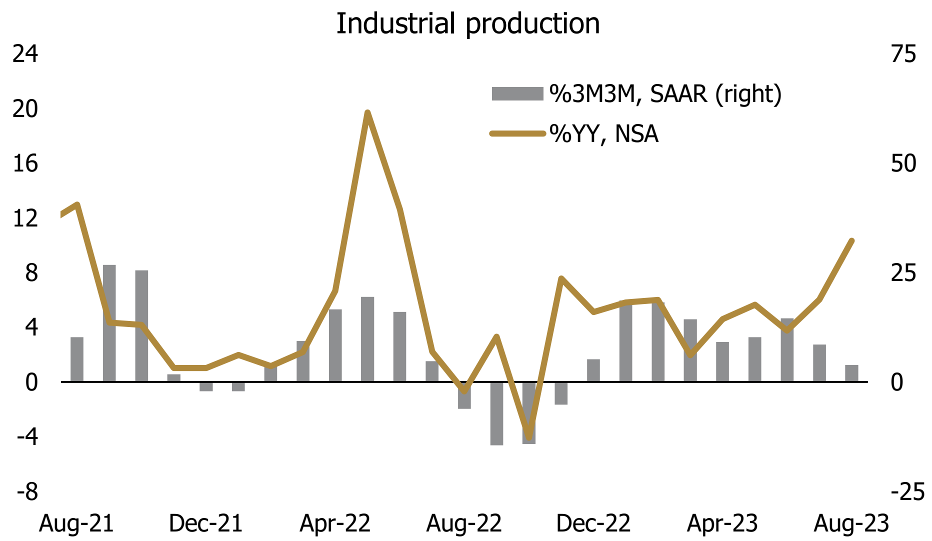
Industrial production growth accelerated to double digits in August; outlook remains positive due to public capex and real estate demand

Key takeaways: Industrial output increased by double digits in August, compared to the corresponding month a year ago. This acceleration in growth was supported by a broad-based improvement in output across sectors and a low base affect. Production was up from the previous month after contracting for two consecutive months. Public capital expenditure and real estate demand drove the output momentum for infrastructure and capital goods, though recovery in consumer goods-related output remained fragile. Despite favorable high frequency and soft data indicators, a weak external sector could pose risks to output growth. However, strength in domestic demand, particularly during the festive season, is likely to keep industrial output growth firm enough to support RBI MPC's overall GDP growth projection of 6.5%YY for FY24.

Summary: Industrial production growth increased to 10.3%YY in August from 6.0% in July, buoyed by a broad-based improvement in growth across sectors and goods, notwithstanding a few laggards and a low base effect. Industrial output contracted 0.7%YY in August 2022. The double-digit growth in latest data was in line with core sector output that hit a 14-month high. In sequential terms (month-on-month change), industrial production grew 1.7% on a seasonally adjusted basis after contracting in June and July, yielding a weak 3-month annualized trend (Figure 1). We assess the underlying patterns in some of the categories that drove these overall changes.

Figure 1: Industrial output growth surged to double digits in annual terms but the monthly momentum remained weak



Source: MoSPI

Figure 2: Industrial production by sector and use-based classification (%YY), 2023, Mar-Aug

(% year-on-year change)	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23
Industrial production	1.9	4.6	5.7	3.8	6.0	10.3
By sector						
Mining	6.8	5.1	6.4	7.6	10.7	12.3
Electricity	-1.6	-1.1	0.9	4.2	8.0	15.3
Manufacturing	1.5	5.5	6.3	3.1	5.0	9.3
By use-based classification						
Primary goods	3.3	1.9	3.6	5.3	7.6	12.4
Capital goods	10.0	4.4	8.1	2.0	4.5	12.6
Intermediate goods	1.8	1.7	3.4	4.6	2.4	6.5
Infrastructure/construction goods	7.2	13.4	13.0	12.9	12.4	14.9
Consumer durables	-8.0	-2.3	1.5	-6.7	-2.6	5.7
Consumer non-durables	-1.9	11.4	8.9	0.3	7.9	9.0

Note: Color code is based on %3M3M, SAAR data.
Red denotes weak momentum, green indicates the opposite.

Source: MoSPI

By sector:

- Manufacturing remained the strongest contributor to overall output growth. Both mining and electricity posted double-digit growth, when compared to the corresponding period a year ago, enabled by relatively warmer weather conditions during the month.
- In terms of seasonally adjusted monthly change, electricity posted the strongest growth, followed by mining and manufacturing. Out of the 23 manufacturing sub-sectors, growth contracted in five categories, compared to 17 in the previous month.

By use-based classification:

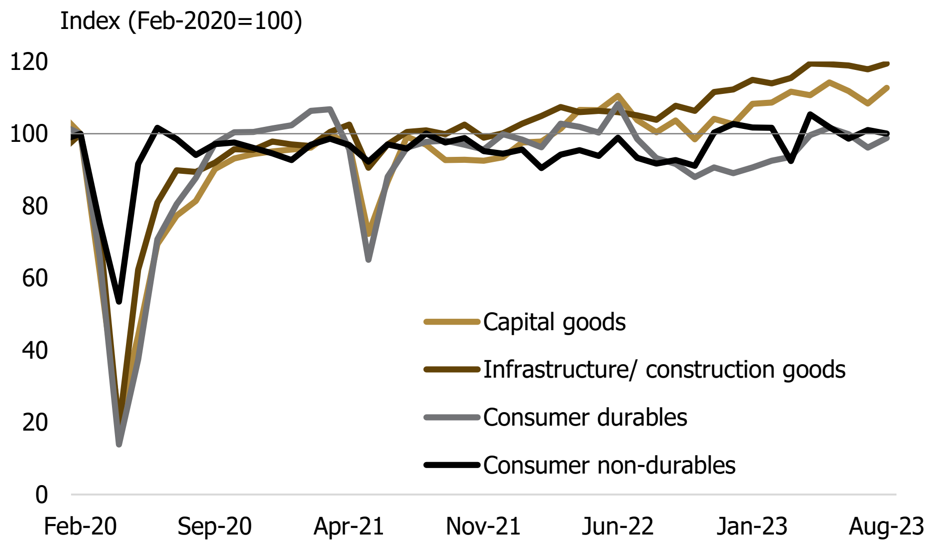
- In terms of use-based classification or types of goods, infrastructure and capital goods continued remain the key drivers of growth due to government's front loading of capital expenditure (capex) during the current fiscal year and strength in real estate demand. Production of consumer goods-related categories remained muted when compared to the pre-COVID trend, though there was improvement in the latest data compared to a year ago.
- In terms of seasonally adjusted monthly change, production of capital and infrastructure goods, and consumer durables increased after declining in June and July. Output of consumer nondurables declined. The underlying momentum, measured by 3-month seasonally adjusted annualized change, remained weak across categories, except for primary goods that mainly consists of mining, electricity, and fuels.

Public capex, real estate demand drive momentum for infrastructure and capital goods. In its latest monthly economic review, the Ministry of Finance, noted strong industrial activity and revival in residential real estate market as emerging domestic growth drivers. The report noted that in addition to the central government's thrust on capex, households' increased propensity to invest in residential properties would drive investment in the economy. This is likely to keep demand high for infrastructure/construction and capital goods. The Reserve Bank of India's (RBI) latest monthly report also acknowledged strong fundamentals in the housing property market, though it also noted declining volumes in the affordable and low-cost segments amid bulk sales in the mid-income and premium segments.

Latest data on public spending shows that during April-August FY24, central government's capex rose 48.1%YY, with the capital outlay (capex excluding loans and advances) up 35.3%. During the corresponding period, there was an improvement in capex at the state level too, with an increase of 45.9% for 23 states, and capital outlay higher by 38.1%.

As a result of higher capex spending and real estate demand, production of infrastructure and capital goods has surpassed the pre-pandemic levels, in seasonally adjusted terms. This is corroborated by latest manufacturing sector data, with the sub-categories linked to these goods recording double-digit year-on-year growth. These include basic metals, non-metallic mineral products, machinery and equipment, electrical equipment, and fabricated metal products. Also, data on the core industrial sector shows robust annual growth in the output of steel and cement.

Figure 3: Production of infrastructure and capital goods has surpassed pre-pandemic levels but remains depressed in case of consumer-related goods



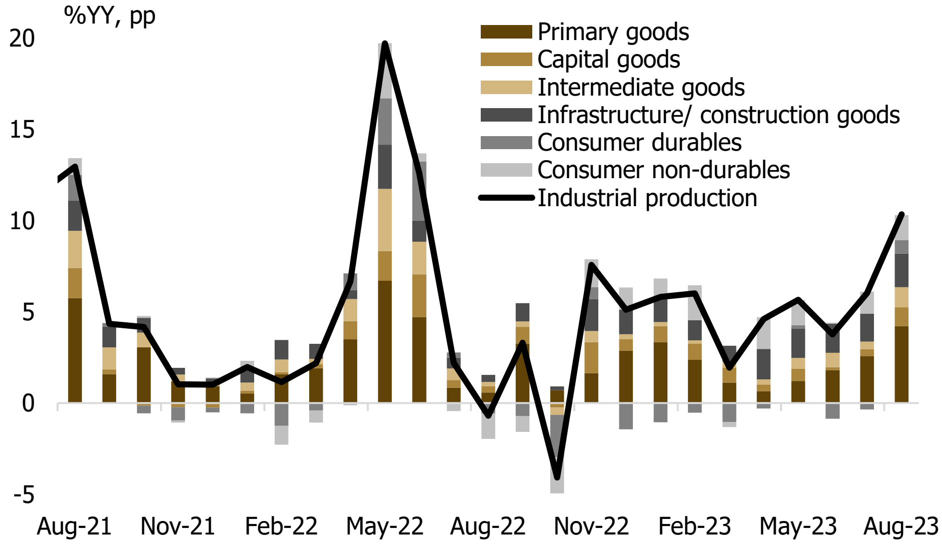
Source: MoSPI

Fragile recovery in consumer goods-related industries output amid a few bright spots. When compared to the pre-pandemic trend and other sectors, recovery in the production of consumer-related goods remained uneven and frail. Consumer durables output increased, when compared to the corresponding month a year ago, after contracting for two consecutive months. However, the overall trend is weak, with output declining in nine of the previous 12 months.

From the perspective of manufacturing sub-sectors, weakness in consumer durables output is revealed in the data on wearing apparel, and computer and electronic products. In terms of year-on-year change, manufacturing of wearing apparel has been in double-digit contraction for more than a year now. Manufacture of computer and electronic products has also been declining for nine consecutive months. Perhaps a silver lining is the manufacture of motor vehicles that has remained strong and grew 12%YY in August. The strength in demand for motor vehicles that is driving robust production is indicated in the data on vehicle loans and automobile sales.

The output of consumer nondurables increased 9.0%YY in August, marking the fifth consecutive month of expansion. In the consumer nondurables basket, bulk of the items belong to manufacturing of food products, pharmaceuticals and chemicals. In August, most of the increase in annual terms was drive by the double-digit growth in the manufacture of pharmaceuticals, even as the output of chemicals remained in contraction for the fourth straight month.

Figure 4: Contribution of types of goods to overall industrial production, (%YY, percentage points) 2021-2023, August



Source: MoSPI

Within intermediate goods, which partly suggest the state of order books of companies, there is a noteworthy softness in the data on manufacture of textiles. In addition to the decline in manufacture of wearing apparel over the past few months, a drop in exports of these items underscores this weakness. From this perspective, a muted external sector outlook is likely to continue undermining the strength of certain segments of the domestic manufacturing sector. In its latest outlook note published this month, the United Nations Conference on Trade and Development (UNCTAD) projected global trade to grow by about 1% in 2023, the slowest pace of growth since the end of the Second World War. In a similar forecasting exercise, the World Trade Organization (WTO) slashed its April forecast for trade growth in 2023 by more than half to 0.8% from 1.7%.

Forward-looking indicators remain strong amid external sector risks. As noted in RBI's latest monthly note, the high frequency indicators showed broad-based gaining of momentum in economic activity in August and September. This is evident in data, particularly on the services sector, pertaining to urban and rural demand, transport, trade, and construction. The festive season is likely to perk up demand, further boosting economic activity. The soft data indicators, including PMI and the latest results from RBI surveys, suggest buoyant consumer and business optimism. Though manufacturing PMI softened slightly in September, the underlying details remained favorable. Services PMI signaled a rise in output to the highest level in over 13 years. The results of the RBI survey on consumer confidence, conducted in September, showed continued recovery with both the current situation and future expectations indices reaching four-year high levels. As per RBI's industrial outlook survey, manufacturers were optimistic about business conditions in Q3:FY24.

Amid these favorable factors, muted demand from the external sector is likely to remain a risk for domestic industrial activity. Inflation could also cloud the outlook if producers are unable to pass on the increases in input prices to consumers or if consumer demand wanes in case of output price increases. Despite these risks, domestic demand is likely to keep industrial output growth strong enough to support RBI MPC's overall GDP growth projection of 6.5%YY for FY24.

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