September manufacturing growth slows, backs rate cut

The rate of growth in manufacturing production in September slowed to 1.4% year-on-year (y/y) after increasing by an unrevised 5.3% in August, Statistics SA said on Thursday 11 November.

Output fell by 0.4% over the month and by 1.5% in the third quarter of 2010 compared with the second quarter.

Negative growth rates were reported by five of the ten manufacturing divisions during the period.

The motor vehicles, parts and accessories division in particular dragged quarter on quarter growth lower.

The 1.4% increase was due to higher production in the petroleum, chemical products, rubber and plastic products division; the food and beverages division; the wood and wood products, paper, publishing and printing division; and the electrical machinery division.

The lower than expected manufacturing production data strongly backs the case for another reduction in interest rates.

The SA Reserve Bank's (SARB) monetary policy committee sits from 17 to 18 November to decide on rates.

Cut likely?

The latest manufacturing production figures, along with a stronger rand, lower inflation and economic growth are some of the factors that have led many analysts to believe that the bank is increasingly likely to cut rates.

"The manufacturing data corroborates our base view for a 50 bps [basis points] rate cut next week, with the repo ending the year at 5.5%," Standard Bank economist Shireen Darmalingam said.

On implications for third quarter gross domestic product (GDP), Darmalingam suggested that the manufacturing sector is likely to subtract 1.2 percentage points from third quarter economic growth compared to a contribution of 1.1 percentage points in the second quarter.

Stats SA will release the third quarter GDP figures on 30 November.

The Bureau for Economic Research (BER) was not expecting a further reduction in interest rates but has since changed its forecast.

It said that recent events such as rand strength had opened the door for another rate cut.

Still in positive territory

According to the BER, whether or not another reduction would be made, the repo rate was likely to remain fairly stable at current lows for the next 12 months, with a moderate tightening cycle projected through 2012.

Although growth in the manufacturing sector slowed in October, encouraging is that it remains in positive territory and has now been in positive territory for ten months.

The slower growth, especially in the previous two months has also been attributed to work stoppages due to strike action in the industry.

Notwithstanding the impact the strong rand continues to have on the manufacturing sector, the months ahead are likely to be slightly better than the 1.4% growth seen in October, given movements in the local Purchasing Managers' Index (PMI).

The seasonally adjusted PMI is a good leading indicator for the total output figure that follows a month later.

It rose to 49.8 in October from 45.9 in September. A reading of 50 and above represents expansion in the manufacturing sector as opposed to a contraction if the reading is below 50.

Nedbank economists expect manufacturing production to remain subdued in the months ahead, mainly reflecting the impact of a higher base in the second half of the last year, softer global growth, a strong rand and weak domestic spending.

"Continued rand strength, labour market weakness and policy concerns over the effect of the rand strength on both mining and manufacturing make a further easing in monetary policy likely," the Nedbank economists concluded.