# Economic Recovery from Policy Shocks

## What does recent Data say?

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- A considerable 4.3% growth was noted in Index of Industrial Production (IIP) for the month of August.
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- But the effect of demonetisation - which has dramatically ruptured domestic supply chains, still looms large.
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- While demand was partially restored with remonetisation, it is increasingly being met by imports.
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- GST related disruptions have indeed compounded these woes.
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## Is the Current Growth in Industrial Output Sustainable?

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- In the months preceding GST, businesses resorted to selling from their inventories rather than purchasing new goods.
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- This was because tax credit on state VAT can’t be claimed once GST sets in.
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- The manufacturers were therefore forced to cutting output in June due to lack of demand.
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- Uncertainty around the new tax regime meant that July’s production was also low.
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- Full production resumed only in August, which would have mainly gone to restock depleted warehouses for the festival season.
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- 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.

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- But restocking alone, which is a one-time affair, can’t sustain a recovery in the months ahead.
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## How does the manufacturing sector look?

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

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- Manufacturing growth since February 2016 shows a clear trend of decline which is particularly visible after demonetisation.
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- 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.
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- The corresponding growth rates for non-oil imports over the same period were quite the opposite.
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- 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.
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## What do these trends indicate?

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

demonetisation and GST, one following the other.
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- Small & medium-sized enterprises (SMEs) in manufacturing clusters, paying workers mostly in cash, were the worst affected.
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- By the time liquidity returned to the system around March many domestic manufacturing units, had significantly cut production.
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- So, whatever demand was restored was increasingly being supplied not by domestic production, but imports.
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## How does the future look?

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- Import rising by over 20% in an economy combating a severe growth and investment slowdown is quite unusual.
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- This will affect both the current account deficit and jobs in India.
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- For reducing imports, rebuilding of broken domestic supply chains is needed.
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- 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.
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- Without manufacturing bouncing back and the capital expenditure cycle resuming, there can be no recovery.
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**Source: Indian Express**

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