

IIP Watch: Industrial production fell in August for the first time in almost two years

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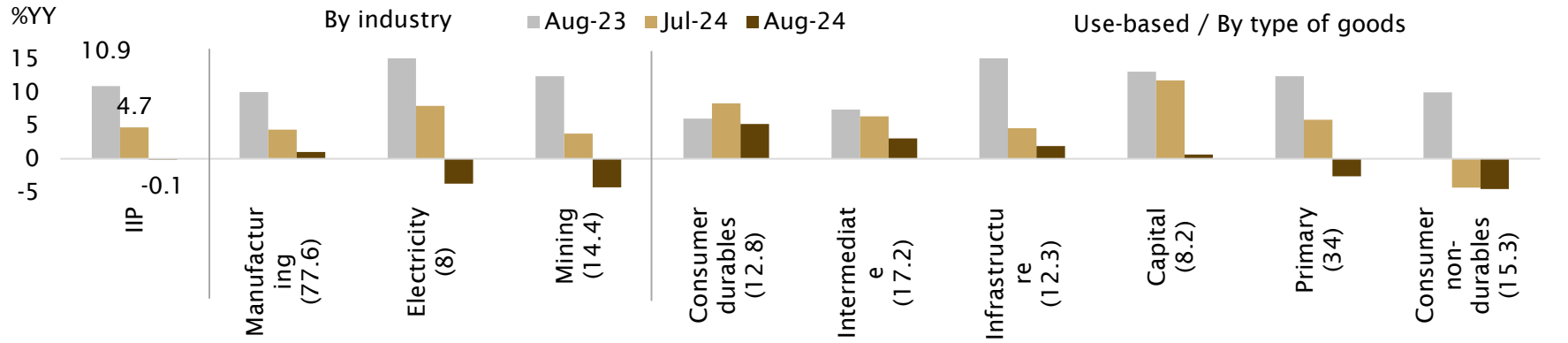
Key takeaways

- For the first time in 22 months, industrial production fell year-on-year in August by 0.1%, compared to 4.7% growth in July (revised lower from 4.8%). The print surprised on the downside amid expectations of moderation (Reuters poll: 1.2%YY) and not contraction in output growth. Both month-on-month momentum and base effects were unfavorable. By industry, electricity and mining output fell, while manufacturing posted muted growth. In terms of use-based classification, consumer durables output growth eased but held up relatively better than other types of goods. Consumer non-durables production remained in contraction for the third straight month, and infrastructure-related goods also registered moderation in growth. Primary goods output fell for the first time since March 2021.
- Above normal rains during the month (15% above long period average) weighed on economic activity. However, some of the other high frequency indicators such as auto sales and GST revenue growth have turned sluggish recently, indicating potential easing of demand conditions, though it would be too early to conclude that the trend will persist, given the onset of the festive season that typically tends to lift consumer spending. Rural consumption is also expected to receive a cyclical fillip from improved farm sector prospects. So, it is plausible that GDP growth undershoots the RBI MPC's latest forecast for Q2 at 7%YY, but rebounds in H2-FY25. In its next meeting in December, the MPC is likely to weigh inflation pressures as well before it starts to calibrate the policy rate, in what is expected to be a shallow easing cycle.
- Risks to outlook include 1) volatility in global commodity prices that could raise input costs and hurt profit margins 2) policy uncertainties and potential slowdown in major economies such as the US, China and Eurozone 3) lagged impact from of monetary and regulatory tightening on domestic consumption.

Industrial production fell year-on-year in August, the first decline in almost two years



Monthly decline, unfavorable base dragged down industrial output

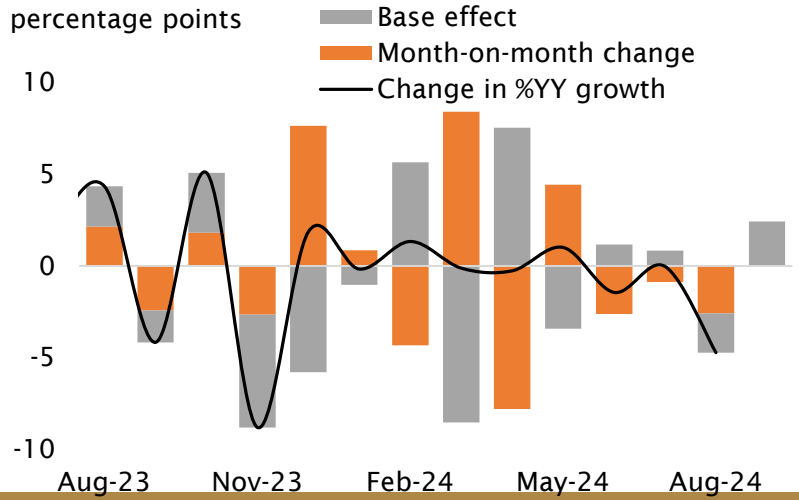
- Industrial output surprised on the downside in August, falling 0.1%YY after increasing 4.7% in July (revised slightly from 4.8%). Both month-on-month momentum and base effects were unfavorable in August. Most market participants had expected a slower pace of growth (Reuters poll: 1.2%) but not a decline, though the fall in core industries output (40% weight in IIP) for the first time since March 2021 was perhaps a telltale signal.
- In non-seasonally adjusted terms, the monthly decline of 2.5% in output was steeper than the historical trend for the month (median decline of 0.3% between FY12-24 ex-COVID years). On a seasonally adjusted basis (accounting for uneven dates of festive season) as well, IIP fell month-on-month, though at a shallower pace of 1.5%. Momentum, measured by 3-month/3-month annualized rate, was the slowest since January.

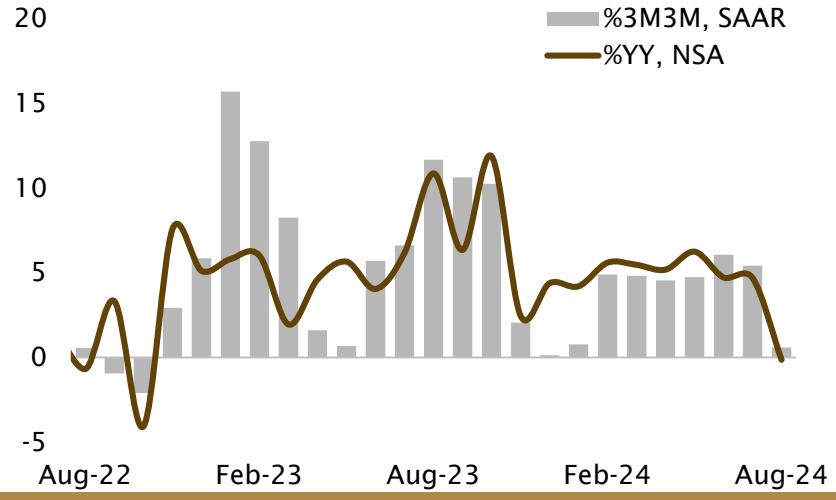
IIP fell y-o-y in August for the first time since Nov-2022

%YY	Weight	Jun-24	Jul-24	Aug-24
Industrial production	100.0	4.7	4.7	-0.1
Sector-based classification				
Mining	14.4	10.3	3.8	-4.3
Electricity	8.0	8.6	7.9	-3.7
Manufacturing	77.6	3.2	4.4	1.0
Use-based/type of goods				
Primary goods	34.0	6.3	5.9	-2.6
Capital goods	8.2	3.8	11.8	0.7
Intermediate goods	17.2	3.0	6.4	3.0
Infra. /construction	12.3	7.1	4.6	1.9
Consumer durables	12.8	8.7	8.3	5.2
Consumer non-durables	15.3	-1.5	-4.3	-4.5

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

Both month-on-month change and base effects were negative in August; shallower decline with seasonal adjustment

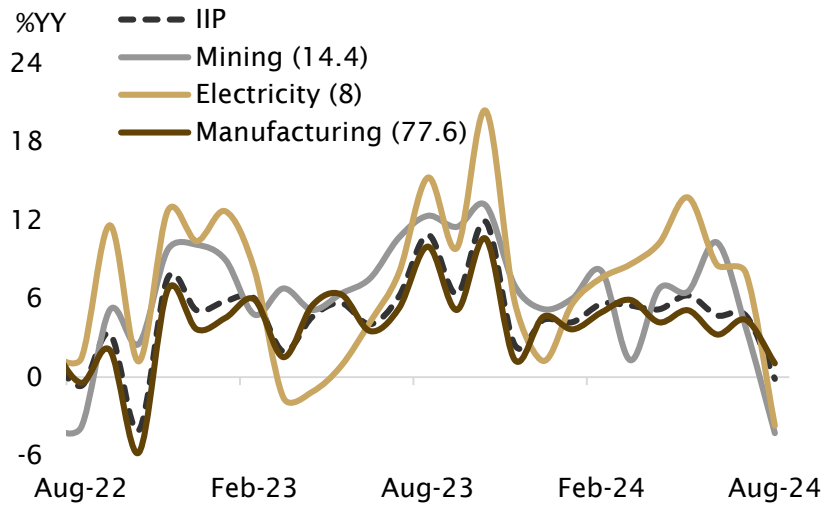


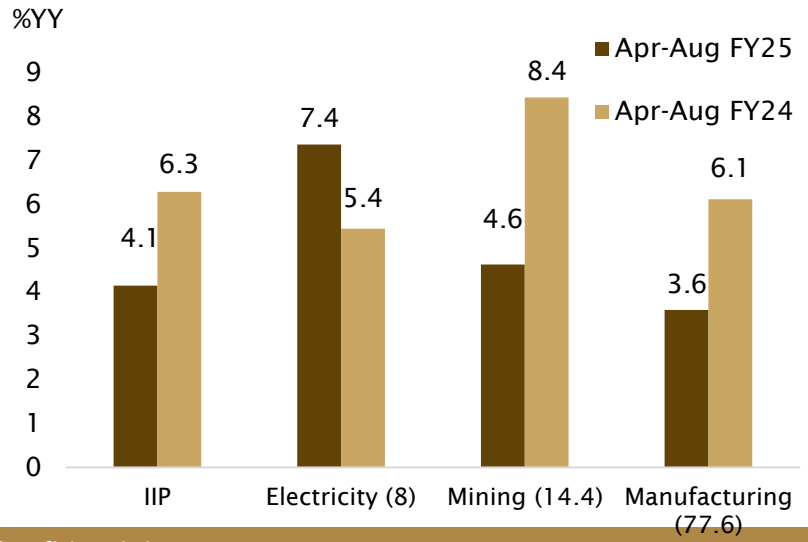


Mining, electricity output fell; manufacturing growth at 22-month low

- The mild year-on-year fall in industrial production in August closely tracked the trend in manufacturing output growth that eased to a 22-month low of 1.0%YY from 4.4% in July. Mining and electricity production fell after a gap of 23 and 15 months, respectively, and dragged down overall output growth by 0.6pp and 0.3pp, respectively. Manufacturing added a tepid 0.8pp during the month, lower than the average of 3.3pp during April-July. The sharpest drag from base effects in August was in case of electricity, followed by manufacturing, and none in case of mining. In terms of monthly momentum, mining output typically tends to fall during the monsoon season but this year, the decline was steeper at 7.8%MM versus median drop (FY13-24) of 2% for the month. Electricity (-3.6%) and manufacturing (-1.6%) output also fell month-on-month in non-seasonally adjusted terms, compared to median growth of 0.7% and 0.1%, respectively.
- In terms of year-to-date data, average industrial production growth was lower at 4.1%YY in April-August, compared to 6.3% in the corresponding period a year ago. Mining and manufacturing underperformed relative to growth in April-August FY24, while electricity output grew at a faster pace. While heatwave conditions during the summer raised electricity demand and supply, above average monsoon eased demand and also weakened mining output. Manufacturing also reflected the impact of these weather conditions, though slower pace of government spending in an election year proved to be a larger drag.

Mining, electricity output fell; manufacturing growth at 22-month low; average fiscal YTD IIP growth slower than FY24

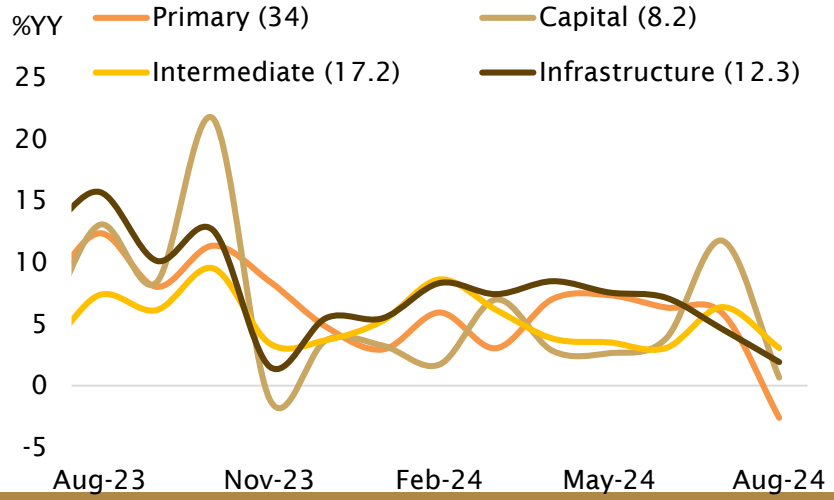


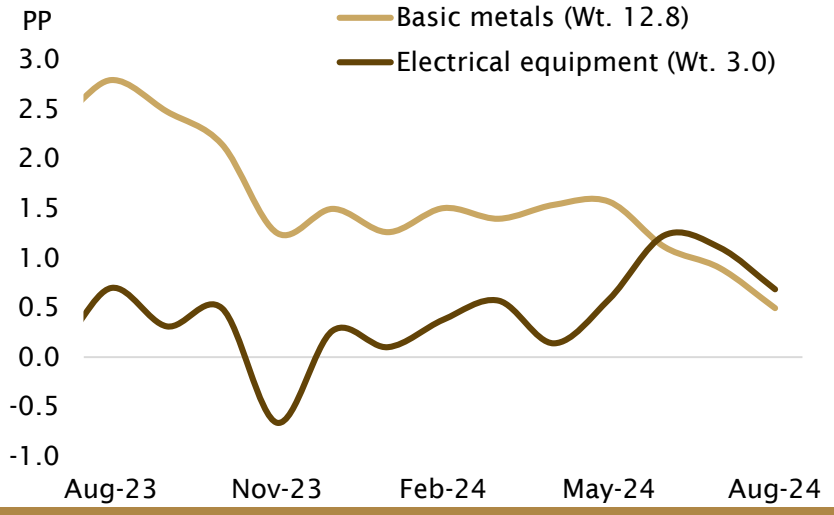


Growth eased in infra-related segments; primary goods output fell

- **Primary goods:** Primary goods output fell year-on-year for the first time since March 2021 due to decline across major components of mining, electricity, and coke and refined petroleum products. Being an index heavyweight, the drag from primary goods on headline IIP was the steepest. Primary goods output tends to decline in August but the drop was sharper this year and exacerbated by negative base effect.
- **Capital goods:** The year-on-year growth was the softest in nine months due to unfavorable momentum and base effect. There was decline in output of machinery and equipment, and fabricated metal products.
- **Intermediate goods:** Both negative monthly change and base effects led to moderation in year-on-year growth. Among manufacturing sub-groups, chemicals output growth eased. Basic metals, which falls under both intermediate and infrastructure goods posted the slowest growth since January 2022. In the past three months, electrical equipment (wt. 3) has surpassed the index heavyweight basic metals (wt. 12.8) in terms of contribution to manufacturing growth due to high double-digit growth. Electrical equipment gets largely classified under consumer durables and capital goods.
- **Infrastructure/construction goods:** Production growth eased to a nine-month low, due to unfavorable base effects, even as monthly growth was in line with historical median for the month. In terms of manufacturing sub-groups, production of other non-metallic mineral products fell, while that of basic metals was sluggish, as noted earlier.

Primary goods output fell for the first time since Mar-21; electrical equipment has been adding more to manufacturing growth

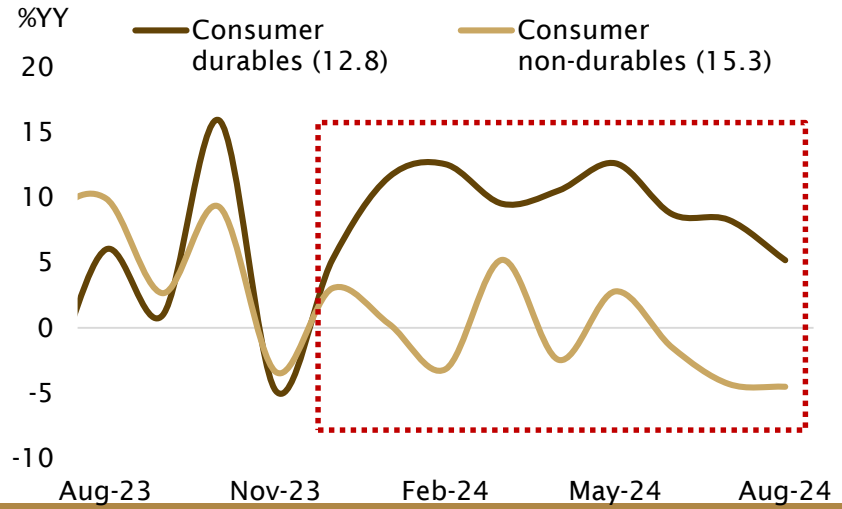


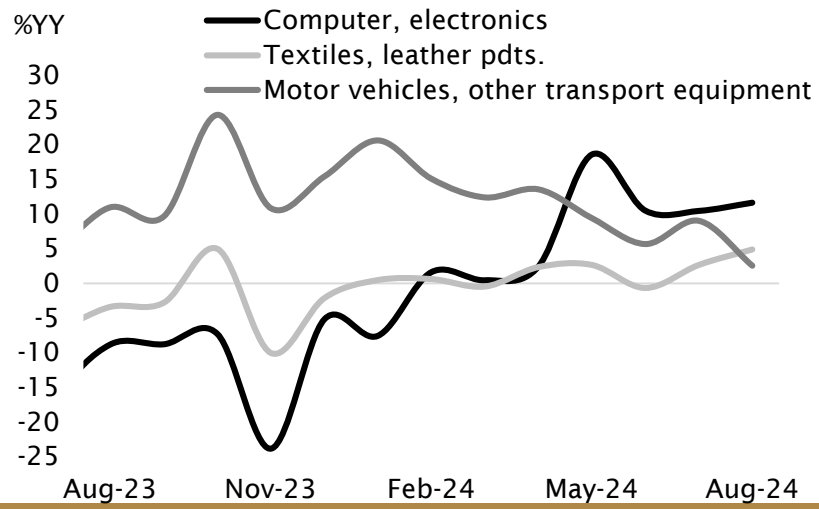


Consumer non-durables stayed in contraction; durables growth eased

- **Consumer durables:** The year-on-year growth continued to ease for the third successive month and was the softest in nine months. The moderation in growth was due to unfavorable base effects, even as the month-on-month momentum was stronger than historical median for the month. In terms of manufacturing sub-groups, there was slowdown in growth of motor vehicles and other transport equipment, probably dragged by languishing sales of certain automobile segments in recent months, and the subsequent buildup of inventories at dealers, particularly in case of passenger vehicles. Production of other consumer durables such as computer and electronic products, and textiles and leather products, is holding up reasonably well.
- **Consumer non-durables:** Consumer non-durables production remained in year-on-year contraction for the third consecutive month. Favorable base effect failed to offset the month-on-month decline in output that was sharper than the historical median for the month. While pharmaceuticals output has also been declining for three months, production of food, beverages and tobacco also fell during the month. Despite moderation in urban demand (passenger vehicle sales, credit growth) in recent months and green shoots of recovery in rural consumption (two-wheeler and FMCG sales), the overall trends in production of consumer durables and non-durables continue to point to the phenomenon of a K-shaped recovery. Improved prospects of farm output due to above normal monsoon this year, and therefore, higher incomes will need to further aid rural consumption, even as lagged impact of monetary and regulatory tightening curb excesses in urban demand.

Trends in consumer goods output continue to show K-shaped recovery despite recent moderation in consumer durables



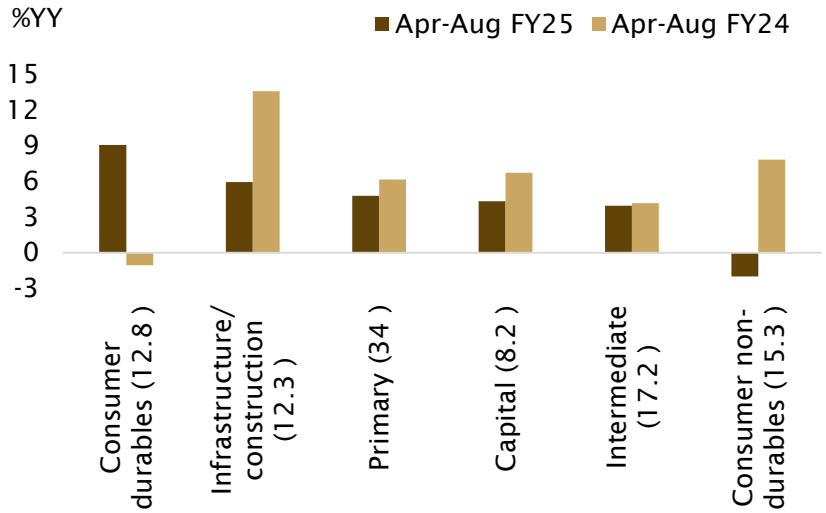


Muted year-to-date trends, except for consumer durable goods

- **Year-to-date trends:** In terms of year-to-date performance of use-based groups, consumer durables and non-durables were at the extreme ends, corroborating the K-shaped recovery pattern in the economy and a reversal from trends seen in the previous fiscal year-to-date data. During April-August, production of consumer durables increased 9.1%YY compared to 1% decline in the corresponding period of FY24. On the contrary, consumer non-durables output fell 2% on an average in April-August FY25 versus 7.8% growth in the respective period of FY24. Infrastructure-related segments have also underperformed so far this year, mainly due to the drag from muted government spending on account of the model code of conduct ahead of general elections. Infrastructure goods output growth more than halved from the respective period in FY24. Primary and capital goods output growth eased, even as intermediate goods growth held up relatively well.

- **Manufacturing sub-sectors:** The year-on-year growth in manufacturing sector (wt. in IIP: 77.6) eased to 22-month low in August. Within manufacturing, output fell year-on-year in 11 out of 23 sub-sectors, higher than five in July. In terms of month-on-month change in non-seasonally adjusted terms, production fell in 12 sub-sectors, again higher than nine in July. Electrical equipment added the most to growth, surpassing the contribution of basic metals for the third straight month, while the steepest drag was from pharmaceuticals.

Muted YTD trends, except consumer durable; electrical equipment top contributor to manufacturing growth for third month in Aug

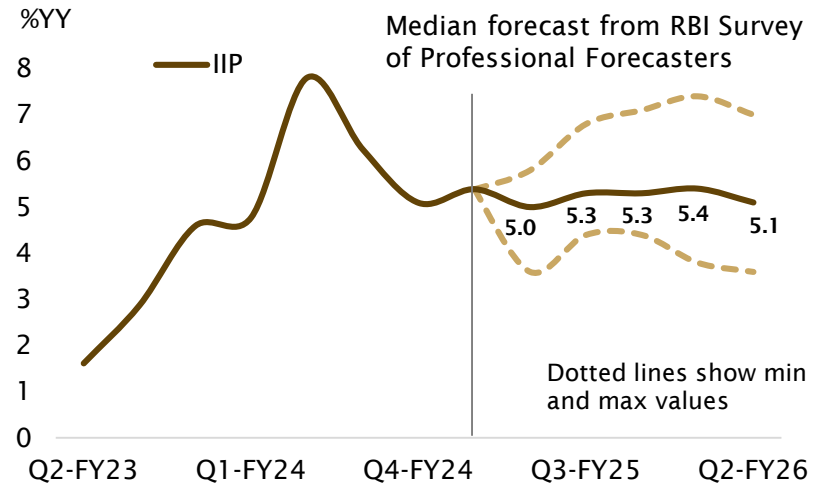


Top / bottom manufacturing sub-sectors by contribution to IIP growth (percentage pts.)	
Electrical equipment (3)	0.68
Basic metals (12.8)	0.49
Chemicals (7.9)	0.27
Wearing apparel (1.3)	0.24
Computer, electronic pdts. (1.6)	0.24
Pharmaceuticals (5)	-0.39
Fabricated metal pdts. (2.7)	-0.22
Other non-metallic mineral pdts. (4.1)	-0.11
Food products (5.3)	-0.10
Coke, petroleum pdts. (11.8)	-0.10

Outlook and policy implication

- Base effect is slated to be favorable in the month of September, and historical trends suggest median month-on-month growth of 0.7%, implying year-on-year growth of around 3%. However, this would indicate an undershoot of forecast based on RBI's latest survey of professional forecasters that stands at an average of 5%YY for Q2-FY25, for which production would need to grow by double-digits in September. This could be challenging with recent weakness in some of the high frequency indicators such as muted GST revenue growth, decline in automobile sales, and softening in PMI services to sub-60 levels.
- Some of the additional risks include 1) volatility in commodity prices due to geopolitical tensions that could impinge on input costs for firms and hurt margins, or alternatively add to domestic inflation, 2) lower external demand in case of a material slowdown in major economies such as the US, China and Eurozone, 3) lagged impact of monetary and regulatory tightening on domestic consumption 4) implications of policy uncertainties in key economies such as the US and China.
- In Q1-FY25, real GDP growth of 6.7%YY undershot the RBI MPC forecast of 7.1%. In its latest policy meeting, the RBI MPC trimmed its Q2-FY25 real GDP forecast by 20bps to 7%. Given the softness in high frequency data in the months of August and September, it is plausible that growth prints below 7% in Q2 as well. However, domestic growth is likely to pick up in the second half of the fiscal year as government's capital expenditure accelerates and rural consumption receives a cyclical fillip from improved farm sector prospects due to above normal monsoon this year. Festive season is also expected to boost consumption that could provide an impetus for the private investment cycle to become broad-based.
- The MPC will have access to Q2 GDP data when it meets again in December. In case the high frequency indicators continue to remain sluggish despite the festive season, it could build a case for a rate cut, though the MPC would also weigh in movements in CPI inflation that rose to a nine-month high in September. Irrespective of the start of easing, expectations persist that it would be a shallow cycle not exceeding 50-75bps.

Average IIP growth likely at 5.3%YY in H2 vs 5.2% in H1



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)		Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24
Agriculture and rural sector	Fertiliser sales	-13.5	0.6	-3.7	10.5	7.3	-1.4	-9.4	-7.7
	Tractor sales	-25.7	-19.5	-2.9	0.5	3.5	1.4	-5.5	
	Tractor registrations	11.0	-3.2	1.4	-1.0	-28.4	-11.9	-11.4	14.7
	Two wheeler sales	34.6	15.3	30.8	10.1	21.3	12.5	9.3	15.8
	Two-wheeler registrations	13.3	5.8	33.6	2.8	4.7	17.2	6.3	-8.5
	Three-wheeler registrations	23.9	21.1	12.9	23.7	5.1	12.9	1.6	0.7
	Household work demand under MGNREGA	0.3	-19.2	-10.6	-14.3	-21.7	-19.5	-16.0	-13.4
Industry, construction and urban sector	Industrial production	5.7	4.9	5.0	5.9	4.2	4.8	-0.1	
	Core sector output	6.7	5.2	6.2	6.3	4.0	6.1	-1.8	
	Cement production	7.8	10.6	0.2	-0.6	1.9	5.5	-3.0	
	Natural gas production	11.1	6.2	7.8	6.7	2.9	-1.4	-3.7	
	Electricity requirement	7.5	9.4	9.0	17.3	8.0	4.0	-5.4	-0.7
	Steel consumption	7.0	12.5	9.6	15.9	19.5	14.4	10.0	
	Fuel consumption	5.9	-0.6	7.8	1.9	2.3	10.6	-2.3	-1.6
	Passenger vehicle sales	12.9	8.9	1.2	4.3	5.0	-1.9	-1.6	-0.4
	Passenger vehicle registrations	12.4	-3.9	18.6	1.5	-6.8	10.2	-4.5	-18.8
Services	Commercial vehicle sales		0.6			3.3			-4.2
	Commercial vehicle registrations	4.8	-1.6	6.0	7.7	-4.7	5.9	-6.0	-10.4
	Railway freight traffic	12.6	9.8	5.3	4.4	11.2	4.9	-5.0	-0.2
	Port cargo traffic	2.1	2.7	1.3	3.8	6.8	5.9	6.7	6.1
	Toll collection (volume)	12.2	10.6	7.6	3.6	5.8	9.4	6.8	6.5
	Domestic air cargo traffic	11.5	8.7	0.3	10.4	10.3	8.8	0.6	
	International air cargo traffic	30.2	22.5	16.2	19.2	19.6	24.4	20.7	
	Domestic air passenger traffic	5.8	4.7	3.9	5.9	6.9	7.5	6.7	
	International air passenger traffic	19.3	15.0	16.7	14.6	11.4	8.9	10.9	
	Tourist arrivals	15.8	8.0	7.7	0.3	9.0			
	GST e-way bills (total)	18.9	13.9	14.5	17.0	16.3	19.2	12.9	18.5
	GST revenue collection	12.5	11.2	12.3	10.1	7.6	10.3	10.0	6.5
PMI (Index)	PMI Manufacturing	56.9	59.1	58.8	57.5	58.3	58.1	57.5	56.5
	PMI Services	60.6	61.2	60.8	60.2	60.5	60.3	60.9	57.7

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