KPMG

The South African economy ahead of the Medium-Term Budget Policy Statement (MTBPS)

Low economic growth pressures Gordhan's highly-anticipated MTBPS

25 October 2016

Low economic growth pressures Gordhan's highly-anticipated MTBPS

IMF reports global growth slowdown in 2016H1

The global economy is currently experiencing its slowest rate of expansion since the 2009 recession. According to the International Monetary Fund (IMF), real global GDP grew by 2.9% during the first half of 2016, which was slightly weaker than in the second half of last year. Weaker-than-expected growth in the USA – the world's largest economy – during the second quarter of 2016 has resulted in a negative revision to this country's growth outlook for 2016-2018. China, in turn, is seeing a slowing rate of growth compared to expansions of +10% p.a. just a few years ago.

Furthermore, while the growth outlook in the euro zone has not deteriorated with the IMF's latest publication, the limited period of time following the Brexit referendum leaves much uncertainty over the event's impact on greater Europe. Closer to home, Sub-Saharan Africa's economy is being weighed down by its largest economies – Nigeria, South Africa and Angola – struggling with a combination of lower international commodity prices and difficult domestic political and economic conditions.

Table 1: Real GDP growth forecasts (%)

	2016f			2017f			2018f		
	Apr-16	Oct-16	*Change*	Apr-16	Oct-16	*Change*	Apr-16	Oct-16	*Change*
World	3.2	3.1	*-0.1*	3.5	3.4	*-0.1*	3.9	3.8	*-0.1*
USA	2.4	1.6	*-0.8*	2.5	2.2	*-0.3*	2.0	1.6	*-0.4*
China	6.5	6.6	*0.1*	6.2	6.2	*0.0*	6.0	5.8	*-0.2*
Euro zone	1.5	1.7	*0.2*	1.6	1.5	*-0.1*	1.5	1.5	*0.0*
SSA	3.0	1.4	*-1.6*	4.0	2.9	*-1.1*	5.0	4.2	*-0.8*
Nigeria	2.3	-1.7	*-4.0*	3.5	0.6	*-2.9*	4.0	3.3	*-0.7*
South Africa	0.6	0.1	*-0.5*	1.2	0.8	*-0.4*	2.4	2.2	*-0.2*

Source: IMF World Economic Outlook (WEO), April & October 2016

Constrained local GDP growth due to multiple factors

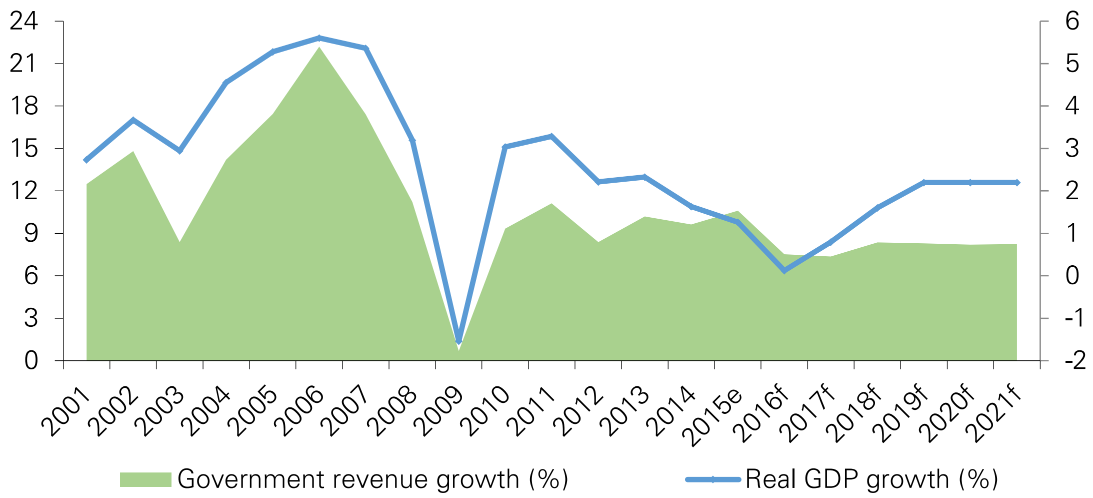
The South African economy expanded by 3.3% q-o-q and 0.6% y-o-y during the second quarter of 2016. This was slightly better than economists had expected and warded of the fear of a technical recession – two consecutive quarters of negative q-o-q numbers. Eight out of the country's 10 economic subsectors recorded positive real q-o-q growth during 2016Q2, while activity related to agriculture, forestry & fisheries and the public utilities sectors continued to contract.

The IMF expects the volume of South Africa's goods and services exports to grow by only 0.7% this year – the weakest growth rate since the country's 2009 recession. With this in mind, the multilateral organisation is expecting the South African economy to grow by just 0.1% this year while the South African Reserve Bank (SARB) has indicated a projection of 0.4% during September.

According to the SARB Monetary Policy Committee (MPC), the local economy is being constrained by weak domestic fixed investment and low levels of business and consumer confidence. Surveys by the Bureau for Economic Research (BER) indicate that only four out of 10 local businesses are satisfied with prevailing business conditions, while consumer confidence is weaker than seen during the 2009 global financial crisis and recession.

Over the medium term, the SARB expects economic growth to pick up to 1.6% by 2018. This is notably lower than the 2.4% projection offered by the National Treasury in its assumptions for the 2016/17 fiscal budget, released in February 2016. Indeed, the health and outlook for the South African economy has declined quite notably over the past eight months. This will be reflected in Minister of Finance Pravin Gordhan's highly-anticipated Medium-Term Budget Policy Statement (MTBPS) on October 26.

Figure 1: Economic growth and change in government revenue



Negative impact on sovereign rating

Weak economic growth was in June this year identified by S&P Global Ratings as a threat to South Africa's sovereign credit rating. The agency currently rates South Africa "BBB-" with a negative outlook, and any adverse adjustment to this assessment would see the country removed from the list of investment-grade sovereigns. In early October, S&P reiterated the growth issue, as well as the threat of political tensions hampering much-needed reforms, as challenges to the country's rating.

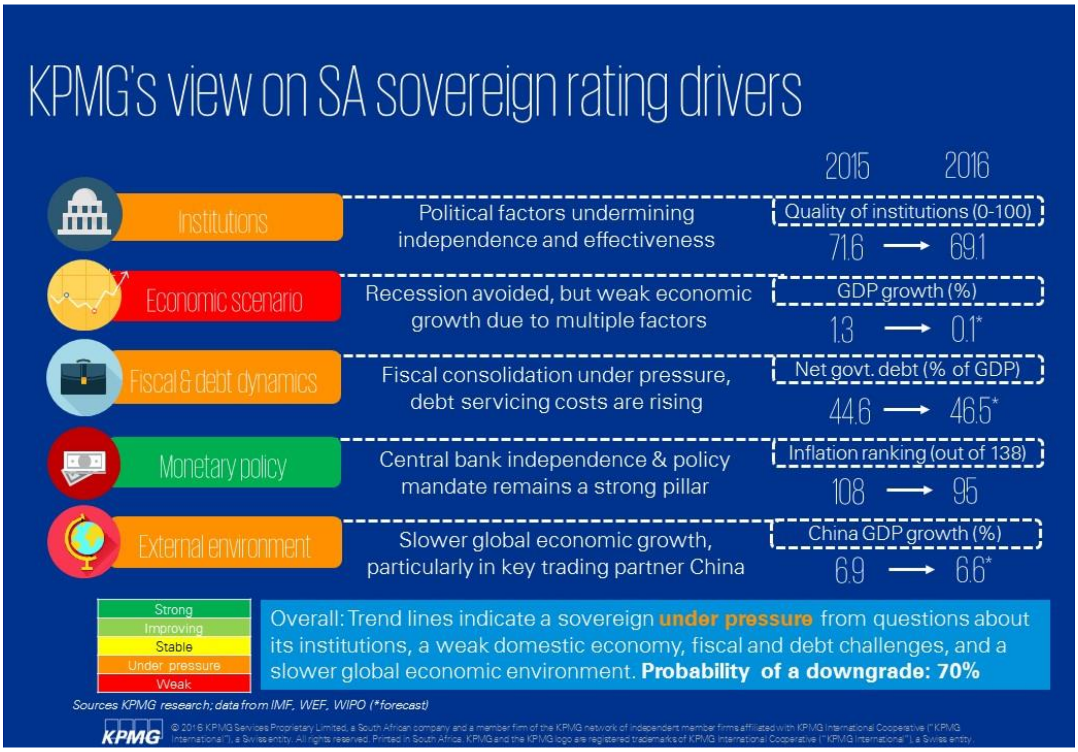
S&P will, during the first week of December, publish its latest official review of the sovereign's rating. If the organisation 1) reduces its economic growth projections for 2016-17, 2) provide a weaker assessment of the quality and independence of institutions (like the National Treasury), and/or 3) increases its government debt forecasts, S&P's analysts could decide to downgrade South Africa's sovereign rating to sub-investment-grade.

In their assessments of sovereigns, rating agencies consider a country's institutions, economic scenario, fiscal and debt dynamics monetary policy and the external environment. At present, political factors are undermining the perceived independence and effectiveness of institutions like the National treasury, Public Protector, National and Prosecuting Authority (NPA).

Local economic growth is pressured by soft international demand, low mineral prices, electricity supply constraints, weak consumer and business confidence, and policy implementation challenges. Fiscal consolidation is threatened by low economic growth (limiting tax income growth), rising pressure from state-owned enterprises with weak balance sheets, and rising debt servicing costs.

Monetary policy remains a strong pillar, with the central bank's independence and adherence to its mandate strengthening this pillar. In turn, the external environment is characterised by slower economic growth in China (SA's largest trading partner), weaker-than-expected growth in the USA, and the adverse effect of the Brexit decision in Europe and the United Kingdom.

Figure 2: KPMG's view on South Africa's sovereign rating drivers



Overall, trend lines indicate that the South Africa sovereign is under pressure from a weak economy, fiscal and debt challenges, questions about its institutions, and a challenging external environment. Given the current conditions, the probability of an S&P downgrade before year-end is estimated at 70%. Minister Gordhan has his work cut out for him.

Contact us

Lullu Krugel
Chief Economist
KPMG South Africa
Tel: +27 (0)82 712 4049
Email: lullu.krugel@kpmg.co.za

Christie Viljoen
Economist
KPMG South Africa
Tel: +27 (0)63 682 0217
Email: christie.viljoen@kpmg.co.za