



Herman van Papendorp

Head of Investment
Research & Asset
Allocation



Sanisha Packirisamy

Economist



Roberta Noise

Economic Analyst

Production growth slightly firmer in July 2019

Highlights

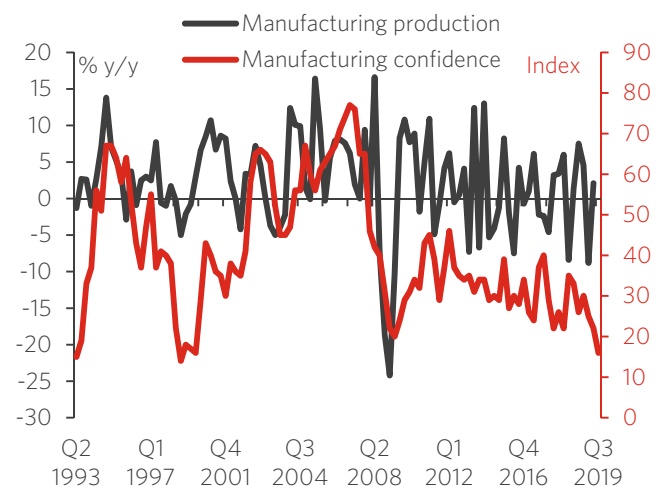
- The manufacturing sector contracted by 1.1% in July 2019 from a 3.6% contraction in June 2019. This was slightly below the negative 1.2% expectation by the Iress consensus.
- Six out of the 10 manufacturing divisions detracted from the July print.
- Mining sector production grew by 2.4% in July 2019, an improvement from the 4.1% contraction in June 2019. Mining production excluding gold shot up 5.0%. The Iress consensus, however, expected a more robust recovery of 4.2%.
- Production in eight of the 11 mineral groups in the mining sector grew positively in July 2019.
- The economic strategy policy discussion document published by National Treasury outlined how integral small and medium-sized firms are and gave a list of low-hanging fruit that could help the mining and manufacturing sectors.
- Growth in the productive sectors of the economy is likely to remain under pressure due to depressed sentiment, a slow pace of reform implementation and weak demand.

Manufacturing sentiment points to further downside

Statistics South Africa (Stats SA) released production statistics for July 2019. The Business Confidence Index for the third quarter slipped to a 20-year low, signalling that business conditions remain challenging.

The manufacturing sector contracted by 1.1% in year-on-year (y/y) terms in July 2019 from a 3.6% contraction in June 2019. This was slightly below the negative 1.2% y/y consensus expectation from Iress. The month-on-month (m/m) seasonally adjusted figure did, however, improve to 0.4% from a 1.9% m/m contraction in June 2019. Confidence in the manufacturing sector was two index points shy of reaching its lowest historic value in the third quarter of 2019 at 16 index points (previously 22 index points, see chart 1).

Chart 1: Manufacturing growth remains under pressure, while confidence plummets further

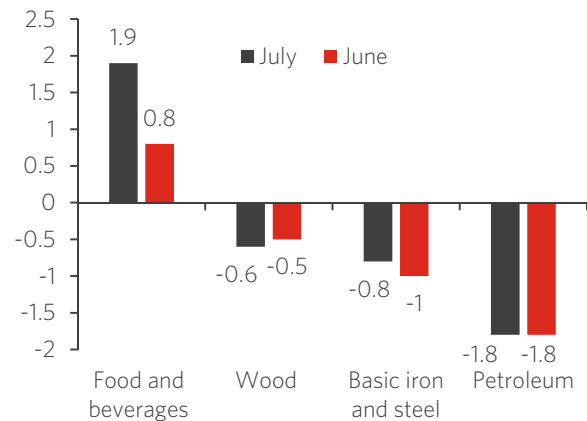


Source: BER, Stats SA, Momentum Investments

Six out of the 10 manufacturing divisions detracted from the July print. Petroleum, chemical products and rubber and plastics detracted 1.8% (contracted by 8.0% y/y), followed by basic iron and steel which detracted 0.8% (contracted by 4.4% y/y) as well as wood and wood products, paper, publishing and printing which detracted 0.6% (contracted by 5.1%) from the July 2019 print. Food and beverages added 1.9% (grew by 7.0% y/y and up from 0.8% in June 2019, see chart 2).

The shallower negative manufacturing production print in July 2019 was somewhat pre-empted by the more positive Purchasing Managers' Index (PMI) reading for July 2019, which breached the 50 neutral mark to record in positive territory. The improvement in the PMI was partially explained by an inventory build-up in the manufacturing firms related to the platinum group metals (PGM), in anticipation of a protracted platinum sector wage negotiation ahead. Nonetheless, the PMI for August 2019 reversed to 45.7 index points (back into contractionary territory), strengthening the above rhetoric. The reversal in the PMI also confirms weakness in business confidence in the manufacturing sector in the third quarter of 2019.

Chart 2: The food and beverages sector was the only positive contributor to growth in manufacturing volumes (%)



Source: Stats SA, Momentum Investments

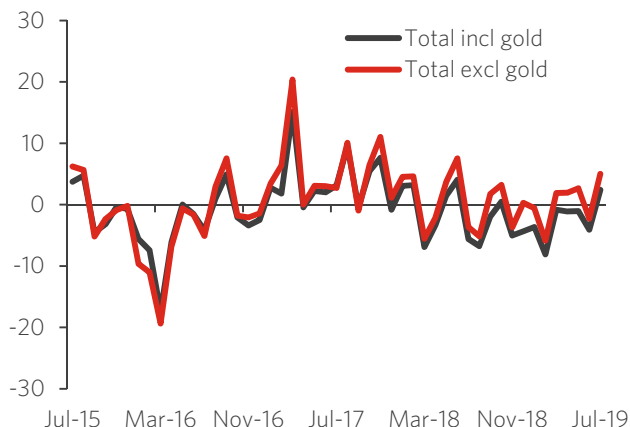
The manufacturing sector contributed 0.3% to overall economic growth in the second quarter (up 2.1%), after contracting by 8.8% in the first quarter of 2019. Persistent low confidence will likely cap growth prospects.

Wage negotiations could threaten the sustainability of the rebound in the mining sector

Production in the mining sector grew by 2.4% y/y in July 2019, an improvement from the 4.1% y/y contraction in June 2019, as per Stats SA data. Mining production excluding gold shot up 5.0% y/y (see chart 3). The Iress consensus, however, expected a more robust recovery of 4.2% y/y.

Production in the mining sector, however, contracted by 3.8% m/m (seasonally adjusted) in July 2019 from positive growth of 3.0% in June 2019. The seasonally-adjusted change in the latest three months (ended July 2019) relative to the previous three-month period rose 4.1%, highlighting an improvement in momentum.

Chart 3: Mining recovers in July 2019 (% y/y)

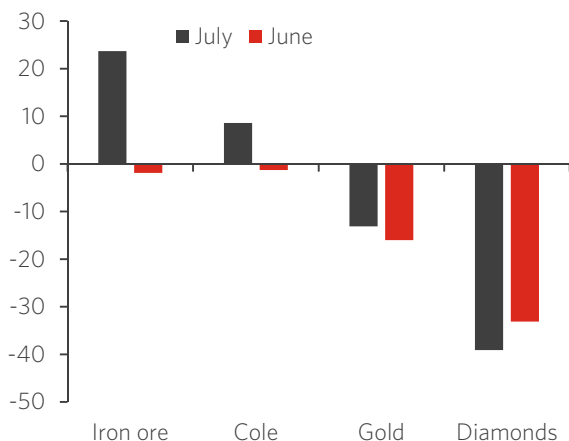


Source: Stats SA, Momentum Investments

Production in eight of the 11 mineral groups in the mining sector grew in July 2019. Iron ore production grew by 23.7% y/y from a 1.9% y/y contraction in June 2019 (added 2.8% to total mining volumes). Coal grew by 8.6% y/y in July 2019 from a 1.3% y/y contraction in June 2019. Diamonds contracted by 39.1% y/y for the third consecutive month in July 2019, previously contracting by 33.1% y/y in June 2019. Diamonds detracted 2.7% from the July mining print, which was more significant than the 1.7% detraction in June 2019. Gold production remained constrained and contracted by 13.1% y/y. However, this contraction was narrower than the 16.0% y/y fall in

June 2019. Gold detracted 1.9% in the July print, having previously detracted 2.1% (see chart 4).

Chart 4: Mining production volumes (% y/y)



Source: Stats SA, Momentum Investments

Production in PGMs improved to 2.7% y/y (previously negative 6.3% y/y) in July 2019 and added 0.6% to the July print. PGMs performed well in the first quarter of 2019. The price per ounce for the PGM basket increased 13.8% and the price of the platinum, palladium, rhodium and gold basket increased 33.2% in the same period.

Wage negotiations for PGMs sector started in July 2019 and has reached a deadlock. The Association of Mineworkers and Construction Union (Amcu), which is the

largest union in the platinum sector, is demanding a significant basic wage of R17 000, motivated by the significant price appreciation of PGMs. A few employers are, however, offering increases as low as 3.3%, given the uncertain global outlook.

Platinum sector wage negotiations are different from how wage deliberations are conducted in the gold sector. Wage negotiations in the platinum sector are done on a company basis and not on a sector basis. Amcu has a 36% representation in the platinum sector relative to 31% for the National Union of Mineworkers (NUM). Although this gives Amcu members an advantage in the wage negotiations, the union might still be bruised from the longest gold strike, which ended earlier this year.

Wage deal offerings span a wide range and therefore present the threat of protracted deliberations in the platinum sector.

The mining sector grew more than 10% (previously 14.4% after the June revision) in the second quarter of 2019, up from a 10.8% contraction in the first quarter. This positive growth rate in the second quarter could slow in the third quarter of 2019, if wage deliberations go unresolved.

More favourable business conditions needed to boost production growth

Medium-sized businesses still generate the highest turnover in a majority of the sectors, except in the logistics and business services sectors (see chart 5). The smaller businesses are, however, more labour intensive and are responsible for 50% of employment and remuneration represents 30% of value add. The share of profits-to-remuneration registers at a staggering 77% for small businesses, 71% for medium businesses and a lower 60% for large businesses.

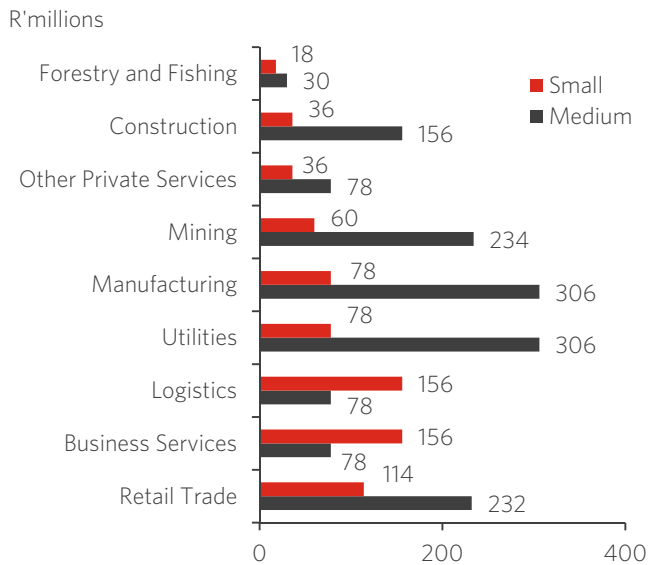
The economic strategy policy discussion document published by National Treasury towards the end of August 2019 outlined how integral small, medium and micro enterprises (SMMEs) are to growth in the economy.

The policy paper stated that SMMEs contribute 45% to GDP.

The document outlined a list of low-hanging fruit that could help small and medium firms in the mining and manufacturing sectors. The Department of Trade and Industry (DTI) has implemented its one-stop shop to aid SMMEs in accessing all that is needed to establish a business by reducing the red tape that usually slows down the process. Access to state institutions like the SA Revenue Services (Sars), Home Affairs, Environmental Affairs, Eskom and the Companies and Intellectual Properties Commission is available at the one-stop shop. This initiative aids in encouraging start-ups and is likely to develop growth in the production sector and the overall

economy, given the significant contribution the sector adds to growth.

Chart 5: Maximum turnover for business size categories



Source: Stats SA, Momentum Investments

The paper also suggests that the Industrial Policy Action Plan (Ipap) should reduce the amount of targets and focus on the targets that are easier to attain to increase the success rate of Ipap. This will specifically help SMMEs in the production sector that are facing financial strain because of the lack of state support.

Increasing capacity at the International Trade Commission (Itac) to have a fairer representation of SMMEs and large firms will contribute to reducing the bias SMMEs face through the cyclicity of export dumping, from which larger firms are insulated.

These are still only suggested reforms that have not yet been voted on or accepted as economic policy by the various departments. The current domestic business climate is, however, still challenging and continues to retard growth. According to BankservAfrica's monthly economic transactions index (Beti), significant growth in the second quarter is unlikely to be sustained in the third quarter of 2019. The index declined by 0.9% monthly and quarterly in August 2019, from a 2.7% rise in July 2019.

Growth in the productive sectors of the economy is likely to remain under pressure due to depressed sentiment, a slow pace of reform implementation and weak demand.

