IIP Watch: Industrial production growth steady in July

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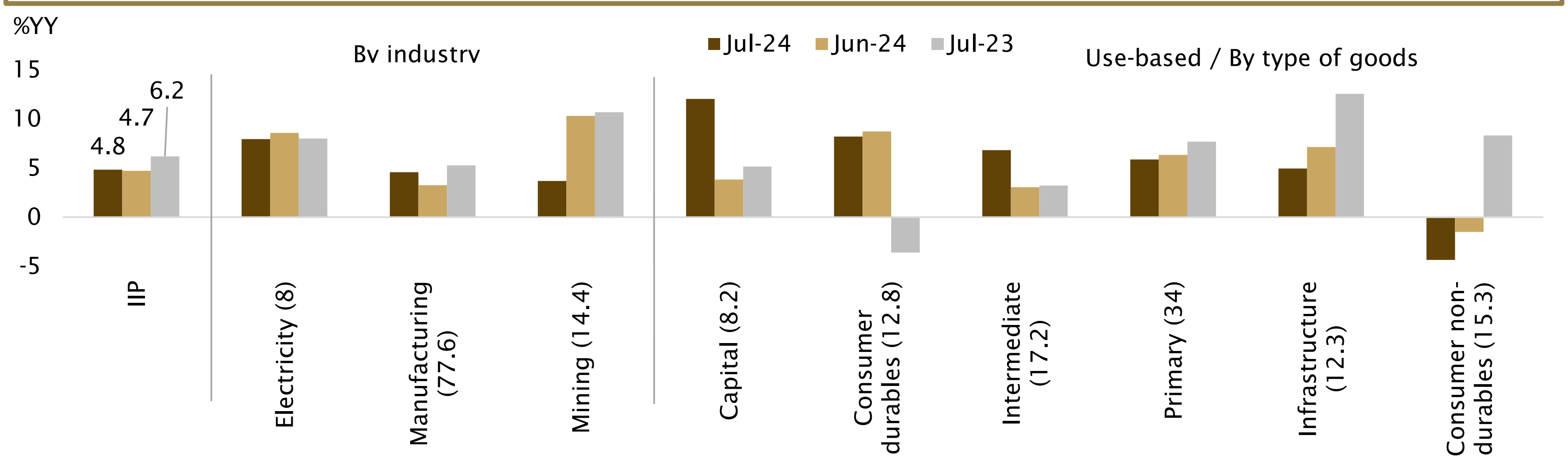
Key takeaways

- Industrial production growth held steady in July at 4.8%YY, compared to 4.7% in June (revised up from initial estimate of 4.2%) and was mostly in line with market expectations (Bloomberg survey: 4.6%). Favorable base effect offset the month-on-month decline in output, though seasonally adjusted data indicated improvement in output following a contraction in June.
- By industry, the marginal improvement in year-on-year growth was led by manufacturing, even as mining and electricity output grew at slower rates, probably dragged down by cooler temperatures and monsoon. In terms of use-based classification, capital goods output rebounded after remaining muted in Q1, reflecting the pick up in government capital expenditure. The year-on-year growth in consumer durables held up well, while consumer non-durables continued to disappoint, contracting at a steeper pace compared to June. However, details show that the K-shaped recovery based on trends in production of consumer durables versus non-durables mask the green shoots of revival in rural areas and the recent signs of easing in both urban and rural demand.
- Going forward, the catch up in public capex spending and improved prospects of farm output are expected to lend support to consumption and industrial activity. The start of monetary easing by the US Fed FOMC could prompt the RBI to soften its hawkish tone that could act as a tailwind to domestic consumer and business sentiments that have been showing signs of weakness lately.

IIP growth steady in July, aided by manufacturing; capital goods output rebounded, consumer non-durables stayed weak



IIP growth steady; favorable base offset negative monthly momentum

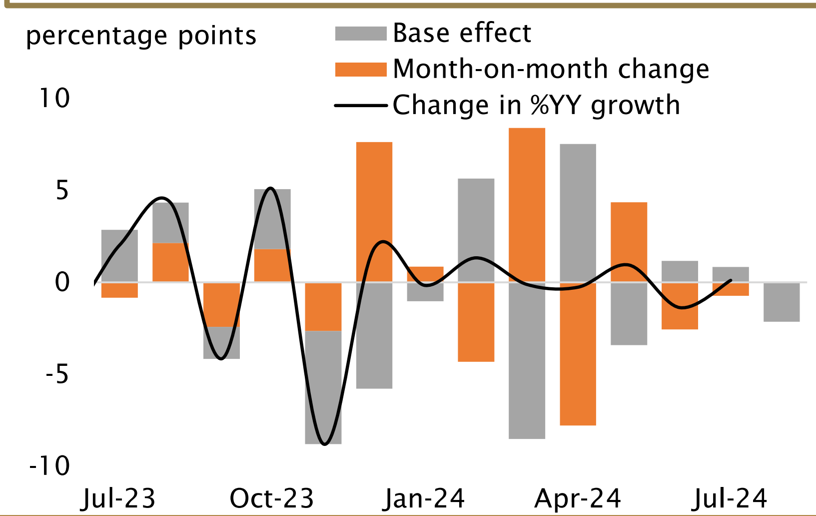
- Despite printing sub-5% for the second successive month, IIP growth held steady at 4.8%YY in July compared to upwardly revised 4.7% growth in June (from 4.2%) and was largely in line with market expectations (Bloomberg survey: 4.6%). The mild improvement in year-on-year growth from the previous month was due to favorable base effect that offset the month-on-month decline in output.
- In non-seasonally adjusted terms, the monthly decline in output of 0.7% was largely in line with the historical trend for the month (median decline of 0.8% between FY12-24 ex-COVID years). On a seasonally adjusted basis (accounting for uneven dates of festive season), IIP grew 0.6% month-on-month after declining 0.8% in June. Momentum, measured by 3-month/3-month annualized rate, eased slightly from June.

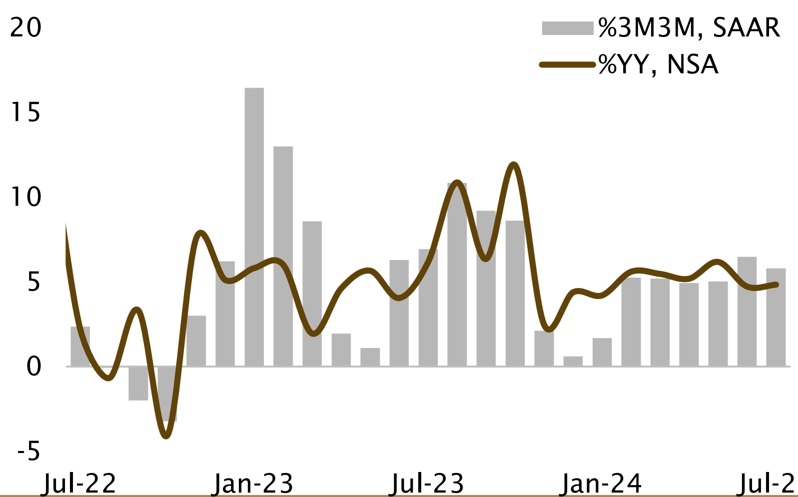
IIP growth remained sub-5% in July

%YY	Weight	May-24	Jun-24	Jul-24
Industrial production	100.0	6.2	4.7	4.8
Sector-based classification				
Mining	14.4	6.6	10.3	3.7
Electricity	8.0	13.7	8.6	7.9
Manufacturing	77.6	5.0	3.2	4.6
Use-based/type of goods				
Primary goods	34.0	7.3	6.3	5.9
Capital goods	8.2	2.9	3.8	12.0
Intermediate goods	17.2	3.9	3.0	6.8
Infra. /construction	12.3	6.3	7.1	4.9
Consumer durables	12.8	12.6	8.7	8.2
Consumer non-durables	15.3	2.5	-1.5	-4.4

Note: Color code is based on %3M3M, SAAR data. Red shows high momentum, blue indicates the opposite.

Favorable base offset month-on-month drop in headline IIP; seasonally adjusted annualized data firm amid slight easing

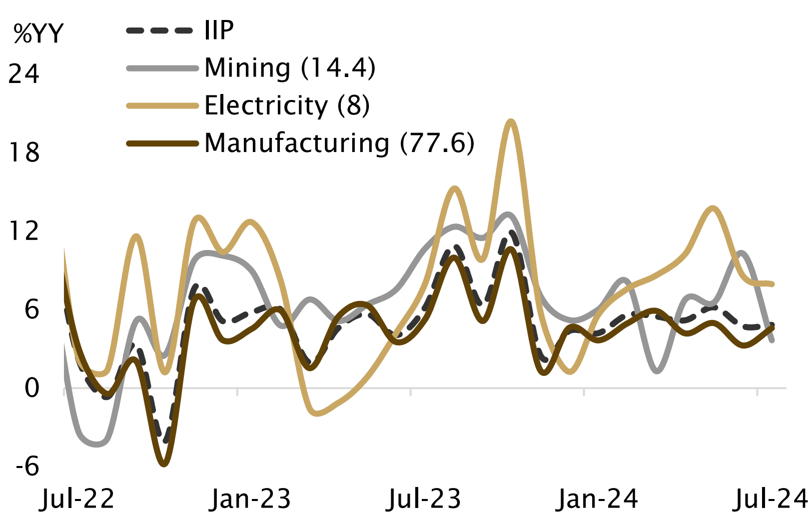




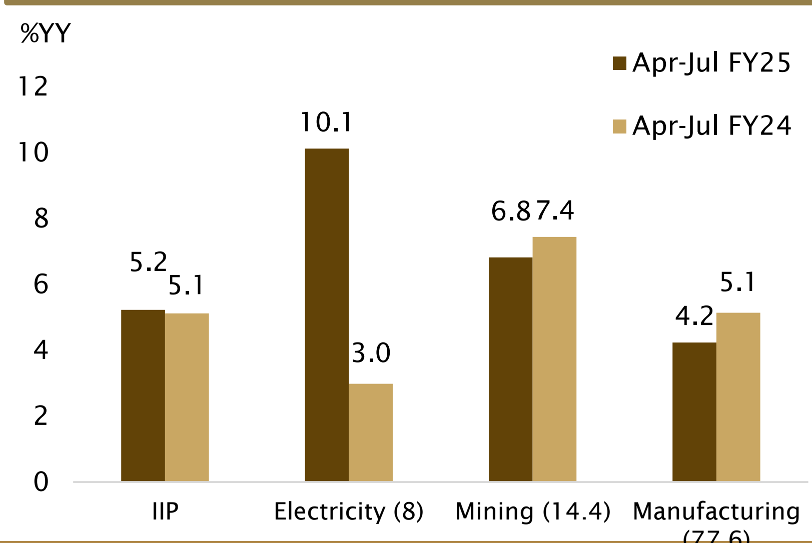
Manufacturing growth improved in July; mining, electricity eased

- The mildly higher year-on-year growth in overall industrial production in July was due to improvement in growth and contribution of the manufacturing segment compared to the previous month. Manufacturing output rose 4.6%YY in July, up from 3.2% in June, as the month-on-month momentum was positive (both in seasonally and non-seasonally adjusted terms), offsetting slightly unfavorable base effect. Manufacturing added 73% to industrial growth in July, higher than the average of 59% in Q1-FY25. The year-on-year growth in mining dwindled to single-digits after increasing over 10% in June. Electricity output growth eased to a five-month low but was above that of mining. In non-seasonally adjusted terms, the month-on-month performance was weak in case of both mining and electricity, relative to historical trends for the month, probably reflecting the impact of weather patterns and offsetting favorable base effects.
- In terms of year-to-date data, industrial production growth held up well in April-July, compared to the corresponding period a year ago. The stable performance was despite the disruptions induced by heatwave conditions (that probably raised demand for power but dragged down manufacturing activity) and the slowdown in capex spending by the government due to the model code of conduct around the time of general elections. Manufacturing contributed 63% on average to IIP growth in April-July FY25, lower than 78% in April-July FY24, indicating scope for catch-up.

Manufacturing growth up in July; mining, power eased



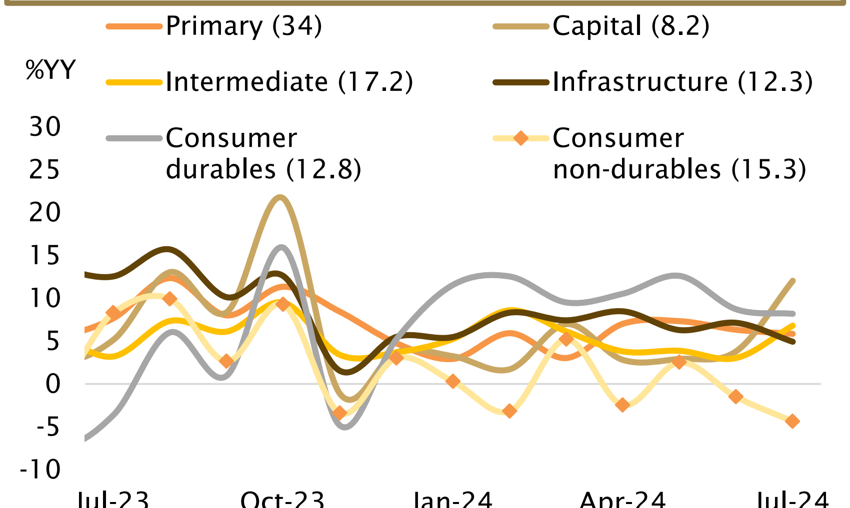
IIP held up YTD despite weather, election-related woes



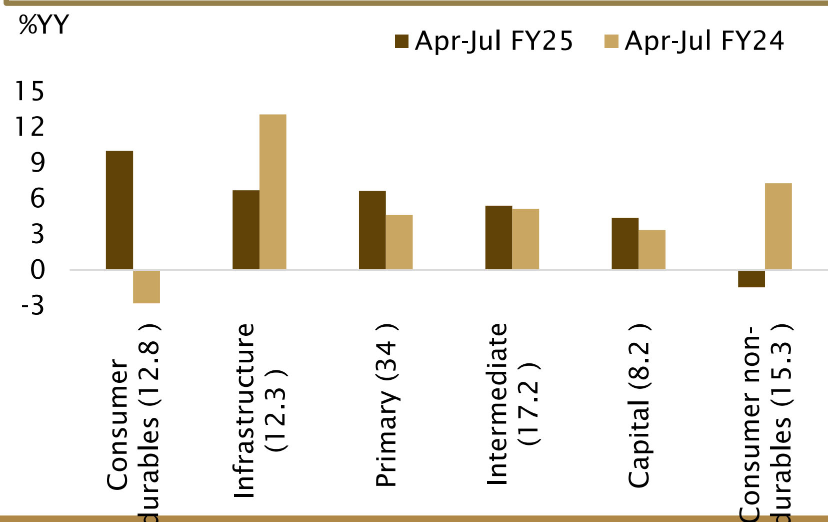
Rebound in capital goods; continued drop in consumer non-durables

- Capital goods output, which largely comprises machinery and equipment, rebounded in July to the highest in nine months at 12%YY, versus 3.2% average growth in Q1-FY25. Resumption in government spending, both at the Centre and States, post the general elections, is likely to have boosted capital goods production. Capital outlay (expenditure ex-loans) at the Centre surged 85%YY in July, following 35% decline in Q1.
- There was also an improvement in production of intermediate goods to 6.8%YY from 3% in June, probably reflecting the pick up in chemicals output that grew at the fastest pace in 16 months at 4.7%YY.
- However, infrastructure/construction goods production growth moderated to an eight-month low, mostly reflecting the drag from basic metals (wt. in IIP: 12.8) that has been displaced by electrical equipment (wt. in IIP: 3) as the largest contributor to overall industrial production growth over the past two months. Electrical equipment is largely classified into capital and consumer durable goods that performed well in July.
- The year-on-year growth in consumer durables output eased for the third straight month in July but held up well in YTD terms, increasing 10%YY versus 2.8% slump in April-July FY24. This marked a reversal from the trend in consumer non-durables output that fell 1.4%YY FYTD, versus average growth of 7.3% in April-July FY24. The drag on non-durables was mainly from decreases in output of pharmaceuticals and food products.
- Primary goods, the heavyweight in use-based classification, added the most to overall IIP growth in July despite slight easing in year-on-year growth compared to June. In addition to mining and electricity, primary goods includes coke and refined petroleum products that grew at the quickest pace in seven months.

Rebound in capital goods; consumer ND in contraction



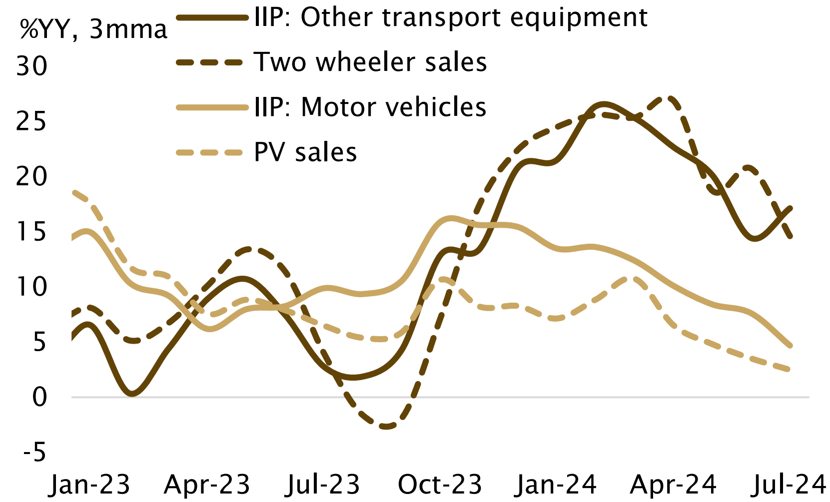
Trend reversal in consumer durables vs non-durables



Rural segment continues to outperform urban amid easing in both

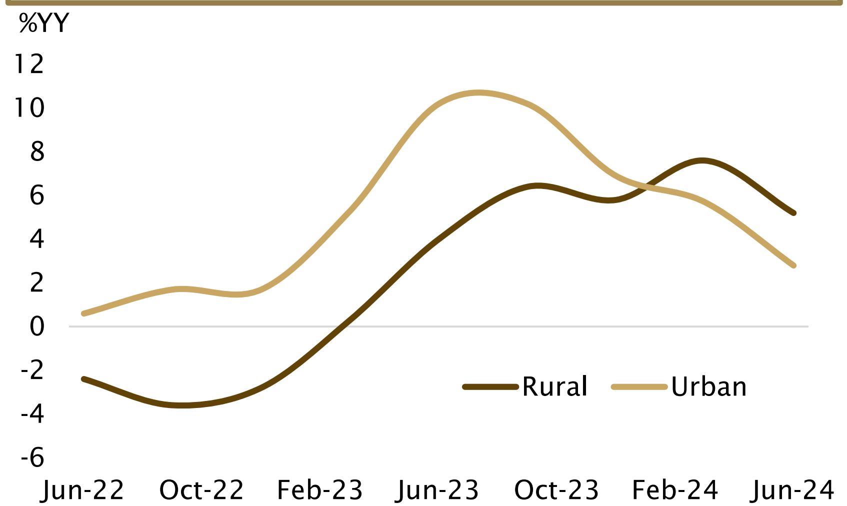
- Within the manufacturing sector (wt. in IIP: 77.6), production increased month-on-month in 15 of 23 sub-sectors in July, marking an improvement from seven in June. In terms of year-on-year growth, output growth was positive in 18 sub-sectors, higher than 15 in June.
- The relative underperformance of consumer non-durables compared to durables continues to lend support to the K-shaped recovery in the economy but masks the underlying green shoots of recovery in rural demand. In addition to the weakness in the manufacture of food products, the drag on non-durables could be partly attributable to the pharmaceuticals segment that registered an average decline of 0.2%YY in April-July FY25 compared to robust growth of 15.4% in the corresponding period of FY24.
- The trend in FMCG sales is largely corroborated by data on auto sales and production. In recent quarters, FMCG sales growth in rural areas has outpaced its urban counterparts. Echoing a similar rural-urban divide, two-wheeler sales continue to beat passenger vehicle sales that are currently plagued by high inventory levels.
- With manufacturing sub-sectors of IIP, motor vehicles includes data on passenger cars, while other transport equipment includes two-wheelers and bicycles. The output trends in both these segments track demand patterns for rural and urban areas, respectively.
- Two points to note though – 1) the relative strength in rural demand is supported by a low base and 2) despite overtaking the urban consumption growth, both rural and urban demand are showing signs of easing in recent data.

Auto data corroborates trends in rural vs. urban divide



Note: Other transport equipment includes two wheelers, bicycles

Rural FMCG sales continue to outpace urban growth



Outlook and policy implication

- After contracting in Q1, public capex spending is showing signs of recovery, and is expected to gather pace in the remainder of the fiscal year. This could continue to boost the output of capital goods that rebounded in July, and also support production of infrastructure/construction goods. The increase in revenue spending by poll-bound states, as indicated by higher fiscal deficit estimates in the final budgets for FY25, could aid rural recovery, in addition to the cyclical fillip expected from improved monsoon and farm output this year. Additionally, fiscal incentives in the Union Budget for FY25 to support energy transition and investment in new sectors are likely to further propel industrial activity. Some of the schemes that the Centre approved this month include the PM-EDRIVE scheme, another semiconductor unit to develop an ecosystem within the country, seven schemes for the farm sector (including support to develop digital infrastructure).
- Bank credit to industry has also been improving in recent months, swinging back to double-digit year-on-year growth in July after a gap of 20 months. Results from recent rounds of RBI surveys show improvement in investment intentions by services and infrastructure firms, and higher capacity utilization in the manufacturing segment. These indicators bode well from the perspective of recovery in private investment, but overall signals remain mixed. Data on external commercial borrowings for April-June FY25 not only showed lower net inflows but also increased use of funds for working capital and general corporate purpose, compared to use towards import/local sourcing of capital goods in the corresponding period a year ago. Also, cumulative FDI data for April-June FY25 shows lower year-on-year inflow to key sectors such as automobiles, constructions, pharmaceuticals, chemicals, non-conventional energy, etc.
- High frequency indicators on economic activity show some weakness in August, particularly automobile sales, including commercial and passenger vehicles. However, rural activity is holding up well, and so are the PMI indicators. With monsoon and sowing progressing well, farm output is expected to support overall growth in the economy, though risks from extreme climate-related events need to be watched out for. Even as the domestic monetary easing cycle is expected to be delayed and shallow, the start of easing by the US Fed FOMC could prompt the RBI MPC to ease its hawkish tone that could lend support to consumer and business confidence that have been faltering lately.
- Past data on industrial production shows that base effect will be unfavorable in the month of August and historical trends indicate momentum could also be negative that could ease the year-on-year growth compared to July. However, there is scope for improvement in month-on-month momentum, as government capital expenditure accelerates and consumption gains strength from rural demand.

Select high frequency indicators

Colour codes based on minimum and maximum Z-score values since April 2023 for respective variables; green shows improvement, red indicates weakening. (Reversed for MGNREGA data where a fall implies improved farm activity)

	(%YY, unless mentioned otherwise)	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24
Agriculture and rural sector	Fertiliser sales	-9.0	-13.5	0.6	-3.7	10.5	7.3	-1.4	
	Tractor sales	-14.5	-25.7	-19.5	-2.9	0.5	3.5	1.4	-5.5
	Tractor registrations	21.2	11.0	-3.2	1.4	-1.0	-28.4	-11.9	-11.4
	Two wheeler sales	26.2	34.6	15.3	30.8	10.1	21.3	12.5	9.3
	Two-wheeler registrations	15.0	13.3	5.8	33.6	2.8	4.7	17.2	6.3
	Three-wheeler registrations	36.9	23.9	21.1	12.9	23.7	5.1	12.9	1.6
	Household work demand under MGNREGA	-5.0	0.3	-19.2	-10.6	-14.3	-21.7	-19.5	-39.3
Industry, construction and urban sector	Industrial production	3.8	5.7	4.9	5.0	5.9	4.2	4.8	
	Core sector output	3.6	6.7	5.2	6.2	6.3	4.0	6.1	
	Cement production	4.0	7.8	10.6	0.2	-0.6	1.9	5.5	
	Natural gas production	5.5	11.1	6.2	7.8	6.7	2.9	-1.5	
	Electricity requirement	5.9	7.5	9.4	9.0	17.3	8.0	4.1	
	Steel consumption	3.8	12.7	11.2	11.5	11.9	21.1	14.6	
	Fuel consumption	8.1	5.9	-0.6	7.8	1.9	2.3	7.5	-2.6
	Passenger vehicle sales	12.9	9.5	8.9	1.2	4.3	5.0	-1.9	-1.6
	Passenger vehicle registrations	13.3	12.4	-3.9	18.6	1.5	-6.8	10.2	-4.5
Services	Commercial vehicle sales	0.6			3.3				
	Commercial vehicle registrations	0.1	4.8	-1.6	6.0	7.7	-4.7	5.9	-6.0
	Railway freight traffic	9.5	12.6	9.8	5.3	4.4	11.2	4.9	-5.0
	Port cargo traffic	3.2	2.1	2.7	1.3	3.8	6.8	5.9	6.7
	Toll collection (volume)	10.2	12.2	10.6	7.6	3.6	5.8	9.4	6.8
	Domestic air cargo traffic	10.0	11.5	8.7	0.3	10.4	10.3	8.8	
	International air cargo traffic	19.3	30.2	22.5	16.2	19.2	19.6	24.4	
	Domestic air passenger traffic	5.1	5.8	4.7	3.9	5.9	6.9	7.5	
	International air passenger traffic	17.1	19.3	15.0	16.7	14.6	11.4	8.9	
	Tourist arrivals	10.4	15.8	8.0	7.7	0.3	9.0		
	GST e-way bills (total)	16.4	18.9	13.9	14.5	17.0	16.3	19.2	12.9
	GST revenue collection	10.4	12.5	11.2	12.3	10.1	7.6	10.3	10.0
PMI (Index)	PMI Manufacturing	56.5	56.9	59.1	58.8	57.5	58.3	58.1	57.5
	PMI Services	61.8	60.6	61.2	60.8	60.2	60.5	60.3	60.9

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