AGRIBUSINESS
RESEARCH

SA agricultural machinery sales up notably in May 2020

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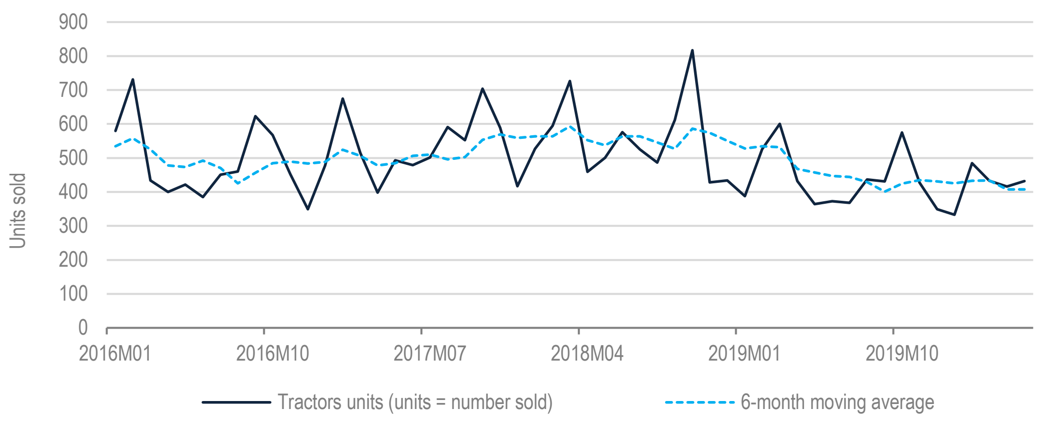
South Africa's agriculture and allied industries have thus far not been as hard hit by the coronavirus pandemic as other sectors of the economy. The case in point is the tractor and combine harvester sales, which were up 19% and 15%, respectively, year on year in May 2020, with 432 units and 31 units sold. Primarily, the classification of the agricultural sector and its value chains to operate during the lockdown period as part of essential services was a key catalyst to sustaining the sales last month. By comparison, the automobile industry, which has been affected by lockdown regulations amid the pandemic saw new vehicle sales decline by 68% y/y in May 2020 (which was under level-4 lockdown regulations) following a sharp 98% y/y contraction in April when there were strict level-5 lockdown regulations.

Exhibit 1: South Africa's tractor sales



Source: SAAMA, Agbiz Research

Another important factor behind the uptick in the May 2020 agricultural machinery sales is that farmers bought the existing stock at relatively affordable prices, ahead of the inevitable price increases which will prevail as a result of the weaker rand. Moreover, South Africa's winter crop planting season, which was in full swing in May, specifically in the wheat, barley, canola and oat-producing regions, namely the Western Cape, Northern Cape, Free State and Limpopo, also added to an increase in tractor sales. In the case of combine harvester sales, a supporting factor is also that South Africa is expecting its second-largest grain and oilseeds harvest on record in the 2019/2020 production season. The harvesting process for this crop started to gather momentum in May and is now in full swing across the country.

Nevertheless, we think this could be a temporary blip and that South Africa's agricultural machinery sales could remain subdued in future, irrespective of the robust agricultural output expected for the 2019/2020 production year. The drag on the industry will likely emanate from weak exogenous macroeconomic fundamentals. First, the weaker domestic currency will lead to higher prices for imported agricultural machinery, which will reduce farmers' ability to acquire tractors and combine harvesters.

Second, the recent further downgrade of South Africa's sovereign credit rating to the sub-investment grade could negatively influence the financing of agricultural equipment. As we have previously pointed out, in ordinary times the South African Reserve Bank would have responded to the downgrade by raising interest rates in anticipation of possible exchange rate depreciation and associated inflation risks, which would have increased the cost of capital. However, now the situation is different. The pandemic has disrupted global supply chains, which has led to deteriorating economic conditions. Several central banks, including South Africa, have responded by reducing interest rates to ease financial conditions. Whereas the implied prime rate after the recent policy rate cuts would suggest easier financing conditions, commercial banks are likely to be more risk-averse in the current unprecedented environment.

In a nutshell, the classification of agriculture and its value chain as essential services during the lockdown period has enabled the agricultural machinery industry to operate and record better sales numbers. Nevertheless, the weak macroeconomic conditions could weigh on the agricultural machinery industry's performance in the coming months.