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Negative growth in mining and manufacturing for the first quarter of 2019

Highlights

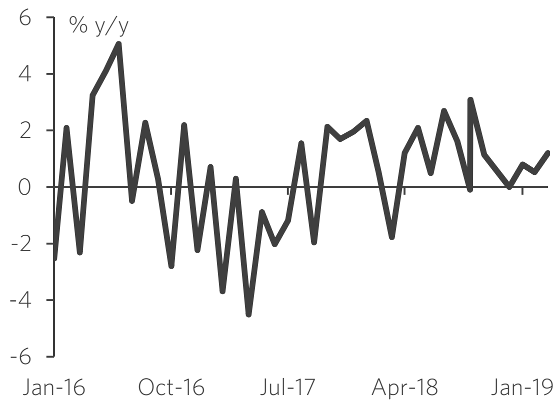
- Manufacturing production volumes increased by 1.2% in March 2019 from 0.5% in February 2019 and recorded growth of 0.8% on a month-on-month (m/m) basis, which was an improvement from negative 2.0%.
- Growth in the manufacturing sector declined in the first quarter of 2019, with seven out of the ten contributing divisions declining in this period.
- The Purchasing Managers' Index (PMI) for April 2019 improved to 47.2 index points from 45.0 index points in March 2019. However, at below the 50 neutral point, the PMI indicates ongoing headwinds in manufacturing.
- Capacity utilisation for February 2019 increased by 0.3% to 80.8% from 80.5% in February 2018, but declined from 83.1% in November 2018.
- The gap between the Bureau of Economic Research (BER) and Statistics (Stats) South Africa (SA) series that track insufficient demand as a deterrent of manufacturing growth has widened since the second half of 2017, as political uncertainty increased.
- Mining production for March 2019 recorded a softer-than-expected decline of 1.1% in year-on-year (y/y) terms, relative to the negative 8.1% y/y decline in February and the negative 7.0% expectation by consensus.
- The mining sector declined by 3.4% in the first quarter of 2019. The decline was driven by negative growth in diamond production of 35.4%, which detracted 1.8% from overall growth in mining volumes.
- The carbon tax, expected to come into effect in June 2019, remains a cost risk in the mining industry and is estimated to negatively affect 6 836 jobs according to the Minerals Council.
- In Momentum Investments' view, production growth for manufacturing and mining could remain under pressure, as insufficient demand remains a binding constraint.

Manufacturing growth declines in the first quarter of 2019

Manufacturing production figures released by Stats SA for March 2019 recorded a 1.2% y/y increase, up from 0.5% in February 2019 (see chart 1). The print outperformed the IRESS consensus expectation of negative 0.5% y/y. Growth also performed better m/m compared to the negative 0.4% consensus expectation, rising to 0.8% in March 2019. Growth in the first quarter of 2019 did, however, decline by 2.4%, with growth in production in seven out of the ten divisions in the manufacturing industry declining during this period.

Contributions to the 1.2% growth rate in the sector came from petroleum, chemical products, rubber and plastic products, which grew by 7.0% and added 1.5% to growth in total manufacturing volumes. Production in basic iron and steel, non-ferrous metal products, metal products and machinery grew by 3.2% and contributed 0.7%. Growth for the year to date for the manufacturing sector registered at 0.9%, which is an improvement from the negative 1.8% recorded in the same period a year ago. Nevertheless, this is still below the 1.4% long-term average growth rate.

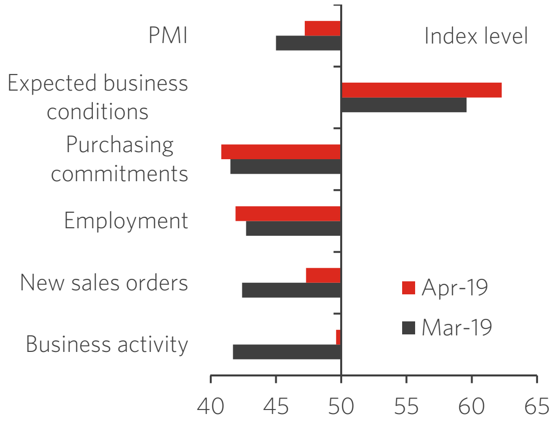
Chart 1: Growth in manufacturing up marginally



Source: Stats SA, Momentum Investments, data up to March 2019

The BER PMI for April 2019 recorded an improvement to 47.2 from 45 index points in March 2019.
The sub-index measuring expected business conditions rebounded to 62.3 from 59.6 index points.
The improvement in some of the main sub-indices was insufficient to rise above the 50 neutral point (see chart 2). Business activity rose to 49.6 index points from 41.7 and new sales orders also improved to 47.3 from 42.4 between March and April 2019.
The sub-component measuring purchasing commitments, however, declined to 40 index points from 41.5, alongside a deterioration in the employment sub-index to 41.9 from 42.7 index points. The marginal improvement in the PMI signals ongoing headwinds and a slow recovery in the manufacturing sector, which will remain contingent on energy utility Eskom's ability to produce electricity for the sector without interruptions.

Chart 2: Slight rebound in the PMI



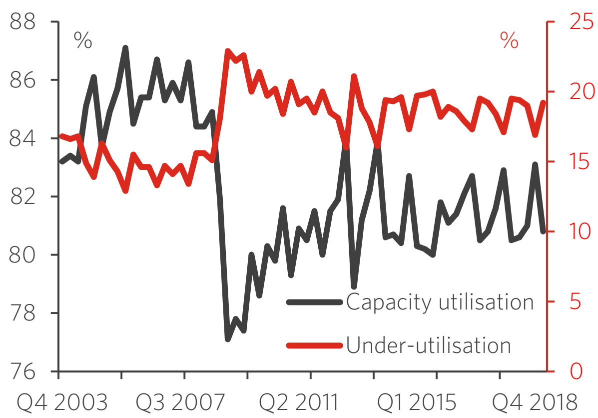
Source: BER, Momentum Investments

Insufficient demand continues to suppress manufacturing production volumes

Capacity utilisation for February 2019 increased by 0.3% to 80.8% from 80.5% in February 2018, but was lower than the 83.1% rate reported in November 2018 (see chart 3). This is below the 86% peak capacity utilisation level, which was last realised in 2007.
In contrast, underutilisation increased from 16.9% in November 2018 to 19.2% in February 2019, but was 0.3% lower relative to February 2018. The rise in underutilisation emanated from insufficient demand rising from 11.7% in February 2018 (and from 10.8% in November 2018) to 12.1% February 2019.

Six out of the ten divisions in the manufacturing sector recorded a decline in capacity utilisation between February 2018 and February 2019, while four of the divisions improved.

Chart 3: Deterioration in capacity utilisation

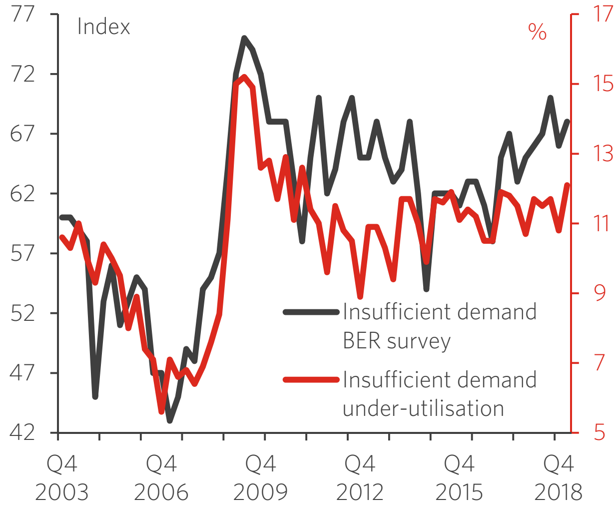


Source: Stats SA, Momentum Investments, data up to Q1 2019

This indicates the broad-based nature of the lacklustre growth environment. The three largest divisions (food and beverages at 25.8%, petroleum, chemical, rubber and plastic products at 23.8% and basic iron/steel, non-ferrous metal products, metal products and machinery (18.7%)) all recorded an improvement in their rates of capacity utilisation.

The BER surveys manufacturing corporates with a list of various questions to get an idea of business conditions in the sector. One of the questions pertains to constraints that deter growth in investment in the manufacturing sector and insufficient demand has come out strongly as one of the reasons underlying muted growth in the manufacturing sector. This index moved up to an average of 65 index points since the 75-index-point peak was reached in the second quarter of 2009. This compares to an average of 53 index points before the peak was reached in 2009. Stats SA's measure of insufficient demand (as a reason for underutilisation) has also shifted higher after peaking in 2009. The gap between the BER and Stats SA series that track insufficient demand has widened since the second half of 2017, as political uncertainty has increased (see chart 4).

Chart 4: Insufficient demand rising as a deterrent to investment in the manufacturing sector



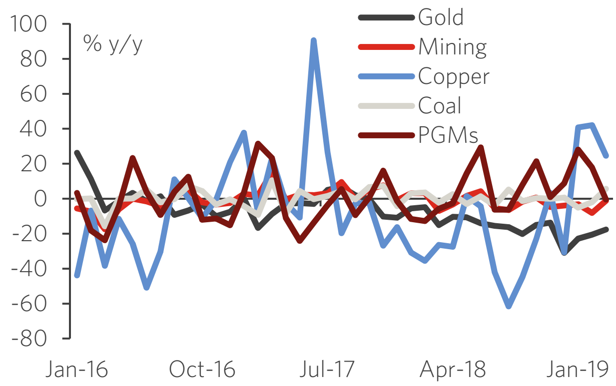
Source: Stats SA, BER, Momentum Investments, data up to Q1 2019

Negative growth in mining production, but narrowing

Stats SA released mining production data for March 2019, which recorded a softer-than expected decline of 1.1% y/y relative to the negative 8.1% y/y print in February and the IRESS consensus expectation of negative 6.95% y/y. However, on a m/m growth trajectory, mining production rose to 3.8% from negative 2.3% in February 2019. The sector declined 3.4% in the first quarter of 2019, driven by production in diamonds production declining by 35.4% and shaving off 1.8% from growth in total volumes. Growth in gold production showed the sharpest decline of 17.7% y/y, while growth in copper production surged by 24.6% y/y in March 2019 (see chart 6). Coal (the highest contributor to total mining production by weight at 24.4%) grew by 5.7%, which were levels last seen in August 2018. Growth in the platinum group metals (PGMs) turned negative (0.5% y/y), following its recent robust growth trajectory, while production in diamond volumes grew positively (3.0% y/y), following two consecutive months of contraction.

Contributions to the 1.1% decline in total mining production emanated from gold (negative 2.3%), other non-metallic minerals (negative 0.5%), chromium ore (negative 0.3%) and iron ore (negative 0.2).
The growth for the year to date for the sector was at negative 4.1%, which is an improvement from negative 6.9% in the same period last year.

Chart 5: Growth in mining production less negative



Source: Stats SA, Momentum Investments, data up to March 2019

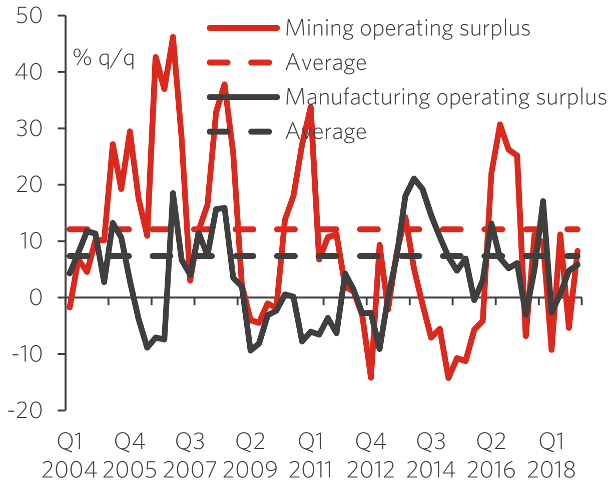
Post-election reforms will likely set the tone for growth in mining and investment, as policy certainty is expected to improve and global demand conditions are anticipated to fare slightly better.

The manufacturing and mining sector had a difficult year in 2018 in terms of operating profit, which fell below its respective long-term averages according to data from Stats SA (see chart 6). The producer price index (PPI) released by Stats SA reported price increases above 5% in the mining PPI, the intermediated manufactured PPI and the final manufactured PPI in the second half of 2018, which attributed to the compression in profits. The PMI sub-index for prices declined to 72.1 index points in April 2019 from 74.3 index points, indicating a marginally softer price environment in the near term. The carbon tax to come into effect in June 2019 remains a risk to costs in the mining industry and is estimated to negatively affect 6 836 jobs, according to the Minerals Council. This adds to the already-negative PMI employment sub-index for the manufacturing sector, which declined to 41.9 index points.

Price increases remain a risk, as inflationary pressures are on the rise. The PPI for final manufactured goods increased notably to 6.2% in March 2019 from 4.7% in February 2019, while PPI for intermediate manufactured goods increased to 6.3% from 3.9% in February 2019.

Coupled with elevated concerns of insufficient demand, these price increases create a weak growth environment for firms in the manufacturing sector.

Chart 6: Growth in mining and manufacturing nominal profits is below average



Source: Stats SA, Momentum Investments, data up to Q4 2018

Momentum Investments does not see the likelihood of production growing robustly in the near term, due to a muted domestic demand, uncertainty in electricity supply and softer global growth conditions.