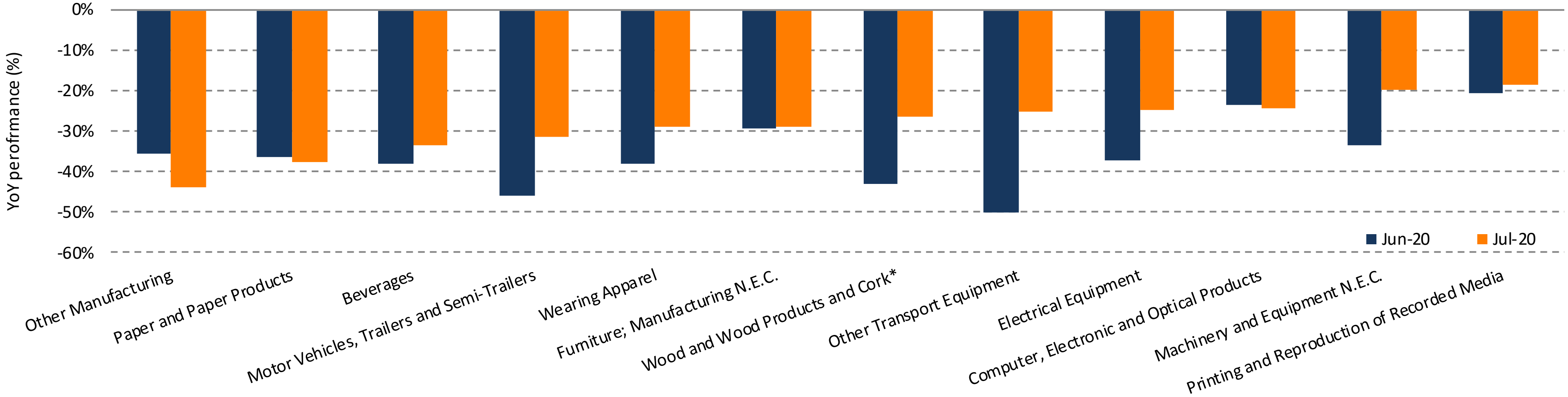
Source: CSO; CEIC; ICRA research

Exhibit 2: Trend in YoY performance of core sector and its sub-components in June 2020 and July 2020



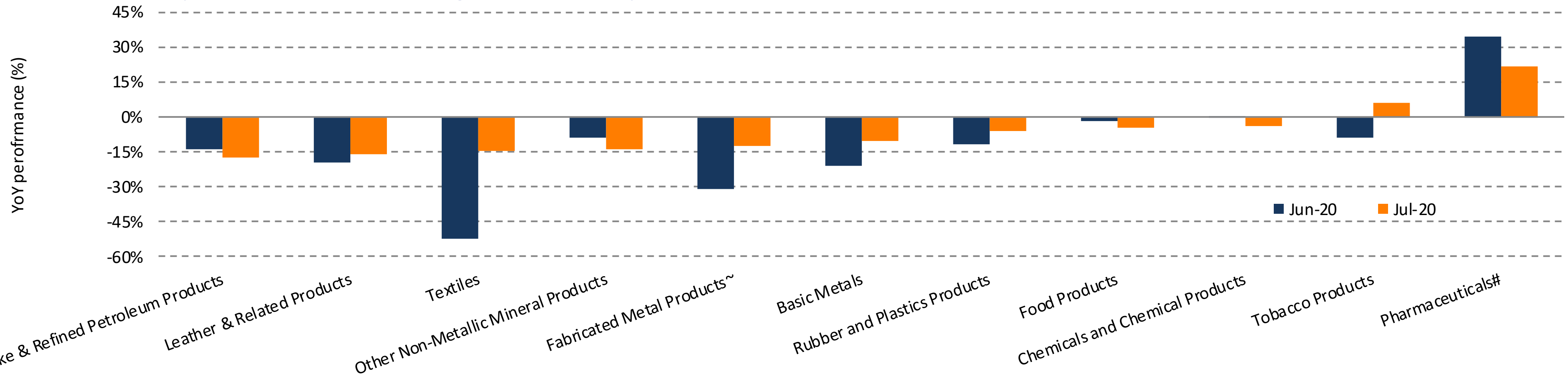
Source: Index of Eight Core Industries, Office of Economic Adviser, Ministry of Commerce and Industry, CEIC; ICRA research

Exhibit 3: Trend in YoY performance of manufacturing sub-sectors in July 2020 relative to June 2020 (PART-I)



** Excluding furniture, manufacture articles of straw and plaiting materials*
Source: CSO; CEIC; ICRA research

Exhibit 4: Trend in YoY performance of manufacturing sub-sectors in July 2020 relative to June 2020 (PART-II)



#Also includes medicinal chemical and botanical products; ~Excluding machinery and equipment
Source: CSO; CEIC; ICRA research

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ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

1809-1811, Shapath V,
Opposite Karnavati Club
S.G. Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,
10th Floor,1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar,Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.icraresearch.in