momentum investments

in the moment

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Mining and manufacturing expected to detract from third-quarter growth following soft September 2019 numbers

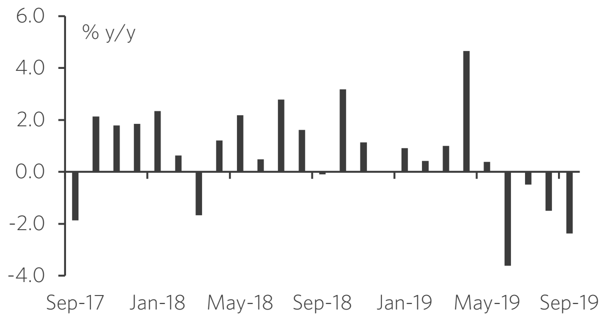
Highlights

- Manufacturing production for September 2019 contracted 2.4% and reported a steeper decline relative to the 1.5% contraction in August 2019. Only one division reported positive growth in September 2019.
- Manufacturing production declined by 0.9% for the third quarter of 2019, with only four out of the 10 manufacturing divisions growing.
- Basic iron and steel subtracted 0.9% from the September 2019 number. Meanwhile, the food and beverages division added 0.8%.
- The Coega Industrial Development Zone has performed well since 2015, supported by government aid, but performance might decline given significant reported fiscal slippage amid low sentiment and use in the manufacturing sector.
- Mining production grew marginally by 0.2% in September 2019, up from a 3.0% contraction in August. Five out of the 12 mining divisions reported growth in September 2019.
- The third quarter of 2019 reported that mining production contracted by 1.6%. The most significant drawdown emanated from platinum group metals (PGMs), iron ore and coal.
- Production is likely to remain weak in the near term on low confidence, utility cost constraints and insufficient demand.

Contraction in manufacturing growth deepened in September 2019

Manufacturing production for September 2019 contracted 2.4% in year-on-year (y/y) terms and reported a deeper contraction relative to the 1.5% y/y dip in August 2019, according to Statistics South Africa (Stats SA) (see chart 1). Seasonally adjusted manufacturing production in the third quarter of 2019 declined by 0.9% quarter on quarter (q/q), previously growing by 0.4% q/q in the second quarter of 2019. Production in four out of the 10 manufacturing divisions grew in the third quarter of 2019, but only one division reported growth in September 2019.

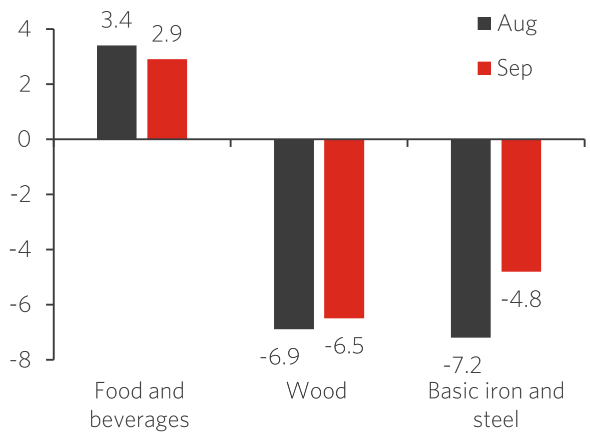
Chart 1: Deeper manufacturing contraction



Source: Stats SA, Momentum Investments

Basic iron and steel subtracted 0.9% (down 4.8% y/y) from the September 2019 number. The wood and wood products, paper, publishing and printing division followed suit and subtracted 0.8% (declined by 6.7% y/y). Meanwhile, the food and beverages division added 0.8% (grew 2.9% y/y) to the September number, previously adding 0.9% in August 2019 (see chart 2).

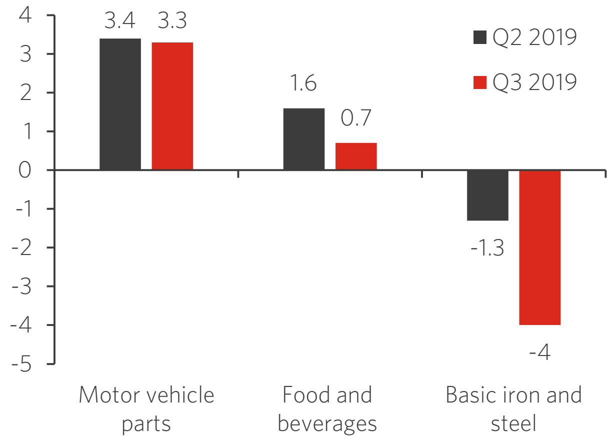
Chart 2: Manufacturing division growth (% y/y)



Source: Stats SA, Momentum Investments

Motor vehicles, parts, accessories and other transport equipment were the most significant contributor in the third quarter of 2019, adding 0.3% (increasing by 3.3% q/q) followed by food and beverage manufacturers which added 0.2% (grew by 0.7% q/q) (see chart 3). Basic iron and steel subtracted 0.8% (contracted by 4.0% q/q) alongside petroleum, chemical products, rubber and plastic products, which subtracted 0.5% (declined by 2.1% q/y) from the 0.9% contraction in the third quarter of 2019.

Chart 3: Manufacturing division growth (% q/q)



Source: Stats SA, Momentum Investments

Year-to-date (YTD) manufacturing production shrunk by 0.2% y/y. Manufacturing output is unlikely to improve in the near term given the dim outlook in the sector underpinned by a stubbornly low Purchasing Managers' Index and record-low manufacturing confidence of 16 index points.

Structural constraints cloud outlook for manufacturing production

Stats SA surveyed the Coega Development Corporation (CDC) Special Economic Zone tenants to determine growth and performance between 2015 and 2018 in the largest Industrial Development Zone (IDZ) in Southern Africa. Non-manufacturers in the IDZ had 78.8% growth in income relative to a 14.8% increase in income for manufacturers between 2015 and 2018.

However, growth in employment rose by 46.4% for non-manufacturers relative to 53.6% for manufacturers in the same period. There has been a 17.3% increase in total employment in the IDZ. Turnover for non-manufacturers grew by 80.4% and only 13.2% for manufacturers. However, net profit after tax rose to R314 million in 2018 from a R131 million loss in 2015 for manufacturers. Non-manufacturers equally saw a rise in profit after tax to R94 million in 2018 from a loss of R30 million in 2015.

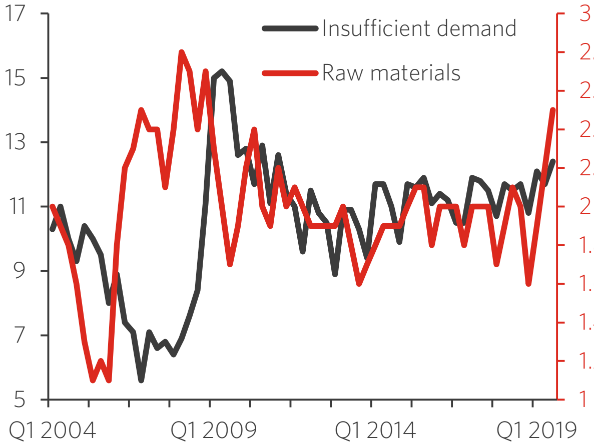
Manufacturers reported a 4.4% improvement in their profit margin in 2018 from negative 2.7% in 2015. Non-manufacturers similarly saw a 4.2% improvement from negative 7.9%.

Relative to the general manufacturing sector, the CDC IDZ received state funding to the value of R5.5 billion to date, which has assisted tenants in the weak business environment. Funding will likely slow, as government continues to face fiscal slippage. The CDC IDZ has secured 18 new investors, who have pledged R2.1 billion. This will hopefully aid manufacturing production against bleak domestic and global economic conditions.

Manufacturing use of production capacity weakened to 80.3% in August 2019 from 81.3% in May 2019, which was also lower than the 81.1% reported in August 2019.

Insufficient demand remains the main reason for the decline in use (see chart 4). In August 2019, insufficient demand increased to 12.4%, up from 11.7% in May 2019 and was higher than the 11.7% rate a year ago. This was the highest level observed since the first quarter of 2011.

Chart 4: Reasons for under-use in the manufacturing sector (%)



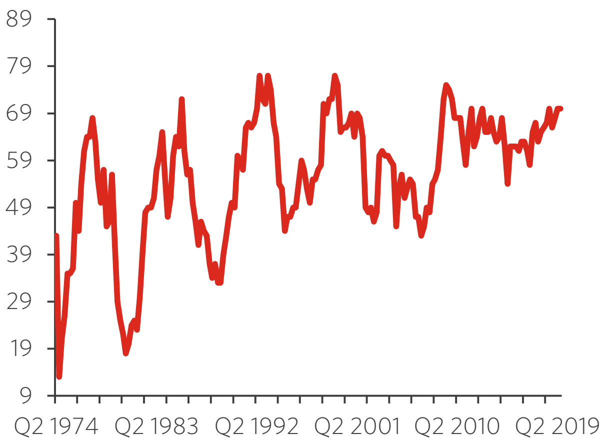
Source: BER, Momentum Investments, data up to Q3 2019

The rating for the shortage of raw materials also rose marginally to 2.5% in August 2019, up from 2.2% in May 2019 and up from 2.0% in the same period a year ago.

Labour was sufficiently supplied in August 2019. This reading remained at 1.2% between August 2018 and August 2019.

The Bureau of Economic Research's (BER) Manufacturing Survey reported similar trends in the third quarter of 2019, showing a rise in insufficient demand as a constraint to investment (see chart 5).

Chart 5: Insufficient demand as a constraint (%)



Source: BER, Momentum Investments

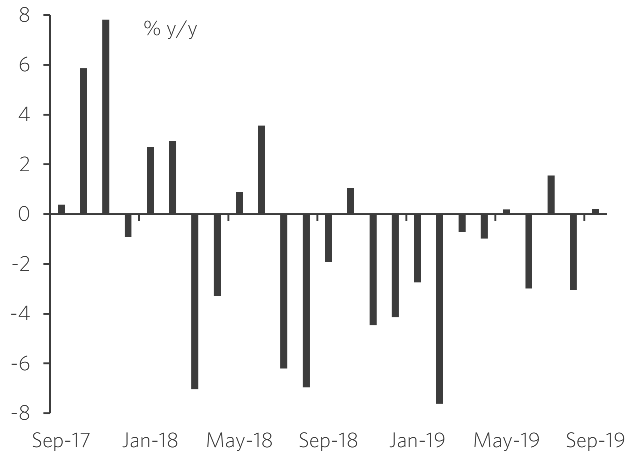
Tepid growth in mining production in September 2019

Mining production surprised and grew marginally by 0.2% y/y in September 2019, up from a 3.0% y/y contraction in August 2019, as published by Stats SA (see chart 6). The Iress consensus expected a follow-up decline of 2.3% y/y. Five out of the 12 mining divisions reported growth in September 2019.

Iron ore added 0.9% (grew by 8.2% y/y), followed by other non-metallic minerals, which added 0.8% (grew by 13.6% and other metallic minerals, which added 0.7% (grew by 38.0% y/y). The largest detractions arose from diamonds, which subtracted 0.6% (contracted by 15.7% y/y) and manganese ore deducted 0.5% (declined by 7.3% y/y).

Manganese ore slumped into negative territory after showing robust growth in the last few months. Production in diamonds, gold and PGMs continued to contract in September 2019.

Chart 6: Mining production grew marginally (%y/y)



Source: BER, Momentum Investments

Mining production contracted by 1.6% q/q in the third quarter of 2019 down from the 4.1% q/q growth rate reported in the second quarter of 2019. The most significant drawdown arose from PGMs, which deducted 2.0%

(contracted 8.2% q/q), followed by iron ore (declined 2.7% q/q) and coal (decreased 1.3% q/q), which both subtracted 0.3% from the third-quarter number. Additions to the third-quarter number arose from gold, which added 0.7% (grew 5.8% q/q) and other non-metallic minerals, which added 0.5% (increasing by 7.6% q/q).

The YTD decline in mining production was on the heels of the 2.0% contraction in 2018 at 1.7%. Lost production from the gold strike and the ongoing platinum strike will likely constrain a rebound in mining production growth in 2019.

SA is listed a country with a looming water crisis, likely from 2040, according to the World Resource Institute. These water challenges are attributable to climate change and inefficient maintenance of water infrastructure.
The mining sector is significantly dependent on water for processing ore and dust suppression among other uses.

The SA Minerals council highlighted that the mining sector has lamented that water access has been a long-term concern. The sector uses water to the value of R8.1 billion according to the council's estimates per year, which translates into 3.6% of total production costs for the sector. Smaller mining companies feel the brunt more.

Reportedly, there has been growth in the number of partnerships between municipalities and mining companies on improvements of water infrastructure to help alleviate some of the water shortages as a result of inefficient maintenance.

Electricity shortages also remain a risk to production in the coming quarters. Production is likely to remain weak in the near term amid low confidence, utility constraints and insufficient demand.