Is SA exiting the recession?

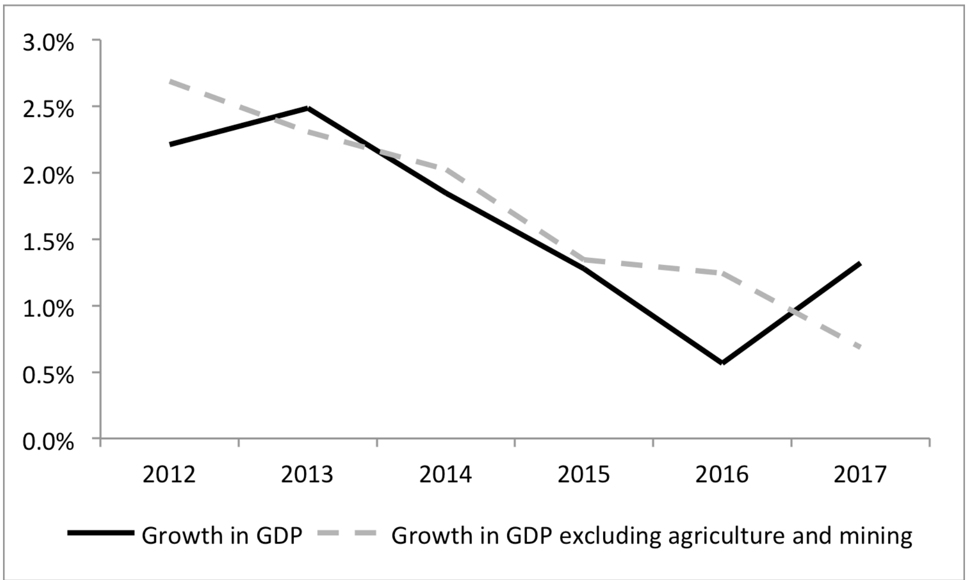
Willem Boshoff

On Tuesday, StatsSA announced 2017Q4 GDP figures, which suggests a year-on-year growth in real GDP of 1.9% for that quarter. This raises two questions. Firstly, looking back, is the economy on a stronger footing than previously believed? Secondly, looking forward, is the economy entering a stronger growth phase, i.e. has the recession ended?

Was the SA economy on a stronger footing in 2017, given higher Q4 growth?

The aggregate number is misleading and it is useful to consider individual sectors. Closer inspection shows that the stronger increase in GDP was driven by a surge in quarterly agricultural output and, partially, stronger mining output. In contrast, the rest of the economy grew by less than 1% year-on-year in 2017Q4.

Furthermore, not only was growth in the broader economy (i.e. barring agriculture and mining) relatively weak in 2017Q4, it was the weakest since the start of the current recession (November 2013), as shown below:



Therefore, the newest 2017 data does not suggest to me that the South African economy was turning any big corners. Officially, South Africa is still in a 'growth' recession (during which GDP does not decline, but during which growth is slow to non-existent) and the new data does not offer sufficient evidence to conclude that it has ended.

As an aside, it is also quite inaccurate to ascribe the 2017Q4 growth improvement to political developments of last year, which have been too late and too unpredictable to have contributed to higher growth. Even so, it is useful to consider whether we can expect the recession to end in 2018, with the economy growing faster going forward.

Is the SA economy entering a strong growth phase, given higher Q4 growth?

The SARB determines the likelihood of the recession ending within the next two to three quarters based on the behaviour of a 'composite leading indicator', which is composed of 11 underlying variables. Based on the most recent data, I interpret the signal from each of these variables as follows:

<table>
<tr><th></th><th>Leading Indicator Series</th><th>Signal concerning end of recession</th></tr>
<tr><td rowspan="3">BER Opinion Surveys</td><td>Volume of orders received in manufacturing</td><td rowspan="3">Expected positive, due to confidence boost (figures available next week)</td></tr>
<tr><td>Average hours worked per factory worker in manufacturing</td></tr>
<tr><td>Business Confidence Index: manufacturing, construction and trade</td></tr>
<tr><td rowspan="2">International indicators</td><td>Composite leading business cycle indicator of South Africa's major trading-partner countries</td><td rowspan="2">Positive, based on the SARB's own assessment as early as June 2017</td></tr>
<tr><td>Commodity price index (US$) for South Africa's main export commodities</td></tr>
<tr><td rowspan="3">Financial indicators</td><td>Real M1 money supply</td><td>No change (growth not faster than past years)</td></tr>
<tr><td>Interest rate spread: 10-year government bonds minus 91-day Treasury bills</td><td>Positive (relatively strong evidence, but weaker in recent months)</td></tr>
<tr><td>Gross operating surplus</td><td>Positive</td></tr>
<tr><td rowspan="3">Capacity indicators</td><td>Number of new passenger vehicles sold</td><td>No change (mildly negative)</td></tr>
<tr><td>Number of building plans approved: Flats, townhouses & houses larger than 80m²</td><td>No change (mildly negative)</td></tr>
<tr><td>Job advertisements: The Sunday Times</td><td>No (new) evidence</td></tr>
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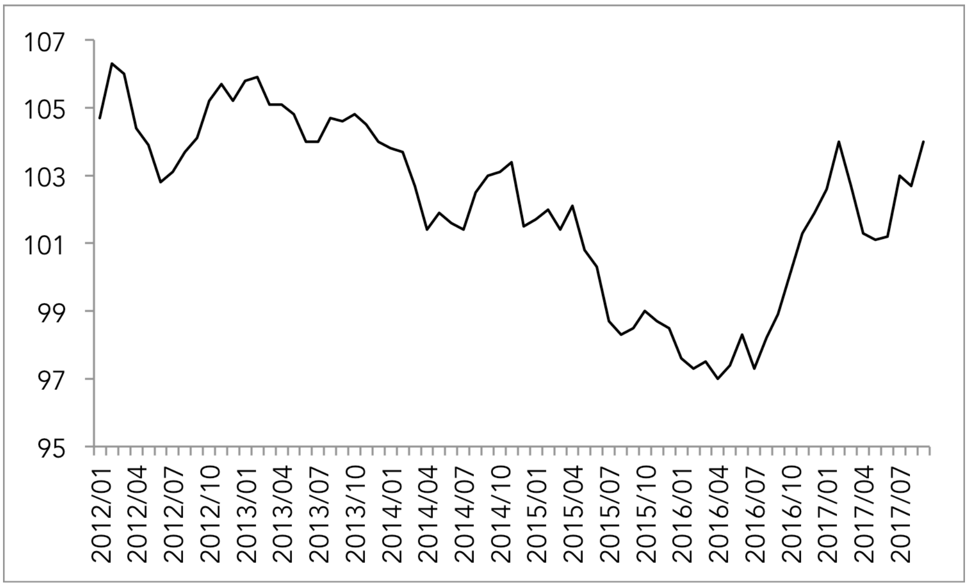
The SARB indicated already in June 2017 that the international indicators suggest an upswing (as is evident in mining). Back then, few other variables supported calling the recession over. However, things may have changed somewhat. Financial variables (especially the interest rate spread) are most supportive of calling the recession at an end. Although one may also cite buoyant share prices as indicating recovery, these have been less accurate predictors of previous cycles, and the SARB has consequently removed them from its list of leading indicators.

In contrast, those variables dealing with the real economy, i.e. those measuring productive capacity (vehicle purchases, construction and job opportunities), suggest a slowdown in 2017 relative to 2016. This clearly does not support concluding that the growth recession will end soon.

On balance, the evidence from the above variables *weakly* favours the conclusion that the end of the growth recession is approaching. This conclusion is consistent with the evidence from the composite leading indicator itself, which summarizes all of the information in one series: while the leading indicator has experienced a clear turning point in 2016 already, it has temporarily slumped, but appears to have resumed its upward trajectory in late 2017.



The analysis in this brief suggests that a strong broad-based upswing in the South African economy is neither imminent, nor a foregone conclusion. For this to happen, the current positive tone of the domestic financial markets, the palpable confidence boost following the political developments of early 2018 and the (currently still) favourable international environment will have to translate into improved consumption expenditure and, especially, long-term investment.

Prof Willem H. Boshoff
Stellenbosch University
Ph.D. (Stell), M.Sc. (Oxford)

+27 (0)83 398 6248
wimpie2@sun.ac.za
www.ekon.sun.ac.za/wboshoff
LinkedIn: http://za.linkedin.com/in/whboshoff