STATE OF THE **SA BUSINESS CYCLE**

1st Quarter 2020 15 March 2020

NAVIGATE THE BUSINESS CYCLE WITH CONFIDENCE

With a solid understanding of the country's economic history and by applying the appropriate econometric techniques, Business Cycle Analytics is a provider of reliable real time and forward-looking information on the domestic business cycle

SA ECONOMY IN CLASSIC RECESSION BEFORE COVID-19 HITS

Real GDP growth decelerated to a trickle of 0.2% in 2019, from 0.8% the year before. The level of real GDP contracted in both quarters during the second half of the year, taking it to 0.6% percentage points below the level a year earlier. Excluding the impact of the drought in agriculture during the 2015-16 season, this was the first year-on-year contraction since the adverse impact of the Global Financial Crisis (GFC) in 2009.

On a quarter-to-quarter basis, overall real GDP contracted by 1.4% (annualised) during the final quarter of the year following a 0.8% contraction during the third quarter. This statistic suggests the economy has entered a classic recession. On the production side, the shrinkage was led by the agricultural sector (-7.6%); transport & communication (-7.2%), construction (-5.9%), electricity & water (-4.0%) and retail, wholesale & accommodation (-3.8%). Manufacturing real GDP also contracted (-1.8%) as did the general government (-0.4%). The wide dispersion of the recessionary forces was visible from the fact that all

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three broad sectors, i.e., the primary, secondary and tertiary sectors contracted during the fourth quarter of 2019. Electricity supply outages contributed to the declines in output levels in the other sectors.

However, a precipitous fall in real domestic spending, driven by a collapse in fixed and inventory investment toward the end of last year, played the key part. The economy was also impacted by the global economic slowdown through 2019. Total real exports ended 6.6% below the level a year ago during the fourth quarter and was down 2.5% for the full year. Even import volumes ended the year in negative territory, dragged down by the contraction in real domestic spending. This parlous state of economic affairs all existed before the impact of the COVID-19 pandemic in the first quarter of 2020.

In fact, the BER's suite of business opinion surveys in various sectors of the economy indicated that activity levels deteriorated further during the first quarter of 2020 (the survey closed just before the first COVID-19 case was reported, i.e., the 5th of March). Business confidence fell to a 21-year low of 18 index points and consumer confidence declined to levels beneath those witnessed during the Great Recession in 2009.

Furthermore, SA's rapid worsening fiscal metrics during the course of 2019 alerted all three major ratings agencies to put SA on a negative outlook during the second half of the year. These led to credit rating downgrades in March and April this year, taking SA to general sub-investment grade and SA exiting the World Government Bond Index (WGBI). The impact of the COVID-19 pandemic added to reasons for the downgrade and has since overshadowed the economic bloodletting.

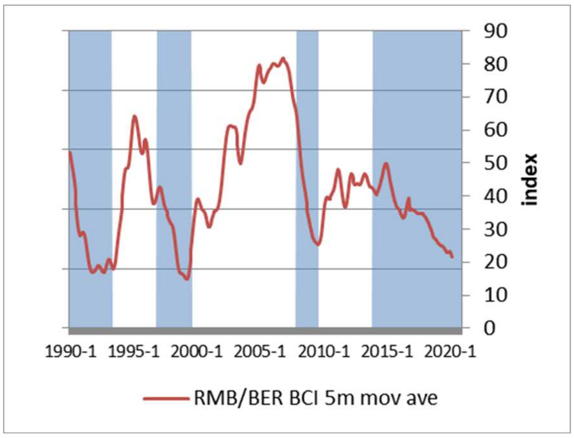
Projections of sustained contractions in real GDP for the full year range between 5% and 10% (and even worse in more serious epidemic scenarios). It is hard to fathom the economic, social and (most likely) political consequences of such a deep contraction in economic activity, seven years into the country's longest post-war economic downturn.

Following the peak of the current business cycle (December 2013), the BER's recession algorithm revealed a downward 'inflection point' in the early part of last year (i.e., 62 months into the economic downturn), when all five its components entered into recessionary territory. By March 2020, ahead of the COVID impact, all five components were in deep recessionary territory (less so in the case of manufacturing output and capacity utilisation).

The COVID-19 pandemic, and the measures implemented to contain the spread of the virus, have wreaked havoc across the globe. SA's GDP will take a massive hit, particularly during the second quarter of the year and even beyond.

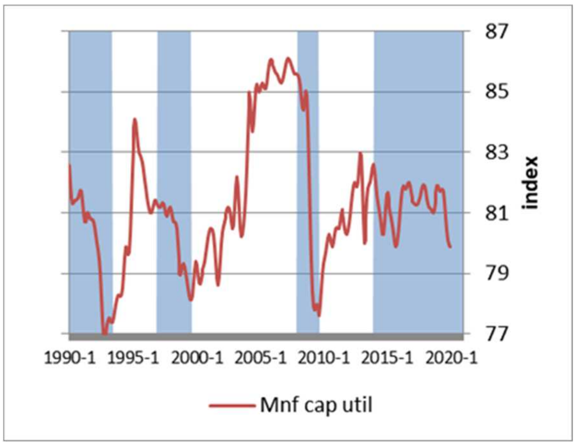
SA is not only extraordinary vulnerable to the pandemic impact; the country was already in a precarious economic position when it entered the borders.

Figure 1: Business confidence



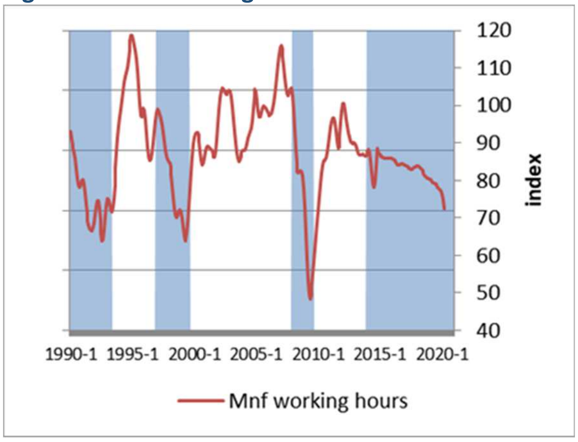
Source: BCA

Figure 2: MNF production capacity utilisation



Source: BCA

Figure 3: MNF working hours



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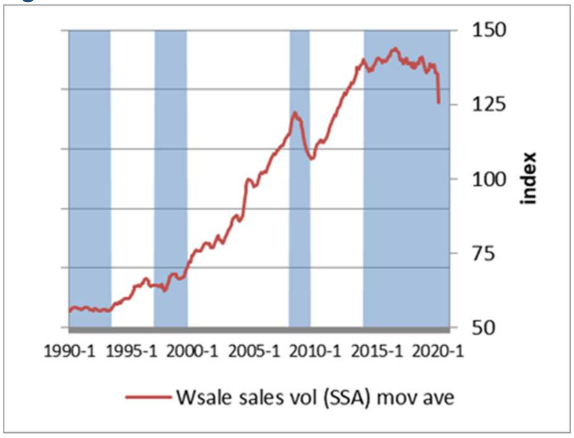
After five weeks of lockdown, the country has to uniquely navigate opening-up the economy as it faces the exponential growth phase of its epidemic. Furthermore, following years of dithering with structural economic reforms (including fiscal reforms), debt levels are expected to explode in order to finance the unfolding holes in household, business and government budgets. The arising economic challenges in all sectors of society are unprecedented and will require equally unprecedented cooperation and goodwill from all to overcome these.

15 March 2020

Figure 4: Wholesale sales volumes



Source: BCA

"When you adopt a cyclical worldview, your outlook will be in the minority whenever the chance of an economic turning point is high"

Achuthan & Banerji

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