momentum investments

The Macro Research Desk

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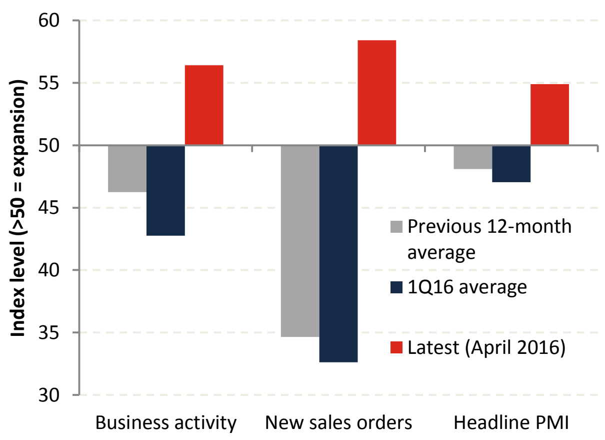
Pace of improvement in April PMI unlikely to be sustained

PMI at highest reading since 3Q13

Notwithstanding a muted global backdrop and ongoing domestic challenges, the Barclays/BER Purchasing Managers' Index (PMI) continued on its upward trend, racing ahead to 54.9 index points in April 2016 from 50.5 points in the previous month. The reading was also markedly higher than the recent October 2015 trough where the overall index dipped to 43.3 points.

The improvement in the headline index was driven by both current and expected conditions as reflected in the business activity and new sales orders indices. The business activity sub-index rose to its highest level since January 2015 and has improved for three months in a row. The new sales orders component surged to a reading of 58.4 points (see chart 1), the highest level since mid-2011. Barclays attributes this improvement to import substitution which has benefited some manufacturers in light of a weaker exchange rate as locally-produced goods started becoming cheaper in relation to imported products. Despite a recent pullback in the local currency, the rand has depreciated by nearly 21% against the US dollar and by 19% on a trade-weighted basis over the twelve-month period to the end of April 2016. The survey suggested that there was an uptick in exports which facilitated a rise in the index despite poor domestic demand conditions weighing negatively on local demand.

Chart 1: Sharp uptick in business activity and new sales orders



Source: Barclays/BER

Firmer currency alleviated input cost pressures in April

The price index dipped for a second consecutive month to 77.7 points in April despite a steep fuel price increase. Rand strength over April likely drove the decline in the price index, but this sub-component remains higher than the 71.6-point long-term average highlighting ongoing price pressures for SA manufacturers.

Jobs growth in the sector will be slow to follow

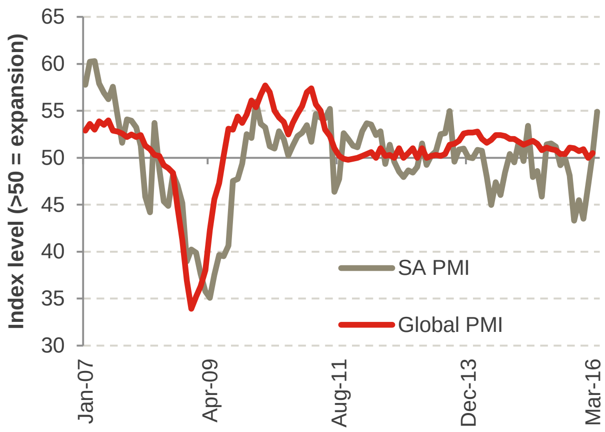
The employment indicator rose above the crucial 50 level for the first time in nearly two years to 50.4 points in April 2016. However, the outlook for employment in the manufacturing sector remains bleak particularly as the recent upward momentum in the PMI is unlikely to be maintained at its current pace. Tenuous labour market relations, steep increases in nominal wage settlements and anaemic growth in domestic demand provide a challenging backdrop for hiring and ramping up fixed investment in the manufacturing sector.

Mixed trends in global manufacturing

Factory activity in the United States (US) expanded moderately in April buoyed by a one-and-a-half year high in the export orders reading. The sub-components revealed that the inventory overhang appears to abating, boding well for growth in the US manufacturing sector. The manufacturing PMI for the Eurozone was revised slightly higher from the original flash estimate from 51.5 points to 51.7 pointing to a modest growth outlook for the region. The sub-components revealed an uptick in export activity, but also noted further disinflationary pressures as businesses continued to cut prices.

Meanwhile, the PMI dropped to 49.2 points in the United Kingdom (UK) from a reading of 50.7 points in March. This was the first time since 1Q13 that the headline index fell below the all-important 50 level, potentially reflecting uncertainty about the upcoming European Union referendum scheduled for the 23rd of June this year. As such, investment and growth in the UK are likely to slow into the second quarter of the year. In China, the Caixin manufacturing PMI (focusing on the smaller and medium-sized enterprises) reading fell unexpectedly to 49.4 index points from 49.7 in March. The survey reported little progress on new orders, while export orders fell for a fifth consecutive month despite actual exports rising at their fastest pace in March earlier this year. We expect conditions in the traditional sectors of growth, namely exports and manufacturing, to remain under pressure in China in the near term, while the new drivers of growth including consumer and services-led sectors are likely to underpin overall economic activity, keeping growth broadly in line with Chinese officials' estimates.

Chart 2: SA's sharp outperformance unlikely to be sustained



Source: Barclays/BER, Momentum Investments, data up to April 2016 for SA PMI

Broad-based improvement in PMI sub-indices encouraging, but rate of improvement likely to slow

Barclays noted that the broad-based nature of the increase in the PMI signals an encouraging trend, potentially marking a bottoming out in manufacturing production. However, risks prevail. Major downgrades to global GDP growth since the start of the year highlight a fragile growth backdrop globally, while SA manufacturers continue to face soft domestic demand and the potential for electricity and labour disruptions locally which will likely temper the extent to which SA's beleaguered manufacturing sector recovers.