ECONOMY

Q2 manufacturing rebound puzzles economists

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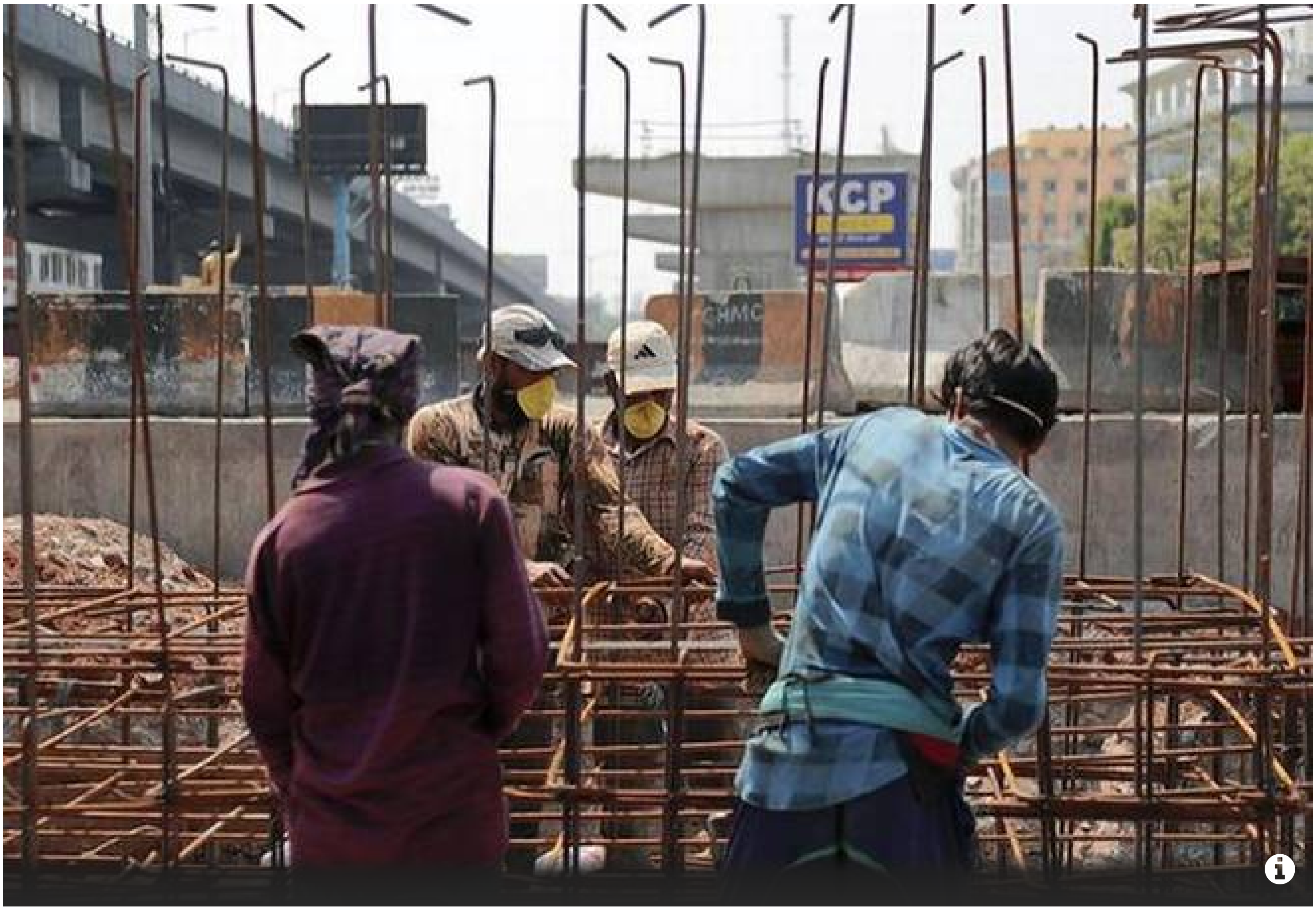
Conflicting signals from official sectoral IIP data that showed a contraction raise questions about accuracy of GVA estimate.



The turnaround in India's manufacturing sector, which rebounded from a 39.3% contraction in GVA (gross value added) in the April-June quarter to clock 0.6% growth in the second quarter, has left economists scrambling to reconcile conflicting data from the government as they try to come to terms with the latest GDP estimates that suggest the economy fared better-than-expected.

India's GDP contracted by 7.5% over the July-September period, as per official data released on Friday, beating most estimates, including a 'nowcast' in the RBI's November monthly bulletin that projected an 8.6% decline in the last quarter .

While services continued to suffer from the COVID-19 pandemic's impact, the industrial sector's contraction narrowed to just 2.1% in the second quarter, after shrinking by a steep 38% in the preceding three-month period. Most of these gains were attributable to the improved performance of the manufacturing sector.

"Though the whole press release [on GDP estimates] is full of surprising numbers, the most astonishing number is the positive growth in manufacturing," SBI group's chief economic advisor Soumya Kanti Ghosh observed in a research report titled 'Q2 GDP shows surprising resilience: Is it good enough to last?'. "Despite being the worst affected sector in Q1 due to the lockdown, it is quite puzzling how manufacturing turned itself around," he wrote.

"The IIP manufacturing and manufacturing GVA growth are highly correlated [almost more than 0.90] and this correlation collapsed in Q2 when IIP manufacturing declined by 6.7% [average of July, August and September] while manufacturing GVA grew by 0.6%. This data requires proper explanation," Mr. Ghosh wrote.

Cost cuts, layoffs may have helped

Aditi Nayar, principal economist at rating agency ICRA, urged caution on reading too much into the manufacturing sector recovery. "While manufacturing volumes had continued to contract, the GVA of this sector posted a marginal 0.6% growth in Q2 FY2021, on the back of aggressive cost-cutting measures, a pared down wage bill and benign raw material costs," she said.

"The extent of the recovery in the performance of the informal sectors in Q2 remains unclear, and we caution that trends in the same may not get fully reflected in the GDP data, given the lack of adequate proxies to evaluate the less formal sectors," she added.

While Mr. Ghosh agreed cost-cutting could have helped boost corporate GVA in the second quarter, SBI Research had found small companies with turnover upto ₹500 crore, were more aggressive in the endeavour and were displaying 10-12% cuts in employee costs. “This could turn a potential headwind in future in terms of a drag on consumption. Additionally, there is evidence of inventory build-up that could act as a drag on future manufacturing growth,” he concluded.

The manufacturing growth needed to be viewed in the context of the low year-earlier base, said India Ratings and Research principal economist Sunil Kumar Sinha. Manufacturing GVA had contracted by 0.6% in July-September 2019.

“From the supply side while most of the sectors have done as expected and continue to be in contractionary mode, the surprise of the pack is manufacturing sector,” Mr. Sinha said.

“The positive growth in the manufacturing sector can be attributed to the higher activity with the easing of the lockdown restrictions as well as a favourable base effect,” CARE Ratings chief economist Madan Sabnavis and senior economist Kavita Chacko, wrote in a note analysing the latest GDP print.

The National Statistical Office (NSO) has stressed that its GDP estimates were hampered to some extent by the restrictions imposed in the first quarter of this financial year during the nationwide lockdown.

“Though the restrictions have been gradually lifted, there has been an impact on the economic activities. In these circumstances, some other data sources such as GST, interactions with professional bodies, etc., were also referred to for corroborative evidence and these were clearly limited,” the NSO noted in its latest release.