

IIP

Propelled by low base

India Equity Research | Economy



IIP for June 2018 climbed 7% YoY (consensus: 6.1%, Edelweiss estimate: 5.8%) from 4% YoY in May with the surprise largely attributable to electricity and, to a lower extent, manufacturing. A couple of trends stand out: 1) The strong rebound in manufacturing to 6.9% in June from 3.9% in May is propelled by a low base (pre-GST de-stocking in June 2017); adjusting for base, we think the growth would have been 3.5–4.0% YoY, which is similar to May and, in fact, softer than the pre-DeMon trend. 2) By industry, while momentum in autos, computer electronics and refinery products remains healthy, labour-intensive categories such as textiles and leather goods continue to exhibit weakness, which is a cause for concern.

Going ahead, the base effect is likely to be supportive for another month and fade out thereafter. In terms of dynamics, while government spending may invigorate activity in a pre-election year, two concerns are emerging: first, the global economy seems to be hitting a soft patch as evident from PMIs and global trade growth; and second, interest rates in India seem to be rising ahead of the growth cycle.

Supportive base drives IIP improvement

IIP for June improved to 7.1% (higher than our expectation of 5.8%) from 3.9% YoY reported in May. The improvement is largely due to a low base (owing to GST-led destocking in the base period). Sequentially (MoM or QoQ), the growth is similar to the June month/quarter in the previous years. Hence, adjusting for the destocking-led low base, we believe IIP growth is hovering in the 3.5–4.0% range, which is much slower than the 7% average for November 2017–March 2018 and also lower than pre-DeMon trend.

Autos healthy; labour-intensive sectors persistently weak

By sector, autos and computer electronics remain the bright spots posting double-digit growth for 9 straight month. However, persistent contraction in labour-intensive sectors (textiles, gems & jewellery, leather, rubber, etc.) continues to haunt. June was the 17th consecutive month of contraction in this space and is thus, perhaps, weighing on rural wage growth. Recovery in this space is vital to a sustained economic revival.

Watch out for exports and labour-intensive sectors

In our view, the base effect is likely to be supportive of IIP in July as well. However, the following headwinds are emerging: 1) global trade seems to be moderating and forward-looking global indicators such as global PMI and Korea and Japan machine orders have slowed; 2) persistent weakness in labour-intensive sectors is concerning and may drag consumption; and 3) to top it all, bank lending rates are starting to rise, which we believe is happening much ahead of the business cycle. The saving grace is that government spending could ramp up since FY19 is a pre-election year. However, risks to moderation in IIP in H2FY19 remain quite high.

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Table 1: Industrial activity by category

	Weight	Jun-18	Y-o-Y (%)					Apr-Jun (% Y-o-Y)	
			May-18	Apr-18	Mar-18	Feb-18	Jan-18	FY19	FY18
Classification by economic activity									
Industrial production	100.0	7.0	3.9	4.8	5.3	6.9	7.5	5.2	1.9
Manufacturing	75.5	6.9	3.7	5.3	5.7	8.4	8.7	5.3	1.6
Mining	14.2	6.6	5.8	4.0	3.1	(0.4)	0.3	5.5	1.1
Electricity	10.3	8.5	4.2	2.1	5.9	4.5	7.6	4.9	5.3
Classification by use									
Capital goods	8.2	9.6	6.9	11.9	(3.1)	16.6	12.4	9.4	(3.8)
Primary goods	34.1	9.3	5.7	2.8	3.0	3.7	5.9	5.9	2.2
Intermediate goods	17.2	2.4	0.8	1.7	2.5	3.4	5.4	1.6	0.9
Infrastructure/construction goods	12.3	8.5	7.4	7.0	9.1	13.0	7.5	7.7	1.8
Consumer goods	28.2	6.0	1.5	6.4	10.6	7.4	9.4	4.5	3.7
Consumer durables	12.8	13.1	6.4	4.5	6.2	7.5	7.6	7.9	(1.2)
Consumer non-durables	15.3	0.5	(2.1)	7.9	14.1	7.4	10.7	1.9	7.8

Source: CSO, Edelweiss research

Chart 1: Headline and manufacturing IIP back to pre-DeMon levels

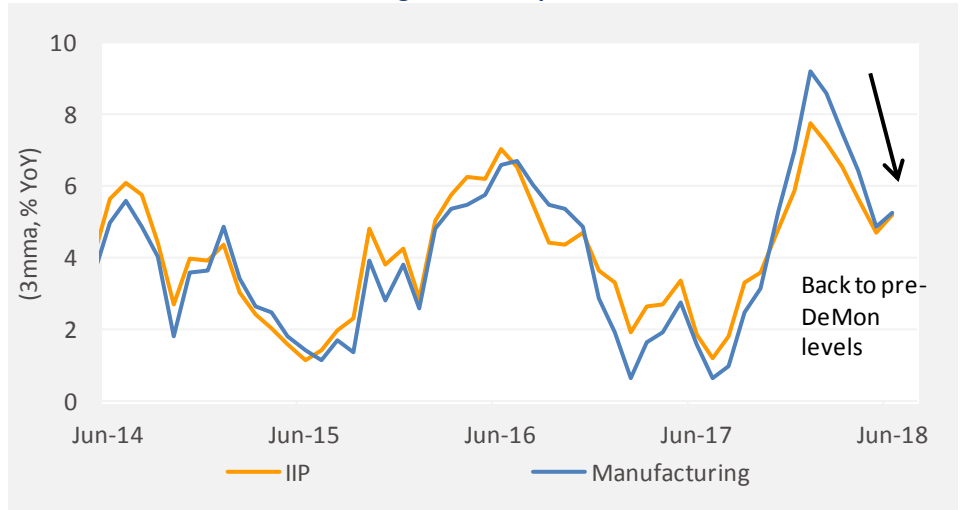


Chart 2: Persistent weakness in labour-intensive sectors a cause for concern



Source: CMIE, Edelweiss research

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