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in the moment

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Positive growth surprise but setback to follow in third quarter

Highlights

- The change in base of comparison led to a large degree of uncertainty around growth leading up to the release of the second quarter gross domestic product (GDP) figure.
- Growth bounced 19.3% in year-on-year (y/y) terms in the second quarter of 2021 from negative 2.6% in the first quarter. Growth surprised to the upside with surveyed analysts, participating in the Reuters Econometer for August, expecting a 18.8% y/y rise.
- The economy expanded 1.2% on a quarter on quarter (q/q) seasonally adjusted basis. Statistics South Africa (Stats SA) no longer reports growth data on an annualised basis given the distortions created by large one-off growth shocks.
- The largest contributions to second quarter growth, based on the production method, came from transport, storage and communication, as well as personal services, which underperformed in the previous quarter.
- Based on the expenditure method, the largest contributions to growth arose from exports, while the dip in inventories detracted the most.
- We expect the additional restrictions imposed during the third wave of COVID-19 infections and riots, predominantly seen in Gauteng and KwaZulu-Natal, to lead to a sharp slowdown in growth in the third quarter before the economy stages a firm recovery in the final quarter of the year.
- Although medical experts are anticipating a fourth wave of COVID-19 infections to hit the economy from around November 2021, they suggest that higher natural rate of infections and further progress on the vaccination rollout plan may result in a lower peak of hospitalisations. If this prediction materialises, it may ease the burden on government to follow up very stringent lockdown rules.

Growth gained momentum in the second quarter

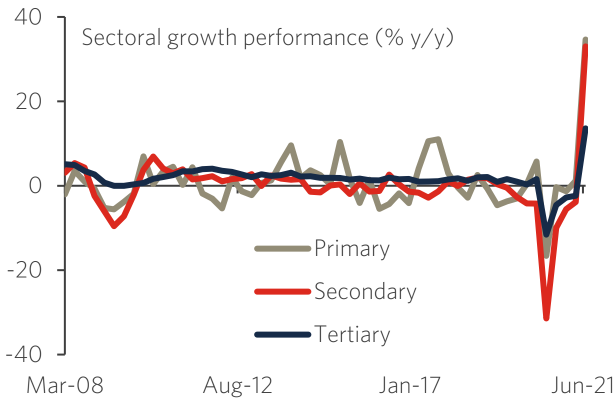
Real growth in GDP for the second quarter of 2021 surprised the market consensus to the upside, but it should be noted that the rebasing and benchmarking exercise undertaken by Stats SA widened the margin of error around forecasts. Growth surged by 19.3% y/y off a weak base created in the second quarter of 2020, when strict lockdown restrictions had prohibited economic activity in around two-thirds of the economy. This exceeded the Reuters August 2021 Econometer implied forecast for second quarter growth of 18.8% y/y.

The growth performance for the first quarter was downwardly revised from a prior estimate of 1.1% q/q to 1% q/q.

Growth recovered in six of the ten economic sectors in the second quarter of the year in q/q terms, with the agriculture and transport, storage and communication sectors staging the fastest recoveries. Meanwhile, growth dipped in the manufacturing, construction, financial services and government services sectors in the same period.

Activity in the primary sector (agriculture and mining) recovered by 34.6% relative to a year ago, while growth in the secondary sector (including manufacturing, utilities and construction) matched the performance in the primary sector at 33% y/y (see chart 1). Meanwhile, y/y economic activity in the tertiary sector (predominantly services) increased by a lesser 13.6% y/y as a consequence of the recovery in most services sectors outside of government services, where job cuts occurred.

Chart 1: Sectoral growth performance



Source: Global Insight, Momentum Investments

Transport and personal services drive production-side GDP growth

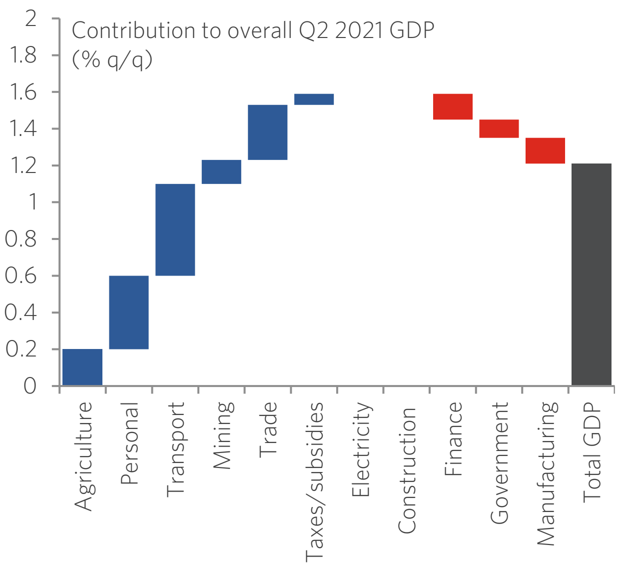
The transport, storage and communications sector (which accounted for 7.4% of overall economic activity in the second quarter) added 0.5% to the quarterly growth rate, followed by a 0.4% addition from the personal services sector (15.6% of overall economic activity).

The rebasing exercise left personal services accounting for a larger share of the economy after the inclusion of education and health activities (previously housed under general government), recreational activities, water waste activities and revised estimates for the non-observed economy, which contributed 8% to total economic activity in 2015. According to Citi and Stats SA, an increase in medical aid memberships and COVID-19 vaccinations added to the growth rate observed in the personal services category.

The third largest contributing sector was trade, hospitality and accommodation (see chart 2). An easing in lockdown restrictions likely boosted activity for catering and accommodation establishments.

After three consecutive quarters of growth, construction activity dipped again by 1.4% q/q, with a decrease in growth reported for residential buildings, non-residential buildings and construction works. The recent rebasing exercise leaves SA's fixed investment share of GDP below 15%. The July 2021 World Bank Report on SA noted that public sector fixed investment as a share of GDP significantly lagged that of its peer group, whereas investment by the private sector has remained soft in light of subdued demand and elevated uncertainty.

Chart 2: Transport and personal services were the largest contributors to growth in Q2 2021



Source: Stats SA, Global Insight, Momentum Investments

According to Stats SA, the 1.9% q/q increase in the mining sector was driven by increased production in platinum group metals, gold and coal. Nevertheless, production in this sector slowed from 4.3% q/q in the first quarter of the year. Stats SA confirmed it had received the monthly mining data for June 2021 in time for it to be incorporated into the GDP release.

Agriculture posted a notable positive contribution to economic activity in the second quarter of the year. With above-average rainfall predicted in the coming months, this sector will likely continue to support overall growth.

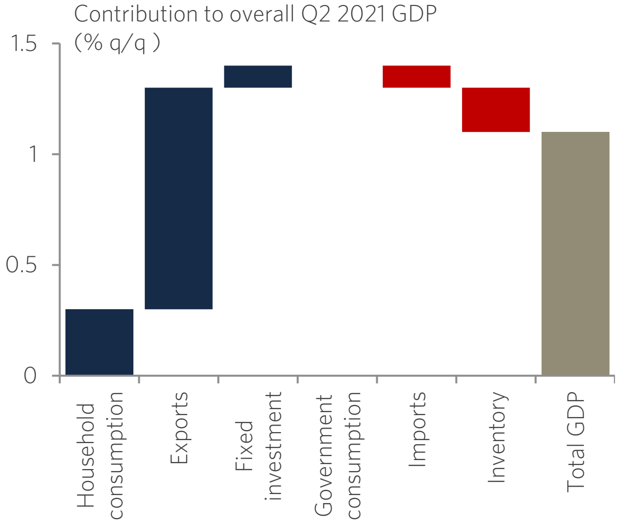
Surprisingly, activity in the financial services sector (which includes banking, insurance, pension funds and real estate) slowed in the second quarter by 0.1% q/q. Contractions in economic activity were also noted in the government services and manufacturing sectors. Stats SA pointed out that a cut in public sector employment contributed to the negative growth figure for government services.

According to Stats SA, six of the ten manufacturing divisions reported a contraction in production volumes, despite the Purchasing Managers' Index reporting an average index level of 57 (above neutral sentiment in the manufacturing sector) for the second quarter. The largest detractor was the petroleum, chemicals, rubber and plastics division.

Expenditure side GDP driven by a robust performance in exports

The largest contributions to growth in the second quarter of 2021, based on the expenditure method, came from household consumption and exports (see chart 3).

Chart 3: Household consumption and exports added the most to growth



Source: Stats SA, Global Insight, Momentum Investments

On a disaggregated basis, household spending on durables and non-durables outperformed. The largest positive contributors were transport, health, food and non-alcoholic beverages, restaurants and clothing. Although a recovery in wages and scope to eat into built-up savings could support household consumption expenditure in the coming months, the longer-term outlook for consumption remains marred by weak employment prospects.

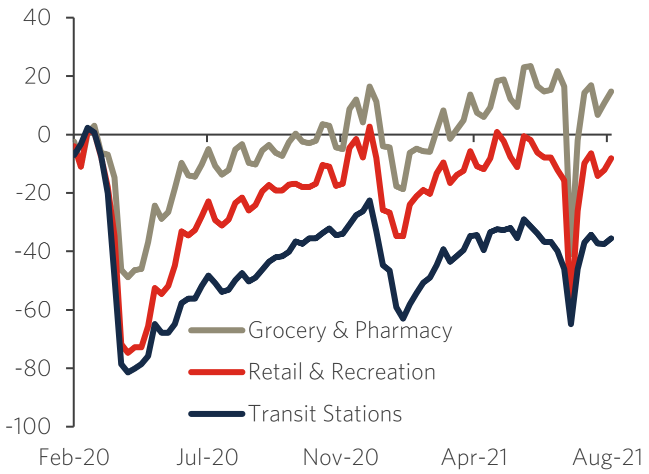
With small and medium businesses and lower-income workers experiencing a disproportionate hit during the pandemic and during the riots in July 2021, there will be pressure on government to continue supporting these households beyond the extended date of the COVID-19 relief funds. This will be challenging to achieve under already-strained fiscal conditions.

A R21.7 billion drawdown in inventories in the second quarter of the year followed a R13.5 billion drawdown in the second quarter (and a R102.7 billion drawdown in the final quarter of 2020). Inventory decumulation occurred primarily in the electricity (coal stockpiles) and mining sectors. The inventory sub-index of the Purchasing Managers' Index increased to 54 points in August 2021, pointing to a potential recovery in inventories in the latter half of the third quarter after stolen and damaged inventories caused a slump in the inventory sub-index to 39.1 points in July 2021.

Stricter lockdown restrictions and riots to hurt third quarter growth

The COVID-19 Community Mobility Reports show a sharp fall in economic activity in KwaZulu-Natal coinciding with the riots that devastated economic activity in the country's economic hubs of Gauteng and KwaZulu-Natal, which together account for half of SA's economic activity (see chart 4).

Chart 4: Google mobility indices for KwaZulu-Natal

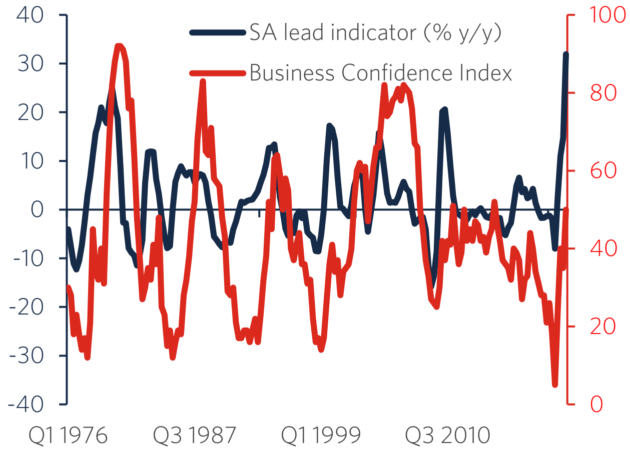


Source: COVID-19 Community Mobility Reports, Momentum Investments, data up to Q2 2021

Although surveyed business confidence rose to the neutral level in the second quarter of the year (see chart 5), data later out this week is likely to show a deterioration in sentiment resulting from the unrest in late July 2021 and continued bouts of loadshedding. Research from NPC BeyondCOVID showed that 89% of the businesses affected by the riots were small and medium-sized enterprises. Of these firms affected in Gauteng and KwaZulu-Natal, 7% shut their doors permanently. On average, businesses surveyed were forced to retrench up to 10% of their staff, while 42% reported damage to their premises.

Notwithstanding an uptick in consumer sentiment in the third quarter, the Bureau for Economic Research's Consumer Confidence Index remained in negative territory signalling consumer strain.

Chart 5: Business sentiment is likely to roll over



Source: Stats SA, Global Insight, Bureau of Economic Research, Momentum Investments

We expect growth to slow significantly into the third quarter due to the unrest and looting as well as the tighter lockdown restrictions imposed in response to the third wave of COVID-19. Although growth should recover into the fourth quarter of the year, a potential fourth wave predicted by health professionals to hit from November could lead to additional restrictions on economic activity. Nevertheless, with higher levels of natural infections and additional vaccinations being rolled out, medical experts are predicting the fourth wave to be shallower than the third.

We expect growth to average around 4% this year, before slowing to around 2% in 2022 and 1.5% in 2023. Our structural view on growth remains impeded by low levels of investment, fiscal strain and lingering unemployment.