momentum
investments

The Macro Research Desk

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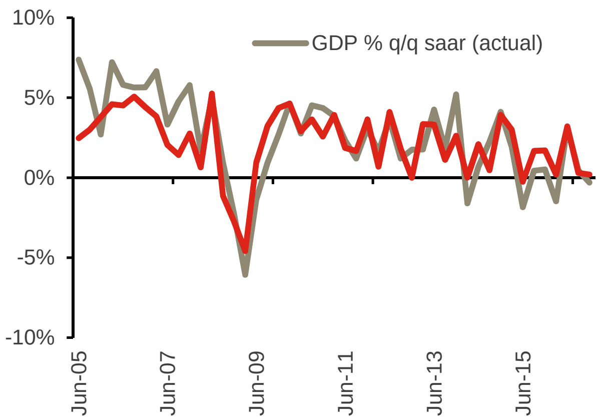
Sluggish economic activity in 2016, but growth has likely bottomed

Real GDP contracted in the final quarter of 2016, leaving overall growth for the year at 0.3%

Real gross domestic product (GDP) growth fell 0.3% in the final quarter of 2016 relative to the 0.4% (upwardly revised from 0.2%) acceleration in the third quarter in seasonally adjusted annualised terms (saar). This translated into the year-on-year (y/y) rate remaining steady at 0.7% for the corresponding period. Growth printed below the market's consensus estimate of 0.6% and missed own forecast for a 0.2% quarter-on-quarter (q/q) saar rise (based on Stats SA's high-frequency data releases on mining, manufacturing, electricity and trade, see chart 1).

Chart 1: Fourth-quarter growth dips into negative territory



Source: Citi, Global Insight, INET BFA, Momentum Investments, data up to December 2016

Growth in mining production according to the GDP figures was even lower than that suggested by the high-frequency data releases on monthly mining production volumes. Similarly, monthly retail trade sales looked more robust than the remainder of the trade, catering and accommodation sector, which reported softer activity levels.

Growth averaged a paltry 1.6% in the past five years, significantly lower than the long-run average of above 3%. Economic activity slowed to 0.3% in real terms in 2016, decelerating from the 1.3% growth rate observed in 2015, thanks to dismal returns from the primary GDP sectors (including agriculture and mining).

Momentum Investments is of the view that GDP bottomed in 2016 and should improve to around 1% in 2017 and 2% in 2018. Higher expected global GDP growth activity should provide a slightly more supportive backdrop for SA's export activity, while a near 20% recovery in global commodity prices during the past twelve months bodes well for a mild uptick in SA's beleaguered mining and manufacturing sectors.

Higher rainfall has led to the Crop Estimates Committee forecasting a 79% increase in the expected commercial maize crop relative to the previous season. Although growth in the agricultural sector declined marginally in the fourth quarter of 2016, upwardly revised crop estimates and a further uptick in agricultural confidence suggests an improvement in upcoming quarters.

Encouragingly, Eskom announced (at the end of January 2017) that all four units of the Ingula Pumped Storage Scheme were in commercial operation, producing a total of 1332 megawatts. Further capacity coming on line this year and next indicates dissipating energy supply constraints, which is positive for SA's growth outlook.

Finally, the SA Reserve Bank's leading indicator has edged higher for the sixth consecutive month in December 2016, highlighting a likely turnaround (albeit mild) in overall GDP growth.

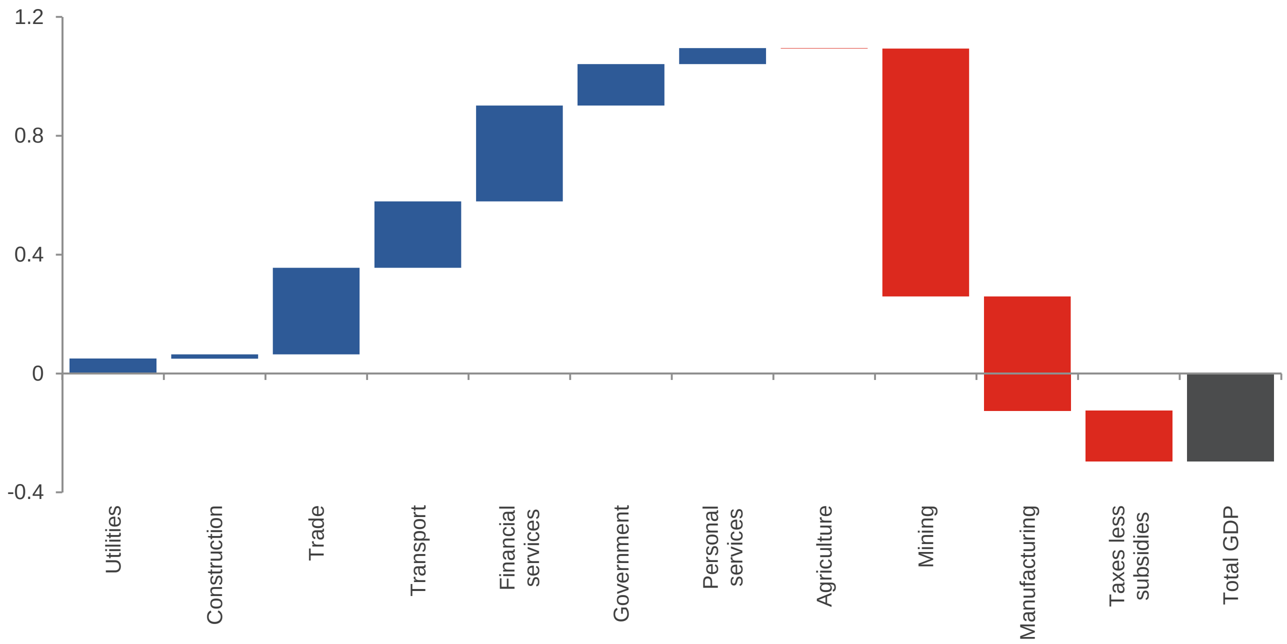
Production-side real GDP

Services remained the backbone of growth in the fourth quarter of 2016

Activity in the tertiary sector of the economy (mostly services) remains the largest contributor to growth. For the past eight quarters, growth recorded an average rate of negative 2% in y/y terms in the primary sector of the economy (namely agriculture and mining) and a barely positive print in the secondary sector (manufacturing, utilities and construction). Meanwhile, activity plodded along at an average rate of 1.5% y/y in the tertiary sector for the corresponding period.

In the final quarter of 2016, negative growth in the agricultural and mining sectors dragged the returns from the primary sector down to negative 4.6% y/y. Lingering drought effects hampered production in the agricultural sector, while lower production in coal, gold and platinum left mining production 11.5% weaker in q/q saar. The mining sector acted as the largest growth detractor in the fourth quarter of 2016 (see chart 2).

Chart 2: Fourth-quarter GDP growth contribution (% q/q saar) using the production-side factors



Source: Global Insight, Momentum Investments

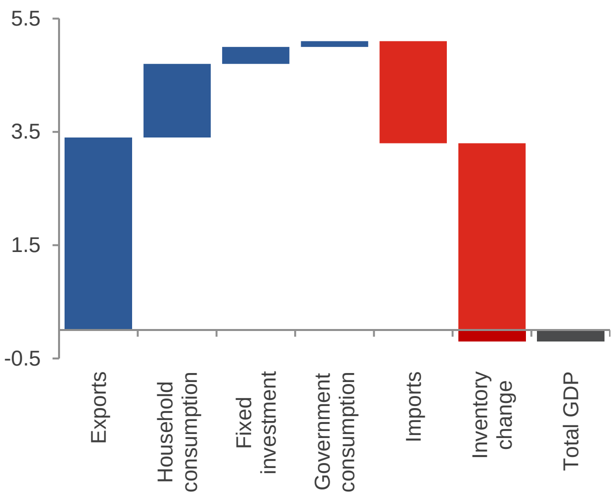
Although growth in the underlying industries within the tertiary sector of the economy has slowed considerably after the global financial crisis, growth printed in positive territory for all of the contributing sectors. Growth in the trade sector increased to 2.1% q/q saar in the fourth quarter of 2016 (from a negative 2% print in the previous quarter), but remained markedly below the 3.5% average rate recorded over the longer term (2.0% post-crisis). Growth in the finance sector (which also includes insurance and real estate) increased by 1.6% q/q saar in the final quarter of 2017. This is significantly below the 4.5% rate logged since 1994 and even lower than the post-crisis average of 2.5%.

Growth in government and personal services slowed to under 1% (q/q saar) in the fourth quarter of 2017, from 2% and 1.4% in the previous quarter, respectively.

Expenditure-side real GDP

Real GDP growth in the fourth quarter of 2017 was largely driven by a revival in exports, but this was more than offset by a R16.4 billion decumulation in inventories (see chart 3). Corporates are likely unwilling to invest in sizeable amounts of inventory in the current uncertain political environment, which may have had a dampening effect on overall demand levels.

Chart 3: Fourth-quarter GDP growth contribution (% q/q saar) using the expenditure-side factors



Source: Global Insight, Momentum Investments

Consumer likely to remain under pressure in the short term

Household consumption expenditure grew at 1.3% y/y in the fourth quarter of 2016, increasing from 0.9% y/y in the third quarter. According to Stats SA, consumer spend in the fourth quarter was largely concentrated in additional spend on food/beverages, clothing and recreational goods/services, while spend on transport contracted outright.

Upper income earners, while still exposed to savings, are facing increasing pressure. Growth in household net wealth has dwindled from 8.1% y/y in September 2015 to 0.9% y/y in September 2016. The ratio of net wealth to disposable income peaked at 399% in the first quarter of 2015, but recently fell back to 379%. While government attempted to alleviate the pressure on lower-income earners in the February 2017 national budget, higher-income earners bore the brunt of tax increases. Higher-income earners were hit disproportionately, by raising the top income tax bracket to 45% from 41% previously. Additionally, the dividend withholding tax was increased from 15% to 20%. Nevertheless, the interest rate outlook could provide some reprieve. Based on Momentum Investments' forecasts for headline inflation in 2017 and 2018, the company expects further interest rates cuts beginning in the second half of 2017 to benefit consumption spend at this end of the market further out.

Although government partly sheltered lower-income earners by compensating for bracket creep (by raising the tax-free threshold from R75 000 to R75 750) and by raising the threshold above which transfer duties are paid (from R750 000 to R900 000) in the affordable housing market, fuel levies (an additional 30c/l) and the Road Accident Fund levy (an extra 9c/l) were hiked, which have a regressive effect on consumers in the economy. Transport services (including bus and taxi fares) constitute an average of 9.8% of the consumption basket belonging to SA's bottom 60% of income earners, whereas the operation of personal transport equipment (including fuel costs) make up an average of only 6.7% of the consumption basket belonging to SA's highest 40% of income earners.

Should food prices fall sharply, as
Momentum Investments expects, real wage growth could still increase for lower-income earners in particular, where a larger portion of disposable income is spent on food. However, this segment of the market remains exposed to a poor employment outlook and stringent lending criteria. With SA corporates still voicing concerns over muted domestic demand and uncertainty regarding economic policy, employment growth is only likely to improve meaningfully beyond 2017, becoming a larger contributor to consumption spend in 2018.

Public sector wages (primarily concerning middle-income earners) are budgeted to increase at 1.6% per year over the medium-term expenditure framework. However, the projected stabilisation in the government wage bill, as a share of expenditure, remains heavily reliant on measures to reduce appointments to non-critical posts in government. As such, limited job prospects could also weigh negatively on this segment of the market.

Uncertainty continues to plague fixed investment growth

Growth in overall fixed investment contracted for the fifth consecutive quarter in y/y terms, leaving the average contraction in 2017 at negative 3.9% y/y. According to Stats SA, the underlying information was a mixed bag. Growth in residential construction, construction works (including railways, roads and bridges) and transport equipment recorded in positive territory in the final quarter of 2017, while non-residential construction and spend on machinery contracted.

Though the Agribusiness Confidence Index ticked higher in the first quarter of this year to 57 points, the increase was driven by positive prospects for the 2016/17 production season following a sharp decline in the aftermath of the 2015/16 El Nino induced drought. Meanwhile, underlying confidence regarding capital investment in agribusinesses declined by 13 points from the previous quarter to 56 points. According to the Agricultural Business Chamber, a dip in investment confidence in the agricultural sector is tied to the rise in radical economic transformation rhetoric along with "controversial land reform statements", which have once again developed into talks of expropriation without compensation, which remains discouraging for future investment activity in the agricultural sector.

Likewise, little progress has been made towards gazetting the mining charter and passing the Mineral and Petroleum Resources Development Act (MPRDA) Bill. Moreover, the implementation of the Mining Company of SA Bill during the course of this year is likely to worsen the relationship between government and the mining sector. Without definitive legislation, SA is unlikely to be seen as an attractive destination for new (and foreign) investment in the mining sector.

While an alleviation of electricity supply constraints should foster confidence at the margin, political noise is likely to remain elevated in the run up to the African National Congress (ANC) National Executive Committee (NEC) elective conference in December 2017. As such, Momentum Investments only expects a more meaningful acceleration in fixed investment projects in 2018.

Trade deficit shrank in the fourth quarter of the year

According to Stats SA, exports grew at 12.5% q/q saar, while imports climbed by a further 6.1%. A further increase in commodity prices likely supported the export of precious metal and other mining products, whereas Stats SA attributes the rise in imports to further acquisitions of machinery and equipment.

A smaller trade deficit should lead to an improvement in the current account deficit, but Momentum Investments expects the structural drag from the net income deficit (driven by interest and coupon payments made to foreign holders of SA bonds and equities) to limit the extent of the improvement. Momentum Investments expects the current account deficit to average close to 4% between 2016 and 2018, roughly in line with its longer-term average.