momentum
investments

The Macro Research Desk


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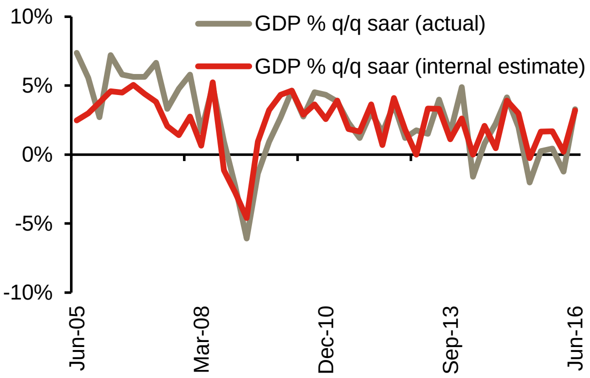
2Q16 GDP recovery influenced by low base in mining and manufacturing

Firm rebound in real economic activity in the second quarter of the year unlikely to be repeated in the next quarter

Real GDP growth increased by 3.3% in the second quarter of the year relative to the first quarter in seasonally-adjusted annualised terms (saar). This translates into a 0.6% increase in year-on-year terms from a 0.1% contraction in 1Q16. The figure exceeded the INET BFA consensus estimate of 2.8% and was marginally above our own forecast for a 3.2% q/q saar rise (based on Stats SA's high-frequency data releases on mining, manufacturing, electricity and trade, see chart 1).

Chart 1: Notable rebound in real GDP growth in 2Q16



Source: Citi, Global Insight, INET BFA, Momentum Investments

The significant rebound in growth was largely attributable to a bounce in mining and manufacturing production. According to Deutsche Bank, the surge in mining production was driven by a reopening of the Amplats refinery and a recovery from safety stoppages in the first quarter of the year, while Stats SA pointed out that production in the petroleum products/chemicals and motor vehicles/parts divisions contributed to the sharp uptick in manufacturing.

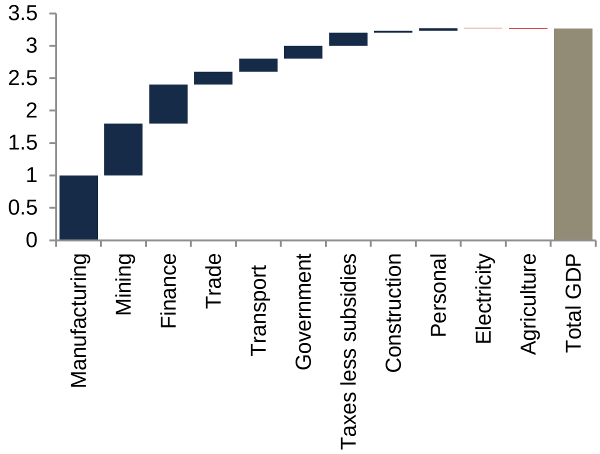
Nevertheless, depressed consumer and business confidence indices point to a slowdown in growth in the third quarter of the year as rising inflation, weak hiring intentions and muted credit growth constrain household spending, while elevated political risks and soft growth in corporate profitability are likely to cap investment growth. Though the second quarter print reduces the risk of an annual recession, growth in economic activity is likely to remain sluggish. We expect GDP growth at below half a percent in 2016, increasing to around a percent in 2017 as additional electricity capacity comes on stream and as commodity prices inch higher in response to an improvement in global demand and in reaction to a further reduction in commodity supply.

Production-side real GDP

Manufacturing and mining production rebound contribute to higher GDP growth in 2Q16

Stats SA reported a significant rebound in real GDP growth from a negative 1.2% q/q saar print in the first quarter of the year to a 3.3% q/q saar increase in 2Q16. The largest contributors to growth were the manufacturing (increasing by 8.1% q/q saar in 2Q16 and contributing 1.0% to overall GDP growth) and mining (growing at 11.8%q/q saar in 2Q16 and contributing 0.8% to overall GDP growth) sectors, while activity in the electricity and agricultural sectors acted as mild detractors (see chart 2).

Chart 2: 2Q16 GDP growth contribution (% q/q saar) - production-side GDP



Source: Global Insight, Momentum Investments

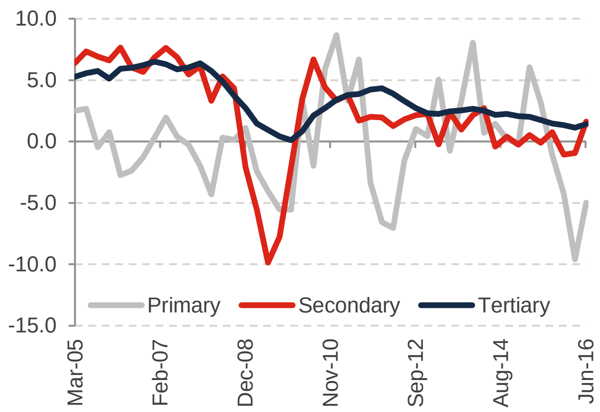
Recovery in growth across primary, secondary and tertiary industries

Growth in the primary sector (agriculture and mining) recovered from a negative 9.6% q/q saar in the first quarter of the year to a less negative 5.0% print in the second quarter (see chart 3) thanks to increased production of platinum group metals boosting the growth contribution made by SA's mining sector. Meanwhile, activity continued to contract in the agricultural sector for the sixth consecutive quarter as the production of field crops and horticulture products continued to decline.

Economic activity in the secondary industry (construction, utilities and manufacturing) recovered to 1.6% q/q saar in the second quarter from a negative 0.9% print in 1Q16, largely owing to an increase in production of petroleum products/chemicals and motor vehicles/parts in the manufacturing sector. Stats SA attributes the negative growth print in the electricity and other utilities sector to less electricity being consumed in the second quarter of the year as well as a decrease in the amount of water distributed given water restrictions in parts of the country.

Activity in the tertiary sector grew at 1.4% q/q saar in 2Q16, in line with the past four-quarter average, but increasing from the 1.1% q/q saar print in 1Q16. The deterioration in growth rates in the transport, trade and government industries was more than offset by an uptick in growth in the financial and personal services sectors in the second quarter of the year.

Chart 3: Growth in primary and secondary sectors recover from a weak first quarter



Source: Global Insight, Momentum Investments

Expenditure-side real GDP

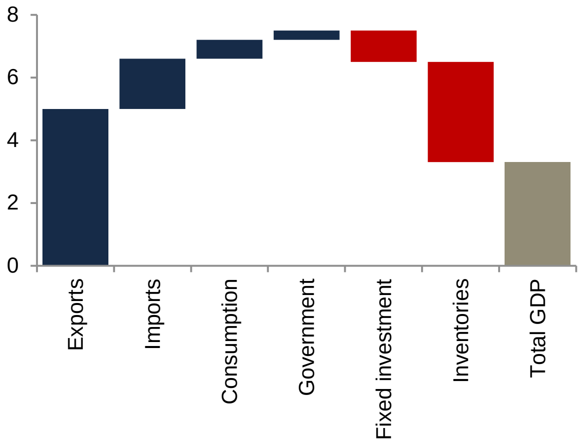
Domestic demand taking strain, while exports make a strong positive contribution to growth

After contracting by 8.1% q/q saar in the first quarter of the year, export volumes reported a robust 18.1% q/q saar (3.1% y/y) increase in 2Q16, buoyed by exports of precious metals and transport equipment. In line with sluggish domestic demand, import growth contracted for a second consecutive quarter at 5.1% q/q saar (-2.6% y/y) in 2Q16.

Household consumption added to overall growth in the second quarter of the year, but inflation pressures, job losses and tepid growth in household credit ensured a very mild uptick of only 1.0% q/q saar (0.9% y/y) in 2Q16 from a 1.7% q/q saar contraction in the first quarter of the year. According to Stats SA, spend on food, housing, furniture and transport decreased, while expenditure related to alcohol/tobacco, health and recreation increased.

The 1.3% q/q saar (1.4% y/y) increase in government consumption came from an increase in employment numbers (likely related to additional hiring for the local government elections) as well as an increase in spending on goods and services. With weak economic growth likely to weigh negatively on revenue collection, Treasury may have to rationalise spending on goods and services in order to meet fiscal consolidation targets.

Chart 4: 2Q16 GDP growth contribution (% q/q saar) – expenditure-side GDP



Source: Global Insight, Momentum Investments

A sharp 4.8% q/q saar contraction in construction works and a 4.2% decrease in machinery spend led to growth in fixed investment contracting for the third consecutive quarter. Growth in fixed investment dipped a further 4.6% q/q saar (-2.8% y/y) in 2Q16 after plunging 10.0% q/q saar in the previous quarter. Slower growth in corporate profitability and decimated business confidence, owing to increased uncertainty on the direction of economic policy, points to continued weakness in private fixed investment spend in upcoming quarters.

The R23 billion drawdown in inventories was the largest growth detractor in the expenditure breakdown of GDP. Destocking was particularly pronounced in the mining and manufacturing sectors. A recovery in inventory accumulation could take some time given an expectation of weak domestic demand by SA corporates. The recent Bureau of Economic Research/Barclays Purchasing Managers' Index for August 2016 revealed weakness in both new domestic sales orders as well as new export orders, flagging ongoing weakness in demand.

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