

Comparing PMI and IIP

What are they?

\n\n

\n

- The PMI for December 2017 is a highly encouraging 54.7, which along with a 6.8% growth in the “core sector” also indicates a big positive for IIP.

\n

- While PMI and IIP have both been used for gauging the health of the economy, it is prudent to understand what they actually stand for.

\n

\n\n

What is “Purchasing Managers Index” (PMI)?

\n\n

\n

- PMI is calculated on the basis of information received on a monthly basis from companies on various factors that represent demand conditions.

\n

- A standard questionnaire is administered to 500 private companies (PSUs are excluded) and the comprehensive score is arrived at.

\n

- 5 parameters in PMI are - new orders (30% weightage), output (25%), employment (20%), supplier’s delivery (15%) and stock of purchases (10%).

\n

- The respondents can either give a “Positive, Neutral or Negative” response and each response is marked as “1, 0.5 or 0” on the score card respectively.

\n

- Hence, if there is unanimous positivity across all parameters, then the PMI score would be 100 (percentage) and an unanimous negative would mean 0.

\n

- While an absolute score of 50 would mean neutrality, anything above it is perceived as an improvement and less than it would mean deterioration.

\n

- Intuitively, it can be seen that the purpose of the PMI is to indicate some degree of confidence level in manufacturing based company perspectives.

\n

- Notably, as PMI is a market sentiment tracker that compares the current month with the previous, it is season sensitive.

\n

\n\n

What is “Index of Industrial Production” IIP?

\n\n

\n

- IIP measures actual production output across the industrial sector.
- Significantly, IIP for December 2017 would be reckoned with the same month in 2016, unlike PMI, which is monthly comparison.
- As it is a comparison over the previous year, it is season neutral.
- Therefore, as the basis of IIP and PMI are different, a comparison between the two is really not appropriate.
- However, as the PMI is released on the 1st of every month and the IIP is known on the 12th, the PMI score is assumed to be a precursor to the IIP.
- But the correlation between PMI and IIP isn't strong and the relationship between the two variables is quite low and insignificant.

\n

\n\n

What is the reason for the lack of correlation?

\n\n

\n

- A sample of 500 companies for PMI is too small to be representative of what is happening at the aggregate level.
- Also, as these companies tend to be the bigger ones, SMEs are under-represented in PMI, whereas IIP is more comprehensive.
- The responses in PMI are of an ‘either or’ variety and is not graded to any number, which inherently marks 2% positivity and 20% positivity as same.
- Also, PMI has only one component, namely “output” (with a weight of 25%) which can be directly related with IIP.
- Also, even with the PMI new orders increasing, it would not necessarily

mean that output would increase in a subsequent period.

\n

- Exclusion of the PSUs is another significant aspect as there is a very high contribution by this segment, especially in capital goods and infra areas.

\n

\n\n

What is preferable?

\n\n

\n

- Hence, it may be said that the PMI is not a leading indicator of the state of industry which is better represented by IIP growth.

\n

- While the IIP growth calculation has its challenges, it is to be noted that the number is used for GDP calculations to account for the unorganised sector.

\n

- But nonetheless, there is room for both concepts in the set of economic indicators that have to be tracked continuously.

\n

\n\n

\n\n

Source: Business Line

\n

