

GDP comment

Technical recession leaves 2018 growth in the doldrums

Stats SA reported that the SA economy slipped into a technical recession in 2018Q2. GDP declined by a much weaker-than-expected 0.7% quarter-on-quarter (q-o-q)¹ in 2018Q2. The Bloomberg consensus was that GDP would recover to post modest growth of 0.6% in Q2, while we had growth of 0.4% pencilled in. The disappointing Q2 print followed an even steeper than initially reported GDP decline of 2.6% q-o-q in the first quarter, resulting in the first technical recession since the 2008/9 financial crisis. Compared to the second quarter of 2017, GDP grew by a seasonally adjusted 0.5% year-on-year (y-o-y), a meaningful slowdown from the downwardly revised 1.4% y-o-y recorded during 2018Q1. This means that real GDP growth was only 0.9% in the first half of 2018, softer than the already depressed 1.3% recorded during 2017.

Domestic financial markets had an immediate negative reaction to the weak data with the rand exchange rate, which had already been under a lot of pressure before the data was released, selling off by a further 20c towards R15.20/\$ shortly after the GDP data was released. Following the weak 2018Q1 GDP print, the initial reaction was to downplay the number as especially in 2017 a weak Q1 GDP figure was followed by a strong rebound in the second quarter. However, as the first set of monthly data for 2018Q2 started to trickle in, it quickly became clear that a similar scenario was unlikely this time around.

It is important to stress that while another significant decline in the **agricultural sector** (see [Table 1](#) for the details) is likely to grab some of the headlines, there is a lot more to the weak GDP data than this. *Indeed, excluding agriculture, GDP recovered to a paltry 0.1% q-o-q after a contraction of 1.6% in 2018Q1.* Relative to our expectations, the major drivers of the weaker-than-expected Q2 GDP figure were the following:

- **Agriculture** declined by more than expected and shaved 0.8 percentage points (% pts) off overall GDP. While we expected another decline, the magnitude handsomely exceeded our expectations. This likely still reflects the impact of the severe drought in the Western Cape, as well as delayed harvesting of summer crops, including maize. Measured quarter-to-quarter, there is likely to be some recovery from the third quarter onwards.
- Value added in the **transport sector** suffered a big decline. This took 0.4% pts from GDP.

The decline in the **trade sector** reduced GDP by 0.3% pts, but this was in line with our expectation.

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

Table 1: Another quarter of broad-based sectoral weakness, driven by agriculture

Seasonally adjusted	q-o-q % (annualised)		y-o-y %	
	2018Q1	2018Q2	2018Q1	2018Q2
Agriculture	-33.6	-29.2	15.7	-1.9
Mining	-10.3	4.9	-0.5	-1.1
Manufacturing	-6.7	-0.3	1.7	0.2
Electricity	0.2	2.1	1.2	-0.2
Construction	-1.9	2.3	-1.3	-0.6
Trade	-3.1	-1.9	0.6	-0.1
Transport	0.9	-4.9	1.8	-0.2
Financial	1.1	1.9	2.2	1.9
Government	1.9	-0.5	0.6	1.0
Personal services	1.2	0.8	1.3	1.1
GDP (total)	-2.6	-0.7	1.4	0.5

Source: Stats SA

Measured from the demand-side, the major drag on GDP came from a sharp decline in **inventory investment**. On its own, this shaved a significant 2.9% pts off GDP. According to Stats SA, the inventory fall was due to large declines in the manufacturing and mining sectors.

Of particular concern was the decline in **household consumption**, which reduced GDP by 0.8% pts. This was unexpected and according to Stats SA was driven by reduced outlays on transport, food and non-alcoholic beverages and recreation.

One of the few positives in the GDP release was that **exports** recovered most of the ground lost in 2018Q1. This contributed a positive 3.7% pts to Q2 GDP.

Table 2: Inventory and consumer spending decline weigh on GDP

Seasonally adjusted	q-o-q % (annualised)		y-o-y %	
	2018Q1	2018Q2	2018Q1	2018Q2
Private consumption	1.0	-1.3	2.7	1.4
Government consumption	1.4	0.7	1.2	1.3
Fixed investment	-3.4	-0.5	0.2	0.1
Inventories (R bn)	8.8	-14.1		
Residual (R bn)	-4.0	-2.1		
Gross Domestic Expenditure	-0.5	-3.4	2.3	0.4
Exports	-17.4	13.7	-0.1	1.2
Imports	-10.7	3.1	3.0	0.8
GDP (total)	-2.6	-0.7	1.4	0.5

Source: Stats SA, BER calculations

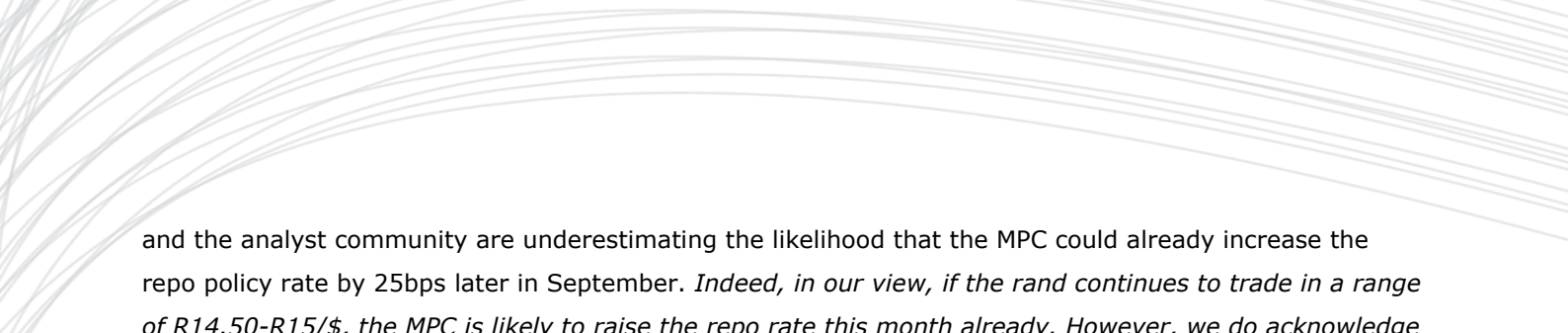
Growth outlook and implications

The BER's third quarter business confidence data will be released next week Tuesday and should provide further insight into the prospects for growth in 2018Q3. Some of the data already available for the quarter does not inspire confidence. The **Absa Purchasing Managers' Index** for the manufacturing sector averaged 47.5 in July and August, below the neutral 50-point mark and two points below the average recorded in the second quarter. Depending on the length, the start of industrial action at Sasol's Secunda refinery and the company's coal mines this week involving up to a reported 6,000 workers has the potential to disrupt mining and manufacturing output in September. Labour union Solidarity has suggested that the industrial action will target different parts of the business over three weeks. Furthermore, the 2.5% y-o-y decline in **new vehicle sales** during August suggests that consumer demand remained lacklustre in 2018Q3. On a more positive note and as mentioned earlier, the **agricultural sector** should put in an improved performance in Q3. Measured from the demand side, we may see at least a partial reversal of the large inventory decline in Q2, which should support the Q3 GDP print. *Nevertheless, the weak first half of 2018 suggests that even with some recovery in the second half, full year real GDP growth may struggle to reach 1%. This compares with our forecast before the latest GDP data of 1.4%.*

On the policy front, the weak GDP data was predictably greeted by a knee-jerk reaction on social media with some commentators calling for a large fiscal stimulus and a lower policy interest rate to support the economy. It is disheartening that those calling for these measures do not heed the lessons from the tragedy unfolding in Venezuela and other examples such as Argentina and Turkey of the dire consequences of reckless macroeconomic policies. Furthermore, in our view, these comments reveal a misdiagnosis of the binding growth constraints in SA. In our view, an approach that provides less policy uncertainty surrounding, for example, the land issue and the Mining Charter is more likely to boost confidence, growth and only then private sector employment over the medium- to long term than overly accommodative macro policy. More broadly, a policy environment that lowers the cost of doing business in SA and treats the private sector as a partner instead of a foe is urgently required. From this perspective, it is worth noting that – despite an unfavourable environment – **private sector fixed investment** increased by 3.1% q-o-q in Q2. In stark contrast, fixed investment by both the **general government** and **state-owned enterprises** declined for a second quarter in a row.

Back in February, the Treasury forecast real GDP growth of 1.5% for 2018. This now seems highly unlikely and combined with headline CPI inflation that is set to average somewhat lower than the 5.3% forecast by the Treasury, nominal GDP growth – a key driver of government revenue growth – is set to be weaker than expected in 2018. Along with the higher-than-expected public sector wage bill and the risk of further bailouts for state-owned enterprises, there is a growing risk of slippage in the **budget deficit projections** outlined in February. *Therefore, the fiscal space to embark on a large stimulus programme has once again been eroded by the public sector wage bill, struggling SOEs and a weak-performing economy.*

Regarding the **interest rate outlook**, the combination of weak GDP growth and domestic demand on the one hand and rising inflation risks on the other complicates upcoming interest rate decisions. Currency movements in the next couple of weeks will be key in influencing our forecast for the outcome of the 20 September Monetary Policy Committee (MPC) meeting. Even at this stage, we think both financial markets



and the analyst community are underestimating the likelihood that the MPC could already increase the repo policy rate by 25bps later in September. *Indeed, in our view, if the rand continues to trade in a range of R14.50-R15/\$, the MPC is likely to raise the repo rate this month already. However, we do acknowledge that the weaker-than-expected state of the real economy will provide a strong argument against a September rate hike.*

A full set of updated macro forecasts will be available in early October.

Hugo Pienaar

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