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MANUFACTURING CIRCLE INVESTMENT TRACKER

A quarterly index tracking investment spending in the manufacturing sector

Q3 2018

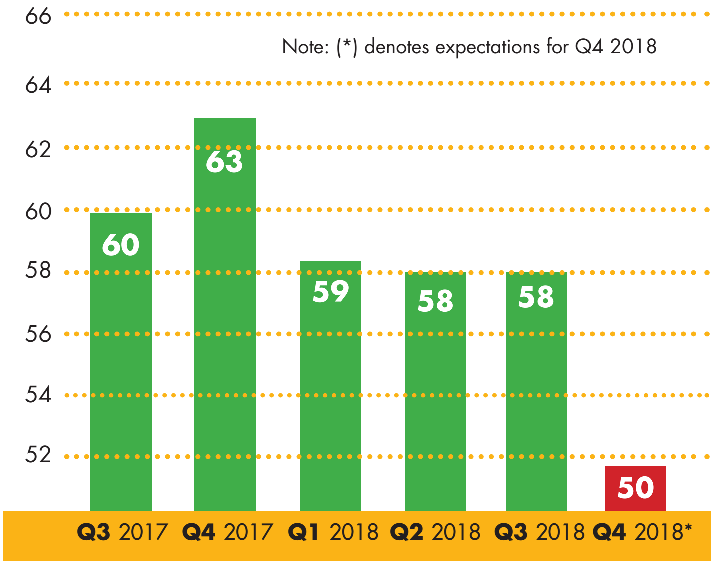
SUMMARY FINDINGS AND OUTLOOK: MODERATED MANUFACTURING INVESTMENT IN Q3 2018

The MCIT Composite Index measures the investment by manufacturing firms in the following indices:

1. Inventory
2. Plant and Equipment
3. Property (Land and Buildings)
4. Human Capital
5. Research and Development (R&D)

The MCIT survey for Q3 2018 revealed stable investment spending on par with industry expectations and firmly above the 50-point mark. The MCIT Composite index was unchanged at 58 index points on a quarter-on-quarter basis, while declining by 2 indices from 60 in Q3 2017 and by 12 index points from Q3 2016. The downward trend is reflective of the current recession in the country *(See Figure on next page).*

The investment outlook for the 4th quarter of 2018 is filled with uncertainties. In line with the distressed manufacturing PMI, manufacturers' investment sentiment for Q4 2018 is projected to drop to 50 index points. Investment cuts are expected on inventory and maintenance and replacement of plant and equipment, lowering the overall investment levels for the 4th quarter.



The lacklustre demand, especially infrastructure projects, rising inputs costs due to inflation and increasing electricity prices, and depreciation of the Rand, added to inadequate skills (from labour supply side), policy uncertainty, subdued investor confidence, weak investment returns, trade protectionism/restrictions, cheap steel imports, are some of the hindrances cited by manufacturers in the steel sector. The planned Chinese investment in the stainless steel sector is not helping domestic investment prospects. The industry has continually emphasised that the sector is small and there is no room for new entrants (suppliers) in the stainless steel sector. They have called for beneficiation in the sector to support export competitiveness and bolster the sector's contribution to the GDP and its job creation abilities.

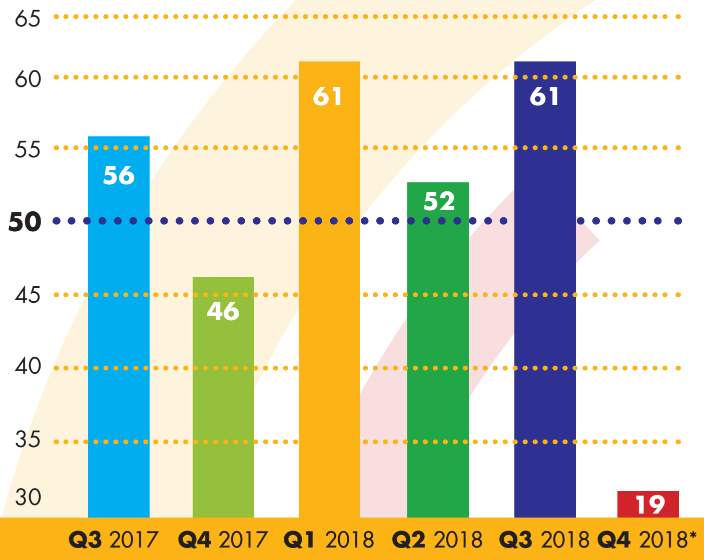
Paper and packaging manufacturers are counteracting rising inputs costs by raising prices of paper and packaging products and by responding to increased demand for special packaging. Companies in this sector plan to invest further in property, plant and equipment expansion, maintenance and replacement projects and high quality products to remain competitive. Encouragingly, they foresee opportunities for diversified investment across the manufacturing industry value chains.

In the automotive sector demand for lightweight vehicles is increasing. Manufacturers in the transport equipment sector continue to invest in collaborative strategic growth initiatives that will lead to the adoption of new technologies.

The quarterly labour force survey reported by Stats SA showed that the manufacturing industry shed at least 25 000 jobs, both on a year-on-year and a quarter-on-quarter basis. Among the big industry employers, automotive OEM, wearing apparel, paper and paper products, petroleum and beverages sectors shed more jobs in Q3 2018, which could, to some degree, explain the expected capital savings on human capital remuneration in Q4 2018.

Sub-Index

1. Inventory



Investment on inventory at 61 index points was above both expectations for Q3 2018 and actual performance Q2 2018. In particular, metals, wood, packaging & paper, chemicals and transport equipment sectors contributed to the increase in capital expenditure on inventory in the quarter. The view of manufacturers for Q4 2018 is that weaker domestic demand and export performance will contribute to a very depressed investment outlook of 19 index points.

Note: (*) denotes expectations for Q3 2018
(....) denotes the 50 - point mark

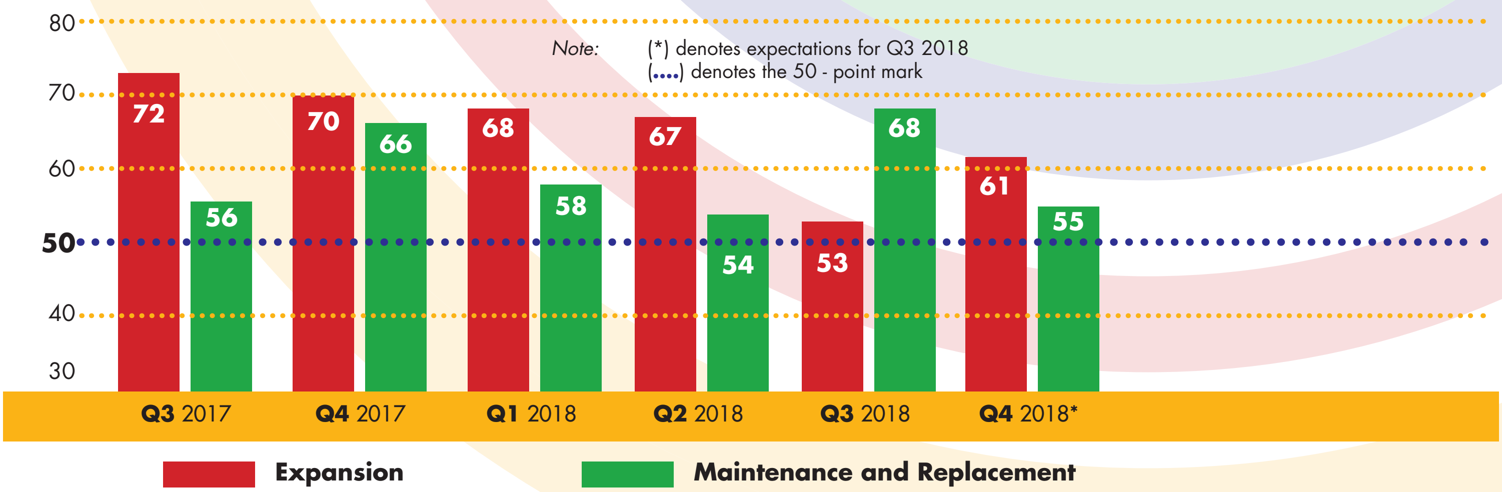
2. Plant and Equipment

The sub-index, Plant and Equipment, is divided into two categories:

1. Expenditure on acquiring new plant and equipment
2. Expenditure on maintaining and replacing existing equipment

Investment on acquiring/expansion of plant and equipment at 53 index points fell sharply compared to both Q2 2018 (67) and Q3 2017 (72). Manufacturers plan to invest more in Q4 2018, indicating the index should rise to 61.

Investment on maintenance and replacement of plant and equipment accelerated by 14 to 68 index points in Q3 2018, but by only 1 compared to Q3 2017. Q4 2018 is forecast to drop to 55.



3. Property (Land and Buildings)

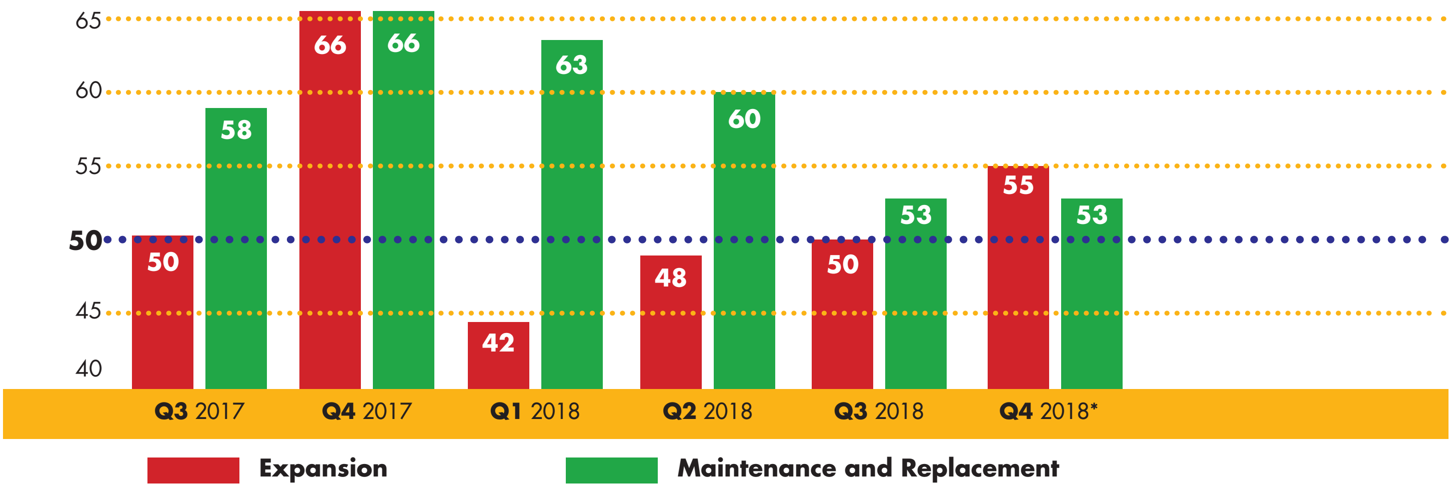
Property (Land and Buildings) is divided into two categories:

1. Expenditure on expanding existing property or the purchasing of new buildings
2. Expenditure on maintaining existing property

The year-on-year expansion of property was unchanged at 50 index points in Q3 2018 and improved quarter-on-quarter by 2 indices compared with 48 index points in Q2 2018. Manufacturers expect investment expenditure in this area to improve in Q4 2018 to 55 index points.

Investment expenditure on maintenance and replacement of land and buildings slowed down by 5 indices year-on-year and 7 indices quarter-on-quarter. Manufacturers do not anticipate further spending on property maintenance in Q4 2018.

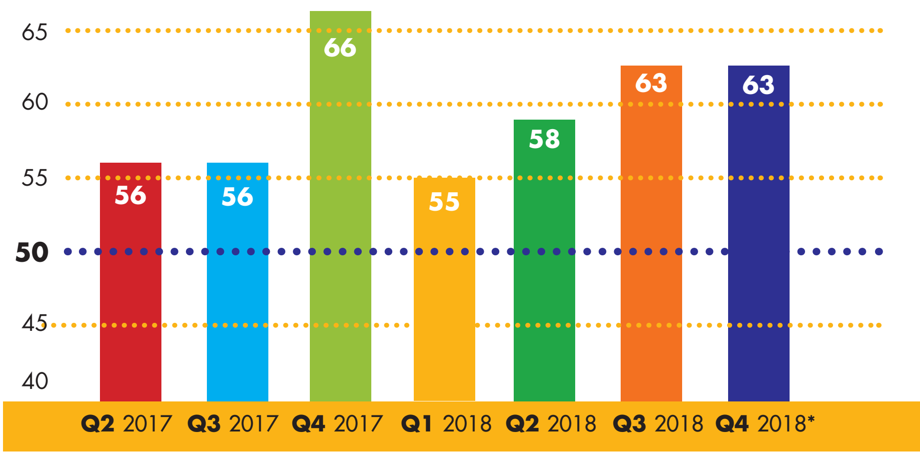
Note: (*) denotes expectations for Q3 2018
(....) denotes the 50 - point mark

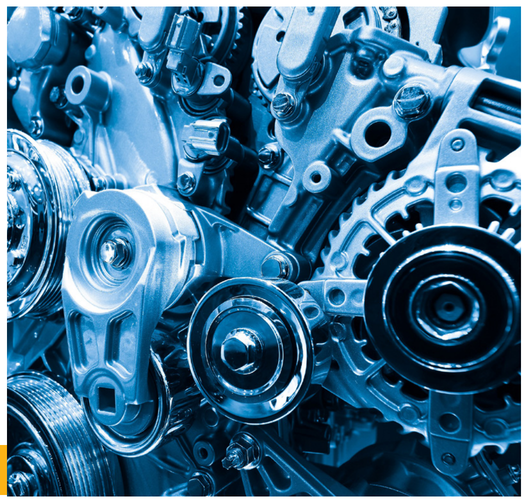


4. Research and Development

Capital expenditure on R&D at 63 points strengthened by 5 indices versus Q2 2018, and improved by 7 indices, year-on-year. Manufacturers are not planning further investment spending on R&D in Q4 2018.

Note: (*) denotes expectations for Q3 2018
(....) denotes the 50 - point mark





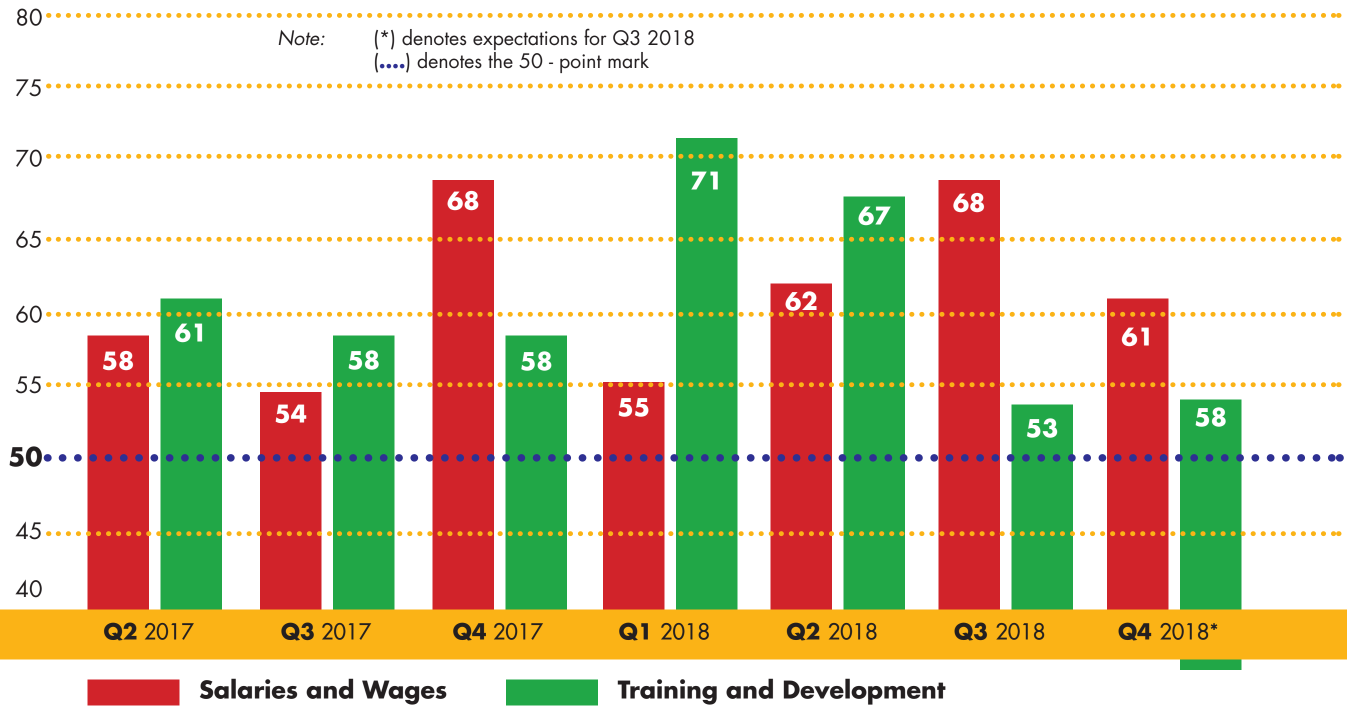
5. Human Capital

Human Capital is divided into two categories:

1. Expenditure on salaries and wages
2. Expenditure on training and development

Expenditure on remuneration grew strongly in Q3 2018, rising by 14 indices from 54 in Q3 2017 and by 6 indices from 62 in Q2 2018. The increase is partly due to annual inflation related salary adjustments, among others. Q4 2018 is expected to see a reduction in remuneration spend to 61.

The quarter-on-quarter investment on training and development decreased significantly by 14 indices to 53 index points, with the year-on-year reduction 5 index points. Manufacturers plan to channel more financial resources towards training and development in Q4 2018, with the forecast up to 58 points.



Background and objective

The Manufacturing Circle Investment Tracker (MCIT) is a composite index tracking investment trends in the manufacturing sector on a quarterly basis. The focus of MCIT is on actual expenditure patterns of a sample of manufacturing firms across all sub-sectors of the sector. 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.

The objective is to develop and derive insights about manufacturing investment patterns in the South African economic environment. The micro-level MCIT data aims to supplement existing macro-level data to deepen the understanding of trends in the manufacturing sector. Trade and Industrial Policy Strategies (TIPS), on behalf of the Manufacturing Circle, compile this publication.

Survey sampling: Profiling the firms surveyed in Q2 2018

The majority of sampled companies in Q3 2018 operate in the basic iron and steel (38%); motor vehicle (10%); and electrical machinery and electronics (10%) manufacturing sectors. Furthermore, more than half of respondents/ manufacturers reported that their investment spending in the third quarter of 2018 is within their budget range i.e. (actual not more than 5% above or below budget), with the larger chunk of the budget (81%) allocated towards R&D, human capital and property expansion.

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