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MANUFACTURERS CONTINUE TO INVEST,
ALTHOUGH EXPENDITURE MODERATED IN Q2 2018

Key results (expenditure Q1 to Q2)

- Overall index **up** from 58 to 63 index points
- New plant & equipment **down** from 67 to 63; maintenance & replacement of existing equipment **up** from 54 to 70
- Expanding existing property **up** from 48 to 60; maintaining existing property **up** from 60 to 62
- Inventory **down** from 52 to 46
- R& D **up** from 58 in Q1 to 68 in Q2
- Salaries & wages **up** from 58 to 84; training & development **up** from 63 to 79

The Manufacturing Circle today released its Investment Tracker (MCIT) for the second quarter of 2018. MCIT is a quarterly composite index tracking investment trends in the manufacturing sector. The focus of MCIT is on actual expenditure patterns of a sample of manufacturing firms in the areas of property, plant and equipment, inventory, human capital and research and development. A reading above the neutral 50-point threshold indicates that expenditure is expanding; below the neutral 50-point threshold indicates that expenditure patterns are declining.

Says Philippa Rodseth, MC executive, "*the objective is to develop and derive insights about manufacturing investment patterns in the South African economic environment. Our survey covers investment in property, plant and equipment, inventory, human capital and research and development. Our micro-level data aims to supplement existing macro-level data to deepen the understanding of trends in the manufacturing sector.*"

More than 65% of respondents reported that their investment spending in Q2 2018 was within budget, and overall, investment in 7 out of the 8 sub-indices increased in Q2 2018. Companies invested more on human capital (salaries, wages, training and development) as well as on plant and equipment for expansion, upgrades, replacement and maintenance, while spending on inventories decreased.

Rodseth adds, "*Despite the drought in the Western Cape having had a major impact on some manufacturers, others are starting to see a pleasing increase in demand.*" She notes, "*It is encouraging that the composite index remains solidly above the 50-point mark, which indicates that expenditure is increasing, eventhough it has dropped below the 62 index point average recorded over the past nine quarters.*"

In line with expectations provided in Q1 2018, the latest Q2 **composite index** shows moderated investment by manufacturers compared to the preceding quarters. The year-on-year MCIT reduced by 8 indices to 58 index points, compared to 65 in Q2 2017.

The decline is due to a decrease in investment on inventories, a reduction in replacement and maintenance of property, plant and equipment as well as a decline in human capital training and development. Some respondents noted that the effects of the drought in the Western Cape had negative outcomes for production volumes. In addition, subdued demand and production over-capacity affected inventory investment. Furthermore, the risk of expropriation of land without compensation discouraged agriculture companies from further investments in new property.

Capital expenditure on acquiring **new plant and equipment** declined 13 points to 67, from 80 points in Q2 2017, while investment on **maintenance and/or replacement** of existing plant and equipment dropped 16 points to 54 over the same period.

Looking to the next quarter, some companies in the food, beverages and tobacco sectors, still feeling the effects of the drought, will not be increasing investment. The other respondents expect investment in new plant and equipment to improve by 4 points to 63 index points in Q3 2018, while spend on maintenance of plant is projected to rise by 16 points to 70 in the next quarter. Manufacturers in the packaging and paper sector have indicated that they continue to strive to achieve a global competitive advantage by investing in biomaterials and bio-chemicals. Any new investment by the textiles and clothing sector in plant and equipment will be to meet growing export demand.

Expenditure on expanding **existing property** or purchasing new buildings recovered by 6 index points to 48, up from the revised 42 points in Q1 2018, but disappointingly remained below the 50-point mark where it has been since this time last year. The quarter on quarter growth, was mainly a result of the new production facility in the electrical machinery and electronics sector to boost local production of pre-paid electricity meters.

Although spending on **maintenance and replacement** of property fell from Q1 2018, year on year, investment recovered sharply - by 11 points - from 49 points in Q2 2017 to 60 in Q2 2018.

Manufacturers are more optimistic about investment spending on existing property and new buildings, as well as maintenance or replacement for Q3 2018, projecting growth by 12 and 2 points to 60 and 62 index points respectively. The improved export demand for textiles, clothing and leather goods is one of the reasons manufacturers are expecting to increase investment in the third quarter. Other manufacturers - in the packaging and paper sector - plan to increase capital spending on new property to increase capacity to optimal levels, minimise production costs, to use less water and harness the benefits of new technology.

Expenditure on **inventory** fell to 52 index points in Q2 2018 compared to 54 this time last year and dropped 9 points since Q1 2018. Manufacturers are anticipating a further decline in 46 points in Q3 2018, due to reduced turnover and lower demand as a result of customers with cash flow problems and the increase in customer liquidations or business rescue.

Food, beverage and tobacco producers in the Western Cape continue to face lower crop levels, which they expect to persist, resulting in reduced inventory levels. In the basic iron and steel sector, import pressure and the lack of adherence by government to designation has led to lower inventory levels. In the diverse sectors producing chemicals, minerals, energy, water, defence and security related products, companies have inventory build ups due to customers delaying taking delivery of goods.

Investment in **R&D** rose slightly to 58 index points in Q2 2018 and was higher than in the same quarter last year. Encouragingly, manufacturers plan to increase spending on R&D to the highest reading since the start of the MCIT Composite index to 68 index points in Q3 2018. The reasons differed across sectors: manufacturers in the basic iron and steel sector anticipate growth in expenditure to keep them on par with global competitors whose products continue to be imported into South Africa. Companies in textiles, clothing and leather goods will invest further to meet growing export demand. In contrast, some in the electrical machinery and electronics sector plan to reduce expenditure on R&D in Q3 due to having fewer orders in the pipeline. Manufacturers in food products, beverages and tobacco products are adopting cost-containment measures to mitigate the effects of the drought.

Expenditure on **salaries and wages** recovered in Q2 2018 to 62 compared to 58 in Q2 2017 and 55 index points in Q1 2018. There was an increase in spend on **training and development**, up by 6 points compared to this time last year and 4 points higher than the previous quarter. Salary adjustments due to inflation and annual increases (including the rise in the minimum wage), partly contributed to the improvement.

A sharp rise is anticipated in Q3 2018 to 84 index points in salaries and wages and 79 points in training and development spending. This is to support or accelerate production processes to meet outstanding orders and growing export market demand in various sectors. In some cases, the moratorium on new appointments is starting to lift as companies anticipate returning to normal production levels.

Rodseth notes, "*the tough economic conditions in 2018 continue to impact manufacturers. We are encouraged that despite the moderation in investment, companies are optimistic going forward about improved expenditure in the various sub sectors of our index*."

She adds, "*right now, the SA manufacturing sector has significant underutilised capacity, and urgent demand-side interventions are required to slow the rate of job losses and de-industrialisation before real growth is observed, and new jobs are created. Until and unless adequate demand is created for current capacity (whether it be through exports, import replacement or incremental aggregate domestic demand), we cannot expect to see significant additional investment in the sector. We need a collaborative approach to drive demand-side interventions*."

She concludes, "*Manufacturing, with its strong multiplier effects on value addition, job creation, export earnings and revenue generation, is the one sector in the economy that has the potential to create jobs. But growing demand for manufactured products is the key to its success. The Manufacturing Circle - the voice of our industry - is working actively to bring about a resurgence of manufacturing in South Africa. The focus areas for implementation of projects which will make a difference are skills, local procurement, fiscal policy, trade policy and infrastructure*."

For further information and interviews:

Jo Bryden – jo@manufacturingcircle.co.za

Background Notes:

The Manufacturing Circle Investment Tracker (MCIT) is compiled by Trade and Industrial Policy Strategies, tracking investment trends in the manufacturing sector on a quarterly basis.

Dominant sub-sectors include motor vehicle, parts and accessories and other transport equipment (30%); basic iron and steel, non-ferrous metal products, metal products and machinery (26%); and petroleum, chemical products rubber and plastic products (20%). The majority of enterprises surveyed are medium to large sized firms, employing more than 200 employees and together employ more than 51 700 staff members. They have combined annual revenue estimated at R113.4 billion and the annual average revenue is around R4.54 billion.

The latest survey sample of manufacturers in all nine provinces of South Africa showed that Gauteng (at least 40%) and Western Cape (at least 20%) continue to host the majority of the manufacturing operations. Most companies sampled in Q2 2018 operate in the basic iron and steel (15%); motor vehicles (15%); textiles (15%); and packaging (11%) manufacturing sectors. Western Cape hosts most of the operations in the textiles, clothing and leather goods sector, while Gauteng hosts basic iron and steel sectors. Motor vehicle operations are spread across Eastern Cape, Gauteng, Free State and Kwa-Zulu Natal provinces.