INDUSTRIAL PRODUCTION
Overview

Growth in industrial sectors in the post 2008-2009 period has been unimpressive globally, with the exception of East Asia and Pacific, and China in particular. After bouncing back in the immediate aftermath of the crisis global industrial production growth weakened again in the second half of 2010, and after a short-lived acceleration dipped again in mid-2011 and in the second half of 2012. Financial turmoil in high-income countries, and uncertainties surrounding the course of policy actions in high-income countries combined in some cases with policy-induced slowdowns in some of the larger developing countries and/or capacity constraints have restrained the pace of activity.

Overall, more than four years after the financial crisis began, global industrial output is only 5.3 percent higher than its pre-crisis peak. Output in high-income countries is still 6.5 below pre-crisis levels, with output in the Euro area and Japan sharply lower and output in the United States having almost regained pre-crisis levels. Output in developing countries outside China is 2.6 percent higher than its pre-crisis peak.

Growth in developing countries has been most dynamic in East Asia and Pacific mainly reflecting double-digit IP growth in China, where output is 67.9 percent higher than the pre-crisis high, versus 12 percent in the remaining countries in the region. Industrial output in South Asia and Europe and Central Asia are 19.6 and 2 percent higher respectively than their pre-crisis peaks. Industrial output in Latin America and the Caribbean and Sub Saharan Africa is more or less in line with the pre-crisis levels. Middle East and North Africa is the only developing region where industrial output is lower than four years ago, largely due to the fall in production associated with the socio-political unrest during the Arab Spring.

Recent economic developments

Industrial production growth strengthened to an above trend pace in early 2013

Output strengthened in much of the world toward the end of 2012 and into the first quarter of 2013, with global output expanding at a close to 3.4 percent annualized pace in the three month leading to March, supported by strengthening final demand and rising inventories (figure IP.1).

Developing countries industrial output expanded at about a 5.1 percent annualized pace during the first quarter of 2013, with East Asia and Pacific’s industrial production growing at a 8.6 percent annualized pace and China’s industrial output expanding at a 9.7 percent annualized pace in the first quarter of 2013 (figure IP.2). Industrial output growth in other developing regions has varied markedly, but has been generally much softer. Growth has remained unimpressive in Latin America and the Caribbean as performance in Mexico has been softening and despite a modest improvement in growth in Brazil (figure IP.3). Output growth remained relatively flat in Europe & Central at 2.4 percent annualized pace in the first quarter of 2013, on account of relatively weak...
performance in Russia and Turkey. Growth remained strong in the South Asian subcontinent despite a deceleration of growth in India expanding at an 7.7 percent annualized pace in the first quarter of 2013. Data for the Middle-East and North Africa and Sub Saharan Africa lags, but was still declining in both regions in the three months to February.

Among high-income countries outside of the Euro Area industrial output also accelerated – reaching 3.5 percent up from 0.7 percent in the fourth quarter of 2012, mostly on rapid expansion in the United States and Japan. A recovering housing market and the creation of more than half a million payroll jobs in the first quarter of 2013 have supported the acceleration in activity, boosting consumer demand. Investment demand has also recovered with capital goods orders rising at a 20 percent annualized pace in the first quarter of 2013. As a result industrial production in the U.S. expanded at a 4.4 percent annualized pace in the first quarter of 2013, up from the 2.6 percent annualized pace recorded in the final quarter of 2012, despite a significant fiscal drag. In Japan, the relaxation of both monetary and fiscal policies, have prompted a sharp rebound in activity, with industrial production growth rebounding to 9 percent annualized pace in the first quarter of 2013.

In the Euro area industrial production stabilized, expanding 0.7 percent annualized in the first quarter of 2013 compared to a 8.1 percent annualized pace of decline in the fourth quarter of 2012. An increase in energy and capital goods production was behind the improved outturns. Excluding Germany, where output performance has been more robust (up 1.2 percent annualized pace in the first quarter of 2013), the improvement in industrial sector performance is less dramatic as output declined most rapidly among the high-spread economies that are enduring the harshest fiscal consolidations.

Capital-goods orders point to increased global capital spending in early 2013, but momentum may be weakening. After a sharp decline in mid-2012, G3 capital goods orders recovered briskly in the latter part of 2012, with shipments following a similar path (figure IP.4). Capital- goods orders
rose at a rapid pace in the first quarter of 2013, with US capital goods orders rising at a 21.4 percent annualized pace, up from a 13.8 percent expansion in the fourth quarter of 2012. In Japan, after a robust recovery in the last quarter of 2012 (15.5 percent) capital goods orders growth accelerated markedly to 31.8 percent in the first quarter of 2013, while in Germany capital goods orders rose 3 percent over the same period, almost half the pace recorded in fourth quarter of 2012 (8.3 percent). In developing countries, capital goods orders eased only slightly, rising at an 22 percent annualized pace in the first quarter of 2013, down marginally from the 19 percent pace recorded in fourth quarter of 2012, pointing to sustained investment growth in these economies.

Data for April suggest however that the pace of expansion of capital goods orders might be easing in the US in the second quarter of the year. Similarly capital import orders by developing countries are also showing signs of moderating.

...but there are signs of moderation in the pace of expansion into the second quarter

Forward-looking indicators like purchasing manager’s indexes suggest a slower pace of activity for the second quarter, as fiscal tightening in the US cuts into activity there and capacity constraints in many developing economies moderate growth – which should nevertheless continue to expand broadly in line with underlying potential. Indeed the step down in the global manufacturing Markit PMI in April to the lowest level since December (but still above the 50 mark that indicates expansion) followed by a marginal increase in May suggest that global manufacturing output growth is moderating into the second quarter of 2013. Sentiment regarding leading indicators components such as new orders and finished goods inventories improved only modestly.

Notably high-income and developing countries PMIs moved in opposite directions in May, with sentiment improving in most high-income countries surveyed and deteriorating in three quarters of developing countries.

Business sentiment in the U.S. is weighed down by the fiscal drag, with higher taxes likely to weigh on consumer spending, and budget sequestration further limiting domestic demand growth. The US manufacturing ISM index softened at the end of the first quarter and dropped below the 50 growth mark in May, on softer domestic demand and notwithstanding a boost in external demand. Meanwhile the business sentiment as gauged by the Markit PMI deteriorated to a six-month low in April, before inching up to 52.2 in May, remaining in growth territory.

PMIs in major developing countries such as Brazil, China, India, Russia and Turkey all declined for two or more consecutive months.

The moderation in output in East Asia is expected to be relatively broad, as suggested by PMI indexes. The May PMI has been weaker than expected in China, where the PMI retreated 1.2 points to 49.2. In China industrial output growth has decelerated further to 7.4 percent annualized pace in the three months leading to April. Interpreting the trade and industrial output data for East Asia is made more difficult by the timing of the Lunar New Year which fell in February this year.

Although PMIs improved in the Euro area in May, to the highest level since 2012, they continue to indicate contraction albeit at a slower pace. Sentiment improved in Germany, France, Italy, and Spain (albeit from depressed levels). Meanwhile sentiment in Japan improved for a fifth consecutive month, to its highest level in more than a year, as inventories are relatively low while orders are rising.

Noteworthy is the fact that despite stabilizing at a higher level than the one recorded in the fourth quarter of 2012, business sentiment remains at historically low levels globally, suggesting business confidence remains fragile and is yet to return to pre-crisis levels.

...nevertheless growth is expected to remain solid at a trend like pace

Industrial production growth in developing countries is expected to moderate to a more sustainable pace over the short term, with growth
in China remaining in the low double-digit range, while output elsewhere in East Asia moderates. The continuation of supportive fiscal policy with a front-loading of infrastructure spending is expected to benefit China’s industrial production. In addition, according to recent surveys labor demand continues to outpace labor supply, especially in the service sector, and might lead to increased labor income in the months ahead, which should be supportive of private consumption.

Some of the manufacturers in the region may be challenged by the large depreciation in the Japanese yen, induced by monetary easing, and may lose market share over the short-term, although other than China and Thailand, most countries in the region do not compete directly with Japan (see Main Text). Japanese output is expected to continue to post a robust recovery, following an 8 percent annualized bounce back in the first quarter of 2013.

Growth in industrial output is also expected to remain soft in countries with capacity constraints, including some of the larger developing economies. Industrial output performance will remain weak in Brazil, despite significant stimulus from the government, as high production costs, and capacity constraints continue to weigh on growth. Furthermore retail sales growth has decelerated markedly, as rising inflation has caused real wage growth to slow. Quarterly industrial production growth in South Asia is projected to moderate, as growth in India slows from unsustainable levels.

In Latin America, the weakness in the Mexican industrial sector should be reversed in mid-2013, as the Mexican manufacturing sector growth will re-link with the better performing U.S. manufacturing. However, performance in Argentina’s industrial sector is likely to be weak as a result of recent policies that restrict access to foreign currency for essential capital imports.

Growth in industrial production is expected to strengthen in the second half of 2013 in Europe and Central Asia, supported by modestly stronger domestic and high-income European demand, which should help narrow the still wide output gap in the region. Still weak private credit growth will continue to weigh on industrial sector activity this year.

Growth in Middle East and North Africa will recover but remain subdued despite large excess capacities, in part due to weak domestic demand.

In the Euro Area output is projected to strengthen modestly in the second half of the year, as the pace of fiscal consolidation eases and pent-up demand forces should support growth.

The recent declines in commodity prices, including oil and metals prices appear to mainly reflect higher supply (see commodity annex and main text). Lower input prices rather than suggesting slower demand going forward, should provide a fillip to activity, both by increasing real incomes and reducing production costs.

In order for growth in global industrial production to return to its long time trend over the medium term the pace of growth in high-income economies needs to accelerate as they still account for a significant share of global industrial output, and lead in global innovation for local markets, which is expected to support growth in industries such as automobile, chemicals, machinery and pharmaceutical (McKinsey 2012).

In terms of growth rates industrial sectors were much more dynamic in developing countries, expanding at an annual pace of 8.5 percent over the 2002-2007 period compared to 2.6 percent in high-income countries (figure IP.5). Among developing countries East Asia and Pacific was the most dynamic region (11.2 percent average annual pace), followed by South Asia (9.4 percent) and Europe.

Fig IP.5 Growth in major developing economies is weaker than in the pre-crisis period

Source: World Bank; Datastream.
and Central Asia (8.1 percent). Latin America and the Caribbean’s performance was less impressive (5.1 percent), expanding at the same pace as that of Sub-Saharan Africa. Middle East and North Africa expanded at a slowest pace among developing regions (4.1 percent).

During the boom years (2002-2007) global industrial production expanded at an average pace of 4.1 percent a year, with developing countries accounting for about 54 percent of growth in global industrial production (figure IP.6). East Asia and Pacific contributed more than 36 percent to global growth, with China alone accounting for almost a third. Among developing regions the second largest contributor to growth in global industrial production was Latin America and the Caribbean (8.7 percent), followed by Europe and Central Asia (6.4 percent) and South Asia (5.4 percent) (figure IP.7).

A significant part of the expansion in the global industrial production came from rapid growth in the construction, mining, and utilities sectors in developing countries. These sectors together accounted for close to 30 percent of overall global growth during the 2000-2010 period, with China accounting for more than half of that contribution (17 percent). The expected slowdown in investment in China over the coming years, partly as the property market cools down, may subtract from the global industrial production trend growth if not supplemented by stronger growth in other major emerging economies with large infrastructure gaps such as India and Brazil, whose infrastructures are perceived as inadequate given their level of economic development (WEF 2012-2013).

Overall growth in the industrial sector, and manufacturing in particular, stands to gain from the shift in demand towards developing economies. Output in industries that need to be close to consumers due to cost structures (high transportation costs) and that produce products that are not heavily traded (food processing) is likely to expand rapidly as income in developing countries continue to rise.

Risks and vulnerabilities

The downside risks of a further deterioration in performance in the Euro area, of steeper fiscal consolidation in the United States and Japan, persist although the probability associated with these risks has declined since our January 2013 edition. An additional risk is that of an abrupt slowdown in investment in China which would have significant consequences for exporters of capital goods in particular in East Asia but also Germany and the United States.
If commodity prices decline markedly capital expenditures, which have risen sharply during the boom years especially in oil and metals markets, could slow significantly, affecting capital goods producing countries. Lower commodity prices and lower fuel prices in particular could boost real disposable incomes and bolster demand for other manufactures.

There is also an upside risk associated with the performance of the U.S. economy and its resilience in the face of the fiscal drag. Similarly the performance in the Euro Area could be stronger than in our baseline.

As policies in high-income countries become less accommodative the cost of capital is likely to rise over the medium term and costlier capital could limit investment and growth in industrial production. (GEP 2010).
References


