momentum investments

in the moment


Herman van Papendorp
Head of Investment Research & Asset Allocation


Sanisha Packirisamy
Economist


Tshiamo Masike
Economic Analyst

GDP overshoots expectations at 0.6% q/q in the second quarter

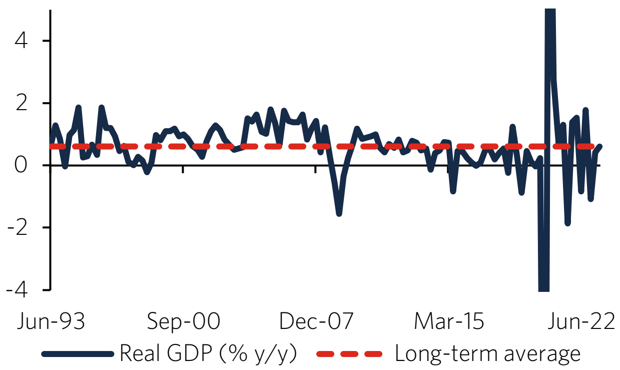
Highlights

- According to Statistics South Africa (Stats SA), seasonally adjusted (sa) real gross domestic product (GDP) rose by 0.6% quarter-on-quarter (q/q) in the second quarter of 2023. This represented the second consecutive quarterly uptick in economic growth from negative 1.1% q/q recorded in December 2022.
- Growth beat the Reuters median consensus expectation of 0.1% q/q by a large margin.
- Year-to-date (January to June 2023) economic growth was 0.9% higher than the first half of 2022.
- The overall economy has consistently recorded activity slightly above pre-pandemic levels (2019 average) since the third quarter of 2022 and the second quarter GDP print maintained this trend. Robust output in agriculture, finance and personal services has been enough to overshadow the below pandemic output in mining, manufacturing, utilities, construction and trade. However, mining and manufacturing performed reasonably well in the second quarter and left overall activity much closer to pre-pandemic levels.
- Mining and manufacturing production benefited from loadshedding not exceeding stage 6 as previously warned of in the months leading up to winter. These two industries are demonstrating increasing resilience.
- On the demand side, the only component registering below pre-pandemic activity is fixed investment. The sharp growth in fixed investment in the second quarter did, however, bring fixed investment closer to the 2019 average.
- According to historical trends of Eskom's Energy Availability Factor (EAF), the Council for Scientific and Industrial Research (CSIR) flags the risk of higher stages of loadshedding (within the maximum stage 6) in the coming months. Stage 6 was announced on 4 September for the first time since 13 July 2023.
- Merchandise trade statistics published by the SA Revenue Services (SARS) recorded a trade surplus of R8.07 billion in the second quarter as the value of exports outpaced that of imports. However, according to Stats SA, the volume of imports grew faster than exports which resulted in imports detracting the most from growth.
- On account of less loadshedding experienced during winter, we revised our growth forecast for 2023 up to 0.2% from 0%. However, the better-than-expected growth outcome for the second quarter is likely to lift this estimate closer to 0.5%. The International Monetary Fund's (IMF) and the SA Reserve Bank's (SARB) growth estimates of 0.3% and 0.4%, respectively, are likely also subject to an upward revision following the positive growth surprise for the second quarter. That said, loadshedding still remains a major risk to the growth outlook.
- The SARB's composite leading business cycle indicator decreased by 3.9% q/q in the second quarter of 2023 which suggests a weak growth trajectory in the very near-term.

Positive growth surprise

According to Stats SA, real GDP growth for the second quarter of 2023 rebounded to 0.6% q/q, noticeably beating the Reuters median consensus expectation of 0.1% q/q for the second consecutive quarter. Quarterly economic growth in the second quarter matched the pace of long-term average growth (0.6%) as seen in chart 1. However, this was below the recent peak of 1.8% q/q recorded in the third quarter of 2022.

Chart 1: GDP growth in Q2 matches long-term average of 0.6%

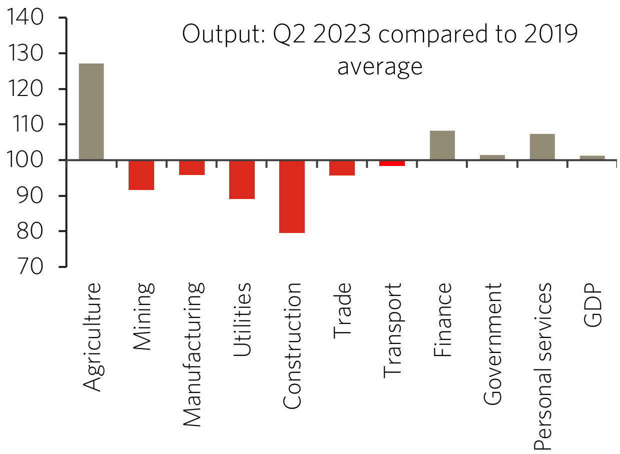


Source: Global Insight, Stats SA, Momentum Investments
Data until second quarter of 2023
y-axis truncated

The size of the overall domestic economy has consistently remained slightly above pre-pandemic levels since the third quarter of 2022. This is largely due to robust activity in the agriculture industry, finance sector and personal services as seen in chart 2. Relative to the average in 2019, economic activity registered in the agricultural industry is 27.2% stronger. Finance and personal services were 8.2% and 7.3% higher, respectively. The transport industry temporarily recovered to pre-pandemic levels in the first quarter of 2023 but slipped back below in the second quarter. The recovery is lagging in mining, manufacturing, utilities (electricity, gas and water), construction and trade (wholesale and retail) when compared to pre-pandemic levels highlighting consumer weakness and an energy-constrained economy.

The construction industry was 20.4% weaker in the second quarter of 2023 relative to 2019 which points to the prolonged impact of the pandemic and is reflective of higher interest rates and lower disposable income dampening demand.

Chart 2: Six of the 10 industries are operating below pre-pandemic levels

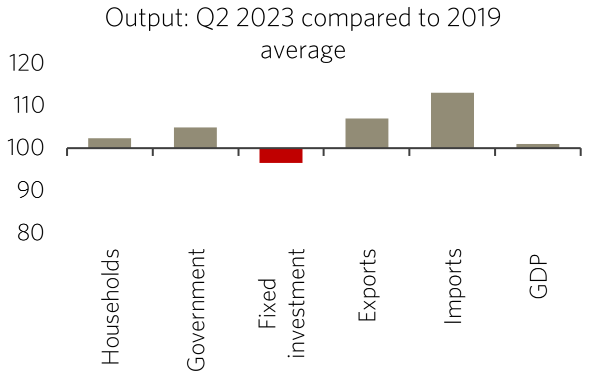


Source: Global Insight, Stats SA, Momentum Investments

Two years post the pandemic, employees are still working from home and office space vacancy rates remain elevated, albeit improving off its lows. The *Daily Investor* reported on the second quarter report of the SA Property Owners Association (SAPOA), which reveals that office vacancies in SA were 15.6% at the end of the second quarter compared to 11% in 2019. Johannesburg is reported to have the highest office vacancy rate of 18.7% in the second quarter (12.5% at the end of 2019) which translates to an estimated R2.8 billion lost in rental income annually. According to SAPOA, the improvement in vacancy rates is due to lower rentals drawing in occupants. Therefore, an improvement in vacancy rates does not necessarily imply that rental income is on the rise.

The demand side has fared better than the production side. In the second quarter of 2023, household consumption, government consumption, exports and imports remained above pre-pandemic levels as seen in chart 3. The only lagging component on the expenditure side was fixed investment, which registered 3.7% weaker than the 2019 average.

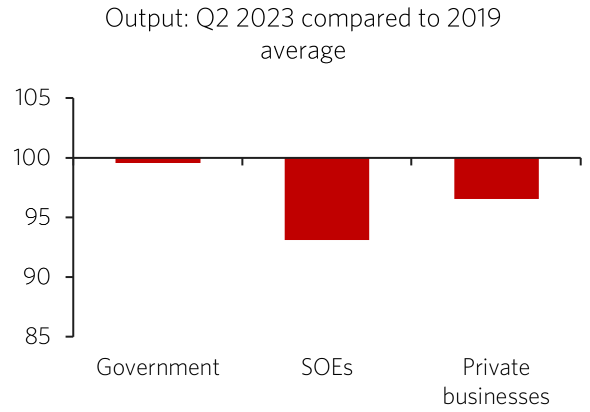
Chart 3: Broad-based demand side recovery



Source: Global Insight, Stats SA, Momentum Investments

Fixed investment was predominantly weighed down by state-owned enterprises (SOEs), which were 6.9% weaker, and private businesses (3.5% weaker) as seen in chart 4. Fixed investment by government edged above pre-pandemic levels in the first quarter of 2023 but slipped back in the second quarter.

Chart 4: Fixed investment below pre-pandemic levels across the different organisations



Source: Global Insight, Stats SA, Momentum Investments

We do, however, note that there has been an improvement as fixed investment was 14.5% weaker in the third quarter of 2021 and this improvement was largely driven by SOEs and private businesses. Recovery in fixed investment by the private sector was at a much slower rate until the most recent uptick in the second quarter. We expect higher investment from the private sector from next year as electricity mitigation projects commence and as more businesses invest in alternative sources of energy.

Bringing the focus to quarter-on-quarter growth shows that the biggest drivers of growth in the second quarter were agriculture, forestry and fishery which rose by 4.2% q/q in the second quarter from an unanticipated deterioration of negative 11.9% q/q in the first quarter (revised from 12.3 q/q) and manufacturing (2.2% q/q from 1.5% q/q) from the production side. From the expenditure side, growth was lifted by a substantial rebuild in inventories and fixed investment (7.9% q/q from 0.2% q/q)

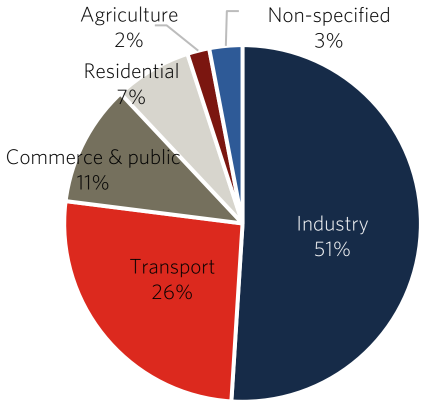
Economic growth in the second quarter resulted in GDP for the first half of 2023 being 0.9% higher y/y, which is lower than the 1.2% y/y recorded in the first half of 2022. Slowing y/y growth has been stifled by mounting challenges such as the cost-of-living crisis, recurring power outages, logistic constraints and a weaker global economy.

Non-occurrence of above-stage 6 loadshedding benefited energy-intensive industries

Mining and manufacturing output rose by 1.5% q/q and 2.3% q/q, respectively, in the second quarter of 2023 and consequently aided economic growth. Mining added 0.1% to GDP growth and manufacturing had a slightly larger contribution of 0.3%.

Despite the higher frequency of stage 6 loadshedding during the second quarter, manufacturing and mining output grew on a quarter-on-quarter basis. This is partly because these sectors benefit from load curtailment which allows them to plan production better and helps to build resilience. Fortunately, the risk of higher stages of loadshedding beyond stage 6 that was flagged in the months leading up to winter did not materialise. In the event of loadshedding beyond stage 6, energy-intensive industries could have possibly been subjected to higher load reduction (above the maximum of 20%) which would have negatively affected production and these industries' contribution to economic growth. Mining and manufacturing cumulatively accounted for 15.9% of GDP in the second quarter according to the production approach.

Chart 5: Industry accounted for more than half of energy demand in 2018

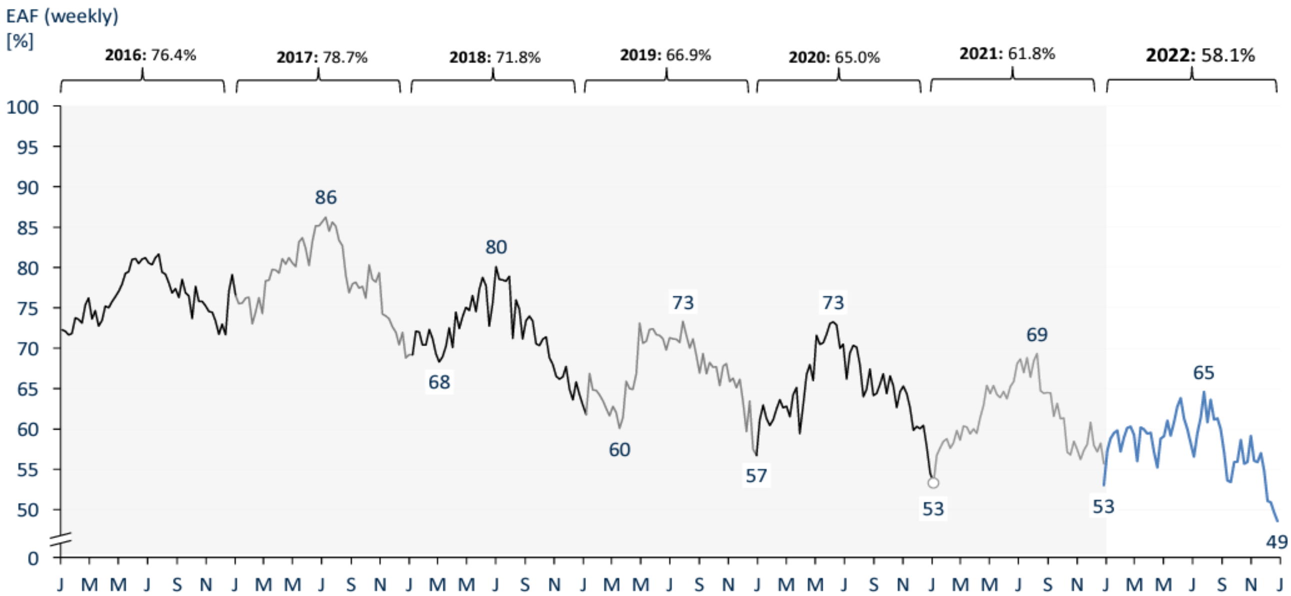


Source: DMRE, Momentum Investments
Commerce and Public services sector include financial services, information technology, retail, tourism and the services industry

According to the 2021 energy sector report published by the Department of Mineral Resources and Energy (DMRE), the industrial sector, which consists of chemicals and petrochemicals (28%), iron and steel (13%) and mining and quarrying (10%), accounted for 51% of energy demand in 2018 while the agriculture sector accounted for only 2% of energy demand.

While winter has gone by without experiencing the worst-case scenario of stage 8, the risk of a higher frequency of stage 4 to stage 6 loadshedding hangs over the economy in the warmer months. According to the CSIR, Eskom's EAF generally improves towards the winter months when the power utility conducts less planned maintenance. Planned maintenance is then ramped up after winter which brings the EAF down again (see chart 6). This points to the likelihood of more intense loadshedding in the coming months which may dampen economic activity. Moreover, large generating units (Kusile Units 1, 2 and 3, Koeberg Unit 1 and Unit 4 of Medupi) remain offline. Koeberg Unit 1 is expected to be operational by November 2023 before Unit 2 is taken offline and the plan is to have both units operational by mid-2024. Kusile Units 1 to 3 are expected to return to service by the end of December 2023 and Medupi Unit 4 by August 2024. On 4 September 2023, Eskom announced the implementation of stage 6 loadshedding for the first time since 13 July 2023 due to an increase in unplanned outages.

Chart 6: EAF trends signal more intense loadshedding in the coming months

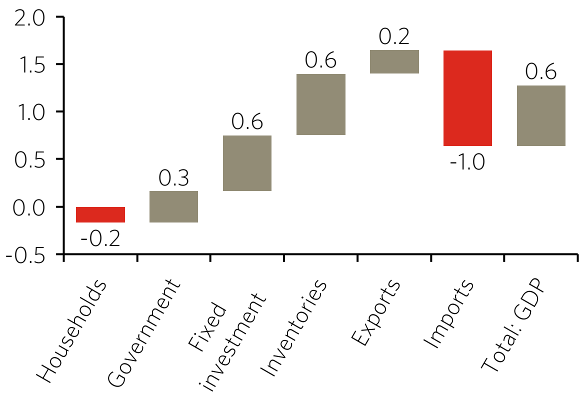


Source: CSIR

Imports detracted the most from growth in the second quarter

The components that detracted from growth in the second quarter according to the production approach were transport, storage and communication (negative 1.9% q/q from 1.1% q/q in the first quarter) as well as trade, catering and accommodation (negative 0.4% q/q from 0.7% q/q). The decline in trade correlates with the 1.1% q/q decrease in retail trade sales in the second quarter. On the demand side, imports of goods and services (3.4% q/q from 4.8% q/q) had the largest negative contribution. Of the 0.6% q/q growth rate, exports added 0.2% and imports detracted 1% (see chart 7) which resulted in a net effect of negative 0.8% from growth. As noted by Stats SA, growth in imports was mainly due to 'increased trade in machinery and electrical equipment; vegetable products; artificial resins and plastics; base metals and articles of base metals; and animal and vegetables fats and oils'.

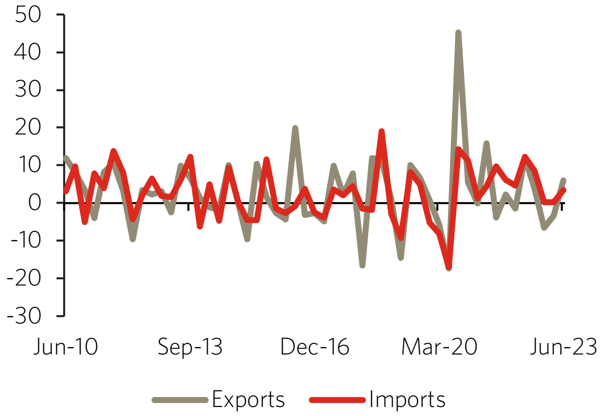
Chart 7: Fixed investment and inventories contributed the most to Q2 GDP



Source: Stats SA, Momentum Investments

Merchandise trade data published by SARS reveals that growth in the value of exports (including BELN – Botswana, Eswatini, Lesotho and Namibia) outpaced imports and resulted in a positive trade balance of R8.07 billion in the second quarter of 2023. Total exports increased by 6% q/q to R513 billion, and imports were 3.4% q/q more at R505 billion (see chart 8). The higher export revenue was largely generated in May (R183 billion) and SARS attributes this to increased flows of platinum, gold and diamonds.

Chart 8: Value of merchandise exports outpace imports in 2023Q2, % q/q



Source: SARS, Momentum Investments

July trade statistics started off the third quarter on a positive footing with a large merchandise trade surplus of R16 billion which overshot the Reuters median consensus of a R1.3 billion deficit. The swing from a trade deficit in June (R4.7 billion) to the July surplus is due to a 4.6% month-on-month (m/m) increase in the value of exports to R174 billion combined with a sizeable decrease of 7.6% m/m in the value of imports to R158 billion. SARS underpins the growth in exports to vehicles as well as gold and petroleum oil. Imports were lower due to a decrease in petroleum oils, electric accumulators and electrical transformers, static converters and inductors.

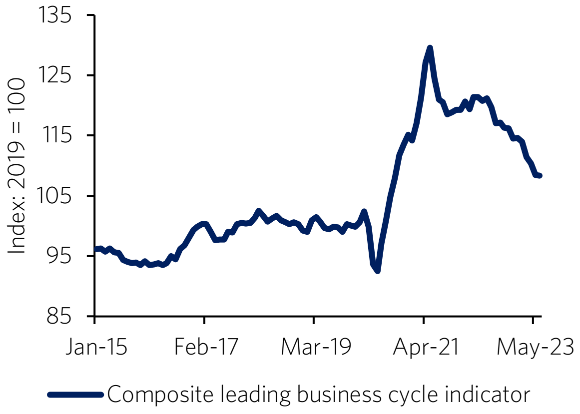
Upward revisions for 2023 GDP growth

Domestic economic growth surprised positively in the first two quarters of the year, with the country averting a technical recession in the first quarter and the second quarter growth being at the same rate as the long-term average rate of 0.6%.

On account of less loadshedding experienced during winter, we revised our growth forecast for 2023 up to 0.2% from 0%. However, the better-than-expected growth outcome for the second quarter is likely to lift this estimate closer to 0.5%. The IMF and the SARB's upwardly revised growth estimates of 0.3% (previously 0.1%) and 0.4% (previously 0.3%), respectively, are likely also subject to further upward revisions following the positive growth surprise for the second quarter. That said, loadshedding still remains a major risk to the growth outlook.

The direction of the SARB's composite leading business cycle indicator is on a downward trend (see chart 9), signalling a slowdown in the coming months. The leading indicator decreased by 3.9% q/q in the second quarter of 2023 which indicates a deterioration in economic activity in the first quarter of 2024 (six-month lag). During the second quarter, the deterioration in the index was more pronounced in May (negative 1.7% m/m). According to the SARB, the decrease in May was largely due to a decline in the number of residential building plans approved and a decline in SA's export commodity price index denominated in United States dollars. Only three of the 10 leading indicator components contributed positively, namely, 'a widening of the interest rate spread and an acceleration in the six-months smoothed growth rate of the real M1 money supply (notes and coins in circulation)'. On the back of a deterioration of the leading indicator, we are unlikely to see a meaningful improvement in growth over the very near term.

Chart 9: Leading indicator points to slower growth



Source: Iress, SARB, Momentum
Data until June 2023

At the SARB's Biennial Conference, the IMF noted that SA needs to address issues related to the energy sector, reduce crime, and focus on improving the efficiency of SA's logistics to achieve sustainable long-term growth. In August, *News24* reported that the Passenger Rail Agency of SA (PRASA) could not operate railway lines in a Cape Town suburb due to homeless people setting up camp on the railways. This event reflects the hardships faced by SA citizens and indicates the need for holistic intervention to improve economic activity.