Subir Gokarn: The industrial divide

Performance across industries provides some sense of the different drivers of the recovery.

Subir Gokarn | New Delhi November 16, 2009 Last Updated at 00:04 IST

With the release of the numbers for the Index of Industrial Production (IIP) for September 2009, we now have a picture of how the manufacturing sector has performed over the first six months (April-September) of 2009-10. The broad picture is, of course, reassuring in that it suggests that the sector has hit bottom and is now in a state of steady, if modest, recovery. The clear indicator of this is that the growth rate of the sector during this period, 6.3 per cent, is a full percentage point higher than it was during the corresponding period of 2008-09, when the downturn was getting under way.

But, it would be instructive to take a look at the numbers beneath the numbers. How different industries are performing depends on how the economic environment is shaping up and this, in turn, provides an insight into the contribution that different components of the fiscal-monetary policy response have made to the recovery.

The manufacturing sector is divided into 17 industry categories. Looking through the growth rates of these categories during the first half of 2009-10, it is quite clear that the recovery is still quite unbalanced. Let us divide up the 17 into three groups, based on their first half growth rates.

The first group, consisting of relatively fast-growing industries (10 per cent or higher) would comprise Other Manufacturing Industries (13.9 per cent), Rubber, Plastic, Petroleum and Coal Products (12.6 per cent), Wool, Silk and Manmade Fibre Textiles (11.7 per cent) and Machinery and Equipment Other than Transport Equipment (11 per cent). This is a motley mix and, clearly, not attributable to one specific driver or stimulus measure.

The easiest to explain are the first and the last. A significant component of Other Manufacturing Industries is consumer durable products, which, as a separate category, grew by 18.9 per cent during the first half. This performance can presumably be attributed to the implementation of the Sixth Pay Commission recommendations beginning in October 2008. Almost two years' worth of arrears being paid out in two instalments obviously created an enormous pool of purchasing power, at least some of which is being used to buy new durable goods.

The performance of the Machinery & Equipment industry indicates that businesses are continuing with their plans to maintain and expand capacity. This category has been among the top performers in the manufacturing sector for quite a while, but had seen its growth rate drop sharply as the downturn set in. Its relatively rapid turnaround, though still far short of its peak performance, suggests that the slowdown was neither intense nor persistent enough to dramatically alter business plans. Expansion plans may have been scaled down, but have apparently not been shelved. Clearly, maintaining and expanding productive capacity is key to sustaining growth, so this bodes well for the sustainability of the recovery — unless, of course, businesspeople have got it all wrong!

The Wool, Silk and Manmade Fibre Textile industry has done well because the industry it feeds into, Textile Products, has also done reasonably well. The Rubber, Plastics, Petroleum and Coal Products performance presumably reflects the higher demand for energy stemming from the recovery; consistent with this explanation, Electricity Generation, which is separately measured by the Index, grew by a respectable 6.8 per cent during the first half.

The second group (growth rates between 5 and 10 per cent) comprises Transport Equipment and Parts (9.1 per cent), Textile Products (9 per cent) Basic Chemicals and Chemical Products (7.5 per cent), Non-Metallic Mineral

Products (7.2 per cent), Basic Metals and Alloy Products (6.8 per cent) and Wood and Wood Products, Furniture and Fixtures (6.8 per cent). The Sixth Pay Commission explanation, I think, also holds for the performance of the Transport Equipment and Parts industry, in which cars and two-wheelers appear to have done the best. The performance of Textile Products is somewhat counter-intuitive, since exports, into which a lot of this output feeds, remain on a negative growth path. Presumably, then, this growth is coming from increased domestic demand, which perhaps reflects steady consumer confidence.

The Chemicals industry, which has the largest weight in the index, encompasses a wide range of products and feeds into virtually every other industry. Its performance, like that of Energy, indicates a revival in many of the activities, which it feeds into. On the other hand, the performance of Non-Metallic Mineral Products, which mainly comprises cement and glass, and the Wood Products industry are amenable to a more specific explanation — the persistence and revival of construction activity. Since construction was the target of a number of the stimulus measures, a combination of these and tactical responses by the real estate sector seems to have worked reasonably well. Basic Metals and Alloys also feed into multiple sectors, many of which have been discussed above, so its performance may be a little weaker than expected; this may reflect competition from imports in a situation of global excess capacity.

The last group (growth rates below 5 per cent) comprises Paper and Paper Products, Printing and Publishing (1.5 per cent), Leather and Leather and Fur Products (1.1 per cent), Cotton Textiles (0.9 per cent), Metal Products and Parts (-1.6 per cent), Beverages, Tobacco and Related Products (-2.6 per cent) and Food Products (-11.6 per cent). Of these, the performance of Cotton Textiles is clearly related to sluggish exports; in combination with the patterns visible in other textile segments, it appears that domestic demand favours products made from Manmade Fibres. Leather has also, apparently, been adversely impacted by the export environment, with no domestic offset available.

The performance of Metal Products and Parts is, again, somewhat inconsistent with the performance of the industries that use them and competition from imports could be the explanation here as well. The negative growth in Beverages and Tobacco and Food Products is somewhat surprising, since the demand for these products is typically viewed as being relatively insensitive to the business cycle. At least as far as food products are concerned, higher food prices may be constraining households from spending on packaged and processed foods. This is not directly related to the recovery, but is certainly a consequence of the macroeconomic situation.

Let me conclude with the most important implication. The Pay Commission recommendations appear to be the most significant component of the stimulus and they are permanent and ongoing. This should make the decisions on exit a little easier.

The author is chief economist, Standard & Poor's Asia-Pacific. Views expressed are personal