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GDP numbers "better-than-expected", but a depression may be looming

By Maarten Ackerman

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The market expected the economy to shrink by 3.8% over the first quarter so the -2.0% print for Q1 2020 GDP (quarter-on-quarter, seasonally adjusted and annualised) might be slightly better than anticipated, but it almost means nothing. This performance takes us only up to the end of March so it includes less than five working days of the lockdown.

Maarten Ackerman, chief economist and advisory partner, Citadel

The worst, by far, is yet to come from one of the globe's harshest lockdowns. And this grim result follows on from the recessionary environment that we were already stuck in with -1.4% in Q4 2019, which itself followed -0.8% in Q3 2019. I have previously warned that we could potentially even see a depression as a result of the additional impacts of the COVID-19 crisis weighing on an economy that was already stuck in recession before the crisis started.

Only the tertiary sector holding its head above water

Looking more closely at some of the details, the primary and secondary sector both contracted, falling -11.8% and -7.5% quarter-on-quarter respectively. The tertiary sector was the only sector to deliver positive growth, achieving a lacklustre 1.3% quarter-on-quarter.

In terms of the massive decline in the primary sector, it's important to note that China had already gone into lockdown in the first quarter, and saw a -7% decline in its GDP as a result of the pandemic. As one of our biggest trading partners, this was a major contributing factor in the contraction seen among South Africa's primary industries.

Although we saw a sharp increase in the agricultural sector, mining placed a massive 21.5% drag on the primary sector, largely as a result of China's downturn. Nothing could lift the secondary sector and with manufacturing off 8.5%, the whole sector was 7.5% lower, while the tertiary sector mustered a positive contribution from everything except trade to post a modest 1.3% gain.

This is a small ray of light for the economy, given that ours is a service-based one: if things can return to normality, these sectors can contribute positively.

Government still overspending …

On the expenditure side, government final consumption expenditure (GFCE) was the largest contributor to growth, rising by 1.1%, followed by household final consumption expenditure (HFCE) which rose by 0.7%.

It's unfortunate that GFCE is still the biggest contributor. We know that we are in a tight fiscal environment where revenue is shrinking because there is no growth, yet government continues to spend beyond its means.

Worse, such expenditure was driven by an increase in employment. These numbers are clearly not aligned with the reality of our situation and the Minister of Finance was, indeed, correct when he stated in the Supplementary Budget last week that "Our Herculean task is to close the mouth of the hippopotamus!"

… while the investment contraction has plummeted to a 12-year low

While there was a notable decrease in both exports and imports, the immense shock came from a 20.5% drop in gross fixed capital formation (GFCF). We had been encouraged last year when we posted +5.8% in Q2 2019 for GFCF followed by +4.1% in Q3 2019 and we hoped this would signal better things to come in terms of rebuilding confidence and attracting capital into the economy.

Unfortunately, things turned sour in Q4 2019, with -10% for GFCF, which has now been followed by this collapse in investment spending. This is certainly the biggest decline since the -27% seen during the global financial crisis in 2008, itself the worst since 1960.

Regrettably, this is also a sign of what's to come. We know that infrastructure spend almost ground to a halt during Q2 2020 and so we can expect to see a further dip in this item, possibly to the biggest decrease we've ever seen on record. Although this is a bleak prospect, it doesn't mean it can't rebound – in the years following 2008, for example, the number very quickly moved into strong figures as we came through that recovery.

Ban of alcohol and tobacco sales likely to severely affect Q2 GDP growth

However, for a consumer-based economy (in 2019, HFCE accounted for 62.2% of expenditure on GDP), the 0.7% growth was disappointing. The largest contribution this came from food and non-alcoholic beverages, while the second largest contributor was alcoholic beverages, tobacco and narcotics.

This underlines the significance of the ban on the sales on these items during Levels 4 and 5 of lockdown (and even Level 3 in the case of tobacco products). In the next quarter, this will almost be wiped out because we did not trade in these products for most of the quarter. And here we are talking zero growth, but zero trade entirely. On top of this, there will be limited sin taxes that government collects from the sale of these products, which will severely constrict state revenue further.

There were also certain negative contributors to HFCE: clothing and footwear; transport; and restaurants. Considering that these were showing negative growth already in Q1 before we went into the full lockdown, we can expect to see a massive decline in those sectors in Q2.

If we don't reform swiftly, we'll be on the road to a depression

These numbers confirm that we were in a very poor financial state even before the global pandemic broke out. The updated Supplementary Budget delivered last week made it clear that we are facing significant challenges, so these figures almost appear out of date – the fact that they were printed today hasn't really made a significant difference to our situation.

Considering the global economic trends currently taking place, the South African Reserve Bank (Sarb) and National Treasury's forecasts that the SA economy will decline anywhere between 7-8% this year are likely in the right ballpark.

As mentioned by the minister of finance, if we don't see the economic reforms that South Africa so desperately needs soon, then this recession will develop into a depression, with a significantly long road to recovery. This will then result in not only severe fiscal challenges for the country, but also a worsening of our many socio-economic challenges on the back of that as well.

ABOUT THE AUTHOR

Maarten Ackerman is the chief economist and advisory partner at Citadel.