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Growth collapse not as bad as feared, but worst still to come

Highlights

- Real gross domestic product (GDP) declined by less than expected by 2% in quarter-on-quarter seasonally-adjusted and annualised (q/q saar) terms in the first quarter of 2020 and was 0.1% weaker on a year-on-year(y/y) basis. GDP surprised to the upside, given the June 2020 Reuters Econometer median growth expectation of negative 3.8% q/q saar.
- GDP declined for three consecutive quarters since the third quarter of 2019, with all indications pointing to a worsening in economic activity in the second quarter of 2020, as a result of the lockdown restrictions imposed by government in an effort to prepare the country's health facilities for a rise in COVID-19 infections.
- The agriculture sector staged the largest recovery in the first quarter of the year at 27.8% q/q saar, while an increased incidence of load shedding bit hard into the mining and manufacturing sectors, which contracted by 21.5% and 8.5% q/q saar, respectively.
- Based on the expenditure stack up of GDP growth, fixed investment growth detracted the most from overall economic activity, due to a 45% q/q saar collapse in transport equipment and a contraction of 26.9% in machinery. Businesses continued to run down inventory levels in light of falling demand, which further eroded growth.
- SA's leading indicator for April 2020 began to reflect the worsening economic climate that spread throughout the second quarter of the year. A further collapse is expected in upcoming months, as reflected by the crash in business sentiment in the second quarter of the year, when lockdown restrictions had the largest negative effect on growth outcomes.
- We expect growth to contract by 8.1% this year and are pencilling in a shallow recovery of 2% in 2021, as an increase in the number of business closures and persistently higher levels of unemployment detract from the expected upturn. In our view, the level of economic activity is only likely to return to pre-COVID-19 levels by 2023/2024. This negative output gap will likely contain inflation in the near term and, as such, we expect further modest monetary policy easing of up to 50 basis points.

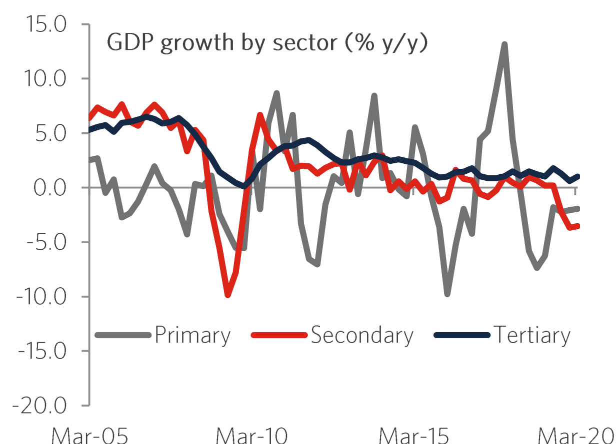
Growth slide continues into the first quarter of 2020

Real GDP surprised to the upside in the first quarter of 2020, but contracted for the third consecutive quarter. GDP decreased by 2% in the first quarter of the year in q/q saar terms and printed higher than the June 2020 Reuters Econometer median growth forecast of 3.8% q/q saar.

Growth in half of the ten economic sectors languished in negative territory for the first quarter of the year, including mining, manufacturing, utilities, construction and trade. Meanwhile, activity in the agriculture, financial services, government, transport/ communication and personal services sectors supported growth.

GDP slipped 0.1% in the first quarter of 2020 in y/y terms. On a disaggregated basis, the secondary sector (manufacturing, utilities and construction) experienced the largest fall in growth, followed by the primary sector (agriculture and mining). Growth in the tertiary sector (largely services) continued to trend marginally in positive territory (see chart 1).

Chart 1: Primary and secondary sectors underperformed in the first quarter



Source: Stats SA, Global Insight, Momentum Investments

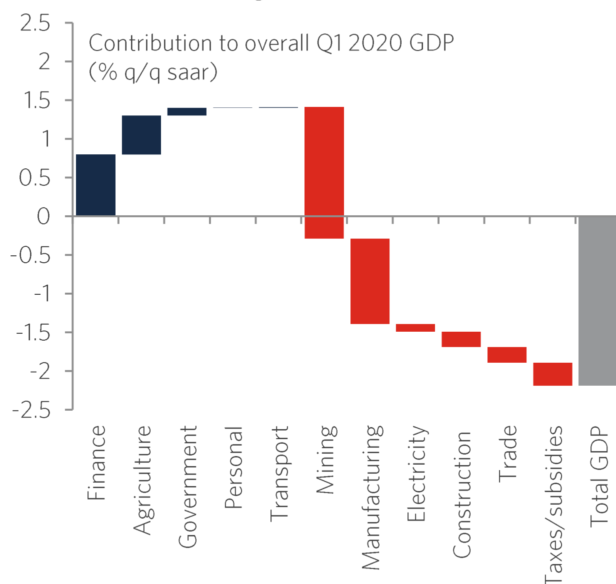
Production-side real GDP

The agriculture (which includes forestry and fisheries) and financial services sectors (including insurance, banking and real estate) posted the largest contributions to GDP growth in the first quarter of 2020 (see chart 2) of 0.5% and 0.8%, respectively.

According to Statistics South Africa (Stats SA), activity in the financial services sector increased due to financial intermediation services, insurance and pension funding, auxiliary services and other business services. Meanwhile, activity in the agriculture sector bounced on an increase in the production of field crops, horticultural products and animal products.

Stats SA noted the decline in mining activity was predominantly caused by decreased production in iron ore, manganese ore, chromium and other metallic minerals. In the manufacturing sector, a dip in production in the petroleum, chemical, metal products and motor vehicle sectors drove overall production levels lower.

Chart 2: Financial services and agriculture were the main contributors to growth in Q1 2020



Source: Stats SA, Global Insight, Momentum Investments

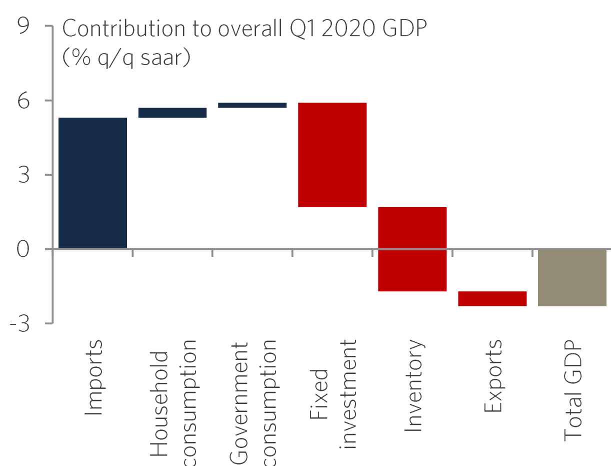
Expenditure-side GDP

The largest contributor to growth, based on the expenditure method, came from a reduction in imports, which bolstered growth in the first quarter of 2020 (see chart 3).

The reduction in imports added 5.3% to overall growth in the first quarter of the year, driven by decreases in machinery, electrical equipment, mineral products and travel services. Household consumption added 0.4% to the first-quarter growth number. On a disaggregated

basis, household spending was propped up by spending on food and beverages, housing and furnishings, while spending on transport and clothing detracted from overall household consumption expenditure. We expect a further slowdown to follow in household consumption expenditure, as many firms surveyed in the Stats SA lockdown surveys have indicated their intention to either scale back on the number of workers hired or reduce working hours and pay.

Chart 3: Contraction in fixed investment and large inventory drawdown detracted from growth



Source: Stats SA, Global Insight, Momentum Investments

Fixed investment cut 4.2% from the overall growth figure for the first quarter of the year. The largest contractions in fixed investment were in the machinery and transport equipment components, but all sectors contributed to the contraction, including residential and non-residual construction. Although government aims to accelerate infrastructure build, government's special adjustment budget highlighted a delay in a number of projects, as part of the reprioritisation programme. Moreover, elevated economic uncertainty and muted demand is expected to suppress fixed investment activity in the private sector in the coming quarters.

There was a R67.3 billion drawdown in inventories in the first quarter of the year, primarily in the mining, manufacturing and trade sectors. Inventories are likely to remain volatile in the period ahead, as disruptions to the global supply chain continue to play out as a result of COVID-19 and the damaging effect global lockdowns have had on global trade activity.

Expecting a deep contraction in growth, followed by a shallow recovery

The leading indicator has started its descent (see chart 4), but will likely plunge further in upcoming months in response to a rapidly deteriorated economic environment in the second quarter. On 23 March 2020, the president announced that the rise in COVID-19 cases in SA had necessitated a national lockdown. The country moved from a hard lockdown (level five restrictions) to level four from 1 May 2020. Lockdown regulations were subsequently eased to level three on 1 June 2020 with a number of restrictions being eased later in the month to allow for more businesses and services to operate.

The Bureau of Economic Research's Business Confidence Index for the second quarter crashed to an all-time low of five index points (see chart 5), signalling deep distress in the business sector.

Chart 4: Plunge in SA's lead indicator

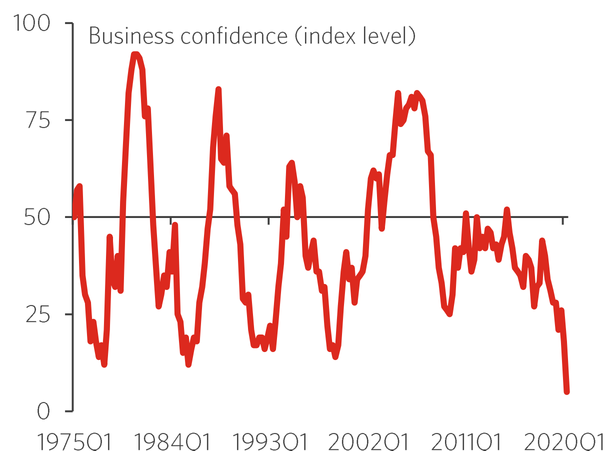
Source: Iress, Momentum Investments

We expect growth to contract by 8.1% this year, which is broadly in line with the June 2020 Reuters

Econometer median expectation of negative 8%. Unlike the Reuters expectation for a 3.1% bounce back in growth in 2021, we see a shallower recovery of 2.0%. We remain cautious of a higher number of business closures and persistently higher levels of unemployment detracting from the upturn in growth envisaged next year.

In our view, the level of economic activity is only likely to return to pre-COVID-19 levels by 2023/2024. This negative output gap (difference between actual and potential growth) will likely contain inflation in the near term and, as such, we expect further modest monetary policy easing of up to 50 basis points. While additional monetary policy easing may be limited in its effectiveness to boost growth, it could provide some financial relief for indebted households and help confidence at the margin. In our view, it is ultimately structural reform efforts, which need to be stepped up to improve SA's weak economic growth trajectory.

Chart 5: Business confidence nosedives



Source: BER, Momentum Investments, data up to Q2 2020

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