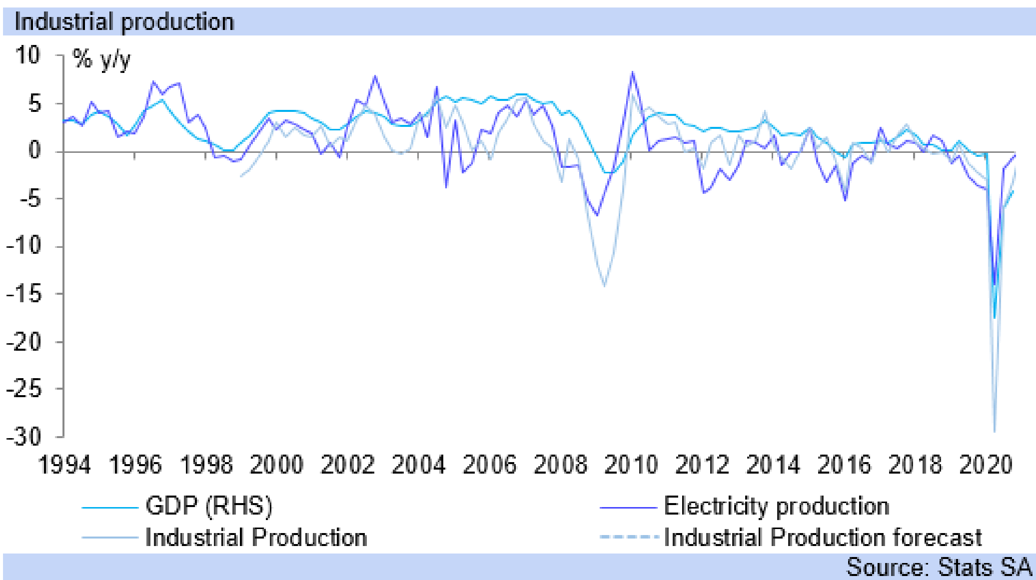
SA Economics

Thursday 13 May 2021

Industrial production note: Q1.21 lift will push GDP growth into positive territory as expected, but also add to the mixed picture, with a number of key data readings outstanding while Fitch has SA's rating unchanged



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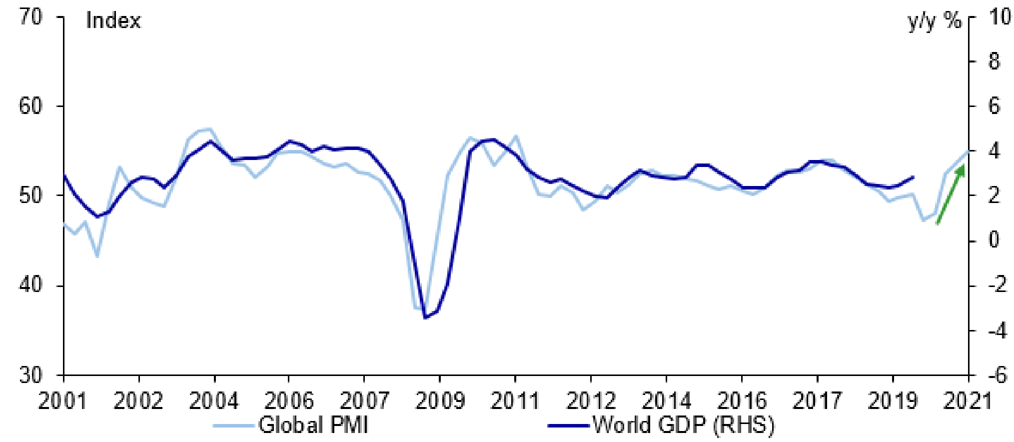
Global PMI and world growth



Source: Bloomberg, IHS Global Insight

Note: Monthly Global PMI data is converted to quarterly data. PMI reading for April and May 2020 is averaged to provide a Q2 2020 reading. The Global PMI readings for Q2 still shows a down downward trend however the PMI reading for May was slightly up from April, rising from 39.6 to 42.4.

- Today's mining production print, at 3.8% qqsa (quarter on quarter, seasonally adjusted) completes the picture for Q1.21 industrial production, which rose by 3.5% qqsa in Q4.21, and so will make a fairly strong, positive contribution to overall Q1.21 GDP.
- Industrial production makes up 21.5% of GDP, consisting of the sub-sectors manufacturing, mining and electricity production. However, the largest sub sector in GDP is real estate, business services and finance at 21% followed by general government at 16.3% of GDP.
- General government expanded consistently in size over the 2010s decade, with the heavy cost of staff wages, as civil servants renumeration grew rapidly in the 2010s, the key component in the marked deterioration of government finances on the expenditure side.
- Fitch still has SA on a negative outlook, stating this week that "(p)ayroll and SOE reforms will be crucial for fiscal consolidation. Compensation of public-sector workers accounts for a large share (around 35%) of government expenditure."
- "Ongoing negotiations on a new wage deal are likely to be difficult and the government is unlikely to meet its target of agreeing on a wage freeze , leading to the risk of expenditure overruns. …. The conditions for debt stabilisation are challenging".
- "The Land Bank default last year and the difficulties of electricity monopolist Eskom Holdings SOC Ltd highlight the risk from contingent liabilities from SOE's high debt and weak finances." These elevate SA's planned peak in debt, and it remains on BB+ with a negative outlook.
- Both Fitch and Moody's ratings are unchanged so far this year, with the negative outlooks retained, but Fitch worries on "further deterioration in South Africa's trend GDP growth rate" and highlights that SA has been through an "exceptionally tough lockdown".

SA Economics

- Fitch comments that “(t)he government is working on structural reforms to accelerate the economic recovery, but the scale envisaged is limited and recent record of implementation is weak so that trend growth is likely to remain very weak, below 2%”.
- While we expect economic growth to quicken to 3.0% y/y out to 2026 on structural reforms, Fitch appears to see less of a positive trajectory, showing concern that “divisions within the ruling party (have been) hindering policy-making”, or essentially implementation.

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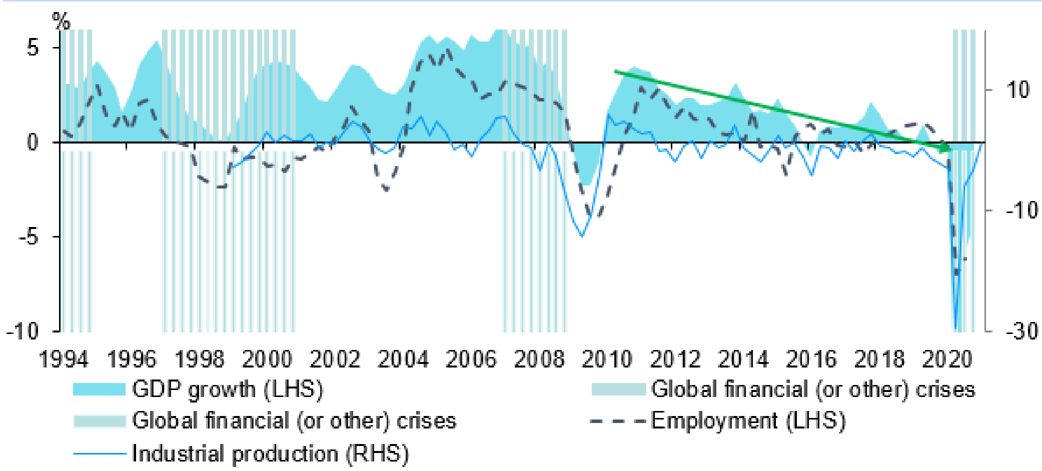
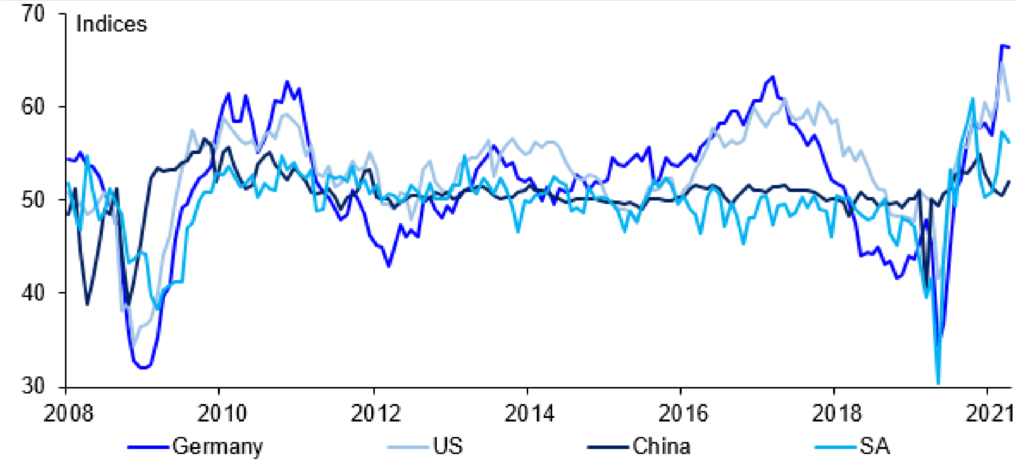
South Africa saw a downward economic growth trend in the 2010s decade



SA Economics

Advanced economies and China's PMI



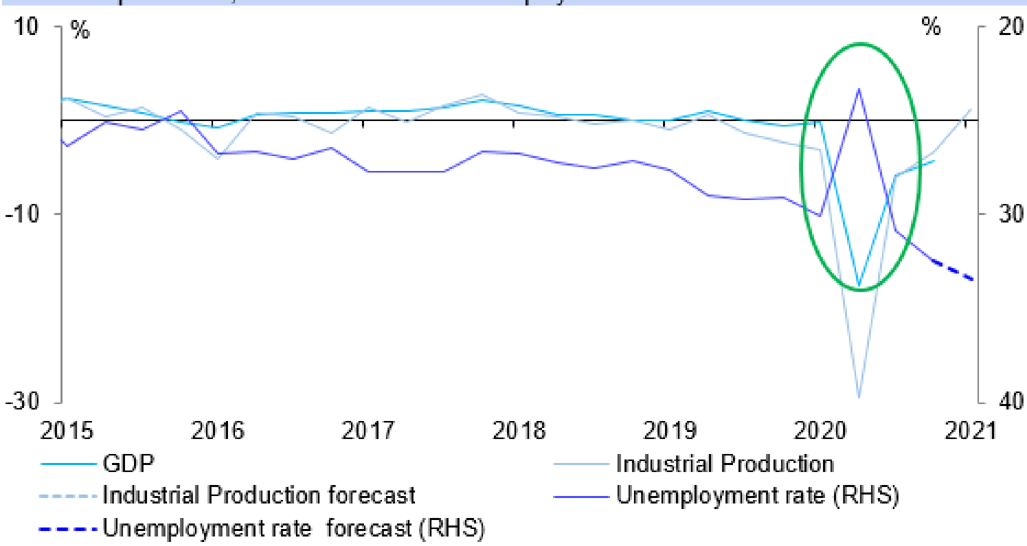
Sources: Bloomberg

- While the South African economy is recovering, Fitch is further concerned that "the scale of the recovery is weak relative to the fall last year, as pandemic risks linger and electricity shortages and tight public finances weigh on growth."
- Credit rating agencies' primary purposes are to assess the credit worthiness of debt, and so revenues matter (influenced by growth). Fitch specifies "conditions for debt stabilisation are challenging, given low trend growth", supporting its negative outlook".
- It does acknowledge that "recent revenue performance has been surprisingly strong, and structurally the structure of debt is favourable", with the strong performance from commodity prices having driven the lift in state revenues collected from the mining sector.
- With Health Minister indicating that SA is in a third wave now, even though the figures are not showing this technically yet, the strength of the economic recovery will continue to depend both on the severity of lockdowns imposed and the pace of the regulatory reforms.
- We are not expecting the exceptionally severe lockdown levels of 4 and 5 to be repeated, but a manifestation of a rapid climb in the seven-day rolling average of new cases would be alarming for the government and would likely see some restrictions tightened.
- Cases of the variant common in India have now been found in SA. On the positive side, "the aim is to vaccinate 500 000 health workers with the J&J vaccine which provides more than 80% protection against severe COVID-19 and death" is now proceeding well.
- SA's pace of vaccination rollout had been extremely slow however, and Fitch further worries that "(t)he slow pace of Covid-19 vaccination programmes means that risks related to the pandemic also remain high." However, mass vaccination is due to begin next week.

SA Economics

- Fitch adds "(m)edian public debt in the (sub-Sharan) region leapt to 68% of GDP in 2020 from 56% in 2019, and is likely to rise further to 75% in 2022". This does not compare favourably with SA which is already at 80% of GDP and expected to peak near 90%.
- The agency warns in particular "(v)ery supportive global financial conditions have mitigated the pandemic shock but gradually less supportive global financial conditions could lead to greater volatility complicating SSA market access." This includes SA.

Industrial production, GDP and the formal unemployment rate from Stats SA



Source: Stats SA

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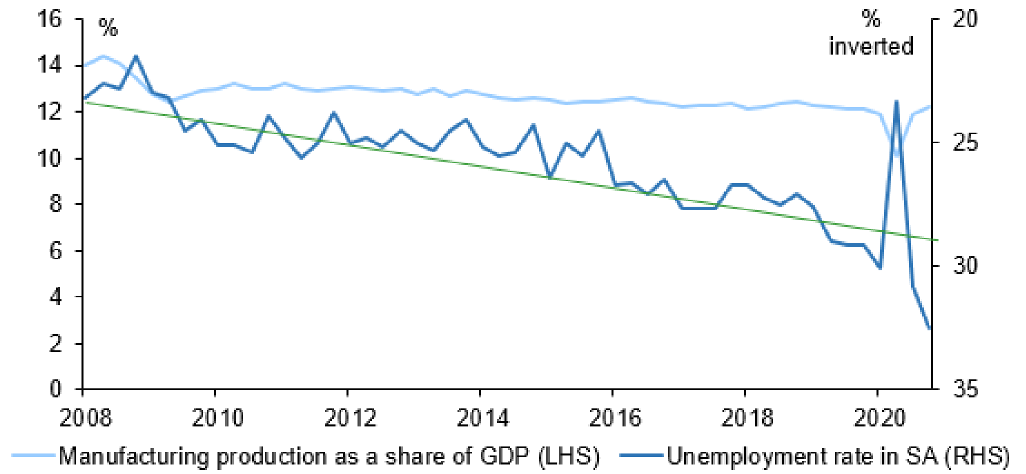
Manufacturing production % of GDP vs Unemployment rate



Sources: SARB, Stats SA