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Business cycle: Q3.19 leading indicator drop indicates slower growth in Q2.20 versus Q1.20, while Q3.19 GDP growth will be close to 0% qqsaa

26th November 2019

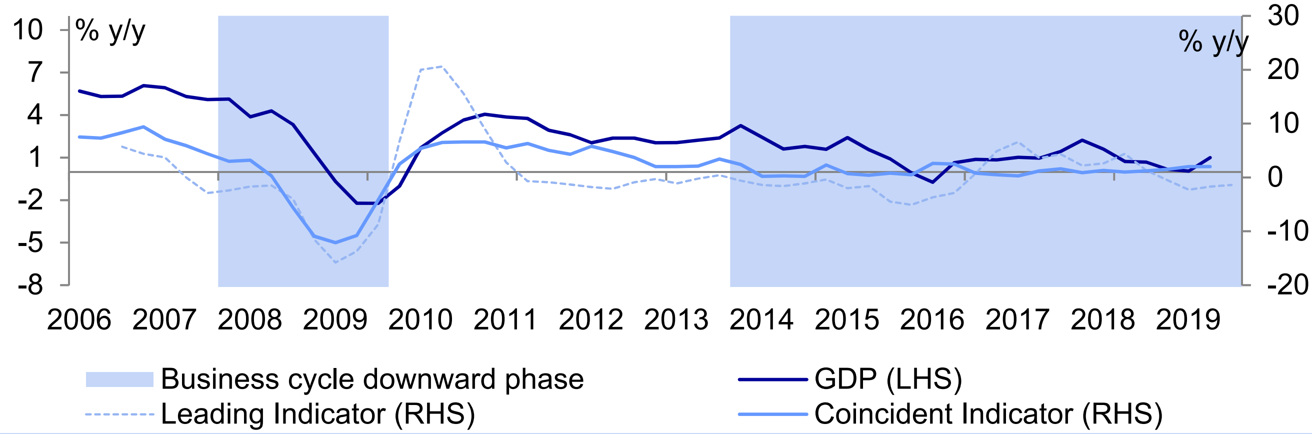
Figure 1: Summary of the composite business cycle indicators*

	2019								
Indices 2015 = 100	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Leading indicator	103.1	105.5	104.9	105.5	104.0	103.2	103.9	103.8	103.2
12-month % ch	-3.2	-2.2	-1.5	-0.4	-1.8	-3.0	-1.5	-1.3	-1.6
Coincident indicator	104.7	104.5	105.0	105.5	105.8	105.4	104.6	103.9	-
12-month % ch	1.8	1.9	2.2	3.1	2.4	1.6	0.9	-0.2	-
Lagging indicator	93.9	95.1	94.1	94.8	96.3	94.6	94.7	94.7	-
12-month % ch	-0.7	-0.1	-0.6	0.4	1.9	0.1	0.2	0.5	-

Source: SARB. The historical data is subject to revision

- September's 2019's leading business cycle indicator, released today by the South African Reserve Bank, dropped to 103.2, from 103.8 in August. The leading indicator for Q3.19 fell to 103.6 from 104.2 in Q2.19.
- The six-month lead (between the leading indicator readings and GDP growth) indicates that GDP growth could slow in Q2.20 versus Q1.20.
- While this is just one set of figures, they are nevertheless of concern as they indicate a Q2.20 slowdown where the first quarter of every year has contracted in SA since 2016.
- Furthermore, GDP growth for Q3.19 is now at risk of coming out closer to 0% qqsaa, than the 1.9% qqsaa previously forecast. A number of sectors have seen disappointing outturns in Q3.19, including industrial production (see "Industrial production: at risk of contracting by around -5.0% qqsaa in Q3.19", 13th November 2019, website address below), while real retail sales returned 0% qqsaa in Q3.19.
- Next year, GDP growth will likely be closer to 1.0% y/y than 1.5% y/y, as structural reforms lag. The IMF warned last night that it projects South Africa's "economic growth to remain sluggish in 2020—below population growth for the sixth consecutive year. … With low growth and low job creation, the increasing labor force is projected to exacerbate unemployment pressures, poverty, and inequality."
- "Failure to implement the needed adjustment in government and SOE spending and efficiency will worsen debt dynamics, erode financial stability, and further raise the country risk premium. With delays in structural reforms, growth and social conditions will worsen…. Time is of the essence."

Figure 2: GDP vs the leading indicator



Sources: SARB, Stats SA

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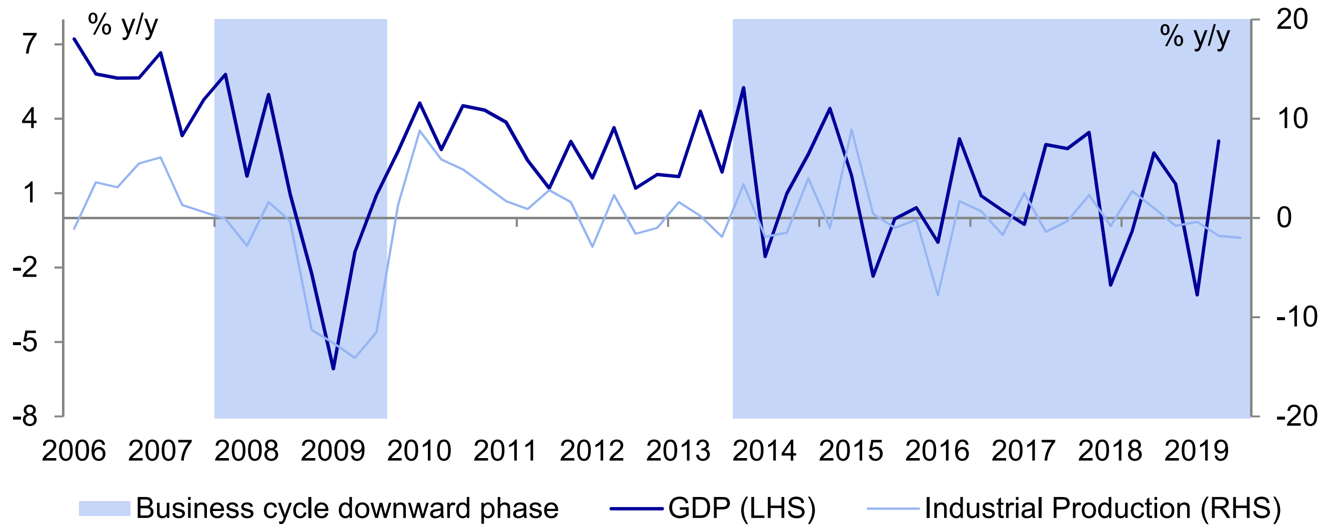
Figure 3: GDP vs Industrial Production



Sources: SARB, Stats SA

- The IMF further warns that South Africa's "vulnerable outlook emphasizes the urgency of rebuilding policy buffers and implementing reforms to put the economy on a sustainable and inclusive growth path. Failure to implement the needed adjustment in government and SOE spending and efficiency will worsen debt dynamics, erode financial stability, and further raise the country risk premium."
- The Monetary Fund recommends that "(r)eversing the trend decline in economic growth and creating opportunities for all South Africans will require cross-cutting product and labor market reforms. These reforms need to be appropriately sequenced."
- Furthermore, its "staff analysis suggests that product markets should be reformed first as they can deliver the highest growth gains with considerable price benefits for consumers. These reforms will buttress private sector development, enhance competitiveness, and provide tail winds to support the needed fiscal adjustment."
- In particular, "(r)enewed focus needs to be placed on reducing the cost of doing business. Streamlining SOE operations and sharing existing infrastructure in electricity, telecoms, and transportation with private operators will reduce high input costs and improve competitiveness. Untargeted subsidies and tax incentives for selected sectors should be replaced by a business-friendly environment that attracts competitive and innovative firms."
- "Dominant market players need to be subject to healthy competition to reduce the high mark-ups in sectors lacking contestation and alleviate constraints that inhibit the emergence of SMEs. The pertinence of a range of regulatory requirements that unduly inflate production costs need to be reconsidered."
- "Labor market rigidities should be tackled by decentralizing wage bargaining to help align wages more closely with productivity and reducing workforce management restrictions to align hiring and other operational decisions with business needs."
- All of these recommendations are not new, but the creepingly slow pace reform is occurring at in South Africa, if at all in a number of areas such as relieving the regulatory burden is damaging confidence (see "Business confidence: drops below levels of the global financial crisis", 11th September 2019 and "Consumer Confidence Update: drops to -7 in Q3.19, as the economic outlook deteriorates on the slow

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Figure 4: Business cycle phases of South Africa since 1945

Upward phase			Months	Downward phase			Months
Post war	-	July 1946	7	August 1946	-	April 1947	9
May 1947	-	November 1948	19	December 1948	-	February 1950	15
March 1950	-	December 1951	22	January 1952	-	March 1953	15
April 1953	-	April 1955	25	May 1955	-	September 1956	17
October 1956	-	January 1958	16	February 1958	-	March 1959	14
April 1959	-	April 1960	13	May 1960	-	August 1961	16
September 1961	-	April 1965	44	May 1965	-	December 1965	8
January 1966	-	May 1967	17	June 1967	-	December 1967	7
January 1968	-	December 1970	36	January 1971	-	August 1972	20
September 1972	-	August 1974	24	September 1974	-	December 1977	40
January 1978	-	August 1981	44	September 1981	-	March 1983	19
April 1983	-	June 1984	15	July 1964	-	March 1986	21
April 1986	-	February 1989	35	March 1989	-	May 1993	51
June 1993	-	November 1996	42	December 1996	-	August 1999	33
September 1999	-	November 2007	99	December 2007	-	August 2009	21
September 2009	-	November 2013	51	December 2013	-		

Source: SARB

pace of growth enhancing reforms", 5th November 2019).

- The IMF attributes South Africa's "(p)ersistently weak economic growth … to stagnant private investment and exports and declining productivity, mainly due to the slow pace of reform to address weaknesses in the business climate, including regulatory constraints, labor market rigidities, and inefficient infrastructure."
- In addition, "(u)nreliable electricity supply has exacerbated the growth constraints. Small and medium-sized enterprises (SMEs) are especially disadvantaged in this environment."
- As we have highlighted, "the reliance on government spending to boost growth has not delivered the anticipated results as the supply-side nature of the growth constraints has not been addressed. … government financing of SOE current spending is not growth-enhancing and has increased debt service costs that are now the fastest growing expenditure item, crowding out other forms of public spending.
- "Thus, the economy has been left with high and rising debt, low growth, and limited fiscal space to respond to shocks." This has severely damaged business confidence.
- Components of the leading indicator that reported negative contributions in September are the number of building plans approved (for flats, town houses, houses over 80 m2), job advertisements, real M1 and the interest rate spread (ten year government bonds less 91-day treasury bills).
- Positive contributions came from the BER's volume of orders in manufacturing (half weight), the commodity price index for SA's main export commodities, the BER's average hours worked per factory worker in manufacturing, the number of new passenger vehicles sold and the composite leading business cycle indicator for SA's major trading partners.
- The SARB's business cycle remains in a downward phase as lengthy, lagged effects of the deteriorating economic, fiscal, policy and political environment over the majority of this decade continues to suppress the business cycle, and so negatively affect confidence, employment and growth.
- With GDP measuring total production, and evincing a downwards trend in its growth since 2011, to likely closer to 0% this year, the changing nature of the economy and increasing prevalence of the 4IR (fourth industrial revolution) also needs to be incorporated into the statistics more fully.

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