COFACE BRIEF

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CONFIDENTIAL

South Africa slips into technical recession

GDP forecast 2017: 0.8%
Coface country risk assessment: C, (high)

What

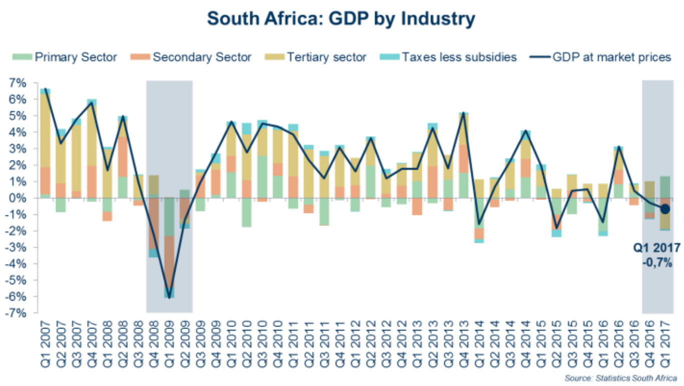
South Africa economy contracted in Q1 2017 by 0.7% (qoq, sa, annualized), following a 0.3% contraction in Q4 2016: **the country slips into technical recession**. Data lagged market expectations of a 0.9% expansion. With unemployment at a record 27.7% in Q1 2017 and inflation still close to the upper end of the inflation target range, retail and hospitality sectors are expected to keep suffering in 2017. Nevertheless, the rebound in the agricultural sector, which grew solidly in Q1, is likely to support a gradual recovery from the 0.3% growth recorded in 2016. Heightened political uncertainty, after the controversial cabinet reshuffle and fuelled by the President facing fresh corruption allegations, seems unlikely to deflate in the next months. For all of those reasons, Coface maintains its forecast of 0.8% GDP growth in 2017.

Why

1 – Weaknesses in consumer sectors
South African Economy shrank in Q1 2017, plunging the country in its first recession since 2009. Poor performances in **the wholesale, retail, catering and accommodations (-5.9%), manufacturing (-3.7%) and construction sectors (-1.3%)** suggest that the 13-year high unemployment rate (27.7%) and stagnant wages (+0.2% in the BankservAfrica Disposable Salary Index in Q1 2017) dragged down the consumer sectors in South Africa. These poor numbers were merely a surprise as weak household consumption, a traditional driver of growth In South Africa, slowed dramatically since the 2008-2009 crisis. After the cabinet reshuffle, Coface (See Brief: '*South Africa: Speculative status looms after the controversial Cabinet reshuffle*', March 2017) had warned after that recession risk was likely to materialise after the cabinet reshuffle and subsequent credit rating downgrades to "speculative" status by S&P and Fitch ratings.

2 – The primary sector prevent a further dip
The only positive note in the data was the primary sector. As expected, the latter rebounded. **Mining and quarrying (+12.8%) contributed 0.9 percentage point to GDP growth**, in large part thanks to favourable base effect, after the sector contracted close to 5% in 2016. Hence, **the silver lining came from the agricultural sector (+22.2%)**, which contributed 0.4% to GDP growth. Indeed, the sector is benefitting from normalising weather conditions after a severe *El Niño* induced drought in 2015/2016 had a devastating impact on agricultural output. The latest forecast from the Crop Estimates Committee for 2017 summer crops were revised upward (+6.5) compared to their previous release, mostly thanks to better-than-expected maize/corn production. The rebound in the primary sector should support higher growth in 2017, according to Coface.

3 – Economy in tatters, Zuma in the doldrums
J. Zuma's poor economic record is likely to put renewed pressure on the President, who faces fresh corruption allegations. 100,000 leaked emails revealed this week by the media showed possible inappropriate interference in tenders. The police opened an investigation over government corruptions on June 5th, just one day before the GDP data release. Nevertheless, the President - who survived accusations of graft and rape before he took office in 2009, an impeachment vote last year (because of corruption allegations) and a no-confidence motion within the African National Congress (ANC), his party, last week South Africa downgrades - is ever again questioned but still in place. He will probably remain in power until the ANC Conference in December 2017, when a successor is to be chosen, if not until the end of his term in 2019.



Risks

1 – Bleak prospects for 2017, possible prolonged recession
This dismal performance in Q1 2017 came before the credit rating downgrades, which has knocked consumers, businesses and investors' confidence. Hence, recession might settle in for a few additional quarters. Supported by the primary sector industry, agricultural and mining output, activity in South Africa should avoid this destiny and even grow 0.8%, slightly faster than in 2016. Nevertheless, these two sectors are vulnerable to external headwinds such as weather conditions in the second half of the year that could undermine already weak growth prospects.

2 – Social upheavals more and more likely
Popular discontent – fuelled by high inflation, low wage raises and high unemployment – grow as evidenced by recurrent demonstrations and recent xenophobic attacks targeting nationals of Nigeria and Zimbabwe. Nationwide protests to ask for Zuma's after the controversial cabinet reshuffle demonstrated publicly South Africans' discontent in a country which used to grow an average of 5% before the crisis. A poll released by Ipsos in late May show J. Zuma's approval rating fell to 2.8% out of 10 people, the lowest ever recorded for a South African since this measure was created in 1993. **On social networks, #ZumaMustFall is proving popular but structural means and peaceful protests have proven unable to remove the President and only fuel popular anger**. Social upheavals would jeopardize a fragile political stability.

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