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First-quarter growth print a shocker

Highlights

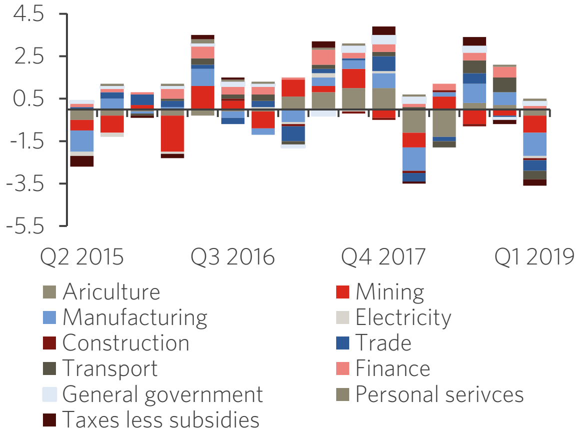
- Real growth in gross domestic product (GDP) contracted by more than anticipated at 3.2% in quarter-on-quarter seasonally adjusted terms (% q/q saar) in the first quarter of 2019.
- Nominal growth for the first quarter of 2019 was the weakest on record, which could impede government's fiscal consolidation efforts in the short term.
- From a supply-side angle, growth was weakest in the primary and secondary sectors of the economy, but pressure was evident in some of the services-orientated industries in the tertiary sector as well.
- The demand-side growth stack-up indicated ongoing weakness in domestic demand components, with household spend and spend by government disappointing by more than expected.
- Weak consumer confidence has manifested in subdued growth in household spend, which plummeted to negative 0.8% in the first quarter of 2019 from 3.2% in the fourth quarter of 2018.
- The weakness in growth in fixed investment is corroborated by downtrodden business confidence, which has failed to track sustainably in positive territory since the global financial crisis.
- Weak growth in corporate profitability has further undermined growth in fixed investment in the local economy.
- The South African Reserve Bank (Sarb) leading indicator has been rolling over since the third quarter of 2018, indicating a robust recovery is not likely in the near term.
- Momentum Investments has downgraded its expectation for real GDP growth for 2019 from 1.0% to 0.6%, but expects a marginal recovery in confidence on the back of less political uncertainty in the second half of the year. Fragile growth and structurally lower inflation has raised the probability of an interest rate cut in the coming quarters.

Growth disappoints more than expected in the first quarter of 2019

Statistics (Stats) SA released the GDP print for the first quarter of 2019, which contracted by more than anticipated at 3.2% in q/q saar terms relative to a 2% contraction estimated by the Iress consensus. This was also significantly below the 1.4% rate reported in the fourth quarter of 2018. While electricity supply shortages contributed to the weakness in growth, subdued activity was broad-based, highlighting weakness in domestic demand in the economy.

Positive contributions to growth (based on the supply-side breakdown) arose from the majority of the services sectors, led by the finance, real estate and business services sector (0.2%), general government (0.2%) and lastly personal services (0.1%).
The remainder of the sectors detracted from total growth, with the largest detraction coming from manufacturing (negative 1.1%), mining (negative 0.8%), trade (negative 0.5%) and transport (negative 0.4%) (see chart 1).

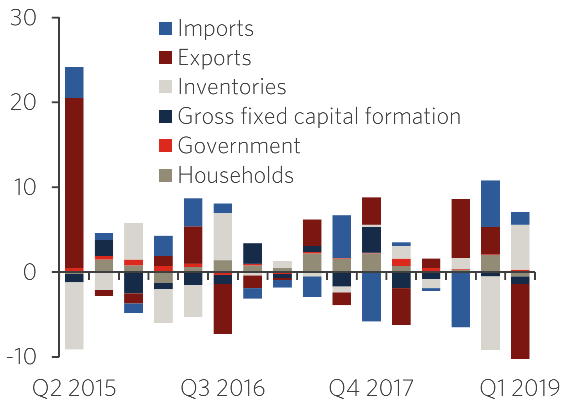
Chart 1: Contributions to supply-side GDP (%)



Source: Stats SA, Momentum Investments

GDP growth (based on a demand-side breakdown) declined by 3.4% q/q from 1.6% q/q in the fourth quarter of 2018. Negative contributions were recorded for exports (negative 9.0%), gross fixed capital formation (negative 0.9%) and household expenditure (negative 0.5%). Positive contributions emanated from inventories (5.3%), general government expenditure (0.3) and inventories (1.5%) (see chart 2).

Chart 2: Contribution to GDP expenditure (%)

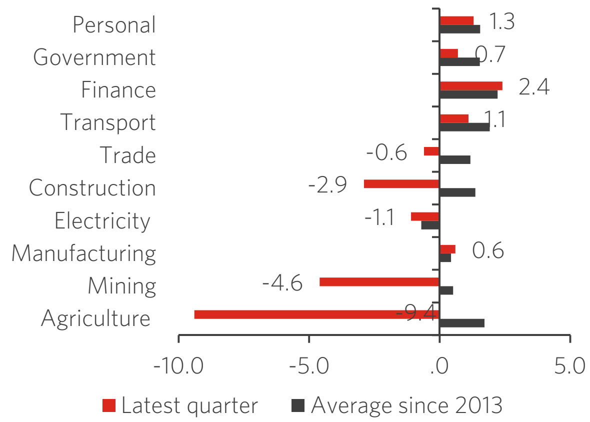


Source: Stats SA, Momentum Investments

Domestic demand has been significantly weaker than initially anticipated amid political uncertainty, slow reform, electricity supply shortages and a constrained consumer. Shortages in electricity supply started in November 2018, but did not affect production as severely as it did in the first quarter of 2019. This could be attributed to the year-end shutdown for the December holiday season. Load shedding, however, continued in the first quarter of 2019 and was partly responsible for the weakness in the trade and production sectors. Suppressed demand prospects has also deterred fixed investment outlays and hiring by the private sector.

The finance sector is the only sector that outperformed its long-term average in the first quarter of 2019. The rest underperformed and growth in half of the industries printed negatively (see chart 3).

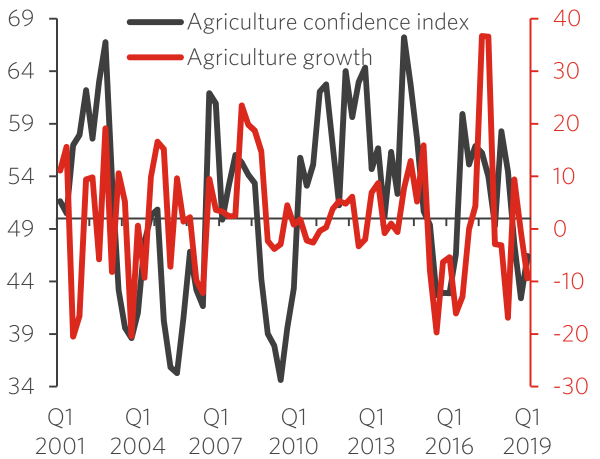
Chart 3: Supply-side growth per sector (%)



Source: Stats SA, Momentum Investments

Growth in agriculture disappointed in the first quarter of the year, relative to what the agriculture confidence index alluded to (see chart 4). The index increased to 46 index points in the first quarter of 2019 from 42 index points in the fourth quarter of 2018, but remained the neutral 50 mark. Despite this slight uptick, growth in the agriculture sector plunged 13.2% q/q from negative 7.9% q/q in the fourth quarter of 2018.

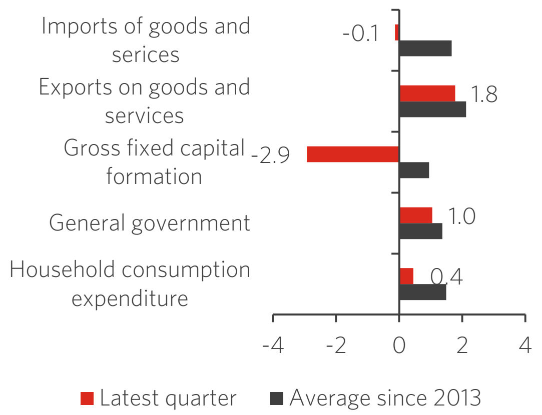
Chart 4: Disappointing growth in agriculture



Source: Stats SA, Global Insight, Momentum Investments

The demand side of the economy showed that four out of the five sub-components showed negative growth in the first quarter of 2019. Growth in all these components underperformed their long-term averages, as calculated from 2013 (see chart 5). This data corroborate weak underlying domestic demand in the economy.

Chart 5: Demand-side growth per sector (%)

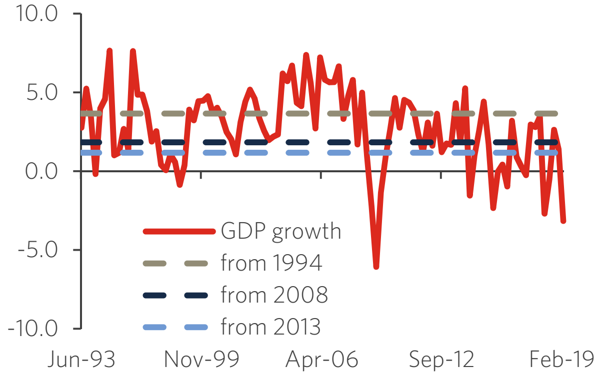


Source: Stats SA, Momentum Investments

The growth trend has been on a downward slide for some time now and has failed to sustainably return to pre-global financial crisis levels. The latest growth print for the first quarter has significantly underperformed the long-term averages since 1994 (democratic era), since 2008 (post-crisis period) and since 2013 (when growth trends in SA began to diverge from the rest of the world) (see chart 6).

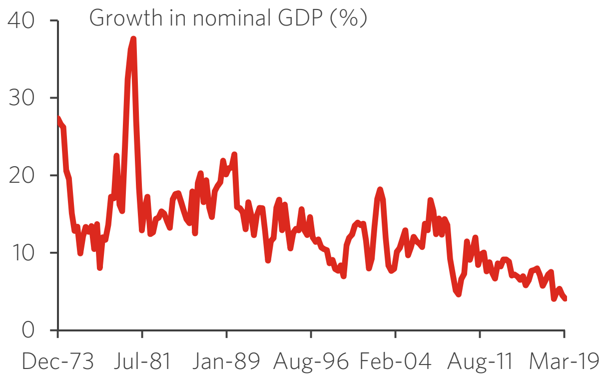
Growth in nominal GDP for the first quarter of 2019 was the weakest it has ever been and poses a risk to fiscal consolidation efforts in the near term (see chart 7).

Chart 6: Growth lower than all long-term averages (%)



Source: Stats SA, BER, Momentum Investments

Chart 7: Weakest nominal growth to date



Source: Stats SA, Momentum Investments

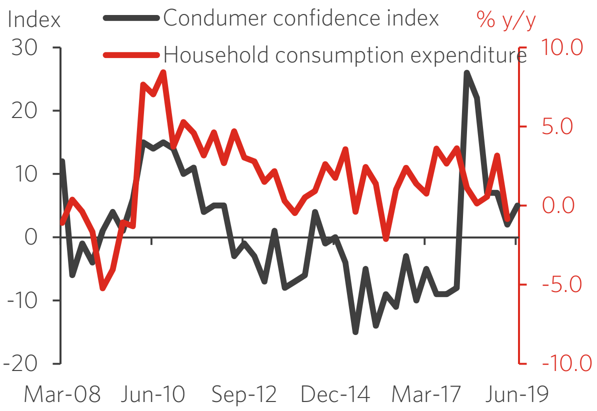
Political instability in SA has remained just below 60, according to the Bloomberg Political Risk Score (the higher the score, the more negative) in comparison to 28 in Turkey and 10 in Brazil. Although the 2019 national elections and the reconfiguration of cabinet have been digested by markets, a reinvigoration of confidence and growth will depend on the ability to embark on the implementation of much-needed structural reforms in economic, regulatory and political areas.

Depressed household and business sentiment

Consumer confidence ticked higher in the second quarter of 2019 to five index points from two index points in the first quarter of 2019, as constraints on electricity supply weighed on sentiment.
Consumer confidence is a composite index, but there is weakness in all of the sub-indices that constitute the sentiment index. The index measuring the appropriateness of the current time to buy durables is negative across all income groups.
This weakness is evident in actual household spend, which has plummeted in the first quarter of 2019 to negative 0.8% from 3.2% and is likely to continue underperforming relative to its long-term trend (see chart 8). Momentum Investments expects growth

in household spend to average around 1% in 2019, which is significantly lower than the 2.1% recorded in 2017 and the 1.8% rate registered in 2018.

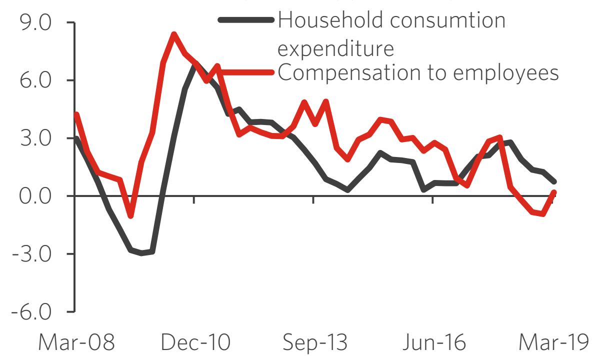
Chart 8: Mild rebound in confidence, but household spend remains weak



Source: Stats SA, BER, Momentum Investments

The dip in growth in household consumption expenditure has matched the negative trend in growth in compensation to employees, which tracked in negative territory for three quarters, since the second quarter of 2018 and only rebounded to 0.2% in the first quarter of 2019 from negative 0.9% in the last quarter of 2018 (see chart 9).

Chart 9: Household spend supported by credit (%)

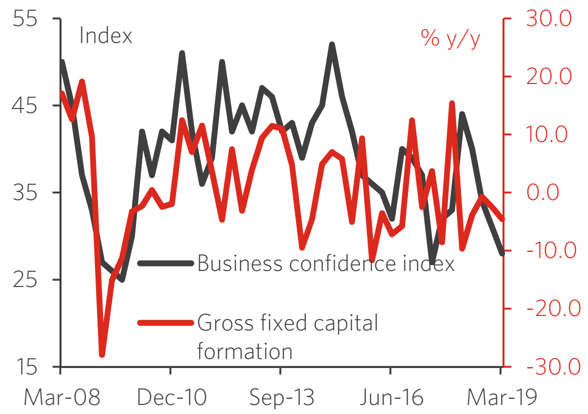


Source: Stats SA, BER, Momentum Investments

This slight mismatch indicates households are relying on other income stream to supplement salaries and wages. This could partly be attributable to growth in household wealth, which has slowed since the second quarter of 2018 from 7.6% to 0.6% in the fourth quarter of 2018. However, given the decline in growth in household net wealth, other sources of income have likely supplemented spend. The income stream that has likely aided household consumption expenditure could be credit extended to households, which rose from 3.9% in the first quarter of 2018 to 5.7% in the fourth quarter of 2018.

Business confidence has failed to move into positive territory on a sustainable basis since the global financial crisis and has corroborated the weakness in gross fixed capital formation, which has been contracting for the past five quarters (see chart 10). Gross fixed capital formation declined by 4.5% q/q in the first quarter of 2019 from negative 2.5% q/q. The decline in growth in fixed investment is highly related to political instability and slow reform, which continues to deter investment by the private sector. The investment conference held in the second half of 2018 has not yet fully reflected in actual investment growth and could be delayed to 2020. Momentum Investments expects growth in fixed investment to contract for the year as a whole, but expects a recovery in 2020, as the political climate becomes less uncertain.

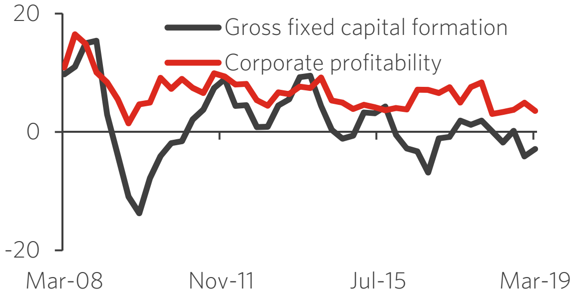
Chart 10: Investment growth undermined by weak business confidence



Source: Stats SA, BER, Momentum Investments

Although growth in total corporate profitability is in positive territory, it continues to track below its long-term average of 10.1% (see chart 11). The gap between fixed investment growth and rates of corporate profitability can be explained by insufficient demand perceptions and elevated political uncertainty hampering investment spend by the private sector.

Chart 11: Negative investment growth amid dwindling corporate profitability (%)



Source: Stats SA, Momentum Investments

Weakness likely to persist in the near term

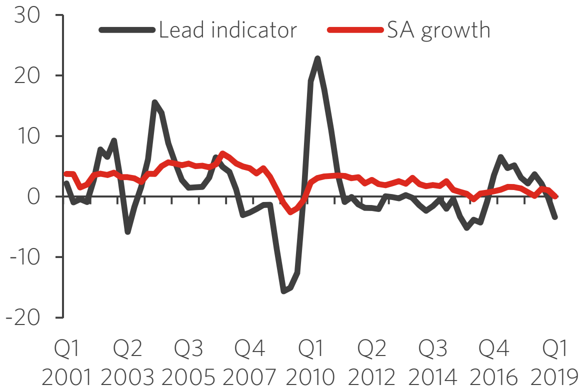
The world economy has been growing slower than SA export growth since 2012 (see chart 12). This is, however, expected to moderate in 2019 and 2020, as anti-globalisation continues to gain traction and the US-China trade war poses a threat to stable SA export growth. Exports grew by 1.8% y/y (negative 26.4% q/q) in the first quarter of 2019 from the 5.4% y/y (11.1% q/q) growth in the fourth quarter of 2018. This was the first decline since the fourth quarter of 2017. Momentum Investments expects export growth to be softer in 2019 and 2020 at 1.9% relative to growth of 3.3% in 2018.

Chart 12: SA export growth has been resilient (%)

Source: Stats SA, International Monetary Fund, Momentum Investments

The leading indicator published by the Sarb has been rolling over since the third quarter of 2018, indicating pressure on growth in the near term (see chart 13).

Chart 13: Leading indicator signalling growth likely to remain moderate (%)



Source: Stats SA, SARB, Momentum Investments

Momentum Investments has downgraded its expectation for real GDP growth for 2019 from 1.0% to 0.6%, but expects a marginal recovery in confidence on the back of less political uncertainty in the second half of the year. Fragile growth and structurally lower inflation has raised the probability of an interest rate cut in the coming quarters.

Investment implications

Momentum Investments' well-diversified outcome-based solutions provide protection against SA economic weakness by also having appropriate exposure to local fixed-income investments that benefit from a poor-performing SA economy and low inflation.

They also have meaningful global exposure that is unaffected by weak local growth conditions, while gaining from the rand weakness likely associated with fragile local growth conditions.