

GDP comment

Notable contraction at the start of 2018

Stats SA reported that GDP declined by 2.2% quarter-on-quarter (q-o-q)¹ in 2018Q1. This was a significantly weaker outcome than the Bloomberg consensus for a contraction of 0.5% and was much softer than our (final) expectation for a 1.1% decline. Compared to the first quarter of 2017, GDP grew by a seasonally adjusted 1.5%, a meaningful slowdown from the 1.9% recorded during 2017Q4. On a number of fronts, including a slowdown in the gross operating surplus (a measure of country-wide profitability), it was a horrible GDP print that reflected broad-based weakness across many sectors.

Amid the financial market euphoria that greeted the election of Cyril Ramaphosa as ANC President in December 2017, a 2018Q1 GDP contraction was certainly not expected. However, as Stats SA released the high-frequency monthly data for January through March 2018, it became increasingly clear that a weak GDP print was on the cards. So how does one square the financial market, business and consumer confidence bounce, as well as Moody's credit rating reprieve in March, with the weak GDP numbers? The short answer is that the confidence rise was to a large extent driven by an expectation that Ramaphosa's election would 1) arrest the decline witnessed during the Zuma years and 2) lay the foundation for improved economic performance in future. When commenting on the RMB/BER business confidence and FNB/BER consumer confidence indices for 2018Q1 (see [here](#)), we argued that the confidence gain was not necessarily based on improved business conditions or income generation in Q1. Rather, it signalled relief at the ANC election outcome and, importantly, most likely reflected a sense of hope for the future. The stark GDP report highlights that the confidence gain was not based on improved underlying macro conditions.

Delving into the detail of the GDP report, it becomes clear that a confluence of factors colluded to push GDP into negative territory during the first quarter. It may be worth noting that these factors have little, if anything, to do with ANC politics. Measured from the production side, they include:

- A steep contraction in the **agricultural** sector (see [Table 1](#) for the details). A high base from 2017, helped by the record maize crop, and the adverse impact of the prolonged drought in the Western Cape weighed on value added in agriculture. *A lower than expected maize crop in 2017/18 and the lingering impacts of the drought may see further negative prints for agriculture in the next quarter or two.*
- Temporary refinery outages that helped push **manufacturing** value added into negative territory. *Manufacturing output should bounce back in the second quarter. Indeed, the average level (50.4 points) of the Absa manufacturing PMI recorded during the first two months of 2018Q2 is not only above the neutral 50-point mark, but also higher than the 49.2 index points registered in Q1.*

¹ Unless specified otherwise, the q-o-q figures mentioned in this comment are expressed at a seasonally adjusted and annualised rate.

- Depressed output in the **mining** sector. Soft rand commodity prices were negative for output in especially the gold and platinum mining industries. *While the speedy resolution of the Mining Charter negotiations should create some certainty in mining, depressed local commodity prices (especially in the case of gold, platinum and iron ore) argue against a short-term strong production and fixed investment response.*
- A decline in **retail** and **wholesale trade** sales after they were boosted by Black Friday buying in 2017Q4. *The impact of the VAT hike in April and an almost R2/litre petrol price increase since March 2018 may limit the extent of a recovery in household expenditure during 2018Q2.*

Combined, the agriculture, mining, manufacturing and trade sectors shaved 2.7 percentage points (% pts) off Q1 GDP. Added to these sectors, the construction and electricity sectors also declined in the first quarter. The broad-based nature of the Q1 weakness is reflected in the trends for the broader sectoral categories. The **primary sector** contracted by a significant 13.8% q-o-q after growing by 4.9% in 2017Q4. The **secondary sector** moved from a 3.1% expansion in 2017Q4 to a 4.9% contraction. **Services** managed to eke out growth of 0.3%, down from growth of 2.7% in 2017Q4. For services, the **finance** and **government** sectors made the biggest positive contribution to overall growth, albeit that even this was marginal (combined positive contribution of 0.5% pts).

Table 1: Broad-based sectoral weakness in Q1

Seasonally adjusted	q-o-q % (annualised)		y-o-y %	
	2017Q4	2018Q1	2017Q4	2018Q1
Agriculture	37.5	-24.2	35.3	19.1
Mining	-4.4	-9.9	5.4	-0.4
Manufacturing	4.3	-6.4	1.7	1.7
Electricity	3.3	-0.5	-0.3	1.1
Construction	-1.4	-1.9	-1.1	-1.3
Trade	4.8	-3.1	-0.1	0.6
Transport	2.8	0.9	1.2	1.8
Financial	2.5	1.1	1.8	2.2
Government	1.4	1.8	0.0	0.6
Personal services	1.0	1.2	1.0	1.3
GDP (total)	3.1	-2.2	1.9	1.5

Source: Stats SA

Measured from the demand-side, the key focus was on whether the robust **private sector fixed investment** figure of 2017Q4 (9.9% q-o-q) would be sustained. In the end, this was not the case with private capex declining by 2.7%. There was also another steep (-9.3% q-o-q) contraction for government fixed investment outlays. This drove the decline in overall fixed investment, which shaved 0.6% pts off Q1 GDP.

Although **household consumption** contributed 0.9% pts to GDP, the growth rate slowed notably relative to 2017Q4 (see Table 2). This was mainly a function of a sharp turnaround in outlays on semi-durable and durable goods. After robust q-o-q growth in 2017Q4, volume growth in these categories declined in Q1.

So, clearly improved consumer confidence levels did not translate into expenditure growth. Having said that, there was a slight acceleration in spending growth when measured on a y-o-y basis.

By far the most significant drag on the expenditure GDP number was **net exports**, which shaved a large 3.1% pts off GDP. This was the result of a 16.5% q-o-q plunge in exports, which took 5.2% pts from GDP. Stats SA mentioned that the export decline was driven by lower shipments of base metals and mineral products (most likely coal).

Table 2: Exports and fixed investment major drags on demand-side GDP

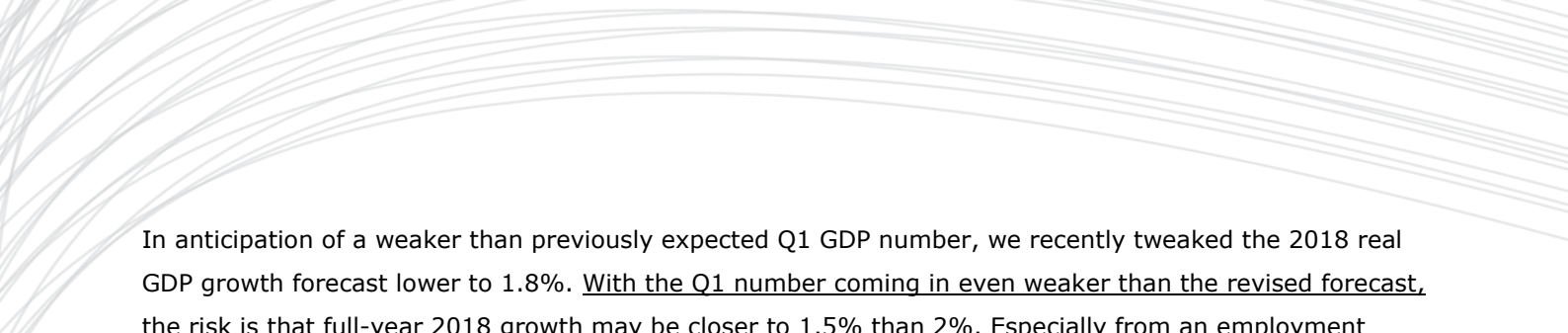
Seasonally adjusted	q-o-q % (annualised)		y-o-y %	
	2017Q4	2018Q1	2017Q4	2018Q1
Private consumption	3.6	1.5	2.7	2.8
Government consumption	1.6	1.2	0.6	1.2
Fixed investment	7.4	-3.2	0.3	0.2
Inventories (R bn)	7.4	11.6		
Residual (R bn)	0.203	2.8		
Gross Domestic Expenditure	6.8	1.0	2.4	2.7
Exports	12.3	-16.5	3.9	0.2
Imports	26.5	-6.5	5.5	4.1
GDP (total)	3.1	-2.2	1.9	1.5

Source: Stats SA, BER calculations

GDP growth outlook

Along with lingering anxiety about the land issue and a more unsettled global environment, the poor Q1 growth figure may dampen the positive mood that has taken hold in 2018. However, in our view it is too early to get despondent about the future growth trajectory under Mr Ramaphosa. For one, as outlined in a recent **comment**, we think the concerns about land have been overblown, in part due to poor communication from the ANC. Furthermore, at least in manufacturing, a bounce-back from temporary constraints in Q1 is likely. In our view, a proper assessment of the growth impact of the Ramaphosa presidency will only be possible after the Q2 growth data is available and more likely only some time after that. In particular, it may take some time for private sector capex to respond to an environment of reduced political and policy uncertainty. The 2018Q2 round of BER business confidence data, set for release on 13 June, will be revealing to gauge to what extent, if at all, the improved Q1 sentiment has been sustained.

Unfortunately, new growth risks have emerged for the rest of 2018. Depending on the length, reports that members of the Public Servants Association are set to go on strike from 11 June does not bode well for 2018Q2 (and potentially Q3) GDP. Essential services staff such as doctors and the police are not encouraged to go on strike, which should help to limit the damage. Another risk for Q2/Q3 growth is the coal supply situation at Eskom. Six power stations currently sit with coal stocks that are less than the stipulated 20 days. With electricity demand normally higher in winter, this poses a risk to electricity supply.



In anticipation of a weaker than previously expected Q1 GDP number, we recently tweaked the 2018 real GDP growth forecast lower to 1.8%. With the Q1 number coming in even weaker than the revised forecast, the risk is that full-year 2018 growth may be closer to 1.5% than 2%. Especially from an employment perspective, this is unwelcome. A detailed update of our macro forecasts will be done at the end of June.

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