SA EXITS THE RECESSION, **BUT GROWTH RATE IS UNSUSTAINABLE**

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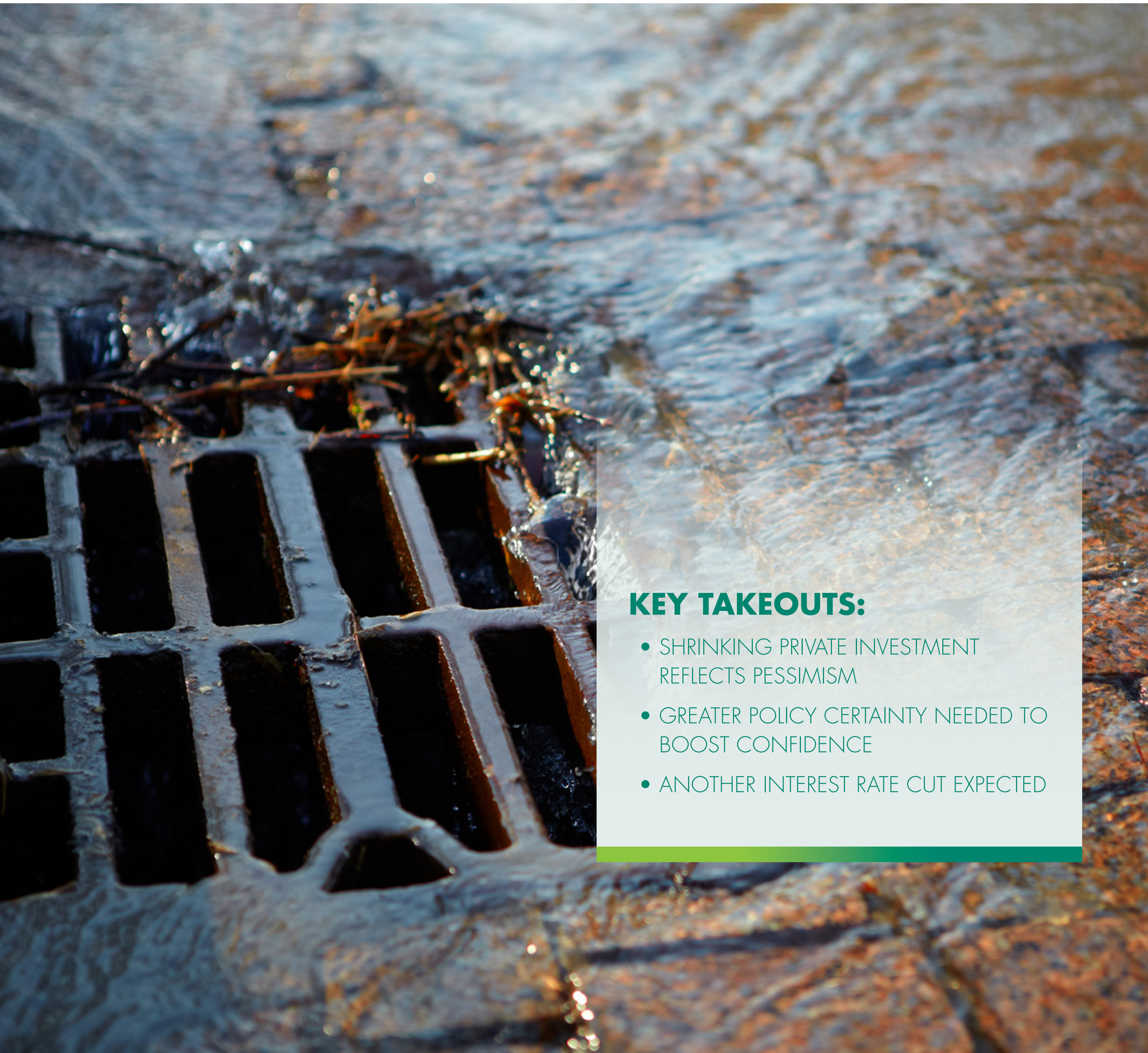
ABOUT **THE AUTHOR**

As Sake Economist of the Year 2016, Rian's insight into and forecasts of how macroeconomic developments impact financial markets inform MacroSolutions' top-down views.



KEY TAKEOUTS:

- SHRINKING PRIVATE INVESTMENT REFLECTS PESSIMISM
- GREATER POLICY CERTAINTY NEEDED TO BOOST CONFIDENCE
- ANOTHER INTEREST RATE CUT EXPECTED

On a macroeconomic front, August was a good month for South Africa. The equity market rose to a new all-time high, inflation fell to the middle of the target range (the lowest level in almost two years), another sizeable trade surplus was recorded and the rand firmed back to below R13.00 to the US dollar by month-end.

RECESSION ENDS AS GDP GROWS 2.5%

In addition to the relatively good news on the financial side of the economy over the past month, the real economy also delivered a pleasant surprise… officially exiting the recession in the second quarter. In recent editions of Fundamentals we highlighted the fact that high frequency data was pointing to a solid recovery in economic activity during the second quarter. This after the shock 0.7% annualised contraction of the first quarter, which officially put the economy into a recession (a recession is defined as two successive quarters of GDP contraction). Early in September, StatsSA released the first estimate of the GDP numbers for the second quarter, which came in at 2.5% annualised – not only surprising analysts' estimates to the upside, but more than reversing the cumulative contraction over the previous two quarters.

Put differently, while we remain concerned about the slow pace of growth in economic activity, the total level of economic activity has risen to a new all-time high.

SA IN A STRUCTURAL SLOW GROWTH TRAP

On a more sobering note, while the second quarter expansion was very welcome, we remain concerned about the sustainability of the second quarter performance. In fact, we fully expect growth to slow again in the second half of the year and our long-standing forecast of 0.8% GDP growth for the full calendar year has consequently remained unchanged. Moreover, a deeper analysis of the GDP numbers indicates that private fixed investment continues to contract. By the second quarter it was no less than 15% lower than the peak reached in the final quarter of 2014. The consistent contraction in private investment reflects businesses' pessimism regarding the outlook for the economy and growing concern over policy direction – and certainty. The implication is that South Africa remains in a structural slow growth trap and will not escape it until greater policy certainty and predictability helps business confidence to recover.

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Since the middle of 2016, we have held a very out-of-consensus view that the South African Reserve Bank would cut interest rates during the second half of 2017, a prediction that came true in July. Given the further drop in inflation in recent months, the stable rand and the still weak underlying economy, we expect the Bank to lower the repo rate by a further 25 basis points at its 21 September meeting. Looking further ahead, we have pencilled in two more rate cuts in 2018, assuming the rand remains broadly stable and inflation remains anchored well into the 3% - 6% inflation target range.

FISCAL CONSOLIDATION A RED FLAG

Despite the relatively good macro news flow over the past month, the one area that is rapidly moving in the other direction is the fiscal situation. With tax revenues badly lagging budget projections during the first four months of the fiscal year, it seems as if the budget deficit for the full year might exceed the budget target of 3.1% of GDP by about half a percent of GDP. In addition, the state-owned enterprises remain a big concern, with many running deficits that have to be covered by the fiscus. The Medium Term Budget Policy Statement in October will provide a clearer picture of the likely outcome for the full year, but markets will also closely watch what actions new Finance Minister Gigaba takes to keep the fiscal situation under control.