

Macroeconomics | **First cut**

IIP sheds pace in September

Base effect and supply-side constraints at play

November 2021

The Index of Industrial Production rose 3.1% (on-year) in September 2021, the slowest pace in seven months, after surging 12% in August. On a seasonally adjusted basis, the index fell 2.8% (on-month), steeper than the 0.7% drop in August. But compared with the pre-pandemic level, or September 2019, it is up ~4%.

Industrial activity decelerated in September mainly because of three factors; waning low-base effect of last year; global shipping constraints dragging merchandise exports; and, semi-conductor shortage curbing production across sectors. Overall, the slowdown in September was led by the mining and electricity sectors, where the base effect had a larger bearing. Even on a sequential basis, the manufacturing sector was impacted less, but certain segments within bore the burden of supply hiccups. Since much of this is a consequence of an unexpectedly robust bounce-back in demand globally, these supply-side issues are expected to be tackled sooner than later. Meanwhile, Covid-19-related issues continue to weigh on the global and Indian economic outlooks, but increasing vaccination rates and a gradual broad-basing of business activity increases optimism about the upcoming quarters.

Key trends in September

- IIP growth slowed to a 7-month low of 3.1% in September, after printing 12% in August. In addition to a waning low-base effect, global and domestic supply-side bottlenecks cast a shadow on domestic industrial activity. On a seasonally adjusted basis, the sequential decline was steeper in September (at 2.8% on-month) compared with August (at 0.7% on-month). Yet, versus pre-pandemic levels, or September 2019, the index is 4% higher
 - Manufacturing was impacted less than the mining and electricity sectors, but textiles, leather, chemicals, electronic and automobiles bore the brunt
 - Data released earlier this month had hinted at the imminent slowdown because merchandise exports were weaker in September (growth halved versus August). Core infrastructure index growth was also wallowing at a 7-month low. Some other indicators such as railway freight cargo and fuel consumption also displayed weakness as the industrial sector faced supply-driven constraints
 - Per use-based classification, the sharpest sequential fall was in the *capital and primary goods* categories, while the *consumer non-durables, intermediate goods and construction goods primary and intermediate goods* categories saw smaller declines.
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Data and details

- IIP rose 3.1% on-year in September 2021. Growth in the manufacturing sector, the largest segment in the index with a 77.6% weight, slowed to 2.7% versus 9.9% in August

The mining sector (14.4% weight) grew 8.6% on-year (versus 23.6% in August). Electricity, the third sub-sector (7.9% weight) saw 0.9% growth versus 16% in August

- Sequentially, on a seasonally adjusted basis, there was an 8.8% decline in output in the electricity sector, 8.1% in the mining sector, and 1.7% in the manufacturing sector
- All core sectors barring natural gas saw deceleration in on-year growth. The slowdown was more pronounced in coal, cement, and steel

Outlook

There are a lot of moving parts beyond and beneath the headline industrial production numbers. To wit, the waning of the low-base effect is making the headline numbers soft, but the global supply-related bottlenecks has become a spoiler. At the same time, there is reason for optimism in the gradual-but-steady improvement in the domestic demand sentiment, increasing vaccination rates, lower Covid-19 caseloads and softer inflation (especially food). The IIP index has also crossed pre-pandemic levels (September 2021 over September 2019, seasonally adjusted basis). The ongoing festival season would also lend support, as indicated by the improvement in manufacturing PMI for October. Exports have also improved in October. But then, the IIP data for the coming months will be weighed down by high-base effect for a few months. It's an up-and-down world out there.

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