

South Africa's manufacturing sector: A glimmer of hope in export prospects

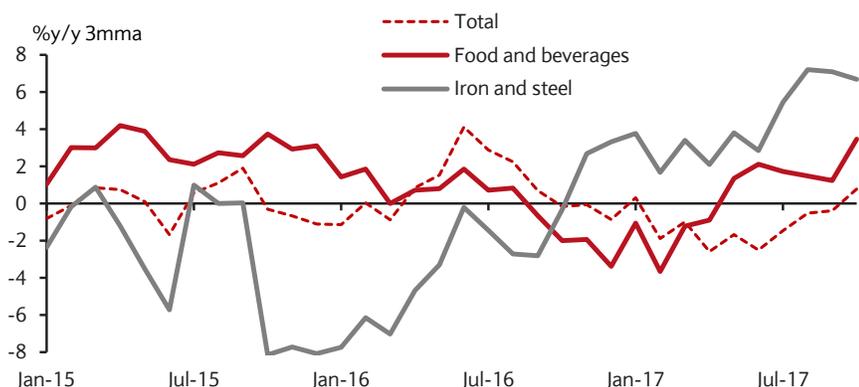
- Manufacturing production in October rose 2.2% y/y, better than we or consensus had expected. This sets manufacturing output in Q4 on a strong footing, after two successive quarters of post-recession expansion.
- The expansion is not broadly based, however. It is due almost entirely to the food and beverages sector and basic metals, which together account for about 44% of total manufacturing output.
- The Absa Q4 manufacturing survey released today also sounds a note of caution about the manufacturing sector's prospects, with sentiment remaining mired deep in pessimistic territory. Manufacturers reported an intensifying margin squeeze, and a record high level of concern about the constraint to their businesses posed by the political climate.
- Nonetheless, South Africa's manufacturers see a glimmer of hope as regards their exporting prospects. For the first time in over a decade, exporters report that export selling prices are increasing faster than domestic selling prices, despite the relative stability of the rand, and that a sizeable net majority are positive about both export sales volumes and order volumes.

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FIGURE 1
The food and basic metals sectors have pulled total output higher



Source: Statistics South Africa, Absa Research

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South Africa's manufactured output got off to a strong start in Q4

Manufacturing output has risen, but only in a narrow way

Manufacturing output in October rose 0.7% m/m sa, equivalent to 2.2% y/y, better than our forecast of 0.5% y/y and consensus's relatively more optimistic expectation of 1.1% y/y. Thus, after two successive quarters of surprisingly strong expansion and recovery from the recession-induced low in the first quarter, South Africa's manufacturing sector appears to have started off the fourth quarter on a strong footing. However, some caution is warranted here as the manufacturing sector as a whole has only just recovered its level of production to that prior to the Q4 16-Q1 17 recession. For the three months to October, total manufacturing production is up 0.8% y/y. Moreover, the recovery has actually been quite narrowly based, with food and beverages (25.2% of the index) up just 3.5% y/y in the three months to October, while the basic iron and steel sector (18.7% of the index) grew a whopping 6.7% y/y. All the other constituent broad grouping subsectors in the manufacturing output index were down y/y in the three months to October. For example, textiles, clothing and footwear was down 4.2% y/y, wood, paper and printing fell 3.9% y/y, petroleum, rubber, plastics and chemicals decreased 1.3% y/y, and motor vehicles dropped 0.4% y/y.

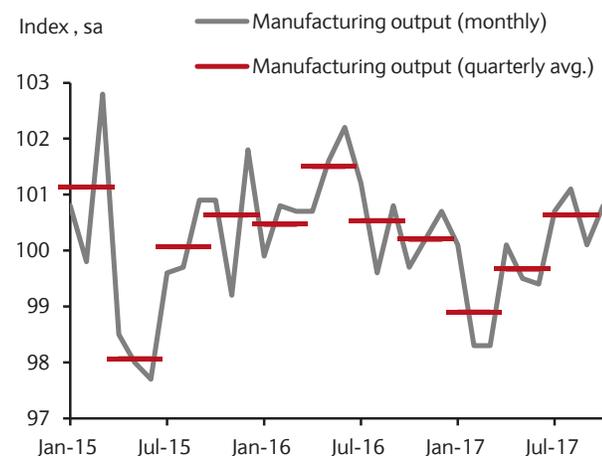
PMI has been rising over last four months, but has nonetheless remained in contraction territory for the last six months

This more cautious assessment of the manufacturing sector, despite the strong headline gains, fits in with the persistently weak survey data. For example, while the Absa manufacturing sector PMI has admittedly been edging up very slightly over the last four months, it still remains well below the neutral level of 50, where it has languished since May. Curiously, it was only in Q1 this year, when gross value added in the manufacturing sector was at a two-year low, that the Absa PMI consistently pegged in expansion territory, suggesting that caution should be exercised when drawing conclusions about the sector from any one set of data, whether it be survey based or output based. The reality is much more ambiguous and it is hard to get a clear picture from the data.

Manufacturing sector remains mired in pessimism

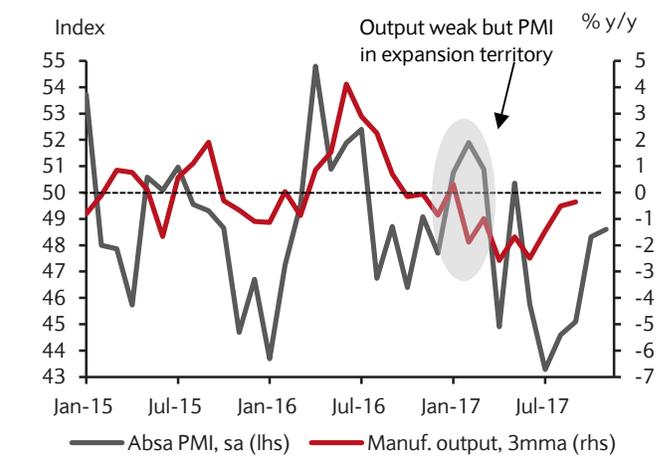
However, Absa's quarterly survey of the manufacturing sector has not presented a very encouraging picture either. The Q4 Business Confidence Index (BCI) which was published on 28 November revealed that the manufacturing sector, one of the five constituent sectors in the BCI, dipped anew, moving from 27 to 24, showing that 76% of manufacturers rate South Africa's business conditions as unsatisfactory. The manufacturing sector's sentiment has now been languishing in pessimistic territory for over a decade. And manufacturers remain quite bearish about their future prospects with a net majority of 30% reporting in Q4 that they expect business conditions to be worse in twelve months' time. Notably,

FIGURE 2
Manufactured output edged up in October



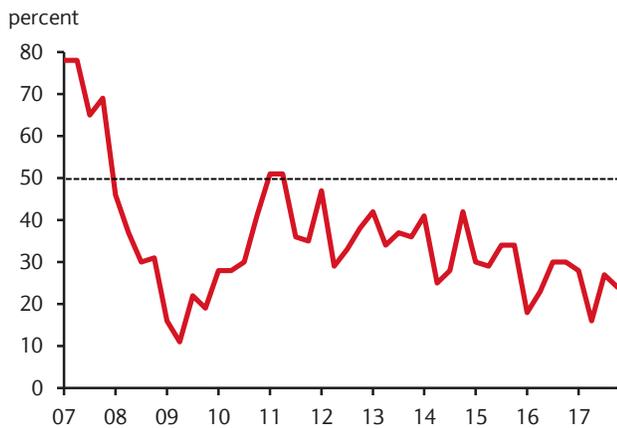
Source: Statistics South Africa, Absa Research

FIGURE 3
Steel and food have been driving recent gains



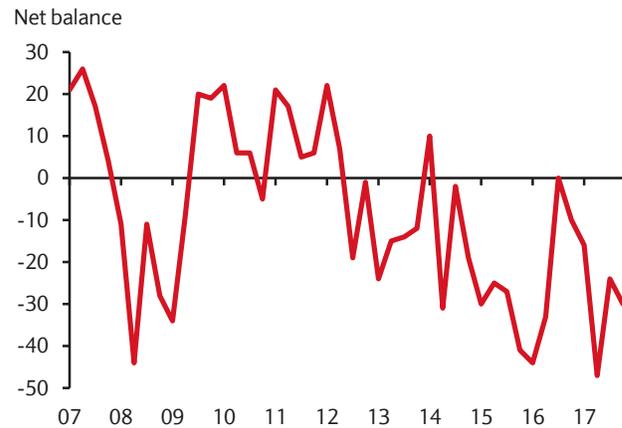
Source: Bureau for Economic Research, Statistics South Africa, Absa Research

FIGURE 4
Manufacturers: a decade of pessimism...



Source: Bureau for Economic Research, Absa Research

FIGURE 5
...and still gloomy about the next 12 months



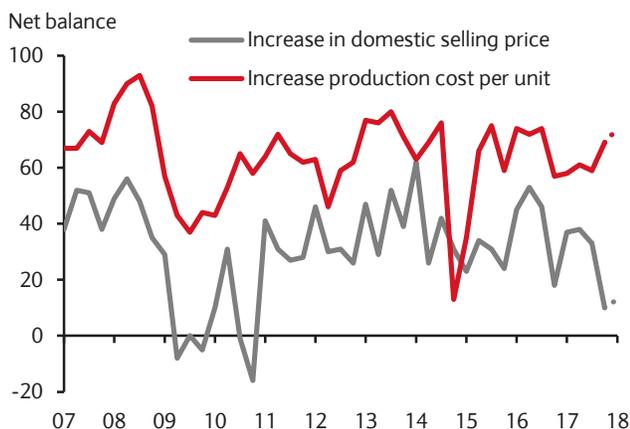
Source: Bureau for Economic Research, Absa Research

insufficient demand remains a significant constraint for nearly two-thirds of South Africa's manufacturers but by far the most significant constraint they report is the "political climate", which currently stands at a record 89%. This suggests that manufacturers' sentiment could improve quite sharply if the ANC's electoral conference produces a business friendly outcome.

Despite the overall gloom, manufacturers have become a lot more hopeful about export potential in Q4

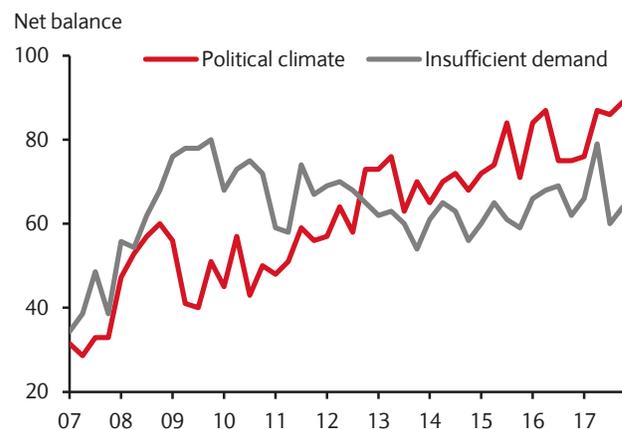
Despite the negative sentiment in the manufacturing sector that persisted into Q4, there is one potential bright spot and that is exports. The Absa manufacturing survey picked up notably more bullishness from South Africa's manufacturers about both current exports sales volumes and export order volumes, especially when compared to manufacturers' opinions about domestic sales and order volumes. (And we are cautious about the apparent recovery in manufacturers' perceptions of domestic sales and order volumes in Q4, as we think the data probably exhibit a seasonal component that will be reversed in Q1). For the first time since the global financial crisis, manufacturers report a more favourable picture as regards the rate of increase in export selling volumes than in domestic selling volumes, despite the relative strength of the rand over the year. Perhaps this optimism reflects more robust demand conditions globally. As a consequence, a net majority of 27% of South

FIGURE 6
Margin squeeze is intensifying



Source: Bureau for Economic Research, Absa Research

FIGURE 7
The political climate constraint is at record highs

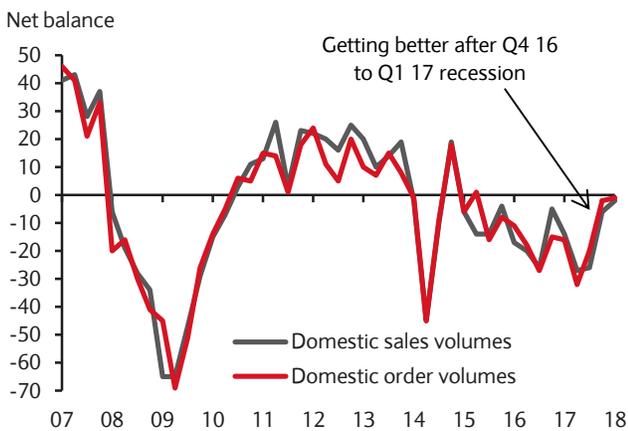


Source: Bureau for Economic Research, Absa Research

African manufacturers expect to be exporting more in 12 months' time. The gains were especially sharp in three particular sectors: transport (including the motor vehicle industry), basic metals, and clothing.

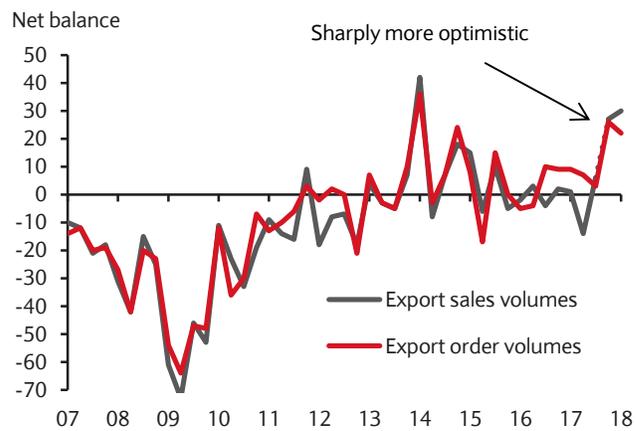
We are encouraged by the improvement in the manufacturers' views on the prospects for exports over the next twelve months but note that this series has been quite volatile in recent history. Nonetheless, it does offer a glimmer of hope. And as we noted above, if the ANC's imminent electoral conference produces a business friendly result, then manufacturing confidence could make some sizeable improvements, unlock some investment spending and lead to stronger production growth. But of course, the converse is also possible.

FIGURE 8
Some improvement in domestic orders...



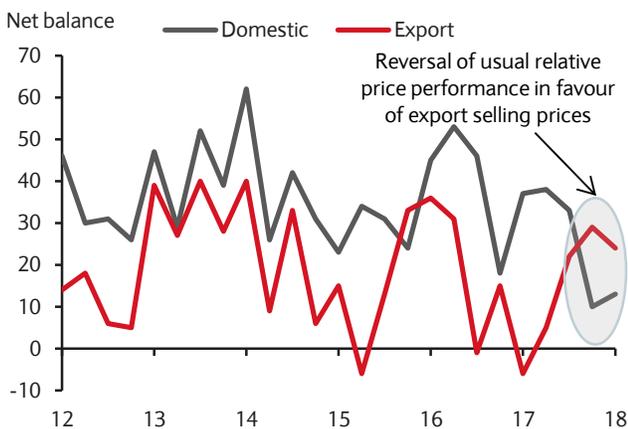
Source: Bureau for Economic Research, Absa Research

FIGURE 9
...but it's the export sector that offers most hope



Source: Bureau for Economic Research, Absa Research

FIGURE 10
Export selling prices rising faster than domestic



Source: Bureau for Economic Research, Absa Research

FIGURE 11
A big net majority of firms expect to export more



Source: Bureau for Economic Research, Absa Research

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