Investec

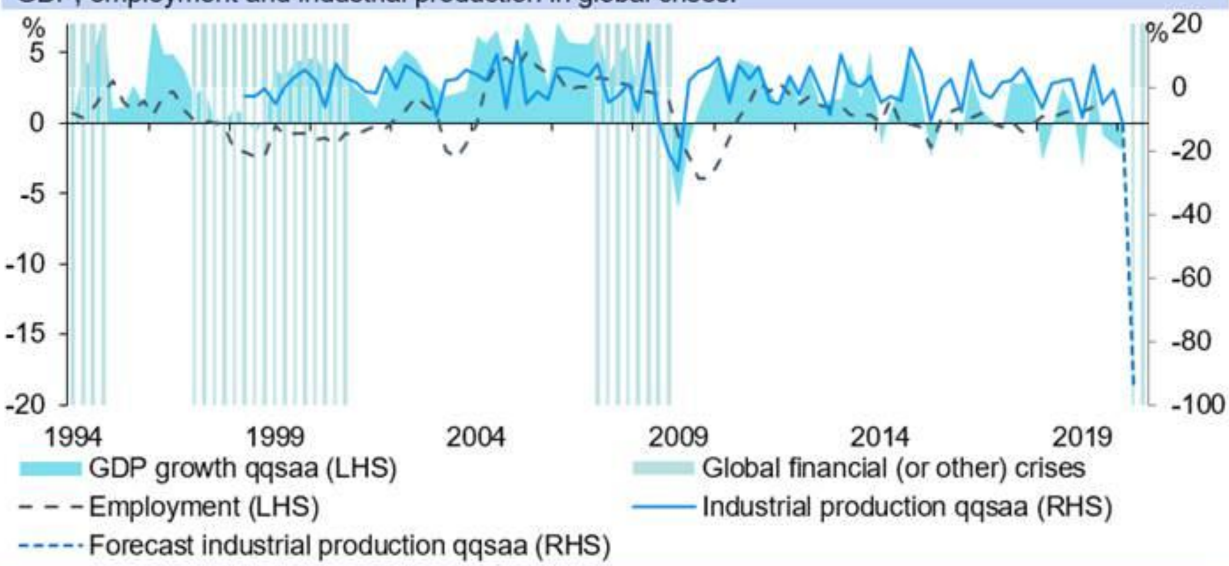
SA Economics

Industrial production note

Thursday 21 May 2020

The first two months of Q1.20 saw industrial production contract by -11.6% sa versus the previous period, which does not bode well for the quarter, or for the GDP outcome for Q1.20 either. Q2.20 will see a deep contraction

GDP, employment and industrial production in global crises:



Source: SARB, Investec, Statistics SA. Note: last industrial production point two month average

- The first two months of Q1.20’s manufacturing and mining data (February’s prints delayed to yesterday) show, in conjunction with electricity production, that industrial production fell by -11.6% vs. the same period in Q4.19, seasonally adjusted, annualised (saa). The three sub-components saw around double digit contractions, on an annualised basis.

- GDP sank into recession in Q4.19, contracting by -0.8% qqsaa (quarter on quarter, seasonally adjusted annualised) in Q3.20, and by -1.4% qqsaa in Q4.19. Industrial production fell by -4.8% qqsaa in Q3.19 and in Q4.19, it fell by -0.7% qqsaa. GDP was driven lower in Q4.19 chiefly by contractions in trade, transport, construction and agricultural activity.

- With Q1.20 GDP figures typically due in June, incoming data so far is showing some marked weakness. The full quarter’s electricity production is available for Q1.20 however, and shows a -7.5% qqsaa contraction, down on the -3.8% qqsaa contraction in Q4.19, and a -7.9% qqsaa contraction in Q3.19. These figures have been due also to electricity shortages.

- Q2.20 has seen Eskom report repair and maintenance, with Medupi’s unit 3 at full generating capacity (793MW) after significant design defects were rectified, and Eskom is working on similar modifications to unit 1 and 6. Unit 4, 2 and 5 will undergo the same modifications in July, August and November respectively.

- While the Covid-19 nationwide lockdown has provided space for the outage of Medupi’s Unit 3 as demand for electricity decreased materially, the lockdown from March 27th already contributed to the sharp -2.0% m/m, sa (seasonally adjusted), decline in electricity production in that month. April however will see a huge plunge in production.

- Level five lockdown, which stretched over the whole of April, saw industry essentially shut down, as miners and manufacturers had to close operations completely except for security, necessary maintenance and other essential services to keep their operations viable for the future. This will see industrial production collapse in Q2.20.

- Mining and manufacturing production account for 90% of industrial production, while electricity production, at 10%, will likely not dip by as much as mining and manufacturing production in April, as households, essential services and other users maintain their demand, or cut back somewhat.

- While May, at level 4 saw some notable opening up, manufacturers and miners still cannot operate at full capacity, while shortages of imported raw materials are also being noted, harming production. South Africa needs to urgently open up its ability to import ALL items, in order to see industrial production benefit from level 4 and the transition to level 3.

- Retailers are already reporting some stock shortages, and interruptions to South Africa's supply chain will worsen as inputs (including raw materials) cannot be accessed. However, availability is also impacted where international supply is negatively affected by lockdowns in those countries of origin.

- Businesses show that 53% have not been able to get the materials, goods or services they need, while 86% of those to who imports are applicable show that their ability to import has been affected, the same percentage reflecting that their ability to export was affected (for those businesses for whom exporting was applicable) – Statistics SA data.

- Depending on what the restrictions are for level 3, industrial production could see close to a -55% y/y collapse in Q2.20, and a -52% drop compared to activity in Q1.20, with shortages to the supply chain, although these figures could be even worse than we estimate as the trajectory of opening up the economy is not certain.

- Statistics SA further shows that, for the businesses that it is applicable, 70% of businesses have not been able to get the goods, services or materials they need. Furthermore, for 44% of businesses (that it is applicable for), show that prices have increased more than normal in the survey period (second two weeks of April).

- This is in contrast to the general decline in purely essential goods and services noted by Statistics SA over most of April and it is likely that some disinflation (falling inflation) or deflation (falling prices) will occur in the short-term. However, in the medium- to longer term an acceleration in price increases, due not only to shortages, is likely.

- Statistics SA also shows that for the proportion of individuals whose income has reduced since the lockdown started, 25% had to close their business and 25% saw their company close down, while 20% saw demand fall for the goods and/or services their business offered. 5% saw reduced hours of work and 3% could not work due to travel restrictions.

- The financial hardship also included 2% seeing UIF payments smaller than their usual salary, 2% saw their remittance from someone who was working decline and the remainder listed other reasons. Of everyone surveyed, 75% have reduced expenditure in the lockdown, 52% have accessed savings and 37% now rely on family or friends for income.

- Furthermore, 41% in the same survey (which is of a small cohort and not of the entire business sector) said they had to obtain new debt to cover their expenses. The Reserve Bank's 2.75% cut in interest rates this year is helpful for reducing debt service costs, but the longer the lockdown lasts the more individuals will lose their jobs/businesses.

- Indeed, 47% already show they had to use their savings (that they were intending to use for other purposes) to cover their living expenses during the national lockdown. Savings are being run-down, while demand is also being negatively affected as incomes moderate. As demand diminishes, GDP responds by declining.

- Additionally, as demand diminishes companies that are still in business see turnover negatively affected and look to cut costs (retrench staff, order less to sell, etc.). This creates a negative cycle, a downwards spiral lower and lower the longer the lockdown is imposed.