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Capital Goods update - 11MFY21

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The Covid-19 Pandemic severely impacted the demand for capital goods in the country as business and industrial activities remained subdued for most part of FY21. Low capacity utilisation rate and uncertainty caused by the pandemic forced most corporates to defer their capex plans during the year which impacted production of machinery and equipment required to build those capacities. However, even before the pandemic broke, the sector was going through a challenging period due to subdued global conditions owing to several issues including the US-China trade war. After a 2.7% growth in FY19, the Index of Industrial Production (IIP) for Capital Goods declined by a sharp 13.96% in FY20. IIP of capital goods continued to fall and was down 23.5% during April to February FY21. This is a steep fall as it came over an 11.5% fall during the corresponding period of the previous year (April to February FY20).

Table 1: Index of Industrial Production (IIP): Capital Goods during Apr-Feb

Period	IIP	YoY growth
Apr-Feb FY19	107.5	4.1
Apr-Feb FY20	95.2	-11.5
Apr-Feb FY21	72.8	-23.5

Source: CMIE

The Index which was already on a negative growth trajectory during FY20, tanked 64.5% yoy in the first quarter of FY21 impacted by the lockdown as industries like automobiles and construction which are the main consumers of capital goods came to a near standstill. Subdued industrial activity also impacted demand for power and addition to power generation capacity during the year, which is one of the largest segment of the capital goods market. During April–February of FY21, 9.7 GW of new electricity generation capacity was installed. This has been the lowest annualised addition in twelve years and nearly half compared with the same period of FY20 (April- February). Besides, challenges in terms of labour shortages, logistical issues in the movement of goods as well as uncertainty caused by the pandemic forced several businesses to defer their capex plans. Though the industry gradually recovered from the shock and the fall in output reduced over the subsequent months it cannot be said that the industry is out of the woods yet due to very low base of last year and growth in output being restricted to few limited sub-sectors of capital goods.

Item Basket and Item Weights

Capital Goods has an **overall weightage of 8.2%** in the calculation of All India IIP Index. There are **67 items covered under this group.**

The sector contains broad range of products which are used in a wide variety of sectors from paper to construction to tractors to electricity etc. Out of the 67 items only 11 items reported positive growth during April to February FY21 vs the corresponding period of the previous year. Below is a table showing items under capital goods that have shown recovery as well as those that reported double digit decline in output during the period.

Table 1: Capital goods items (YoY growth)

Improvement in production	11MFY20	11MFY21
Harvesters and threshers	-62.3	78.4
Pressure vessels and tanks other than boilers	-17.8	17.6
Agricultural Tractors	-14.9	16.2
UPS in Solid State Drives	33.3	15.4
Other agricultural machineries	-3.2	14.8
Filtration Equipment	-10.1	11.4
Conveyors-non-roller type	-0.3	10.7
Steam & other vapour turbines	4.2	10.0
Tractor tyres	-14.0	9.8
Sewing machines	-17.4	0.6
Power generating equipment	-61.7	0.3
Decline in production		
ATM (automatic teller machines)	-2.7	-81.3
Bodies of trucks, lorries and trailers	-4.0	-77.5
Bodies/ chassis of buses and minibuses	5.8	-73.5
Electronic/ electrical conductor wires (single or multiple strands)	-13.2	-70.7
Rice milling machines	-0.9	-70.1
Sugar Machinery	-48.1	-61.5
Construction machine/ equipment (incl. bull-dozers and road rollers)	-24.4	-57.2
X-ray equipment	-44.3	-56.7
Mining machinery	-24.2	-48.9
Machinery & equipment for defence support	-49.3	-48.8
Ship building and parts thereof	51.3	-43.6
Cranes-all types	-24.9	-42.4
Air conditioning systems/ plants for industrial use	-3.2	-39.0
Fire fighting equipment	1.3	-38.6
Solar power system	0.5	-32.7

Note: the above list is not exhaustive

While there are green shoots visible in overall economy on the back of actions taken by the government to infuse liquidity and accelerate investment however challenges remain due to rising raw material prices, logistical issues and labour shortage. The industry is slowly recovering in arresting the decline in FY21. There has been recovery and positive growth for tractors, agricultural equipment's, sewing machines and power generating equipment's. However, a sharp fall in production was witnessed in air conditioning systems, cranes, construction machinery, electronic conductors and wires, fire fighting equipment's due to slowdown in the construction segment. Production of ATM machines and X-ray machines were impacted by slowdown in commercial activities. Decline in sugar machinery is mainly due to overcapacity in the segment. Besides, lower demand for commercial vehicles led to double digit fall in output of bodies of trucks, lorries trailers as well as bodies of buses. A sharp drop in renewable capacity addition impacted demand for solar power systems.

Outlook:

The outlook for capital goods sector remains healthy given the government's thrust on infrastructure development. The Union budget FY22 has proposed a sharp 34.5% increase in capital expenditure, which is expected to boost the demand for capital goods in the country. Investments in power equipment's, renewable energy projects, oil & gas distribution, affordable housing, port development, railway DFC corridors, coupled with robust industrial activity will drive growth in capital goods industry in the near term.

In the Union Budget FY22, the government allocated 1.07 lakh crore out of 1.1 lakh crore for development of railway infrastructure. Dedicated Freight Corridors will benefit railway infrastructure and EPC companies including wagon manufacturers. Anti-collision systems on high density railway networks would provide impetus to engineering companies engaged in railway safety systems.

The Ministry of New and Renewable Energy (MNRE) has announced that it would impose BCD of 40% on solar modules and 25% on solar cells from 1 April, 2022. Both these items currently do not carry any BCD. The increase in BCD is aimed at increasing domestic manufacturing and self-reliance by increasing the cost of imports. This could help in the capacity building and investment decision making of domestic manufacturers.

However, for the capital goods industry to show sustained growth, there is need for private investment to pick up. This will have to be in both infrastructure and manufacturing. With capacity utilization rates still less than 70%, scope for investment is limited except in few sectors which get linked with government spending. The other factor affecting investment in the private sector will be funding for which the government has already announced the setting up of a new DFI. Banks presently will be wary of lending to infrastructure given the uncertainty relating to future NPAs.

The order book position of companies engaged in manufacturing machineries or machinery products has seen a jump in March 2021, as per CMIE data. Almost 10 companies have received orders worth Rs 126.4 billion in March 2021, which is a huge jump from orders worth Rs 3.3 billion booked in March 2020.

Order book position:

Month	Agg new orders - Machinery (Rs billion)	No. of companies
Jan-20	23.6	4
Feb-20	2.0	2
Mar-20	3.3	4
Apr-20	25.7	6
May-20	13.9	4
Jun-20	0.1	2
Jul-20	1.5	3
Aug-20	9.5	4
Sep-20	3.7	3
Oct-20	1.1	4
Nov-20	11.1	6
Dec-20	32.2	2
Jan-21	56.3	6
Feb-21	1.8	1
Mar-21	126.4	10

Source: CMIE

Given all of the above, the fear of renewed lockdown in some states continues to loom due to rising coronavirus cases across the country. This is leading to economic and business uncertainties. Therefore, uncertainties relating to completion of projects will remain in FY22 as well which have the potential to stall the recovery seen so far in the capital goods sector.

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