Herman van Papendorp
(Head of Investment Research and Asset Allocation)

Sanisha Packirisamy
(Economist)

The Macro Research Desk

Growth surprised positively in the final quarter of 2017

Highlights

- **A bounce in agricultural production pulled growth, in the primary sector, higher in the final quarter of 2017**
- **Supportive gains in real wages are expected to underpin consumption, despite a rise in taxes**
- **Fixed investment intentions are only likely to recover meaningfully in 2019, once regulatory and economic uncertainty abates**
- **The trade deficit widened on a faster increase in imports relative to exports**
- **A modest growth recovery is anticipated, but the implementation of structural reform is necessary to propel the economy to a higher growth platform over time**

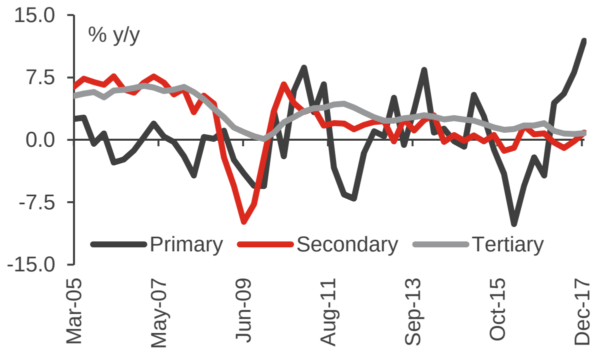
Bounce in agricultural production benefited growth in the primary sector, despite a contraction in mining

Growth in gross domestic product (GDP) surprised considerably to the upside in the final quarter of 2017. GDP increased by 3.1% in the fourth quarter of 2017 in quarter-on-quarter (q/q) seasonally-adjusted terms (saar) and printed significantly higher than the consensus forecast for a 1.8% rise.

Growth for the full year printed at 1.3%, from a revised 0.6% increase in 2016. Annual growth was supported by increased economic activity in the financial services (full-year increase of 1.9%), agriculture (17.7%) and mining (4.6%) sectors, while the trade (negative 0.6%) and construction (negative 0.3%) industries dragged growth lower.

In year-on-year terms (y/y), GDP rose by 1.5%. On a disaggregated basis, growth rebounded strongly in the primary sector (8.1% to 11.9% y/y), while growth rates improved only marginally in the secondary and tertiary sectors (see chart 1).

Chart 1: Growth in the primary sector supported by a boost in agricultural production

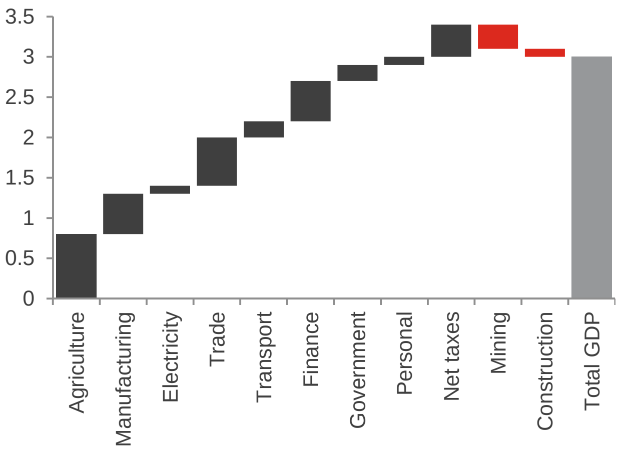


Source: Stats SA, Global Insight, Momentum Investments

Production-side real GDP

The agricultural sector posted the largest contribution (0.8%) to GDP growth in the final quarter of 2017 (see chart 2) and printed in expansionary territory for the fourth consecutive quarter (following a contraction in 2015 and 2016). Agricultural production jumped 37.5% q/q saar, largely owing to a higher production of animal products. Within the primary sector, mining production lagged. The 4.4% q/q saar dip in mining production was largely driven by a reduction in gold and platinum group metals (PGMs).

Chart 2: Growth contribution in Q4 2017 (%q/q saar) – production-side GDP



Source: Global Insight, Stats SA, Momentum Investments

The manufacturing sector was the outperformer in the secondary sector. Growth in manufacturing production increased by 4.3% q/q saar, supported by higher production levels in the food/beverages, petroleum/chemicals, rubber/plastics and iron/steel divisions. Notable contributions were made from the metal products and machinery divisions as well.

In line with a ramp up in manufacturing production, the utilities (electricity, water and gas) industry grew by 3.3% q/q saar. Stats South Africa (SA) reported a dip in residential and non-residential building activity led to a 1.4% q/q saar decrease in the construction industry.

The trade sector (which includes retail, wholesale and motor trade, as well as catering and accommodation) exhibited the fastest pace of growth in the tertiary industry in the fourth quarter of 2017. According to Stats SA, activity picked up by 4.8% q/q saar (contributing 0.6% to overall GDP) in the trade sector, largely owing to an increase in retail, wholesale and motor trade. Increased activity in land freight and communication services drove a 2.8% q/q saar increase in the transport, storage and communication industry. Financial services contributed 0.5% to the overall 3.1% growth print for the quarter, while personal and government services contributed 0.1% and 0.2%, respectively.

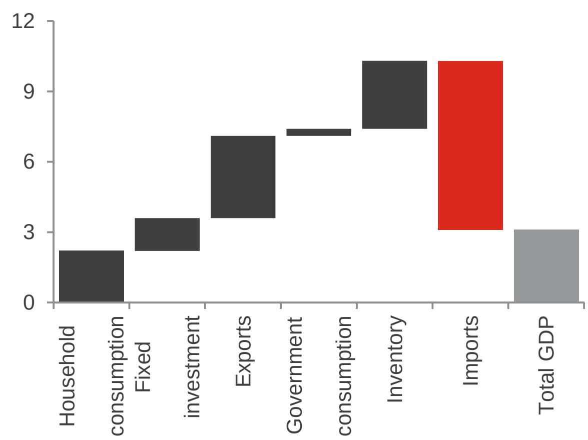
Expenditure-side real GDP

The largest positive growth contribution, based on the expenditure method, came from a robust export performance in the fourth quarter of 2017 (see chart 3). Exports increased by 12.3% q/q saar, buoyed by an increase in exports of base and precious metal products.

Imports were the largest growth detractor in the corresponding period. A firmer currency is likely to have contributed to the rise in imports of machinery and equipment in the fourth quarter of the year.

Despite exports growing at an impressive rate of 12.3%, imports grew at a faster pace of 26.5%, leading to an expansion of the trade deficit.

Chart 3: Growth contribution in Q4 2017 (%q/q saar) – expenditure-side GDP

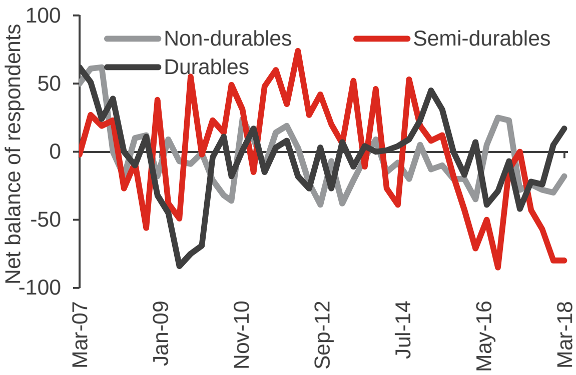


Source: Global Insight, Stats SA, Momentum Investments

Inventory accumulation was the second-largest contributor to growth. Stats SA reported a build-up in inventories of R11 billion in the fourth quarter of 2017 (concentrated in the trade sector).

Stats SA noted a 3.6% q/q saar increase in household consumption in the same period. Clothing/footwear, food and transport were the main contributors to growth in the fourth quarter of 2017. According to the Bureau of Economic Research's Retail Survey, fewer semi-durable (clothing/footwear) and non-durable (food/beverages) retailers expected a deterioration in sales volumes for the first quarter of 2018, than a quarter ago. Meanwhile, more retailers of durable (cars and furniture) goods expected a recovery in sales volumes (see chart 4).

Chart 4: Retail sales volumes improving

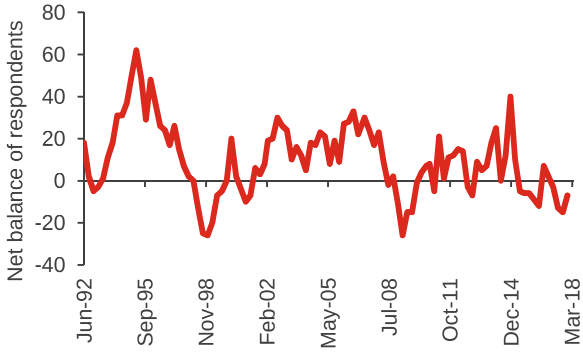


Source: BER, Momentum Investments

While the increase in the value-added tax rate, fuel levies and sin taxes in the February 2018 national budget likely dampened consumer confidence, positive political and economic momentum should boost confidence in the medium term. A favourable inflation trajectory should allow for supportive gains in real wage growth (calculated at 3.4% in December 2017), while improving economic prospects could halt the deterioration in the unemployment rate. Meanwhile, confidence among upper-income earners should continue to be underpinned by firm gains in the housing and equity markets.
Gross fixed capital formation (fixed investment) increased 7.4% in the fourth quarter of 2017, thanks to firm growth in machinery and transport equipment. A weak performance in residential and non-residential building activity detracted from fixed investment in the corresponding period.

In Momentum Investments' opinion, growth in fixed investment could remain weak in the near term (see chart 5) and is only likely to stage a meaningful improvement following the 2019 national elections, where a clearer direction on economic policy is likely to emerge. The Bureau of Economic Research's Manufacturing Survey showed that nearly 90% of manufacturers held off on investment projects due to an uncertain outlook on the direction of economic policy in December 2017. As such, a commitment to reducing regulatory uncertainty should ease conditions for fixed investment. The new administration has promised a finalisation of the mining charter within three months, while a clear statement on the unaffordability of nuclear energy was made at the World Economic Forum earlier this year. Moreover, an Investment Forum is expected to be set up within three months to encourage inward investment into SA.

Chart 5: Net investment intentions are still negative



Source: BER, Momentum Investments

Modest growth recovery anticipated in 2018 and 2019

Since the favourable outcome of the African National Congress (ANC) National Conference in December 2017, a number of positive changes have transpired, including an attempt to begin to restore good corporate governance at key state-owned enterprises (SoEs), a fiscal correction through larger expenditure cuts (outside of higher education), the removal of underperforming ministers in Cabinet and an ongoing investigation into state capture.

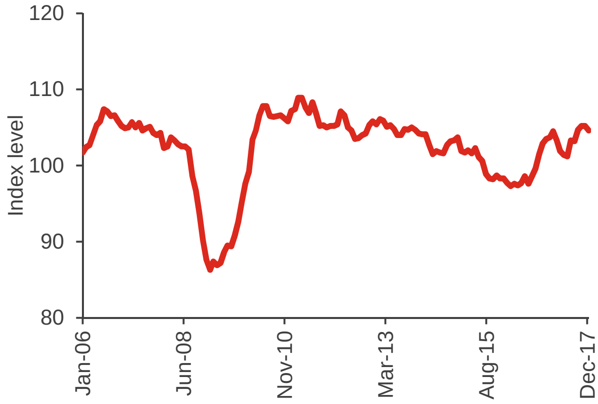
Political shifts have lifted SA investor sentiment, but for growth to be maintained at a higher level, there needs to be a sustainable boost in consumer and business sentiment. Momentum Investments expects a robust global economic recovery to support higher export growth, while consumption and investment may benefit from positive economic and political momentum.

A broader social compact is seen as essential for the successful implementation of reform in SA.
Greater collaboration between government, business, labour and civil society is need to drive the implementation of the new administration's economic plan and elevate the economy to a higher growth platform over time.

The SA Reserve Bank's lead indicator rose to its highest level since 2013 in November 2017 at 105.2 index points, representing an 8.2% increase from the April 2016 trough (see chart 6). In December 2017, the lead indicator edged lower to 104.6 points, but it remains consistent with a growth uptick in 2018, relative to 2017.

Momentum Investments expects growth to average 1.8% for the next three years, increasing above 2% in the outer year.

Chart 6: General improvement in SA's lead indicator



Source: INET BFA, Momentum Investments