momentum investments

From left to right: Herman van Papendorp (Head of Investment Research and Asset Allocation), Sanisha Packirisamy (Economist)

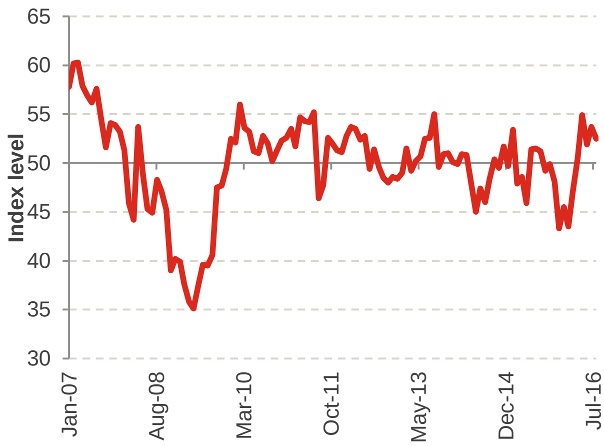
July PMI dips slightly, but still points to a relatively firm start in 3Q16

Manufacturing sentiment signals a decent start to 3Q16, following firm 2Q16 data

The Barclays/Bureau of Economic Research (BER) Purchasing Managers' Index (PMI) fell by 1.2 index points to 52.5 in July 2016. Readings above 50 signal an expansion in manfuacturing activity and as such today's manufacturing sentiment print tentatively indicates a relatively firm start to the third quarter of the year. The index averaged 53.5 index points in the second quarter of the year suggesting a potential rebound in manufacturing activity which declined by 0.9% in year-on-year terms in 2Q16.

Although the business activity sub-component slipped 4.8 index points in July to 49.5 points, the new sales orders index rose to 54.4 index points, painting a promising outlook for future demand levels. According to the BER, demand continues to be supported by an improvement in export performance. This, together with the fact that PMI figures held up in core constituencies in the Eurozone, is a positive signal that the UK's Brexit vote may not be that damaging for SA's export performance going forward. Nevertheless, respondents remained downbeat about domestic demand suggesting little chance of a sharp reversal in gross domestic expenditure in the upcoming quarter.

Chart 1: Headline PMI records above 50 for the fifth consecutive month



Source: Barclays/BER

Stronger exchange rate and lower oil prices erode cost push pressures

The price index moved lower to 72.1 points in July 2016 most likely on the back of lower international oil prices and a firmer domestic currency. The rand strengthened by 4.3% against the US dollar between June and July (using the monthly average), while oil prices firmed up by 6.5% on average over the same time period.

Employment index recovers in line with an improvement in activity

Positive manufacturing sentiment has spilled over into employment prospects. The employment index rose to 52.6 index points in July 2016 from a recent low of 39.3 points in January earlier this year. Jobs data from Stats SA however continued to show a decline in employment in year-on-year terms in the manufacturing sector in 2Q16. According to Stats SA, 9 000 jobs were lost between 2Q15 and 2Q16. We remain cautious on employment gains in the manufacturing sector as 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 sector.

No clear signs of recovery in global manufacturing

Flash estimates for the manufacturing and services industries in the US indicate positive trends in new sales orders and employment gains, boding well for US GDP growth in the remainder of the year, notwithstanding a worse than expect second quarter print.

Meanwhile, the manufacturing PMI in the Eurozone showed a moderation in industrial activity in July. While the headline print remained firmly above 50 index points in Germany, Austria and the Netherlands, the outlook was weaker in Italy (printing at an 18-month low), Spain (31-month low) and France (4-month low). Production volumes grew at their fastest pace in Germany in over two years, whereas further declines in production levels, new orders and staffing levels were noted in France. The ongoing divergence in the economic outlook across the Eurozone poses a key challenge to policymakers in the region.

Manufacturing sentiment disappointed in the UK, in the first PMI reading since Britain's decision to leave the European Union, slipping to a three-year low at 48.2 points. A negative PMI print further reinforces our view for monetary policy easing by the Bank of England in upcoming rate-setting meetings.

Recent gains in the Japanese yen have weighed negatively on exporters' earnings. The Japanese manufacturing PMI sub-index for exports pointed to the fastest contraction in new export orders in more than three and a half years. The headline print remained below the crucial 50 level, at 49.3 points in July, for the fifth consecutive month flagging further stress in economic activity. The latest stimulus efforts by the Bank of Japan (including an increase in its exchange-traded fund purchase program to ¥6 trillion from ¥3 trillion per year, but leaving the benchmark interest rate unchanged at minus 0.1%) disappointed markets, leaving the yen firmer and dashing hopes of a recovery in growth and inflation.

In China, the manufacturing sector showed mixed results. The official survey tracking large and state-owned enterprises ticked 0.1 points lower to 49.9 in July, while the Caixin PMI (surveying smaller private sector firms) rose above 50 for the first time since February 2015. According to JP Morgan, flooding in parts of China negatively affected near-term domestic production by the larger enterprises while an upturn in the tech cycle boosted export-oriented private sector firms. Nonetheless, the growth outlook for the second half of the year remains under pressure and as such supportive fiscal and monetary policies will be necessary to arrest a sharper slowdown in economic activity.

PMI holding up, suggesting we are potentially past the worst in SA's manufacturing performance

With the PMI remaining above the 50 mark for the fifth consecutive month and signs of cost pressures diminishing, manufacturing sentiment likely indicates that we are past the worst point in manufacturing performance. That said, risks to the outlook remain to the downside. Global GDP growth projections and expectations of global trade activity have yet again been lowered by the International Monetary Fund in their latest July 2016 World Economic Outlook update sketching a fragile growth backdrop globally, while depressed domestic demand will likely dampen the extent to which SA's manufacturing sector recovers.

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