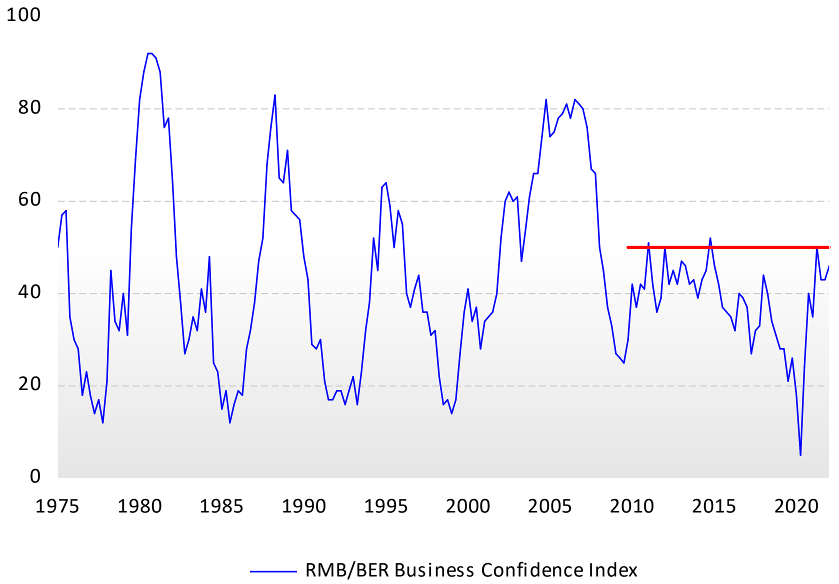
BUSINESS CYCLE ANALYTICS

BUSINESS CYCLE: 2013-TO-DATE

The 2013-to-date business cycle

The SA economy embarked upon an unusual business cycle exiting from the Great Recession impact in 2009. One of the overriding features of this business cycle was the absence of business confidence and growth in fixed investment for the largest part of the upturn and during the downturn (from end-2013). Business confidence did stage some recovery; however, the best the index could do in the post-GFC era, is to reach a neutral level of 50 index points before it declined again – *see Figure 1*. Even during the rebound from the unprecedented COVID-19 impact during 20Q2, the index only recovered to 50 index points (21Q2) before it fell back again. The SA economy has not exited this structural condition.

Figure 1: Business confidence remain subdued in post-GFC era



Source: BER

Domestically, this pattern was driven by two deep-cutting influences[1]. *Firstly*, world-wide economic uncertainty reigning in the wake of the 2008-09 global financial crisis (GFC); the intensity of this uncertainty has been driven to new levels, *first*, by the COVID-19 impact (2020-21) and, of late (February 2022), the outbreak of war between Russia and the Ukraine, threatening to escalate. *Secondly*, the SA economic performance being bedevilled by a serious retrogression of governance under the leadership of the former President, Mr. Zuma.

Figure 2 reveals the poor tendency in fixed investment, inversely related to the extreme levels of general political uncertainty impacting business. The current government under the leadership of Mr. Ramaphosa from 2018, is intent in restoring governance standards. Unfortunately, the record remains checkered as revealed during the COVID-19 pandemic and the *Zondo Commission of Inquiry into Corruption in SA*[2].

The usual business cycle dynamics changed, with no real lift in business confidence and economic growth, but in its place, a 'wait-and-see' attitude in the private sector, preferring to expand overseas. As it turned out, the economy hardly expanded and subsequently, hardly slowed down (at least up to the middle of 2019 when it began contracting in absolute terms). The economy was trapped in a historic long downturn when the COVID-19

[1] Cees Bruggemans (6 March 2014), warned in 2014 that SA's business cycle was being suspended due to the momentous societal changes, combining with the post-2009 global uncertainties.

[2] *The Judicial Commission of Inquiry into Allegations of State Capture, Corruption and Fraud in the Public Sector and Organs of State*, online: https://www.sastatecapture.org.za/

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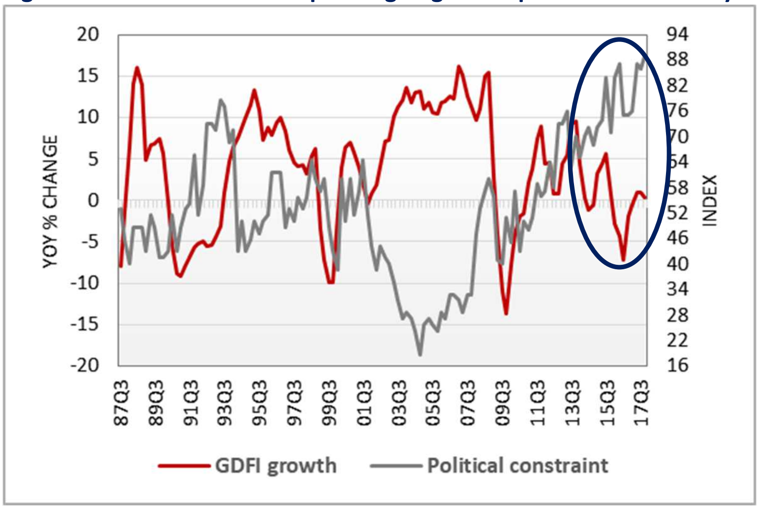
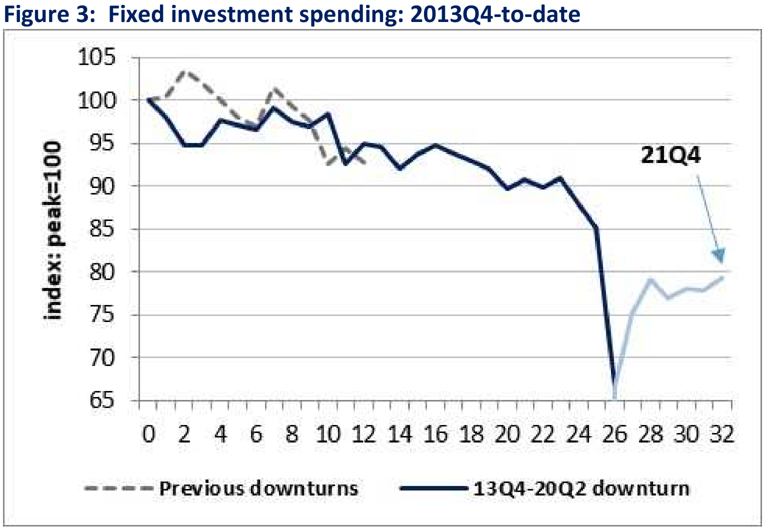
Figure 2: Fixed investment spending vs general political uncertainty



Source: Statistics SA / BER

pandemic hit. This state of affairs is best reflected in the trajectory of fixed investment spending from the onset of the 2013-20 economic downturn; the level of fixed investment spending was still more than 20% below that at the peak of the business cycle, despite the rebound and economic recovery from the pandemic impact *(Figure 3)*. The initial stage of the 2013-20 downturn in fixed investment mirrored that of previous economic downturns; however, the hemorrhage was relentless and the post-covid recovery less than robust.

Figure 3: Fixed investment spending: 2013Q4-to-date



Source: Statistics SA

It needs to be pointed out that the SARB has not officially announced a lower turning point in the economic downturn from the end of 2013. BCA's analysis identified an aborted upturn shaping from the end-2016/early 2017 up to and including the fourth quarter of 2019. It is possible that the SARB will find that the lower turning point early-2017 was not general, or of a spurious nature.

The economy reached a definite upper turning point in 19Q4 according to the BER's recession-dating algorithm. GDP began contracting in 19Q3. It is possible that the rebound from the COVID-19 induced plunge during 20Q2 marks the onset of an economic upturn. Unfortunately this remains difficult to call. The economy rebounded sharply during the second half of 2020 as the economic lockdown measures were relieved. Thereafter, the rate of recovery growth slowed down under the impact of the second COVID-19 wave (December/January), albeit that the upward trajectory was sustained – business confidence increased from 5 to 50 index points between

20Q2 and 21Q2. The economic recovery was shaken again by political unrest (July 2021), sparked by the incarceration of the previous President, Mr. Zuma.

With the release of the 21Q4 GDP statistics, it became clear that, while the economy recovered (or rebounded) from the pandemic impact, it has not entered expansionary territory. The level of GDP in 2021 was equivalent to that which prevailed in 2017. However, given six quarters of recovery (barring the 21Q3 temporary set-back) – and assuming this recovery will be sustained – 20Q2 presents itself as a possible lower turning point in the historically long downturn from end-2013. An upswing phase of six quarters complies with the standard definition of a business cycle. This is tacitly assumed in the current note. Unfortunately, the latest developments in Eurasia, with Russia's unprovoked war on the Ukraine, have deepened the levels of uncertainty again.

Economic downturn: December 2013 to August 2020

SA's pre-covid 5-year average real GDP growth rate dipped to below 1% per annum (2015-19) compared to 2.6% per annum (2010-14). Real GDP growth averaged 3.2% per annum over the 2000-13 period. Over the past decade, the supply side of the economy buckled under debilitating infrastructure constraints, governance issues, economic policy uncertainty and in 2015-17 a serious drought in agriculture. During the second half of 2016 signs of economic recovery were dashed and, as noted, by the middle of 2019 real GDP began contracting in absolute terms.

Apart from the absence of higher business confidence and growing fixed investment during the post-2009 business cycle, another prominent feature was that the mature phase of the expansion also did not deliver the typical overheating business cycle elements. The economy drifted into an economic downturn towards the end of 2013 from the supply side, mainly due to weak global growth, domestic supply-side constraints and deep economic policy uncertainty. This was in sharp contrast to previous cycles.

It is not possible to quantify the adverse impact of the general political climate on the economy. Suffice to say that economic growth ranked very low on the list of priorities of the governing party under the leadership of the former President. SA's economic performance was bedevilled by a serious retrogression of governance. Internal divisions, widespread corruption and issues related to state-capture were at the forefront. Inconsistent policy pronouncements and serious regulatory concerns in key sectors generated a climate of intense economic policy uncertainty. Add to this the lingering uncertainty in the wake of the Great Recession. The pandemic hit in 2020 and at the time of writing a fierce war broke out between Russia and the Ukraine, threatening to escalate.

Figure 2 shows the constraining influence of the general political climate as measured by the BER in a survey of manufacturing executives[3]. The poor tendency in fixed investment was inversely related to the extreme levels of general political uncertainty impacting business. The preceding expansion (2009-13) exhibited a small amplitude due to the flat trajectory of business confidence and fixed investment (and exports). The interesting point is that the same remained true during the downturn.

Real economic growth continued to slow down, but GDP did not contract (by 19Q2 it was 5.2% higher compared to the peak in the business cycle, 13Q4). Business confidence trended lower over this period and never breached the neutral index value of 50. Nonetheless, the tendency in business confidence (initially) held up better compared to previous downturns *(Figure 5, left)*. The resilience in business confidence was not spurious.

It is explained by what may be characterised as another interesting feature of the downturn, i.e., *the resilience in real gross domestic expenditure (GDE), mainly due to sustained positive growth in household expenditure and relatively stable government consumption expenditure (Figure 4)*. This pattern was very different compared to

[3] This indicator reached a historical peak in 2017 in the run-up to the governing political party's leadership conference (December).

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previous economic downturns. In previous economic downturns, counter-cyclical fiscal policy and net exports played a strong role in softening the adverse tendency in overall GDP growth.

Figure 4: Aggregate real domestic and household spending during downturns

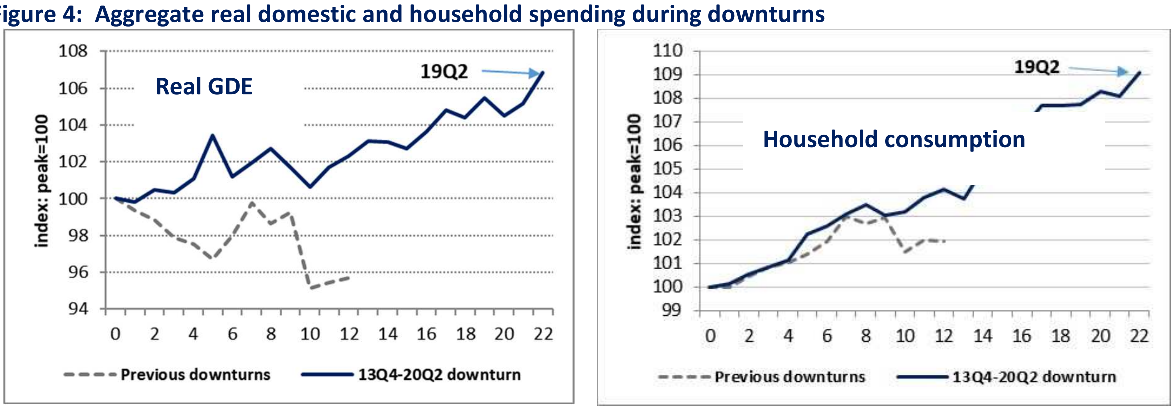
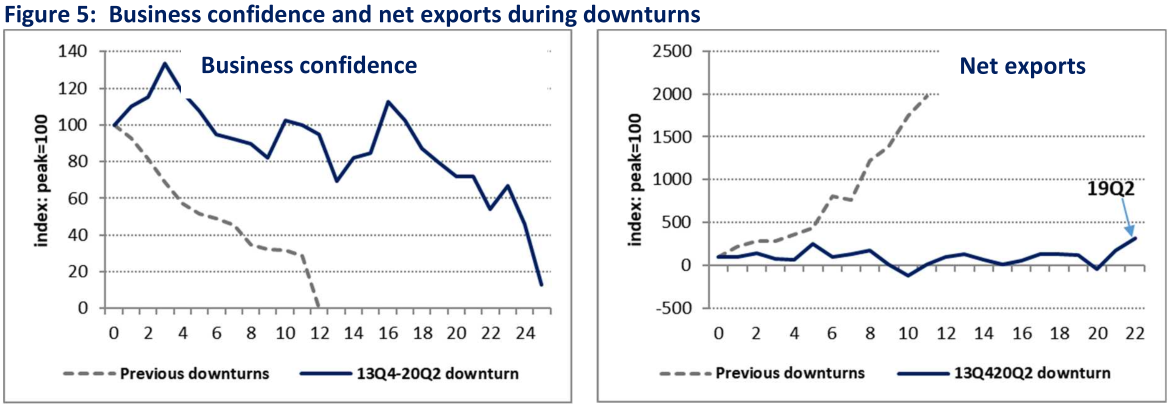


Figure 5: Business confidence and net exports during downturns



Source: SA Reserve Bank / BER / own calculations

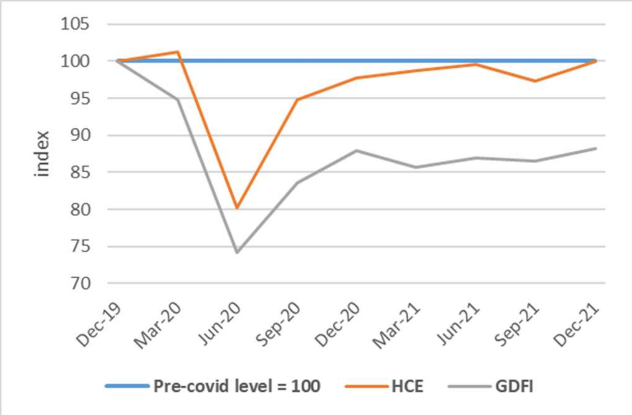
Business confidence did not rise during the expansion, but (initially) it also did not fall as sharply during the economic downturn compared to the typical pattern *(Figure 5, left)*. On the positive side, relative stability was ensured by positive tendencies in household and government consumption spending. This trend translated into unexpected resilience during the economic downturn, but was always going to be unsustainable. On the negative side, private sector hesitancy caused a gradual deterioration in fixed investment spending *(Figure 3)* and employment creation, which eroded any measure of resilience in spending. All caved in during the course of 2019 and was dealt a heavy blow by the pandemic impact in 2020.

<u>Economic upturn</u>: August 2020-to-date

Figure 3 depicts the underlying trajectory of SA's record economic downturn from the end of 2013, namely the tendency in fixed investment expenditure. It also shows the measure of rebound/recovery from the 20Q2 plunge in economic activity as it was locked down to allow the health sector to adjust to the pandemic impact. One of the main features of the post-covid recovery has been the gap that opened up between consumption and fixed investment spending *(Figure 6).*

At the end of 2021, the level of fixed investment remained more than 10% lower compared to pre-covid levels (calendar 2019). The poor level of fixed investment spending is tied to the fact that the economy continued to operate below full production capacity. It was also impacted by uncertainty and – on the infrastructure side – delivery failure. This also explains why the unemployment rate continued to tick-up as employment had hardly recovered from the COVID-19 lockdown shock in 2020.

Figure 6: Gap between HCE and GDFI's post-covid recoveries



Source: Statistics SA

The recovery in consumer spending and GDP in general was mainly driven by the opening-up of the economy as lockdown measures were eased. Including fiscal support (financed from the commodity price windfall) and improved household savings, accumulating through economic lockdown, and some employment creation in the services sectors, these were important drivers of household spending, which returned to pre-covid levels in 21Q4.

Unfortunately, employment creation lagged this recovery and without the associated income growth consumer spending is exposed, hence the flat trajectory in this magnitude during the course of 2021. Higher inflation also impacted adversely. The general recovery in real economic growth became stuck, with quarterly growth in real GDP around 1%. During the third quarter, real GDP contracted as a result of the socio-political unrest in key provinces. On the positive side, the high level of commodity prices stimulated the mining sector, with the increased revenue streams also benefitting the fiscus and other expenditures.

Three components of the BER's recession-dating algorithm registered lower turning points, clustering around August/September 2020. This may be confirming the formation of a proper lower turning point in the downturn phase of the business cycle which commenced in December 2013. High-frequency economic indicators and the BER's business survey results indicated that the economic recovery continued during the first quarter of 2022, including positive developments on the fixed investment front.

The economic recovery will be adversely impacted by Russia's offensive in the Ukraine, which carries a heavy escalation risk. While SA's balance of payments benefited from key commodity price increases, the economy is exposed to the spike in energy and food prices and probable recessions unfolding in key trading partner regions (e.g., the EU). War and geo-political uncertainty have superseded the disruptions caused by the COVID-19 pandemic. The sustainability of the economic recovery and future expansion of the economy remains heavily dependent on a stronger revival in fixed investment, including infrastructure spending. The Russian war will for the foreseeable future cast a shadow over global economic activity and growth.