SA ECONOMY **FAILS TO RECOVER**

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ABOUT **THE AUTHOR**

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KEY TAKEOUTS

- LOCAL MARKETS ARE BUFFETED BY GLOBAL DEVELOPMENTS
- S&P LEAVES RATINGS AND OUTLOOK UNCHANGED
- SHOCK GDP CONTRACTION IN Q1 2018
- WEAKNESS IS SPILLING INTO Q2

May was a tough month for emerging economies as global developments – such as a strong US dollar, trade tensions and rising oil prices – impacted emerging equities, bonds and currencies. South Africa did not escape, as local equities came under pressure, our bond yields rose and the rand weakened against the US dollar.

Apart from global developments, local events started to reflect a slightly more realistic picture after the relative euphoria of the previous few months. Real economic data shows first quarter GDP growth to be negative on a quarter-on-quarter basis (in early June, Stats SA announced that first quarter GDP growth was -2.2% on an annualised basis); inflation will likely quickly head up from the recent low towards 5%; and interest rates are unlikely to be cut again in this cycle. There is also some scepticism around reforms going forward, with continued concerns about land reform, state-owned enterprises' finances and governance, and public sector wage increases. On the positive side, the passing of labour reforms, new state-owned enterprise board appointments and the S&P ratings view managed to provide some balance.

MINING AND MANUFACTURING HIT THE BRAKES

Data released in May confirmed that GDP growth in the first quarter would make a sharp U-turn from the +3.1% annualised growth recorded during the fourth quarter of 2017. Mining and manufacturing data released in April confirmed that mining production recorded -10% annualised growth and manufacturing production was 7% lower on the same basis. Similarly, retail sales recorded a dismal -5% annualised growth in the first quarter.

Other data, including the purchasing manufacturing index, credit extension and vehicle sales, all remains fairly subdued and also indicates that weakness spilled into the start of the second quarter (we remind readers that real economic data gets released with a bit of a time lag – that is why first quarter GDP data is only released in the first week of June).

INFLATION ON THE UP, WITHIN TARGET RANGE

Inflation data for April (at 4.5%) was slightly below expectations. This was up from the recent low of 3.8% and included the partial impact of the VAT rate hike announced in the Budget. We expect further VAT impact to come through in the May inflation data as not all price adjustments for the VAT rate increase were concluded in terms of shelf pricing.

Significant petrol price increases (higher fuel levy in April and the impact of higher international oil prices and a weaker rand exchange rate) will also lead to higher inflation over the coming months. We expect headline inflation to reach 5.1% by July/ August.

The latest South African Reserve Bank monetary policy committee (MPC) meeting confirmed that monetary policymakers have become more hawkish regarding interest rates, given the supply-side shocks (rand and oil price) threatening the inflation outlook. While the MPC will be willing to look through the first-round inflation impact of these shocks, their concerns around potential second-round impacts will likely keep rates on hold, and the MPC hawkish, for some time. Wage settlements and inflation expectations will be closely watched to gauge the second-round risks.

Positive news over the past month came from the passing of the labour reform package in the National Assembly. This package comprises three Bills and aims to improve productivity, employment, investment and growth. The main parts of this package include the national minimum wage (of R3 500 a month) and the secret strike ballot, which means that unions are now forced to ballot members before a strike and this must be in secret. This should help reduce working days lost to strike activity.

In April, ratings agency S&P kept South Africa's credit rating unchanged and also left the outlook at "stable". The agency's key concerns remain weak economic growth, and fiscal pressures. We did not expect that positive political developments over the past several months would have been enough to achieve a more positive outcome. S&P would need proof of significant improvements in growth and fiscal matters, as well as structural economic reforms, before positive ratings changes will be considered.

Looking forward, the much weaker first quarter GDP growth means that we will have to revise our growth forecast for 2018 (currently at 2.1%) down towards about 1.8% or 1.9%. While a rebound is always possible after a negative quarter – and especially now that confidence is improving and the SA Reserve Bank's leading indicator is still pointing towards better growth – the rebound is unlikely to be big enough to reach 2%+ this year. More on this in the next edition. ■