



Strong rebound, but growth momentum expected to slow

Highlights

- After crashing 51.7% in quarter-on-quarter seasonally adjusted and annualised (q/q saar) terms in the second quarter, real gross domestic product (GDP) bounced by more than expected at 66.1% in the third quarter. Economic activity was nevertheless 6% weaker on a year-on-year (y/y) basis. The third-quarter GDP outcome surprised the November 2020 Reuters Ecometer median growth expectation to the upside. Analysts anticipated GDP to strengthen by 34.6% q/q saar, but high-frequency data likely led many analysts to revise this number higher in the run-up to the release.
- An easing of the lockdown restrictions enabled a revival in mobility indicators in the third quarter of the year. These indicators have continued to pick up in the fourth quarter in line with the move to level one. Shopping malls have reported an improvement in footfall, up to around 80% of levels observed this time last year.
- According to the production stack-up of GDP growth, the largest contributors to activity included the manufacturing, trade and mining sectors, which added 16.2%, 14.6% and 11.8%, respectively, to the quarterly annualised growth figure. None of the eleven contributing sectors detracted from the quarterly growth rate.
- Based on the expenditure stack-up of GDP growth, household spending added the most, due to a sizeable contribution from expenditure on transport, alcoholic/tobacco, clothing and food. A notable jump in construction works contributed to an increase in fixed investment, while businesses whittled down inventory levels even further, particularly in the trade and mining sectors.
- After a sharp pullback into May 2020, South Africa's (SA) leading indicator has been drifting higher since. Business confidence similarly showed an improvement in the fourth quarter release. Nonetheless, the sustainability of the recovery remains questionable as drivers behind consumer and business spending remain soft.
- We expect growth to contract by around 8% this year. We are pencilling in a shallow recovery of 2% in 2021, as an increase in the number of business closures, persistently higher levels of unemployment, fiscal stress and ongoing challenges to electricity supply detract from the expected upturn.

Quarterly bounce from a decimated base

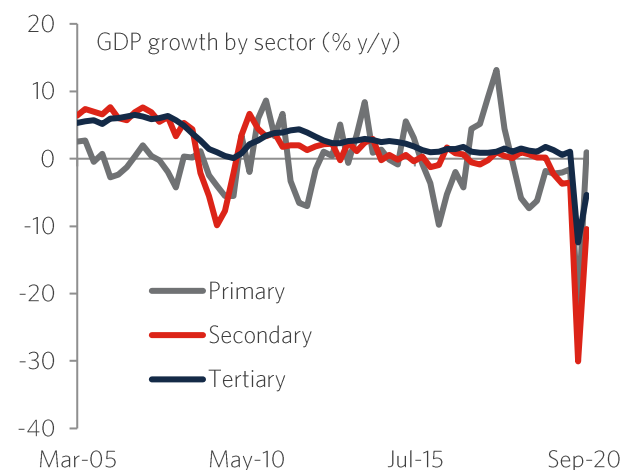
Real growth in GDP for the third quarter of 2020 surprised the market consensus to the upside in line with a further relaxation in lockdown restrictions on mobility and activity. Growth surged by 66.1% q/q saar

in the quarter and exceeded the November 2020 Reuters Ecometer median growth forecast of 34.6% q/q saar.

The growth performance for the second quarter was downwardly revised from a prior estimate of negative 51% q/q saar to negative 51.7% q/q saar. Growth rebounded in all of the 10 economic sectors in the third quarter of the year, with manufacturing, trade and mining staging the fastest recoveries.

GDP slipped 6.1% in the third quarter of 2020 y/y. On a disaggregated basis, the secondary sector (manufacturing, utilities and construction) experienced the largest fall in growth of 10.4% y/y, followed by a 5.4% y/y drop in the tertiary sector (largely services). Growth in the primary sector (agriculture and mining) recovered by 0.9% relative to a year ago (see chart 1).

Chart 1: Bouncing off previous lows



Source: Stats SA, Global Insight, Momentum Investments

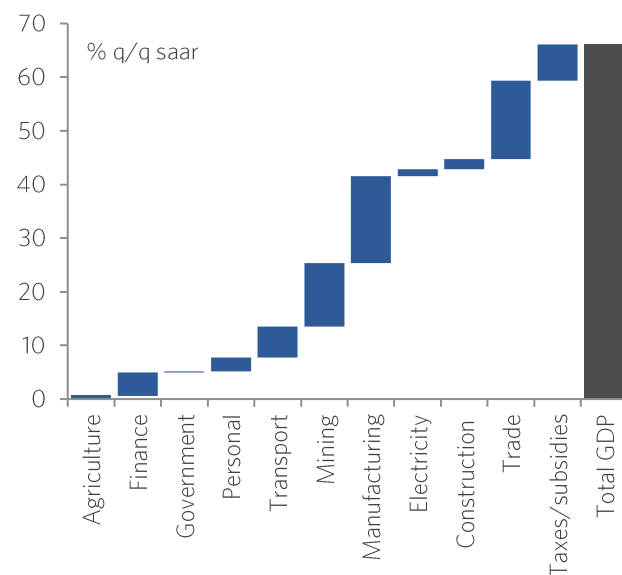
Manufacturing, trade and mining drive production-side real GDP growth

The manufacturing sector (which accounted for 14% of overall economic activity in the third quarter) added 16.2% to the quarterly, annualised growth rate, followed by a 14.6% addition from the trade sector (15% of overall economic activity), which includes retail, wholesale and motor trade as well as catering and accommodation. An easing in lockdown restrictions to level 1 likely boosted activity for catering and accommodation establishments. According to Statistics SA (Stats SA), all 10 manufacturing divisions experienced positive momentum in the third quarter. The divisions, which lifted overall growth by the most, included basic iron/steel, non-ferrous metal products, metal products/machinery and petroleum/chemical products.

The mining and quarrying sector contributed 11.8% to the overall growth rate in the third quarter (see chart 2). Stats SA noted an increase in activity in the production of platinum group metals, gold, iron ore, manganese ore and diamonds.

After eight consecutive quarters of contraction, construction activity sprang higher by 71.1% q/q saar. Stats SA nonetheless warned that the level of construction-related activity remained well below that of recent years.

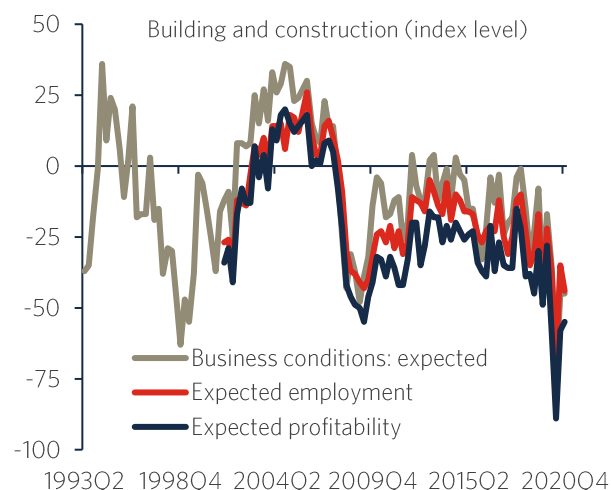
Chart 2: Manufacturing and trade were the largest contributors to growth in Q3 2020



Source: Stats SA, Global Insight, Momentum Investments

The outlook for the building and construction industry remains bleak. The Bureau of Economic Research's (BER) Building and Construction Survey for the fourth quarter of 2020 shows that average expectations of building contractors, building subcontractors, civil engineers, architects and quantity surveyors for business activity, employment and profitability remain solidly in negative territory despite springing back from historic lows (see chart 3).

Chart 3: Downtrodden construction sector



Source: BER, Momentum Investments

Growth in the largest sector of the economy, the government sector (accounting for 19% of economic

activity), increased by a minor 0.9% due to an increase in employment in the provincial government and higher education institutions. The small contribution from the government sector is unsurprising given constraints faced by the fiscus.

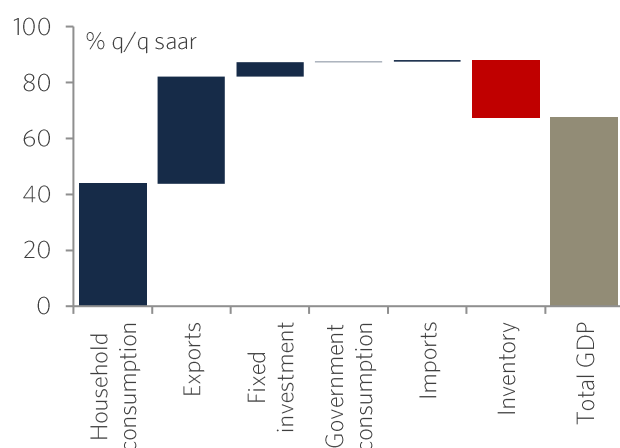
Activity in the financial services sector (which also accounted for 19% of economic activity) leapt higher by 16.5% q/q saar in the third quarter. Increased economic activity was reported for financial intermediation, insurance and pensions.

A further easing in lockdown restrictions drove a 38.6% q/q saar recovery in personal services. Many recreational, sporting and fitness centres resumed business operations during the third quarter.

Increase in expenditure-side GDP supported by household consumption and exports

The largest contributions to growth in the third quarter of 2020, based on the expenditure method, came from household consumption and exports, which detracted by the most in the previous quarter (see chart 4).

Chart 4: Household consumption and exports added the most to growth

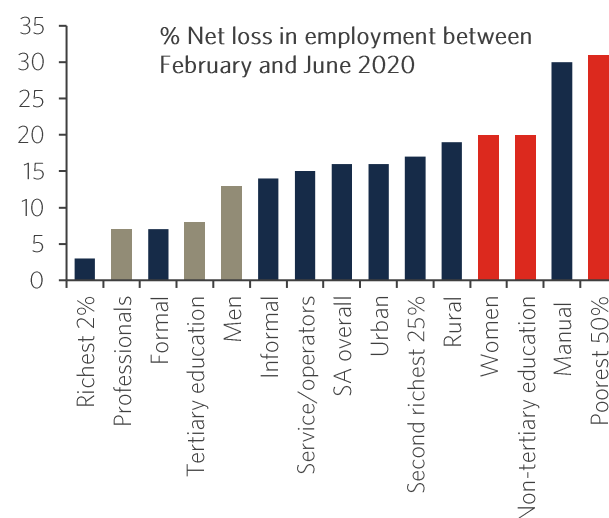


Source: Stats SA, Global Insight, Momentum Investment

On a disaggregated basis, household spending on durables and semi-durables was the most affected by lockdown restrictions in the second quarter and subsequently faced the sharpest uptick in the third quarter. Spending on transport contributed 17.2%

towards the 69.5% quarterly surge in household spending, after tanking 69.4% q/q saar in the second quarter. Notable contributions to household spending were also made by the food, alcohol/tobacco and clothing spending divisions.

Chart 5: COVID-19 exacerbated the polarisation in SA's labour market



Source: NIDS-CRAM, Momentum Investments

We expect household consumption expenditure to remain under pressure in the coming quarters, as pay

cuts and retrenchments weigh on spending. The National Income Dynamics Study – Coronavirus Rapid Mobile Survey (NIDS-CRAM) threw a spotlight on the polarised nature of job losses during the pandemic (see chart 5). The net job losses between February and June 2020 for the poorest 50% of SA's labour force amounted to 31%, 20% for those without tertiary education and 20% for women. Meanwhile, job losses were capped for professionals (7%), those with tertiary education (8%) and men (13%).

With lower-skilled informal jobs likely to take even longer to recover, there will be pressure on government to continue supporting these households beyond the extended date of the COVID-19 relief funds. This will be challenging to achieve under already-strained fiscal conditions.

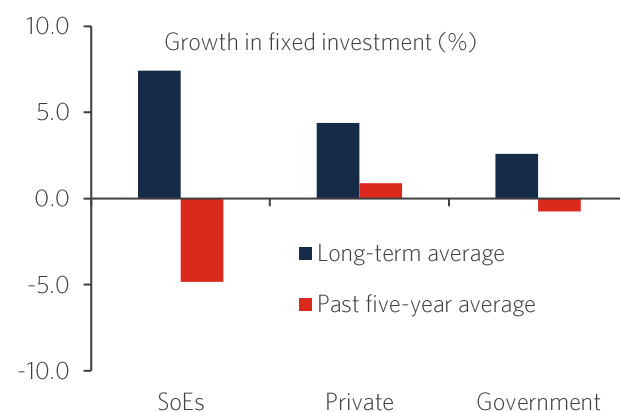
Fixed investment added 5.2% to the overall growth figure for the third quarter of the year, after detracting more than 11% in the second quarter. The main contributors to growth in fixed investment were in the construction works, residential buildings, non-residential buildings and machinery/transport equipment sectors.

Growth in fixed investment spending has disappointed in the past five years (see chart 6). Moreover, implementation delays to large projects gazetted by government could prevent a more meaningful uptick in growth in investment in the near term. A poor performance in infrastructure investment has been driven by concerns over the general political climate as well as a lack of demand (see chart 7).

A R156.2 billion drawdown in inventories in the third quarter of the year followed a R74 billion drawdown in the second quarter, primarily in the trade and mining

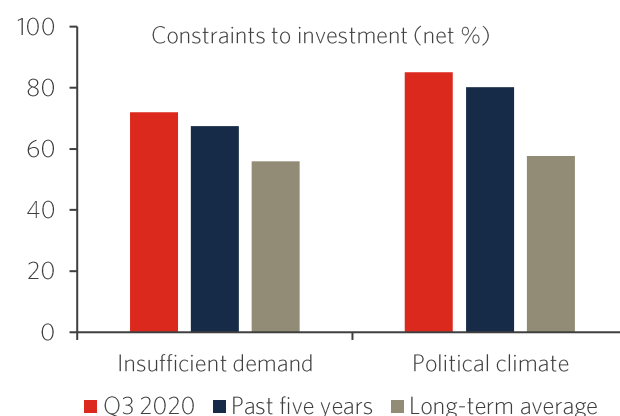
sectors. The inventory sub-index of the BER's Purchasing Managers' Index increased to an average of 54.6 points for the past three months, pointing to a potential recovery in inventories for the fourth quarter of the year.

Chart 6: Little to no growth in fixed investment in the past five years



Source: Iress, Momentum Investments

Chart 7: Insufficient demand and policy uncertainty have deterred fixed investment



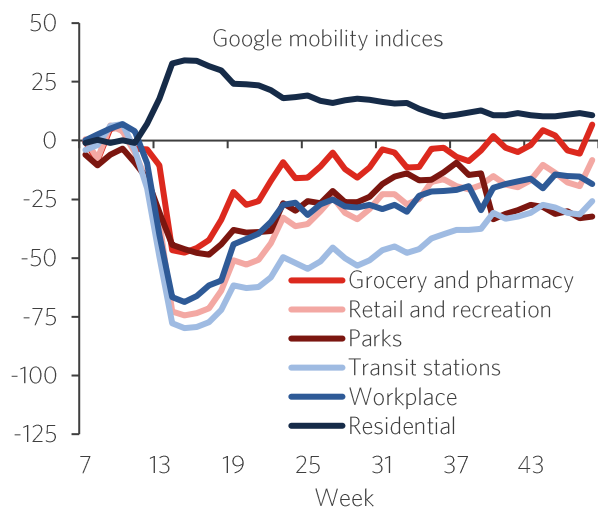
Source: BER, Iress, Momentum Investments

Local growth headwinds stifle the expected economic recovery into 2021

Mobility data gathered by Google shows that activity has nearly recovered to pre-lockdown levels in the SA economy (see chart 8). According to BusinessTech in September 2020, Liberty 2 Degrees reported that foot count across its portfolio was at 80% of 2019 levels. With the move to level 1 restrictions late in September

2020, restaurants were able to operate at increased capacity. International travel was further opened up from 1 October 2020, which should continue to contribute to higher levels of foot count in the remainder of the fourth quarter of 2020.

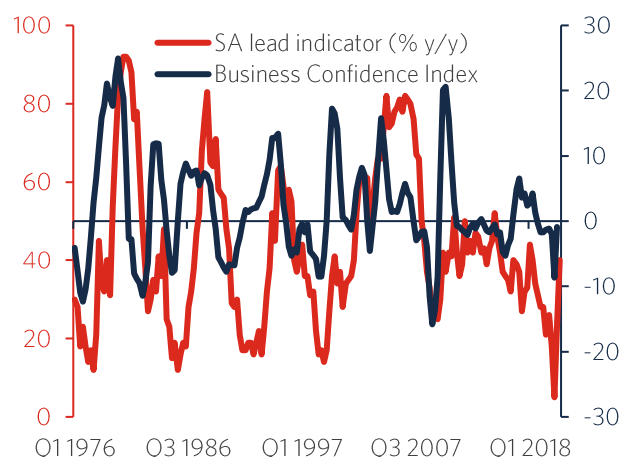
Chart 8: Recovery in SA's mobility indices



Source: University of Witwatersrand, Momentum Investments

The SA leading indicator plunged to a low of 93.5 index points in May 2020 but has since drifted higher as government continued to lighten lockdown restrictions in the economy. Similarly, the BER's Business Confidence Index recovered in the third and fourth quarter readings but caution should be applied regarding the sustainability of this rate of increase (see chart 9). Moreover, business sentiment remains below the neutral level of 50 and the y/y growth rate in the SA leading indicator remains negative.

Chart 9: Business confidence still below neutral

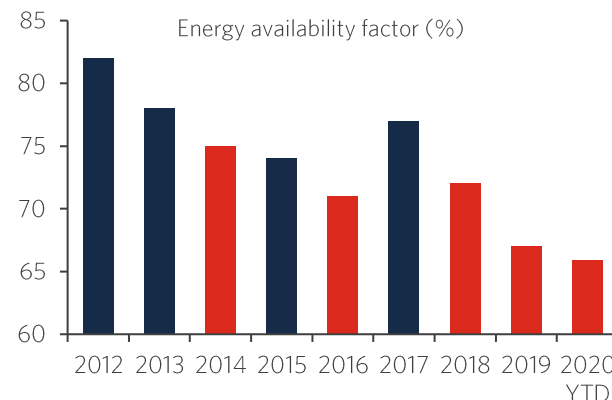


Source: Iress, BER, Momentum Investments, data up to Q4 2020

After contracting at an expected 8.1% in 2020, growth in the SA economy is likely to increase to a below-consensus 2% in 2021, before slowing to 1.6% in 2022. In our view, a likely rise in bankruptcies (given the delay in liquidation proceedings in SA), lingering levels

of elevated unemployment, significant fiscal constraints and ongoing electricity supply constraints (see chart 10) will contain the anticipated recovery from here.

Chart 10: Low energy availability factor



Source: BNP Paribas, Momentum Investments

Red bars = load shedding years

Even though low-hanging fruit such as the auctioning of broadband spectrum, negotiating supplementary power purchase agreements with existing renewable energy independent power producers, implementing gazetted infrastructure projects and reforming visa regulations should provide some growth underpin for the economy, harder-hitting reforms, such as overhauling operational and financial inefficiencies at SA's major parastatals, strengthening state capacity, improving educational outcomes or addressing rigidities in the labour market are unlikely to unfold in the near term. As such, the ceiling remains low on SA's expected growth recovery in the medium term.

Despite the rate of economic growth staging an impressive quarterly recovery, Morgan Stanley notes that the level of GDP generated was back to 2013 levels in the third quarter. In our opinion, trend growth for the next five years has likely fallen to 1.7%. Even with a lower potential growth rate, we expect the output gap to trend negatively for the next three years.

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