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Production print for April 2019 indicates a mild supply-side recovery

Highlights

- Manufacturing growth in April 2019 surprised positively and grew by 4.6%, up from 1.3% in March 2019.
- Growth in eight out of 10 of the manufacturing production divisions improved in April 2019, relative to only five production divisions improving in March 2019.
- This improvement was largely attributable to the low base created in March 2019 and a restoration in electricity supply.
- The electrical machinery division finally broke out of the 15-month long recession and grew robustly at 12.2% in April 2019, contributing 0.2% to growth in total manufacturing.
- The purchasing managers' index (PMI) for May 2019, however, deteriorated to 45.4 index points, alongside a further drop in business confidence for manufacturers to 22 index points in the second quarter of 2019 signalling ongoing headwinds.
- Mining production data contracted by 1.5% for April 2019 relative to a year ago, from a negative growth rate of 0.7% y/y in March 2019, as strike activity continued to plague gold mining volumes in the first half of April.
- Ghana is now the leading gold producer in Africa and supplied 12% of gold output in 2018.
- Although overall business confidence remained stagnant in the second quarter of 2019, three out of the five sub-indices constituting the overall index improved, which could signal a bottoming out of sentiment in some sectors.
- Rising cost pressure, structural bottlenecks and a weaker global backdrop remain key headwinds to growth in production, however, in the absence of load shedding and strike activity, a marginal improvement is expected in the near term

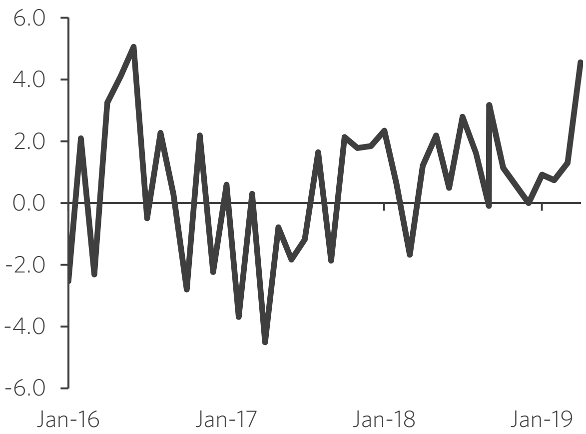
Manufacturing growth for April limits chances of a technical recession

Growth in manufacturing volumes released by Statistics South Africa (Stats SA) surprised positively in April 2019. Year-on-year (y/y) growth rose to 4.6%, higher than the 0.9% Iress consensus expectation and the 1.3% reported in March 2019 (see chart 1). Growth in eight out of 10 manufacturing production divisions improved, relative to growth in only five production divisions improving in March 2019. This improvement was largely attributable to the low base created in March 2019 and a restoration in electricity supply.

The major contribution to this robust improvement could be explained by the basic iron and steel division growing by 9.4% (previously 3.4%) and which contributed 1.8% (previously 0.7%) to growth in overall manufacturing volumes. The motor vehicles, parts and accessories division grew by 18.6% (previously negative 6%) and contributed 1.3% (previously negative 0.5%), followed by food and beverages growing at 3.3% (previously 1.1%) and which contributed 0.9% (previously 0.3%).

Manufacturing production expanded by 2.8% in month-on-month (m/m) terms in April 2019 and improved from the 0.9% increase in March 2019. In the three months ended April 2019, manufacturing production declined. The rate of decline, however, slowed to 1.1% from a 2% contraction in the three months ended March 2019.

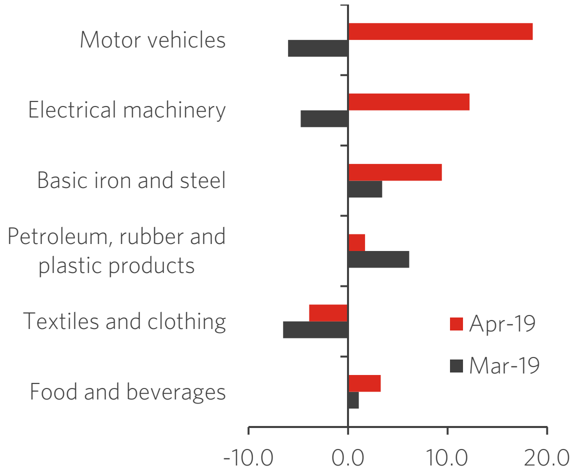
Chart 1: Manufacturing production surge (% y/y)



Source: Stats SA, Momentum Investments

The electrical machinery division finally broke out of a 15-month long recession and grew robustly at 12.2% y/y and contributed 0.2% total manufacturing volumes in April 2019. Growth in the textiles, clothing, leather and footwear division, however, remained in negative territory at 3.9% y/y (previously negative 6.5%) and deducted 0.1% (previously negative 0.2%) from total manufacturing volumes (see chart 2).

Chart 2: Manufacturing production divisions (% y/y)

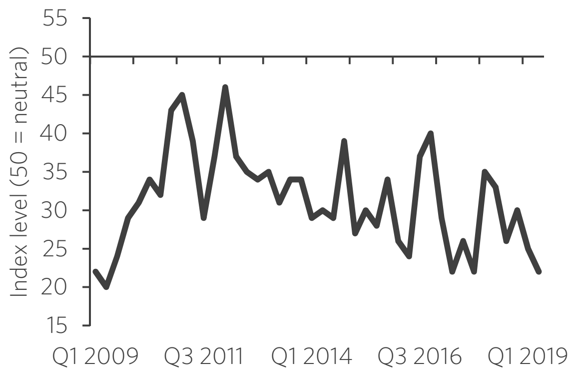


Source: Stats SA, Momentum Investments

The PMI (a sentiment gauge for manufacturers) published by the Bureau of Economic Research (BER) remained below the 50 neutral mark and deteriorated to 45.4 in May 2019 from 47.2 index points in April 2019, indicating persistent weakness in manufacturing business conditions. However, the expected business conditions sub-index remained above 60 index points in the same period boding well for a bottoming out in growth in the manufacturing sector.

The BER Business Confidence Index for manufacturers for the second quarter of 2019 also deteriorated to 22 index points from 25 index points in the first quarter of 2019 (see chart 3). Sentiment continues to display weakness amidst rising administrative costs weighing on production in the economy.

Chart 3: Manufacturers' business confidence weakens

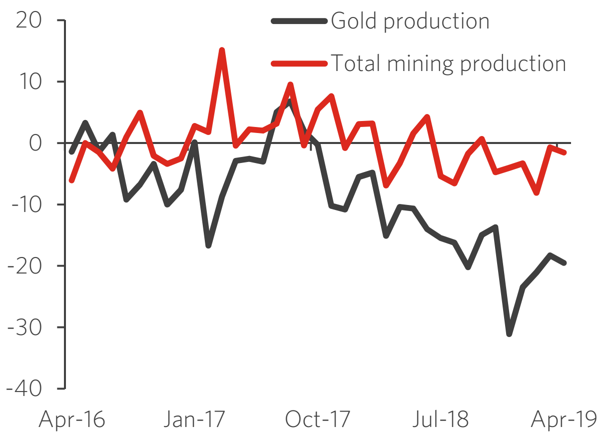


Source: BER, Momentum Investments, data up to Q2 2019

Mining production in April 2019 still bleeding from gold strike

Mining production data for April 2019 remained in contraction and weakened by 1.5% y/y from a revised negative 0.7% y/y print in March 2019. Growth on a m/m basis also reported a 2.3% contraction before growing by 4.2% in March 2019. This figure disappointed the Iress consensus, which expected a 1.4% growth uptick based on a restoration of electricity supply. The five-month-long Sibanye-Stillwater gold mine strike ended in the middle of April 2019, but continued to detract from gold production in the sector for the month. Volumes mined in the gold sector declined by 19.5% y/y in April 2019 from an 18.3% y/y contraction in March 2019. This brings negative growth in gold mining volumes to an 18-month stretch (see chart 4). The decline in gold production subtracted 2.7% from total mining volumes in April 2019. Iron ore volumes contracted by 11.9% y/y, declining for seventh consecutive month and subtracted 1.7% from the April print. This was followed by chromium ore volumes, which declined by 7.2% and subtracted 0.3% from overall mining production.

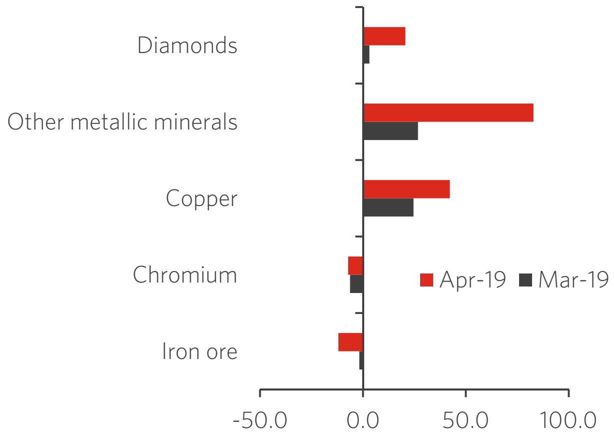
Chart4: Mining and gold production disappoints (% y/y)



Source: Stats SA, Momentum Investments

Growth in half of the 12 commodities in the mining sector improved in April 2019. The largest positive contributor was other metallic minerals, which added 1.3% and surged by 82.8% y/y in April 2019 from 26.7% y/y in March 2019 (see chart 5).

Chart 5: Growth in mining mineral groups weaker (% y/y)



Source: Stats SA, Momentum Investments

Although SA still boasts the largest gold reserves in Africa, gold mining in Ghana gained traction in 2018. Ghana is now the leading gold producer in Africa and supplied 12% of gold output in 2018. SA mining industry stalwart companies are seeing Ghana as a more attractive gold mining hub, which presents cheaper and easier mining deposits. SA scored favourably against Ghana's Policy Perception Index at 64.6 relative to 62.3 in Ghana in the Fraser Annual Survey of Mining Companies for 2018. The survey's investment attractiveness index also placed SA at a higher score of 65.3 relative to Ghana score of 54.9.

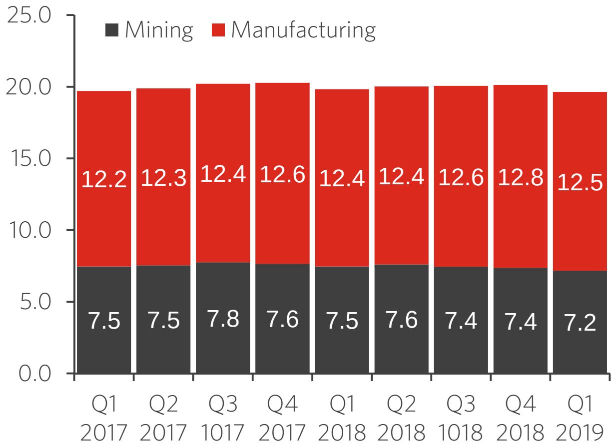
These positive scores, however, do not eliminate the cost pressure gold mining companies face in SA. Steep electricity price increases are a particular constraint for gold mining companies, with a cost basket that is heavily influenced by the electricity usage component. The SA Minerals Council lamented 75% of gold mines have been unprofitable since 2018 and the recent administrative price increases have just added more cost pressure threatening further job losses in the sector. Production halts triggered by labour disputes, through strikes, have also contributed to weakness in the gold mining sector.

Although the alleviation in strike activity should benefit the mining sector in the near term, cost pressure, structural bottlenecks and weaker global outlook continue to pose headwinds to the sector.

Production growth outlook still smothered by domestic constraints

The contribution from mining and manufacturing to the economy weakened in the first quarter of 2019 relative to the fourth quarter of 2018 (see chart 6). The share of manufacturing production to quarterly seasonally-adjusted (q/q saar) growth declined to 12.5% from 12.8%, while the share of mining softened from 7.4% to 7.2% between the fourth quarter of 2018 and the first quarter of 2019. The weakness was attributable to the constraints in electricity supply, which resulted in stage four load shedding in the first quarter of 2019, as well as labour strikes in the gold mining sector.

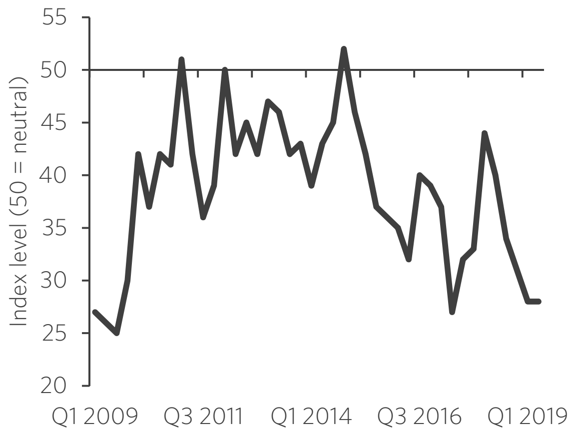
Chart 6: Production share of GDP shrinks (% of economy)



Source: Stats SA, Momentum Investments

The BER Business Confidence Index for the second quarter of 2019 remained unchanged at 28 index points. This is weaker than the 40 index points recorded in the first quarter of 2018 (see chart 7). The index declined for four consecutive quarters before remaining stagnant. Although the economy remains in a volatile state, three out of the five sub-indices that constitute business confidence improved, which is likely an indication of some reprieve in those sectors. Electricity supply constraints in the winter season remain a risk to the recovery in production volumes from the steep first quarter contraction.

Chart 7: Business confidence remains in the doldrums



Source: BER, Momentum Investments, data up to Q2 2019

Momentum Investments is aware of the downside risks to growth posed by weak demand and the possibility of additional load shedding epsiodes, but positive data for manufacturing production and retails sales for April 2019 may ease concerns about a technical recession (two consecutive quarters of negative growth).