Stagnancy in Manufacturing Output Drags Overall Economic Growth *

Dr M. Govinda Rao, Chief Economic Adviser, Brickwork Ratings

Although COVID-related restrictions on economic activity have been substantially relaxed, the relative stagnancy in the manufacturing sector output is a matter for concern. The expansion of the GVA in the manufacturing sector during the second quarter (Q2) of FY22 was the lowest among the secondary and services sectors, at just 5.5%, and as compared to the pre-pandemic level, it was just 3.9%. The sector's performance in the two months of the Q3 too does not infuse much confidence. Growth in industrial production in October was at 3.2%, which is at eight-month low. This growth was not only unimpressive, but was also virtually stagnant, considering the previous month's 3.3% growth. The output of the eight core industries comprising Coal, Crude Oil, Natural Gas, Refinery Products, Fertilisers, Steel, Cement and Electricity actually recorded an increase of 7.5% over October 2020, which implies the contraction has come about mainly in the consumer goods industry. In fact, the weight of the eight core industries in the Index of Industrial Production (IIP) is 40.27%, which means the contraction in the other industries must have been really steep. Stagnancy in the industrial production growth has come about mainly from the automobiles and transport equipment segments. The production of motor vehicles, trailers and other transport equipment declined by 12.6% in October on top of a 9% contraction in the previous month. The manufacture of other transport equipment contracted by 15.6% in October as against 18.5% in the previous month. The manufacture of consumer durables declined by 6.1% as compared to 1.9% last year, and the contraction in the output of capital goods was 1.1% as compared to 2.4% growth in September.

The major reason for the contraction in manufacturing sector growth was supply-side constraints. In fact, the cheer of festive season demand was severely dampened by the contraction in the manufacturing output due to coal shortage, power cuts, an increase in raw material prices and more importantly, the non-availability of semiconductors. According to the Society of Indian Automobile Manufacturers (SIAM), passenger vehicle despatches in October dropped by 27% on a year-on-year basis from 3,10,694 units last year to 2,26,353 this year. This is compounded by an 18% fall in despatches in November as compared to last year's sales. Thus, it is not the lack of demand which is the source of the problem, but the shortage of semiconductors. This problem is not likely to ease soon as there are no easy or fast solutions. The industry relies primarily on the import of semiconductors, and there is a severe global supply shortage. Excess demand due to reduced manufacture is leading to stretched delivery periods, with many turning to purchasing used vehicles.

In all possibility, the November estimate of the IIP may fare worse. While the supply shortage of semiconductors has continued, unseasonal rains have caused problems in the transportation of coal, affecting not merely coal production, but also the generation of power, and these have impacted the production of steel and cement. Power disruptions may have impacted the production of other consumer goods industries as well. The actual position will be known only when the core industries' output and IIP are available later in the month.

These problems will adversely affect the output growth of industry in general and the manufacturing sector in particular in the third and fourth quarters. With contact-intensive sectors, particularly travel, trade, hotels, transport and communication, yet to open up fully, and the real estate sector still suffering from inertia, the services sector too may not register high growth, unless government spending is increased substantially. Besides, there are downside risks arising from the spreading of new variants of the virus, impact of draining liquidity by advanced countries including the US Fed, elevated international crude oil prices and global supply bottlenecks. These developments could pose difficulties in achieving 6.6% growth in Q3 and 6% in Q4 assumed by the Monetary Policy Committee of the RBI, and that would mean that the feasibility of the economy growing at 9.5% estimated for the whole year is in question. The coal supply and power situation would improve, but the shortage of semiconductors cannot be overcome any time soon. Immediately augmenting domestic supply to ease the constraints is not feasible, and attempts to augment imports may not be easy. As there is a significant global supply shortage, the imports will be at significantly higher prices.

The only short-term remedy to accelerate growth seems to be to increase public spending by both the Union and State governments. This would help revive government consumption and capital formation as other growth engines, namely private final consumption, will continue to be in slow motion, and capital formation from the private sector is yet to take off. However, the lack of fiscal space constrains the loosening of the public purse. The higher buoyancy in tax revenues and additional dividend from the RBI is expected to exceed the budget estimate by Rs. 1.7 trillion at the centre. The centre has also placed supplementary demand for grants amounting to Rs. 3 trillion. This implies that the revenue and fiscal deficit may increase when the actual numbers come out, unless the budgeted disinvestment proceeds of Rs. 1.75 trillion are realised. At the state level too, there would be higher revenues from the states' own tax revenues due to better buoyancy of the GST and VAT on petroleum products, as well as shared taxes from the centre. However, it is customary for state governments to show lower fiscal deficit in the budget estimate, and considering the additional expenditure incurred during the second wave of the pandemic and additional spending they had to incur to strengthen the health infrastructure, it may be difficult to adhere to the budgeted revenue deficit of 0.5% of the GDP and fiscal deficit of 3.7%. Thus, the revival process is not likely to be smooth, and challenges to growth acceleration formidable.

** This article was published in the Deccan Herald newspaper on 22 December 2021.*

Contacts:

Investors & Media Contact
+91 95133 99706
1-860-425-2742
investordesk@brickworkratings.com
media@brickworkratings.com

ABOUT BRICKWORK RATINGS

Brickwork Ratings (BWR) is India's home-grown credit rating agency built with the superior analytical prowess of the industry's most experienced credit analysts, bankers and regulators. Established in 2007, BWR aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. BWR provides investors and lenders timely and in-depth research across the structured finance, public finance, financial institutions, project finance and corporate sectors. BWR has employed over 350 working professionals including credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 12,000 ratings across asset classes. BWR is committed to providing the investment community with products and services needed to make informed investment decisions. BWR is a registered credit rating agency by Securities and Exchange Board of India (SEBI) and a recognised External Credit Assessment Agency (ECAI) by the Reserve Bank of India (RBI) to carry out credit ratings in India. BWR is promoted by Canara Bank, India's leading public sector bank. More information on Canara Bank is available for reference at www.canarabank.com

BWR Rating Criteria are available at https://www.brickworkratings.com/ratingscriteria.aspx

Brickwork Ratings, a SEBI-registered credit rating agency, has also been accredited by the RBI, and it offers rating services for bank loan, NCD, commercial paper, bonds, securitised paper etc. BWR has Canara Bank, a nationalised bank, as its promoter and strategic partner.
BWR has its corporate office in Bengaluru and a country-wide presence, with offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi, along with representatives in 150+ locations. BWR has rated debt instruments/bonds/bank loans, securitised paper of over ₹ 10,00,000 Cr. Additionally, fixed deposits and commercial papers, among others, worth over ₹24,440 Cr have been rated.

DISCLAIMER

 In issuing and maintaining its ratings, Brickwork Ratings relies on factual information it receives from issuers and underwriters and from other sources Brickwork Ratings believes to be credible. Brickwork Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Brickwork Ratings' factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Brickwork Ratings' ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Brickwork Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Brickwork Ratings and to the market in offering documents and other reports. In issuing its ratings Brickwork Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed. THE INFORMATION IN THIS REPORT IS PROVIDED "AS IS" WITHOUT ANY REPRESENTATION OR WARRANTY OF ANY KIND. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time, for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Neither Brickwork Ratings nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, "BWR Reps") guarantee the accuracy, completeness or adequacy of the Report, and no BWR Reps shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of this publication. In no event shall any BWR Reps be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages. Brickwork Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities.