Press Release

Base factor drives core sector growth to a thirteen-month high

Onset of monsoon and elevated commodity prices to weigh on core output in the near term

01-July-2022

The output of eight core sectors rose to a thirteen-month high of 18.1% YoY in May-22 from 9.4% in Apr-22 primarily boosted by the favourable statistical base, given the disruptive impact of the second Covid wave last year. On a sequential basis, the index improved by 2.6% MoM in May-22 from a contraction of 8.7% in Apr-22, with all sectors, barring cement, showing a sequential improvement. Ahead of the kharif sowing season, fertilizers production recorded a significant jump of 31.1% MoM after remaining on a declining trend for nearly ten months.

While the base factor may lead to an optically comforting growth rate, it would be more appropriate to compare the numbers with the pre-Covid levels. Encouragingly, on a cumulative basis the core sector registered a growth of 9.3% in Apr-May FY23 as compared to the corresponding period of FY20 led by robust growth in the production of electricity, cement, steel, natural gas, and coal.

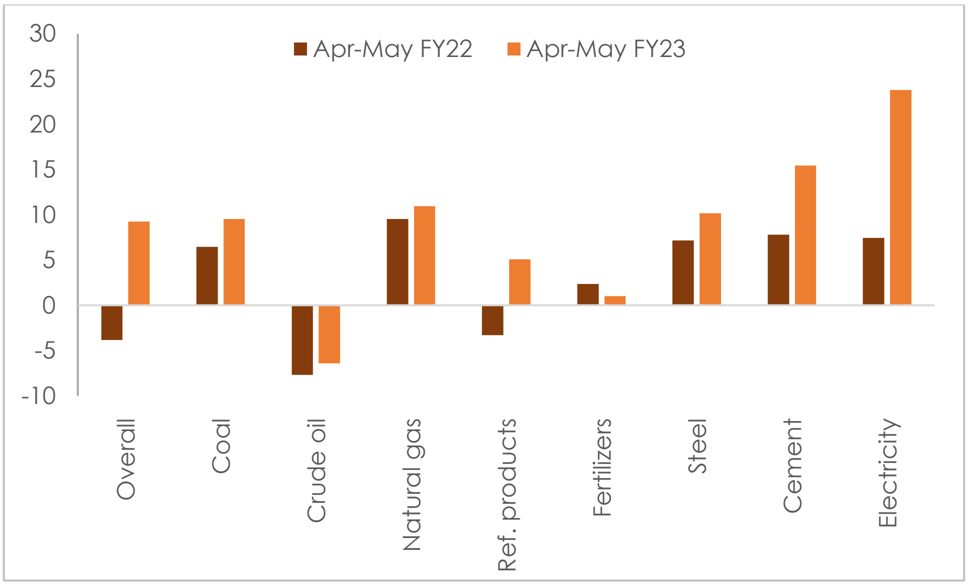
The significant increase in electricity generation in the months of April and May, primarily reflects the high power demand from the residential segment due to the severity of the summer in the current year. Increasing power demand along with surge in global coal prices due to Russia-Ukraine standoff led the coal stockpiles at the domestic power stations to dwindle significantly. Of late, while the coal inventory has improved marginally, with onset of monsoon the mining activities will dampen and will also hamper transportation of coal from mines to power stations thereby weighing on the electricity output. An inadequate coal stock at the power plants before monsoon could lead to yet another power crisis as was faced in the second quarter of last year. However, to avoid a fuel shortage and create buffer stocks, the government has initiated negotiations with a few countries like Russia, Australia, and Indonesia to help Coal India Limited (CIL) import coal at a discounted rate ahead of the onset of monsoon, which may ease the heightened supply pressures in power and other end-use sectors. In this regard, CIL has already issued tenders for importing coal for power generating companies. Nevertheless, with global supply pressures expected to remain tight in H1 FY23 and winter season still some months away, coal shortages and power outages could continue for the next few months.

The heightened activity in the infrastructure space led steel and cement production to remain healthy in FY23 so far, with the sectors recording an expansion of 15.4% and 10.2% YoY respectively as compared to their pre-pandemic levels i.e. FY20. However, the impact of significant increase in commodity prices such as that of coal and the challenges in imports of coking coal amid Russia-Ukraine standoff could put pressure on steel and cement output. Additionally, the arrival of monsoon may impact the production levels in the coming months as construction activities slow down demand during rains. That said, over the longer term of 1-3 yrs, we expect government's initiatives in the form of PLI scheme for the steel sector and its focus on infrastructure segment to play a pivotal role in driving steel and cement output.

Overall, with continued pressure on the prices of certain commodities along with the persistent supply chain bottlenecks induced by the continuing Russia-Ukraine conflict are likely to slow down the revival in the industrial and core sector output in the near term. From growth perspective, we continue to expect GDP growth for FY23 at 7.5% with risks tilted to the downside. Nevertheless, some support is likely to emerge from the capital expenditure focused government expenditure, prospects of a normal southwest monsoon and the benefits from the full unlocking of the economy post the Omicron wave with ~70% of population fully vaccinated. Additionally, the improvement in capacity utilisation (CU) in the manufacturing sector, as per RBI's latest survey to 74.5% in Q4FY22 from 72.4% in Q3 (surpassing the pre-pandemic levels) bodes well from overall production perspective.

Annexure

Chart 1: Performance of core sector growth remains strong vs pre-pandemic levels



Note: The growth rates for FY22 and FY23 are compared with the pre-pandemic period of Apr-May FY20

About Acuité Ratings & Research Limited:

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