ICRA

A MOODY'S INVESTORS SERVICE COMPANY

INDEX OF INDUSTRIAL PRODUCTION AUGUST 2020

Industrial recovery plateaued in August 2020

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HIGHLIGHTS

- Despite a favourable base effect, the pace of contraction in the Index of Industrial Production (IIP) in year-on-year (YoY) terms recorded only a muted improvement to 8.0% in August 2020 from 10.8% in July 2020, indicating a plateauing of the industrial recovery up to that month.

- The contraction of 8.0% posted by the IIP in August 2020, stood in line with our expected range of a 6-8% de-growth for that month.

- In sectoral terms, mining, manufacturing and electricity recorded a mild but broad-based improvement in August 2020 on the back of favourable base effects, while continuing to post a YoY contraction.

- The disaggregated use-based data for August 2020 reveals mixed trends, with a continued improvement in consumer durables, capital goods, infrastructure goods and intermediate goods offset by a slippage in the performance of consumer non-durables and primary goods.

- Amid an unfavourable base effect, consumer non-durables slipped back into a YoY contraction of 3.3% in August 2020, signalling that boost from inventory restocking may have petered out.

- In contrast, a favourable base effect contributed to a sharp narrowing in the YoY de-growth in consumer durables, which posted the largest improvement in August 2020 among the use-based categories. A push to build up stocks ahead of the festive season may provide continued momentum to this category in the near term.

- Various early indicators, such as the output of Coal India Limited (CIL), generation of electricity and GST e-way bills, and non-oil merchandise exports have shown a sharp improvement in September 2020 relative to the YoY performance in the previous month. The sustainability of this pickup remains uncertain, as it has benefitted from a combination of favourable base effects, pent-up demand and inventory build-up, partly ahead of the festive season as well as to insure against sudden supply chain disruptions. Regardless, a continued favourable base effect is expected to propel the IIP into a much narrower de-growth in Sep 2020, with a mild possibility of a low YoY growth in that month, after six months of sustained contraction.

OVERVIEW

Despite a favourable base effect, the pace of YoY contraction in the IIP eased only mildly to 8.0% in August 2020 (-1.4% in August 2019) from 10.8% in July 2020 (+4.9% in July 2019), indicating a plateauing of the industrial recovery up to that month (refer Exhibits 1 and 3). The initial print of the IIP for August 2020 is in line with our expected range of a 6-8% de-growth. In sectoral terms, the contraction in mining, manufacturing and electricity narrowed in August 2020 (refer Exhibit 2). The mild improvement in the broader IIP in August 2020 stood in contrast to the slight worsening in the pace of contraction in the core sector output (with a weight of 40.3% in the IIP) to 8.5% in that month from 8.0% in July 2020 (refer Exhibit 4).

Sectoral performance: On a low base, the contraction in manufacturing output eased to 8.6% in August 2020 (-1.7% in August 2019) from 11.6% in July 2020 (+4.8% in July 2019), and it continued to exert the predominant drag on the overall IIP performance for the sixth consecutive month. The de-growth in mining narrowed to 9.8% in August 2020 (YoY stagnation in August 2019) from 12.8% in July 2020 (+4.9% in July 2019) also benefitting from the base effect, even as this remained the worst affected sector. Similarly, the pace of YoY decline in electricity generation eased to 1.8% in August 2020 (-0.9% in August 2019) from 2.5% in July 2020 (+5.2% in July 2019), despite a substantial base effect related to heavy rains in August 2019.

In terms of the sub-sectors of manufacturing, the production of 20 out of the 23 sub-sectors (with a weight of 62.3% in the IIP) displayed a de-growth in August 2020, as compared to 21 sub-sectors in July 2020. Notably, 16 of the 23 sub-sectors (with a weight of 55.0% in the IIP), recorded an improvement in their YoY growth or narrowing of contraction in August 2020 relative to the previous month. For instance, basic metals witnessed a YoY rise in the output, albeit of a marginal 0.1% in August 2020, after having contracted for six months in a row (-10.5% in July 2020; refer Exhibits 5 and 6). Similarly, the output of other transport equipment rose by 1.7% in August 2020 on a YoY basis as opposed to the sharp 25.3% de-growth in July 2020. Moreover, the contraction in the output of beverages, other manufacturing, and motor vehicles narrowed sharply to 17.1%, 29.2% and 13.6%, respectively, in August 2020 from 33.5%, 43.9% and 31.4%, respectively, in the previous month. In contrast, seven of the 23 sub-sectors (with a weight of 22.6% in the IIP) recorded a deterioration in their pace of YoY growth or widening of contraction in August 2020 relative to the previous month. For instance, the pace of growth of tobacco products eased to 2.9% in August 2020 from 6.1% in July 2020. Moreover, the pace of YoY decline in the output of textiles, coke and refined petroleum products, wood and wood products and paper and paper products, worsened to 16.6%, 21.4%, 32.5%, and 41.3%, respectively, in August 2020 from 14.8%, 17.2%, 26.6% and 37.6%, respectively, in July 2020. Additionally, after recording an expansion of 22.0% on a YoY basis in July 2020, pharmaceuticals output contracted by 1.1% in August 2020.

The improvement in the performance of mining was driven by coal output, which rose by 3.6% in August 2020 in contrast to the 5.7% de-growth in July 2020, while the contraction in natural gas eased to 9.5% from 10.1%, respectively. Data released by the Central Electricity Authority (CEA) indicates that hydroelectricity generation recorded a modest 4.9% contraction in August 2020, after expanding by 13.6% in July 2020, whereas the de-growth in thermal electricity generation remained unchanged at 2.2% in both these months.

Use-based categories: The use-based categories displayed a mixed trend in August 2020, with a continued improvement in consumer durables, capital goods, infrastructure goods and intermediate goods, offset by a slippage in the performance of consumer non-durables and primary goods. Consumer durables posted the largest improvement in August 2020, with a narrowing in the pace of contraction to 10.3% (-9.7% in August 2019) from 23.0% in July 2020 (-2.4% in July 2019), partly benefitting from the favourable base effect. A push to build up stocks ahead of the festive season may provide continued momentum to this category in the near term. Despite some improvement, capital goods stood out as the worst performing use-based category in August 2020, with a de-growth of 15.4% (-22.8% in July 2020), serving as a reminder that the recovery in investment will lag the rest of the economy. Moreover, the YoY decline in the output of infrastructure/construction goods and intermediate goods eased further to 2.3% and 6.8%, respectively, in August 2020 from 8.6% and 11.7%, respectively, in July 2020. In contrast, consumer non-durables reverted to a mild YoY contraction of 3.3% in August 2020 (+3.1% in August 2019) from the mild 1.8% growth in July 2020 (+8.5% in July 2019) driven partly by an unfavourable base effect, but also signalling that the push related to inventory restocking may have petered out. Moreover, the YoY de-growth pertaining to the output of primary goods, worsened marginally to 11.1% in August 2020 from 10.8% in the previous month.

The contraction in the IIP in July 2020 was revised to 10.8% from the initial 10.4%. This was led by a sharp downward revision in the performance of consumer non-durables (to +1.8% from +6.7%), partly offsetting the upward revisions in intermediate goods (to -11.7% from -12.5%), infrastructure goods (to -8.6% from -10.6%), consumer durables (to -23.0% from -23.6%) and primary goods (to -10.8% from -10.9%). In sectoral terms, the contraction in manufacturing was revised to 11.6% from the initial 11.1%, whereas that for mining was mildly revised upwards to 12.8% from the initial 13.0% for July 2020.

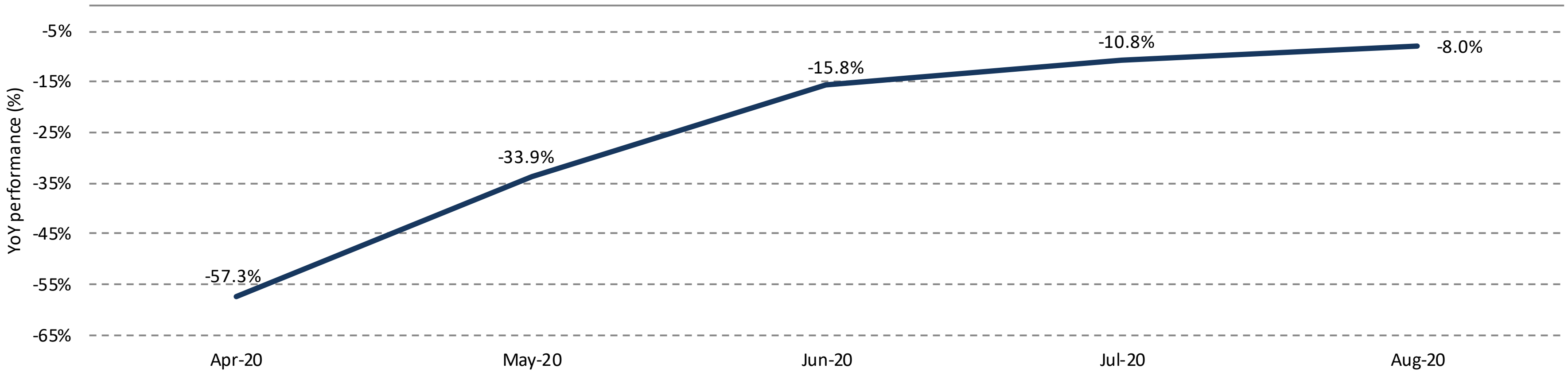
OUTLOOK

In September 2020, CIL's output recorded a sharp expansion of 31.6% on a YoY basis (+7.1% in August 2020). This largely benefitted from the favourable base effect related to the contraction of 23.5% in September 2019 (-10.5% in August 2019), with output curtailed by the excessive rainfall in that month, as well as some improvement in offtake levels. The pickup in the output of CIL, coupled with a low base may push the performance of mining into a mild growth in the just-concluded month.

A favourable base effect also contributed to a turnaround in domestic electricity generation to a growth of 4.2% in September 2020 (as per the tentative data released by the Central Electricity Authority) from the YoY de-growth of 3.3% in August 2020. Additionally, the generation of GST e-way bills rose by a sharp 9.6% in September 2020 after a contraction of 3.5% in August 2020. Further, provisional data pegs the growth in non-oil exports at 5.4% in September 2020, as opposed to the YoY decline of 8.8% in August 2020.

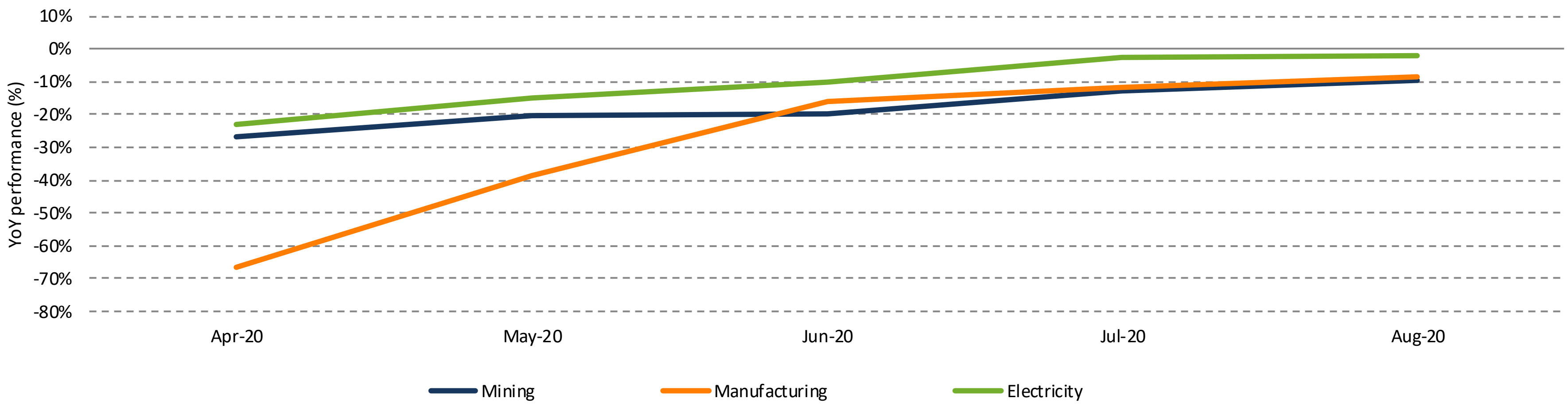
Various early indicators, such as the output of CIL, generation of electricity and GST e-way bills, and non-oil merchandise exports have shown a sharp improvement in September 2020 relative to the YoY performance in the previous month. The sustainability of this pickup remains uncertain, as it has benefitted from a combination of favourable base effects, pent-up demand and inventory build-up, partly ahead of the festive season as well as to insure against sudden supply chain disruptions. Regardless, a continued favourable base effect is expected to propel the IIP into a much narrower de-growth in Sep 2020, with a mild possibility of a low YoY growth in that month, after six months of sustained contraction.

Exhibit 1: Trend in YoY performance of IIP since April 2020



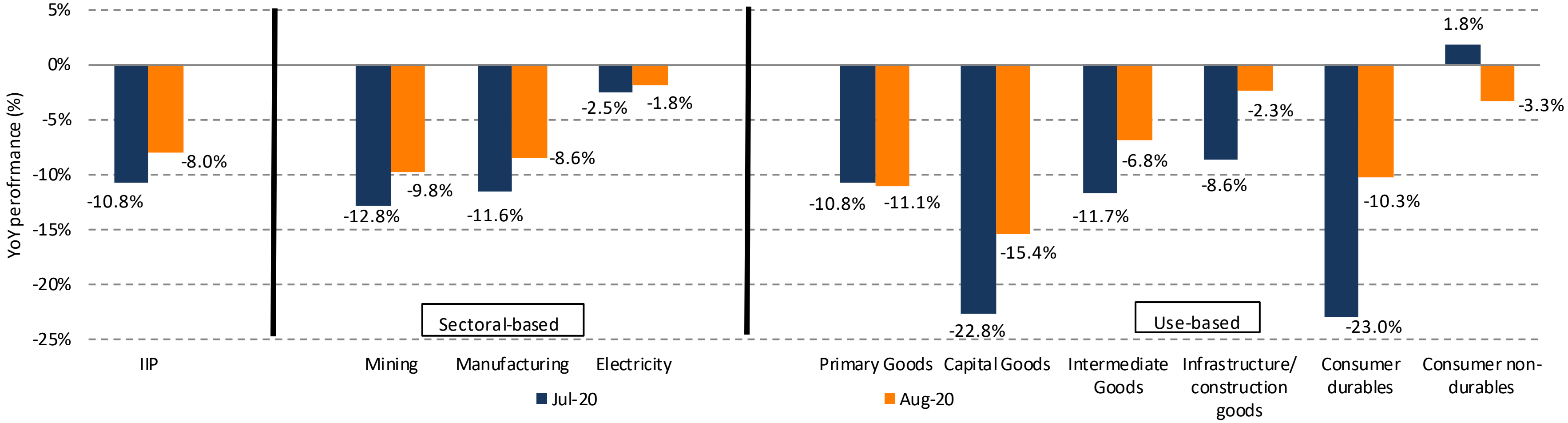
Source: CSO; CEIC; ICRA research

Exhibit 2: Trend in YoY performance of mining, manufacturing and electricity since April 2020



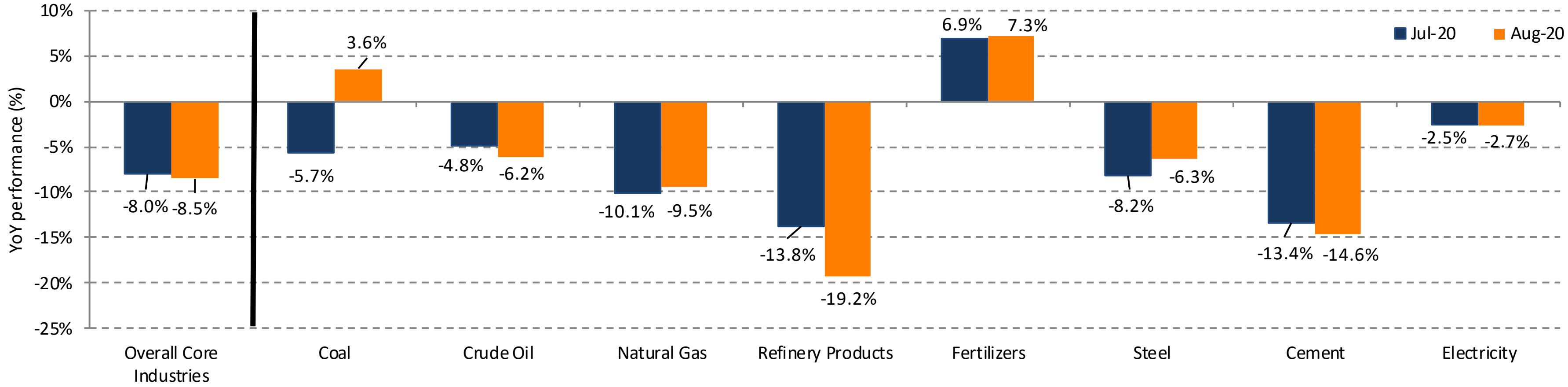
Source: CSO; CEIC; ICRA research

Exhibit 3: Trend in YoY performance of IIP and its sub-components in July 2020 and August 2020



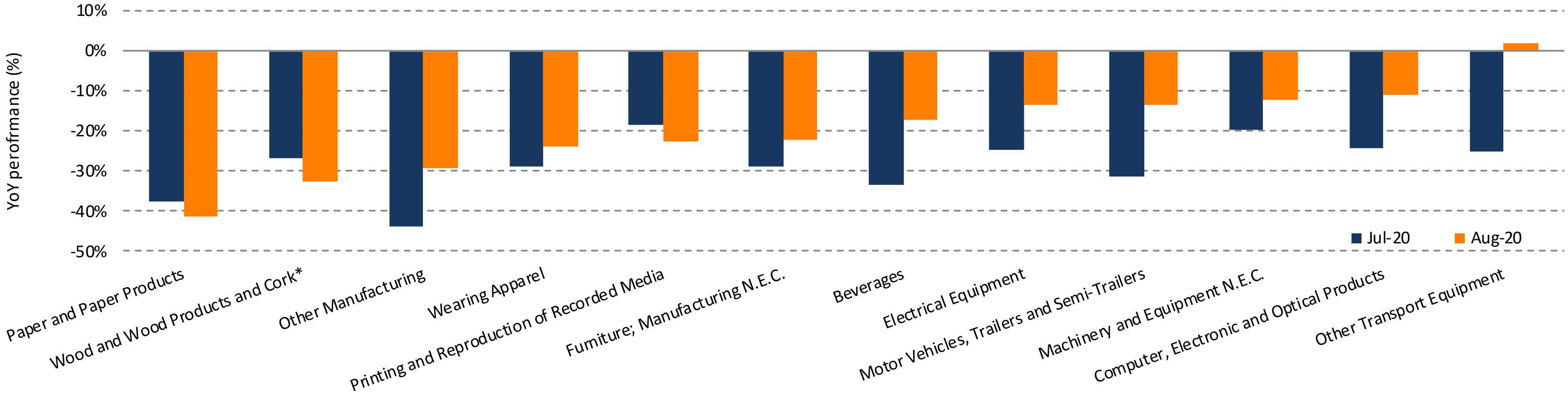
Source: CSO; CEIC; ICRA research

Exhibit 4: Trend in YoY performance of core sector and its sub-components in July 2020 and August 2020



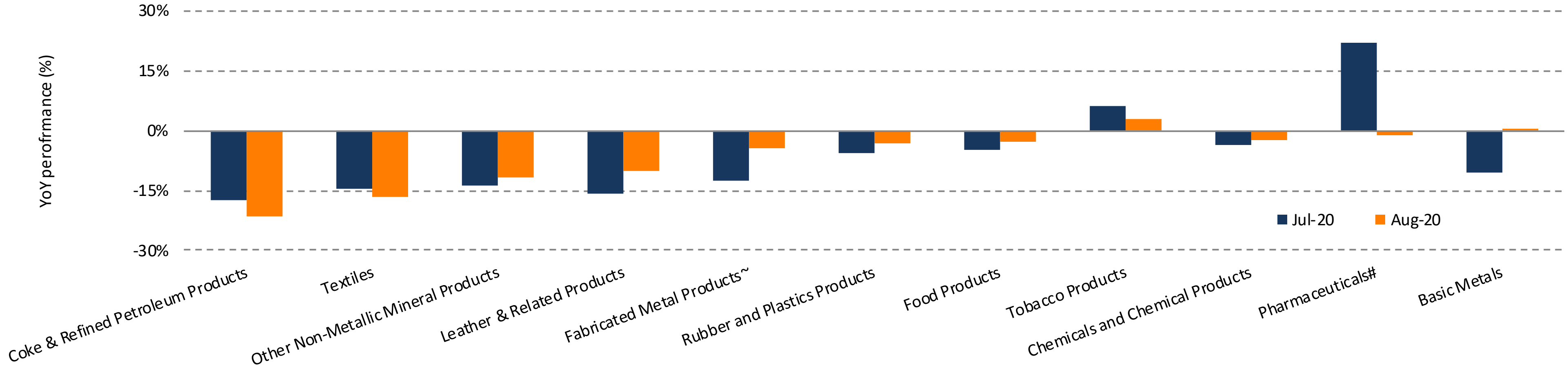
Source: Index of Eight Core Industries, Office of Economic Adviser, Ministry of Commerce and Industry, CEIC; ICRA research

Exhibit 5: Trend in YoY performance of manufacturing sub-sectors in August 2020 relative to July 2020 (PART-I)



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

Exhibit 6: Trend in YoY performance of manufacturing sub-sectors in August 2020 relative to July 2020 (PART-II)



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

ABOUT ICRA

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