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Underwhelming mining and manufacturing prints for February 2019

Highlights

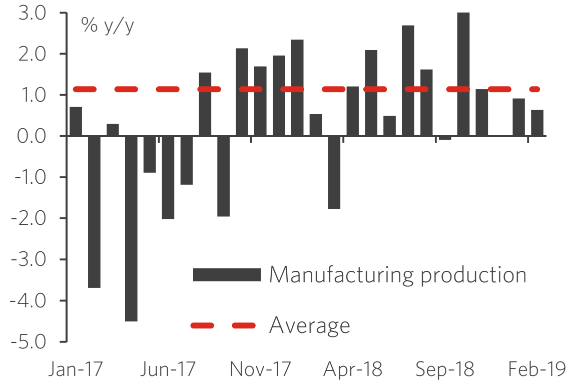
- Manufacturing production volumes, as released by Statistics South Africa (Stats SA) for February 2019, grew by 0.6%, which was weaker than the 0.9% rate recorded in January 2019.
- Six out of the ten sub-components in the manufacturing sector reported an annual contraction, relative to four in January 2019, highlighting broader-based weakness.
- The Purchasing Managers' Index (PMI) for March 2019 declined from 46.2 in February 2019 to 45 index points, pointing to near-term stress in SA's manufacturing sector.
- All five of the main sub-indices of the PMI declined in March 2019 relative to a dip of four out of the five main indices in February 2019.
- Job losses are mounting in the manufacturing sector. The International Monetary Fund (IMF) highlighted a bleak outlook for SA's overall unemployment rate in the medium term.
- Mining production slumped significantly in February 2019 to negative 7.5% in year-on-year (y/y) terms, from a softer negative print of 3.3% in January 2019.
- Growth in gold production volumes has remained in negative territory for the past 16 months and has consistently printed below its negative 6.4% long-term average for the past twelve months.
- SA's mining sector ranking improved to 56th out of 83 jurisdictions in 2018 in the overall policy attractiveness measure in the Fraser Institute's Policy Perception Index. However, a further improvement in the ranking is likely to be delayed by lingering concerns including regulation, labour instability and overall policy uncertainty.
- In Momentum Investments' view, production growth for manufacturing and mining could remain under pressure in the near term in response to slower global growth and local electricity supply constraints.

Growth in manufacturing below long-term average of 1.4%

Stats SA released manufacturing production figures for February 2019, which recorded a 0.6% y/y increase, down from 0.9% in January 2019 (see chart 1). The print, however, came in line with the consensus expectation from IRESS. Month-on-month (m/m) growth declined by 1.8%, which was a deeper contraction relative to the 1.6% decline in the previous month.

Six out of the ten sub-components in the manufacturing sector reported an annual contraction, relative to four in January 2019. Production in food and beverages grew by 0.8% and contributed 3.2% to the annual growth in total manufacturing, while production in the petroleum, chemical products, rubber and plastics division grew by 0.7% and added 2.9% to overall volumes. Manufacturing production in the last three months (ended February 2019) declined by 0.6% relative to positive growth of 0.6% in the previous three months, highlighting a slip in momentum.

Chart 1: Weak momentum in first-quarter growth

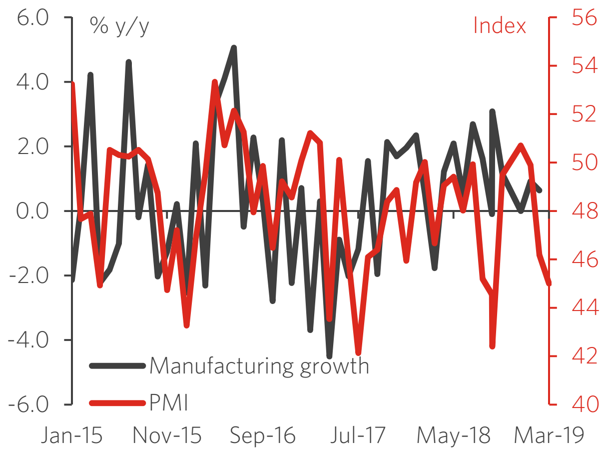


Source: Stats SA, Momentum Investments

Contributions to the decline in the last three months emanated from basic iron and steel, non-ferrous metal products, metal products and machinery, which declined by 2.6% y/y and contributed 0.5% to the overall decline in volume growth. Production in the wood and wood products, paper, publishing and printing division recorded negative growth of 3.2% relative to a year ago and contributed 0.4% to the quarterly decline of 0.6%.

The Bureau of Economic Research's (BER) PMI for March 2019 recorded a decline from 46.2 in February 2019 to 45 index points and dipped below the past six month average of 47.3 points. The underlying new sales orders index dipped further to 42.4 – a worrying drop from the past six month average of 46.6 points. The PMI indicator, which serves as a leading indicator for manufacturing activity, is signalling ongoing weakness in manufacturing output in the near term.

Chart 2: PMI signals a further deterioration ahead



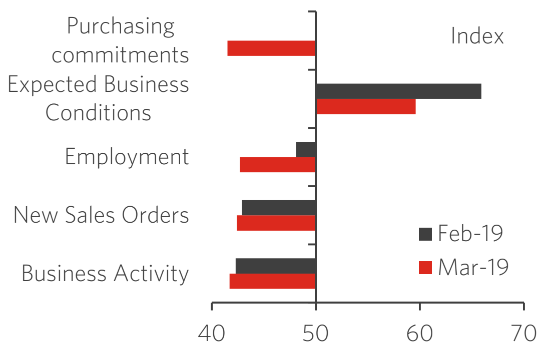
Source: Stats SA, BER, Momentum Investments

Forward-looking indicators point to ongoing tough conditions in manufacturing

All five of the main sub-indices of the PMI declined in March 2019 relative to four out of the five main indices deteriorating in February 2019. The business activity and new sales orders sub-indices contracted for the third consecutive month, declining to 41.7 and 42.4 index points, respectively. The purchasing commitments sub-index also weakened to 41.5 from the neutral mark of 50 reached in February, while expected business conditions dropped to 59.6 index points. While the latter is the only significant sub-index still tracking in expansionary territory, it has historically not performed well as a leading indicator for manufacturing output.

Prices appear to be on the rise again, mostly on the back of higher oil prices. The price of Brent crude oil reached a trough during December 2018 of US$54.4/bbl. However, this has since reversed and reached a high of US$71.59/bbl during April 2019. Although the IMF expects the price of Brent crude oil to average US$54.1 bbl in 2019 and US$55.2/bbl in 2020, Momentum Investments expects a higher level of US$69.7/bbl and US$67.2/bbl for 2019 and 2020, respectively.

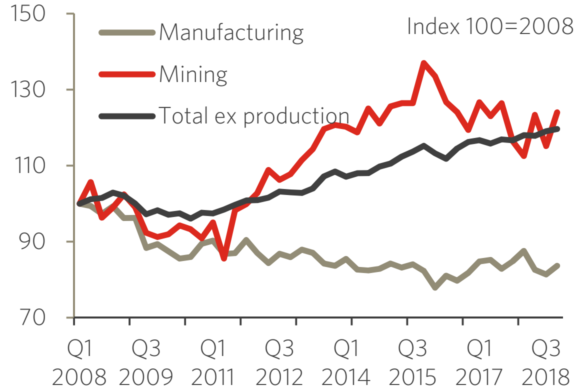
Chart 3: Broad contraction in PMI sub-indices



Source: BER, Momentum Investments

The manufacturing sector has experienced significant job losses since the global financial crisis, despite increased hiring in the rest of the economy (see chart 4). The PMI employment sub-index continued to deteriorate and remained below the neutral mark for the twelfth consecutive month. The index dropped further to 42.7 index points in March 2019 from 48.1 in February 2019. The IMF projects growth in SA (estimated at 1.2% for 2019 and 1.5% for 2020) will be insufficient to bring down the level of unemployment in the near to medium term. It projects an increase is SA's unemployment rate from 27.1% (as at the fourth quarter of 2018) to 27.5% in 2019 and 27.8% in 2020.

Chart 4: Employment in manufacturing has underperformed the rest of the economy



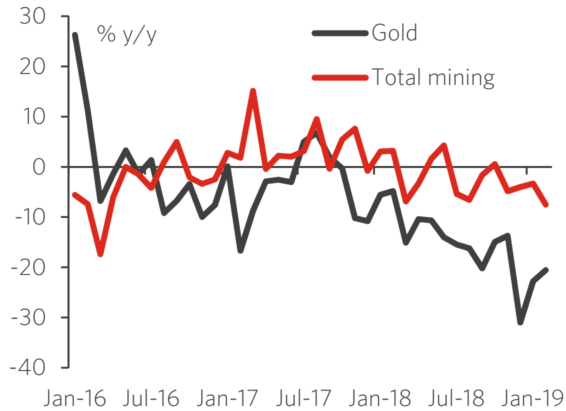
Source: Stats SA, Momentum Investments, data up to Q4 2018

Improvement in global investment attractiveness despite weaker mining production

Mining production released by Stats SA slumped significantly in February 2019 to negative 7.5% y/y, from a softer negative print of 3.3% in January 2019. Monthly growth in mining declined to 1.5% after moving sideways in January. The print disappointed the IRESS consensus, which expected a softer contraction of 4.6% y/y. The February figure represented the fourth consecutive decline, leaving the year-to-date contraction at 5.4%, compared with the same period a year ago. Growth in mining volumes contracted further to 5.4% in the quarter ended February 2019, from negative 4.6% for the previous three-month period.

The decline in mining production was mainly driven by a decrease in production of diamonds (negative 3.2%), gold (negative 3.0%) and iron ore (negative 2.9%). Growth in gold production has been in negative territory for the past 16 months and has consistently printed below its negative 6.4% long-term average for the past year. Gold production slumped worryingly by 14% in 2018, which was the largest annual decline since 2008. The Sibanye-Stillwater mine strike, which is now close to its fifth month, has exacerbated the decline in gold production (see chart 5). Production of platinum group metals (PGMs) was, however, the largest positive contributor, growing by 17.8% y/y and it contributed 2.8% to the growth in overall mining volumes.

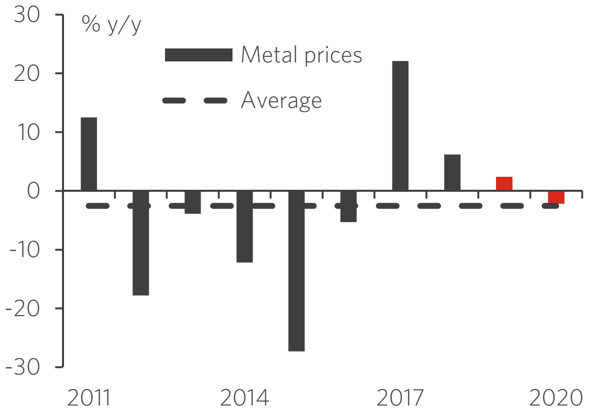
Chart 5: Gold production continues to slump



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

Momentum Investments is not anticipating a strong run in commodity prices, given slower growth in the global economy. While China has traditionally been the biggest commodity importer from SA in the past, it has changed its economic growth model towards an increased reliance on consumption and services, which dampens the outlook for commodity prices going forward. The IMF predicts a slowdown in growth of non-fuel primary commodity prices in 2019 and an outright contraction in 2020 (see chart 6).

Chart 6: Price of non-fuel primary commodities forecasted to contract in 2020



Source: IMF, Momentum Investments

Although the finalisation of the third mining charter instilled some regulatory certainty in the sector, the Minerals Council has recently filed an application for judicial review regarding certain clauses, including the continuing consequences of the previous empowerment transactions, specifically in respect of mining right renewals and the transfer of these rights. Nonetheless, the Minerals Council has mentioned the signed charter is still an improvement from the previous drafts and represents a reasonable and business-friendly charter. This judicial review could bring renewed policy uncertainty in the mining sector and detract from growth in the near term.

The Fraser Institute's annual mining survey for 2018 indicated the SA mining sector has shown overall policy attractiveness in the survey's Policy Perception Index. SA ranked 56th out of 83 jurisdictions in 2018, relative to the country's ranking of 81 out of 91 in 2017. In the overall investment attractiveness assessment, SA's geological attractiveness is taken into account. Here, SA ranked 43rd out of 83 in 2018, up from 48th out of 91 in 2017.

The improvements in this survey are likely attributable to the change in leadership when the Cyril Ramaphosa administration took over and Gwede Mantashe was appointed as the minister of minerals and resources. The Minerals Council has repeatedly mentioned an improvement in communication and transparency since the appointment of the new minerals and resource minister.

There are, however, a few lingering uncertainties, which prevent SA from achieving a higher ranking. These uncertainties include regulation in the sector (partially addressed by the mining charter), the way forward on land expropriation without compensation, inadequate corporate social investment programmes, labour instability and overall political uncertainty. Load shedding remains a risk to mining production for the remainder of 2019. The Minerals Council estimates the mining sector consumes about 30% of Eskom's annual supply.

In Momentum Investments' view, production growth for manufacturing and mining is likely to remain strained due to slower global growth and local electricity supply constraints.