Press Release

Core sector growth eases to a 20-month low

Oil and gas sector continue to constrain overall output

01-Dec-2022

India's core sector growth eased to a 20-month low of 0.1% YoY in Oct-22 as compared to 7.8% in Sep-22. The moderation in the print can be partly attributed to an unfavourable base factor that arose due to a sharp rise in core output in Oct-21 driven by the recovery in coal production. On a sequential basis, the headline index has come in flat as compared to the contraction recorded for the last four consecutive months. On FYTD basis so far (Apr-Oct'22) core sector output stands expanded by 9.4% as compared to the pre-pandemic period of FY20 (Apr-Oct'20) with double-digit growth recorded in the production of coal, followed by fertilizers, cement, steel and electricity. On the other hand, crude oil production recorded a double-digit contraction of -10.0% while production of refinery products remained muted at just 0.9% rise over this period.

Notwithstanding the monthly gyrations in the core sector print, cumulative production of coal stands at a robust 28% in Apr-Oct'22 as compared to its pre-pandemic level. The total coal production in FY23 (by Coal India Ltd. accounting for over 80% of domestic coal production in India) so far has crossed 400 million tonnes as compared to 342 million tonnes in the same period last year. The growth was primarily supported by various government initiatives aimed to reduce the dependence on coal imports along with contribution from new commercial mines that became operational in Q1 FY23. Going forward, the coal production is expected to improve further with the end of monsoon and festive season. India's oil and gas output – be it crude oil, natural gas, or refined petroleum products have remained highly subdued over the last five years despite the sharp pickup in oil prices since the previous year and has translated into a higher monthly trade deficit. Additionally, the windfall tax levied on domestic crude oil production and the export duty on diesel as well as ATF from July'22 may have also led to a lower production level in the current year.

Among infrastructure goods, steel and cement output remained strong at 9.8% and 14.3% as compared to the pre-pandemic Apr-Oct period of FY20. Domestic steel demand regained some momentum led by the festive season which drove the demand for cars and consumer durables higher. However, a slowdown in exports and rising interest rates could add concerns over steel demand from the global markets thereby weighing on production. Nevertheless, over the longer term, we expect government's PLI initiatives for the steel sector and its focus on infrastructure segment to play a pivotal role in driving steel and cement output. Interestingly, the latter's production has unexpectedly dropped in Oct-22 by 2.4% in sequential terms which can be attributed to inventory rationalization and the expected rise in prices to pass on a part of the cost increases seen in the sector.

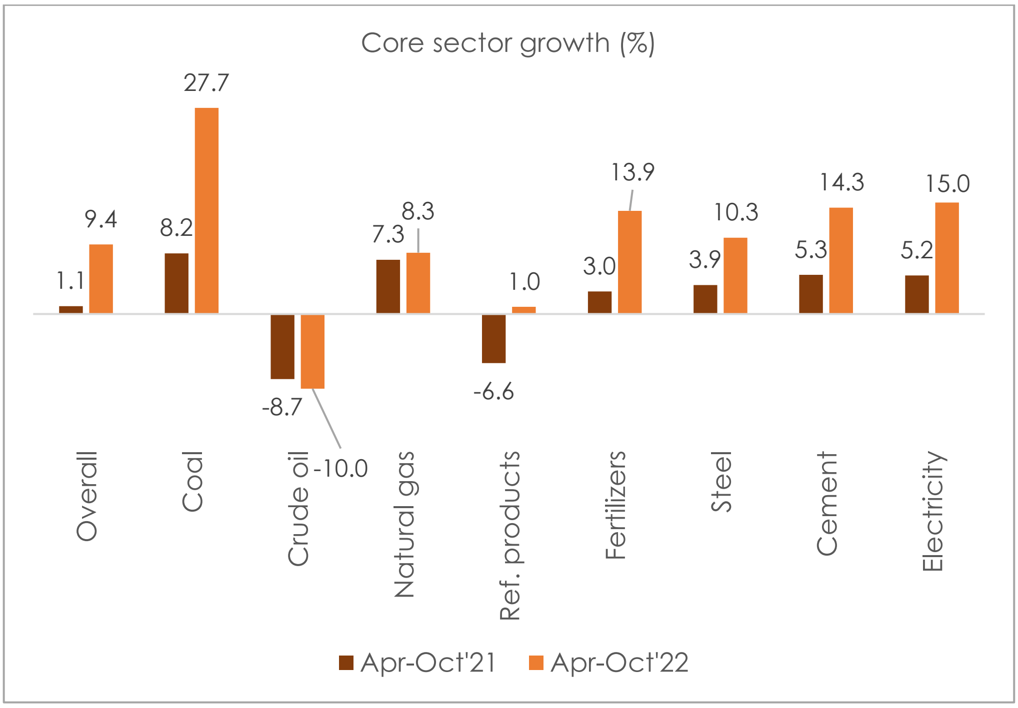
We expect the annualized core sector print to further display some moderation in H2 FY23 with the removal of the base advantage. While the spurt in demand in the festive season may keep the growth print resilient in Q3 FY23, it may not necessarily sustain thereafter amidst the domino effect caused by the increasing weakness in global growth which has already started manifesting in India's export performance. While overall exports have been easing since the start of FY23, for the month of Oct-22, merchandise exports slipped to USD 29.8 bn coming below USD 30 bn mark for the first time in the last 20 months. While a part of this downside could be seasonal, nevertheless outlook on exports remains clouded. IMF in its latest update to the World Economic Outlook report, slashed its growth forecast for 2023 World GDP and World Trade by 20 bps and 70 bps to 2.7% and 2.5% - this marks a sharp loss of momentum vis-à-vis IMF's 2022 growth estimates of 3.2% and 4.3% earlier.

As the favorable statistical effect tapers, the GDP growth is expected decelerate over Q3 and Q4 of FY23. This factors in increased external risks and their impact on domestic growth, despite support from factors such as strength in services demand, upside in rabi sowing, capex-oriented government expenditure and the cool down in global commodity prices. Taking into account these upside and downside factors we continue to peg India's GDP growth at 7.0% for FY23.

Says Suman Chowdhury, our Chief Analytical Officer "Core sector data print has been demonstrating a weakness from Q2 onwards in the current year due to the lack of a broad based momentum across the eight segments and this has continued in Oct-22 as well. At 0.1% YoY and flat sequentially, this is the weakest print since Feb-21. While the lack of momentum in industrial activity can be primarily attributed to the slowdown in the external environment and the resultant impact on exports, it has also been partly due to the base factor arising from a spike in core output last year in Oct-21. What has also pulled down the overall core output in Oct-22 has been the unexpected sequential contraction in cement and oil refinery production, the latter possibly due to the tax on exported petroleum products. Also, there was a material drop in electricity generation which may be due to the slowdown in manufacturing and better rainfall vs last year. We expect core sector output to grow at a modest pace in H2FY23 given the challenging external environment."

Annexure

Chart 1: Performance of core sector growth expands by 9.4% as compared to Apr-Oct'20



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

About Acuité Ratings & Research Limited:

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