THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA FIRST QUARTER 2019

Briefing Note: The economic slowdown

The first quarter of 2019 saw a convergence of poor economic data. The GDP fell by 0.8%; investment, by 1.1%; and exports by 2%. Employment dropped by 1.4%, or 240 000 jobs. Seasonal job losses are not uncommon in the first quarter, but from 2010 to 2018 they averaged just 0.1%, so 2019 saw a significantly larger fall. Meanwhile, the fourth quarter of 2018 – the latest available data – saw net outflows of portfolio capital for only the second time since the global financial crisis in 2008, with almost R35 billion leaving the country.

The specific factors behind the slowdown are complex and contested, but understanding their dynamics is critical for developing appropriate responses. Inevitably, an analytical challenge arises around how much weight to give to international and domestic factors, and to policy missteps as opposed to economic trends. The following figure indicates key issues in each of these areas.

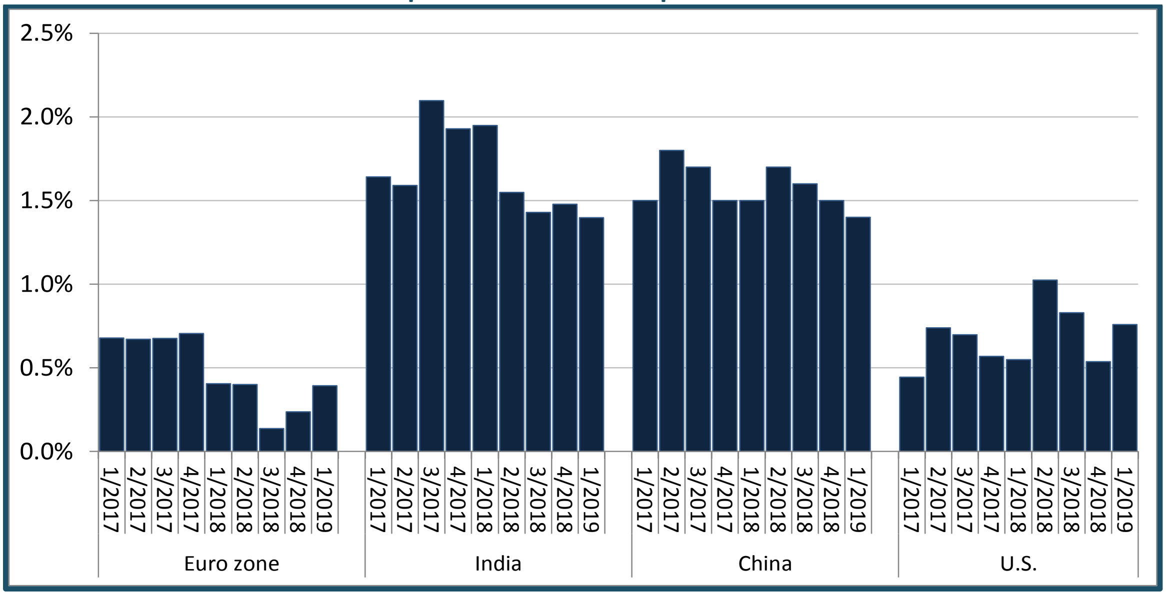
Figure 1. Sources of the downturn in the first quarter of 2019

International economic trends: • Slowdown in all of South Africa's major trading partners except the US. • Slowdown in the region with the end of commodity boom, deepening from 2015.	**International policy:** • Unpredictability of the Trump Administration affecting international investment climate and consumers, especially but not only through trade wars. • Uncertainty about US and EU interest rates leading to unpredictable financial flows. • Brexit affecting EU and UK, both major trading partners for South Africa.
Domestic policy: • Uncertainty due to elections and divided ruling party affecting high-end consumer confidence. • Uncertainty in aftermath of revelations about state capture.	**Domestic economic trends:** • Downward glide path from end of commodity boom (stagnation in heavy industry and mining). • Repeated droughts (linked to climate change). • Slowdown in government spending and SOC investment. • Failure to address on-going blockages to growth, especially electricity and logistics prices, permits of all kinds, workplace inequality and the associated conflict, and limits on skilled in-migration.

Over the past year, all of the dimensions in Figure 1 grew more hostile to growth. The current downturn has become a perfect storm, with domestic and international policy uncertainty aggravating the lingering impacts of the commodity price crash in 2011 and, more fundamentally, the 2008/9 global financial crisis.

China, Europe and India all saw slower growth in the past year; of the major economies, only the US expanded faster in 2018 than in 2017.

Graph 1. Quarterly growth in major economies (not annualised), first quarter 2017 to first quarter 2019

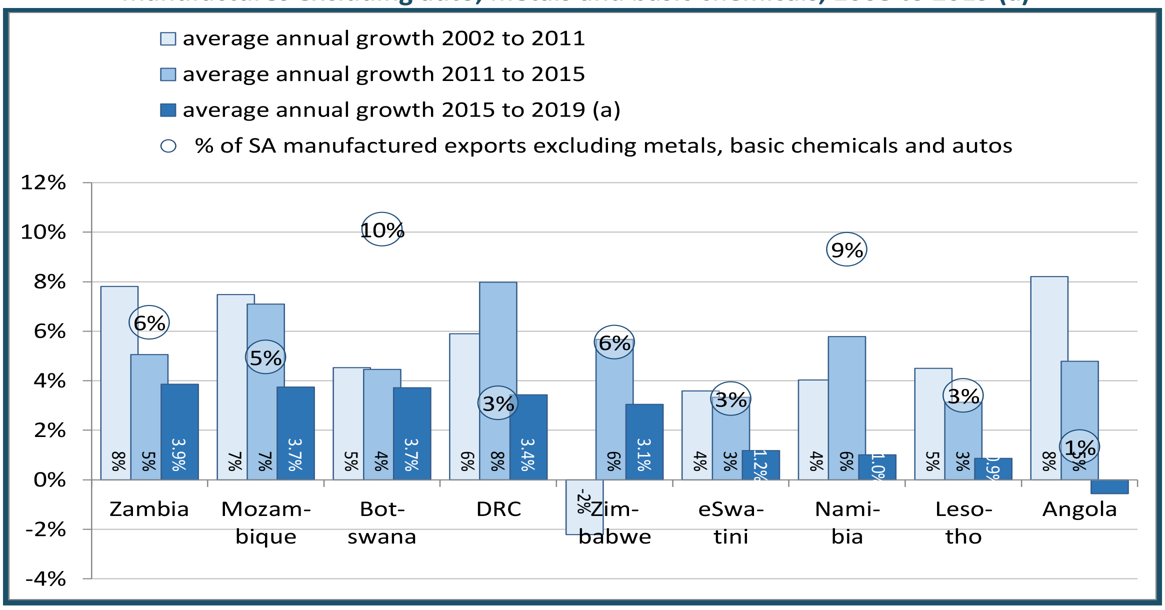


Source: OECD

International trade experienced a sharp contraction in the first quarter of 2019. In part that resulted from the underlying slowdown in major economies, especially China. It also followed from the deepening rivalry and the resulting trade war between the US and China, two of South Africa's three largest trading partners (the third is Germany). US imports fell 9% in the first quarter of 2019 and Chinese imports dropped 11%, while EU imports were essentially flat. South Africa's exports to the US, the EU, Japan and Korea all dropped by over 10%, although its exports to China fell only 3%.

The Southern African region purchases half of South African manufactured exports outside of auto, basic chemicals and metals. It has experienced significantly slower growth since the end of the commodity boom in 2011, with a further slowdown in the past year.

Graph 2. Growth in southern African countries and share in South African exports of manufactures excluding auto, metals and basic chemicals, 2008 to 2019 (a)



Notes: (a) Projected by the IMF from 2018 for all countries, and from earlier years for some. Source: IMF. World Economic Outlook. February 2019.

In terms of international policy factors, the unpredictability of US trade policy aggravated the slowdown in global trade. The trade war between the US and China has contributed to slower growth in both economies, while US threats to impose tariffs on at least some commodities from virtually every major economy adds to uncertainty, deterring investment and undermining sales.

The uncertainty has also made it harder to predict US central bank policies, which largely shape capital flows into emerging markets like South Africa. Interest rates hikes in the US last year encouraged investors to leave South Africa. The risk of a slowdown means the US may end up cutting rates in the coming months, however, which could help reverse the short-term outflows.

Domestic policy factors behind the slowdown are harder to quantify. The past six months were marked by political uncertainty, linked in part to the run-up to the elections, and a drumbeat of reports on the state-capture project. That certainly contributed to delays in investment and consumer purchases, particularly by the higher income group – the top 10% of households – that accounts for over half of household consumption. It likely also accelerated the capital outflow at the end of 2018. The dire state of Eskom, which has a towering debt burden, has also affected both consumer and business decisions.

Domestic economic trends have been unfavourable for the past three years. In this period, public investment and government spending both saw slower growth; Eskom resorted repeatedly to loadshedding; and a series of severe droughts rocked agriculture and tourism, underscoring the failure to develop strategies to minimise the effects of climate change.

In sum, the loss of jobs and decline in GDP in early 2019 reflected a range of domestic and foreign factors in both the policy and economic arenas. The election outcomes should help address policy uncertainty, but only if there is more discipline in discussions, at least within the state and the ANC.

That won't fix the international slowdown, however, which has been aggravated by the repeated mini-crises provoked by unpredictable US dictates. In response, South Africa will have to explore pro-active approaches to sustain growth. Innovative measures are needed given the limited space for a conventional fiscal and monetary stimulus, although pro-cyclical measures should obviously be avoided. In addition to the existing investment drive, they could include for instance more developmental investments of the huge surpluses in the social security funds, especially to expand industrial finance, and more effective measures to promote local procurement. In addition, with global trade under threat, South Africa needs to play a more strategic and consistent role in supporting economic growth in the region, and look to the emerging opportunities from the African Continental Free Trade Agreement.