

## **Economic Recovery from Policy Shocks**

### **What does recent Data say?**

\n\n

\n

- A considerable 4.3% growth was noted in Index of Industrial Production (IIP) for the month of August.

\n

- But the effect of demonetisation - which has dramatically ruptured domestic supply chains, still looms large.

\n

- While demand was partially restored with remonetisation, it is increasingly being met by imports.

\n

- GST related disruptions have indeed compounded these woes.

\n

\n\n

### **Is the Current Growth in Industrial Output Sustainable?**

\n\n

\n

- In the months preceding GST, businesses resorted to selling from their inventories rather than purchasing new goods.

\n

- This was because tax credit on state VAT can't be claimed once GST sets in.

\n

- The manufacturers were therefore forced to cutting output in June due to lack of demand.

\n

- Uncertainty around the new tax regime meant that July's production was also low.

\n

- Full production resumed only in August, which would have mainly gone to restock depleted warehouses for the festival season.

\n

- The fact that, the overall industrial output fell by 0.2% in June and went up marginally by 0.9% in the July, before recovering to 4.3% in August - seemingly confirming this hypothesis.

- \n
- But restocking alone, which is a one-time affair, can't sustain a recovery in the months ahead.

\n

\n\n

### **How does the manufacturing sector look?**

\n\n

- \n
- Manufacturing sector accounts for 77.6% weight within the IIP.
- \n
- This registered a mere 3.1% annual growth in August.
- \n
- Out of its 23 subsectors, as many as 13 posted negative growth.
- \n
- This includes textiles, leather, rubber, plastics, chemicals, paper and furniture - most of which are employment intensive industries.

\n

\n\n

### **What really is moving?**

\n\n

- \n
- Manufacturing growth since February 2016 shows a clear trend of decline which is particularly visible after demonetisation.
- \n
- While the nine months before demonetisation saw an average year-on-year growth of 5.8%, it fell to 1.7% for the nine months after it.
- \n
- The corresponding growth rates for non-oil imports over the same period were quite the opposite.
- \n
- Imports for the nine months after demonetisation grew at an average 21.3%, whereas it was minus 8.5% for the 6 months prior to demonetisation.

\n

\n\n

### **What do these trends indicate?**

\n\n

- \n
- Domestic manufacturing has clearly been hit from the twin blows of

demonetisation and GST, one following the other.

\n

- Small & medium-sized enterprises (SMEs) in manufacturing clusters, paying workers mostly in cash, were the worst affected.
- \n
- By the time liquidity returned to the system around March many domestic manufacturing units, had significantly cut production.
- \n
- So, whatever demand was restored was increasingly being supplied not by domestic production, but imports.

\n

\n\n

### How does the future look?

\n\n

\n

- Import rising by over 20% in an economy combating a severe growth and investment slowdown is quite unusual.
- \n
- This will affect both the current account deficit and jobs in India.
- \n
- For reducing imports, rebuilding of broken domestic supply chains is needed.
- \n
- This will involve either the SMEs adjusting to the new tax regime or the formal sector taking up the space ceded - both of which will take time.
- \n
- Without manufacturing bouncing back and the capital expenditure cycle resuming, there can be no recovery.

\n

\n\n

\n\n

**Source: Indian Express**

\n