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Quarterly Economic Brief

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The Parliamentary Budget Office (PBO) has been established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act no. 9 of 2009). The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills. The PBO supports the implementation of the Act by undertaking research and analysis for the finance and appropriations committees.
The PBO provides quarterly analysis of economic developments for Members of Parliament following the release of quarterly economic data by Stats SA, the South African Reserve Bank and the National Treasury.

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This report incorporates data available up to and including the 25 September 2018, and was released during the fourth term of the 2018 Parliament term, on the 4 October 2018 ahead of the 2018 MTBPS. Stats SA only releases GDP and the Quarterly Employment Survey for the third quarter in December.

Overview

The South African economy entered a technical recession in the second quarter with several sectors experiencing quarterly contractions. Slow growth and poor investment contributed to unemployment reaching record highs. Despite downward revisions to the GDP growth outlook, revenue growth to date has generally kept up with projections from the 2018 Budget Review. Slower growth, but with relatively buoyant revenue, imply a slight deterioration in the budget deficit and debt-to-gdp outlook over the medium-term.

Recent developments in the global economy have adversely affected the South African and other emerging market economies. The poor economic performance and the large exchange rate fluctuations indicate how vulnerable the South African economy remains to short-term capital flows. This vulnerability is, in part, due to high levels of household debt, moderating public spending, and lower investment. These factors seem to have exacerbated negative domestic effects of downturns in the business cycle and other economic developments such as the recent drought. The end of monetary stimulus and quantitative easing also contributed to a reduction in capital flows to South Africa. At the same time, continued pressure on global aggregate demand may affect the extent to which South African export growth could support improvements in the real economy.

Gross domestic product[1]

The South African economy entered a technical recession in the second quarter of 2018, its first recession since 2009. Compared to the previous quarter, the economy contracted by 0.7 per cent, following the 2.6 per cent contraction recorded for the first quarter of 2018. However, when compared to the second quarter of 2017, the economy grew by 0.4 per cent. Over the first half of the year, the economy grew by 0.6 per cent.

Table 1: A technical recession

% change q/q (saar)	Agriculture	Mining	Manufacturing	Utilities	Construction	Trade	Logistics	Business services	Government	Personal services	GDP
2Q2018	-29.2	4.9	-0.3	2.1	2.3	-1.9	-4.9	1.9	-0.5	0.8	-0.7
1Q2018	-33.6	-10.3	-6.7	0.2	-1.9	-3.1	0.9	1.1	1.9	1.2	-2.6
4Q2017	39.0	-4.4	4.3	3.3	-1.4	4.8	2.8	2.5	1.4	1.0	3.1
3Q2017	41.7	6.2	3.7	-6.1	-1.2	-0.1	0.8	1.9	1.1	1.2	2.3
2Q2017	36.9	7.8	2.9	8.1	-0.7	0.9	2.6	3.1	-1.9	1.7	2.9
1Q2017	25.6	12.6	-4.1	-5.6	-1.2	-5.6	-1.3	-0.5	-0.5	0.3	-0.5

Data: Stats SA

Quarterly contractions were experienced in five of the ten sectors recorded by Stats SA, indicating a broad-based recession. The contraction in the agriculture sector had a disproportionate effect on overall quarterly economic performance. The agriculture sector contracted by a significant 29.2 per cent over the quarter, subtracting 0.8 percentage points from the quarter's growth. The observed quarterly contraction in agriculture is, in part, due to moderating output following record-high output during 2017. Agriculture output, measured in real rand value of production, was marginally above its 10-year average.

[1] All expenditure/growth data is seasonally adjusted and annualised unless otherwise stated

Figure 1: Sector growth contribution is mostly negative

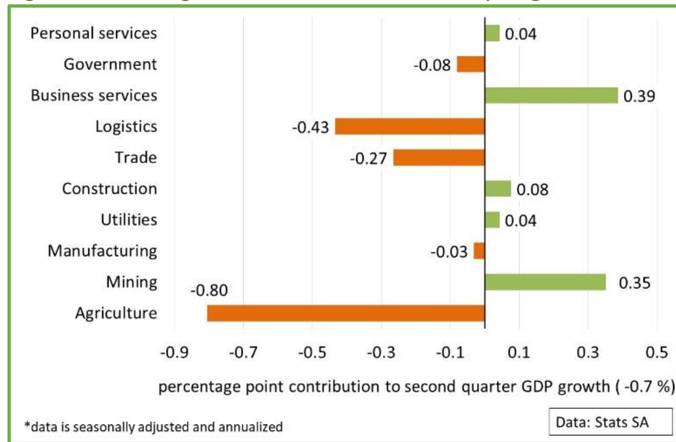
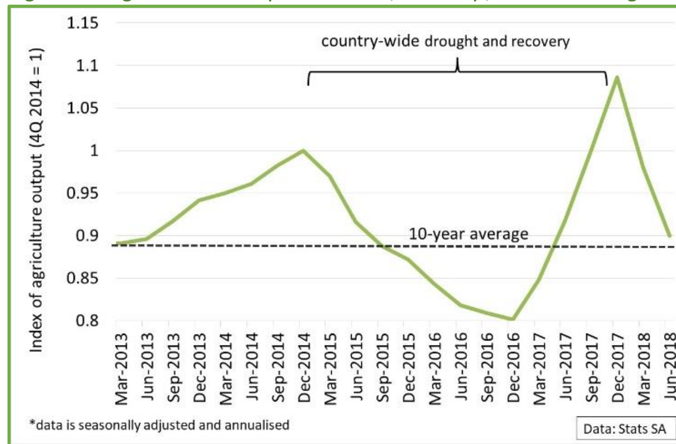


Figure 2: Agriculture output - down, then up, and down again



When the agriculture sector is excluded, the economy grew by 0.1 per cent over the quarter. The consecutive contractions in the manufacturing and trade sectors are likely to have decreased demand for logistic services, resulting in a worsening performance of the logistics sector.

What is a technical recession?

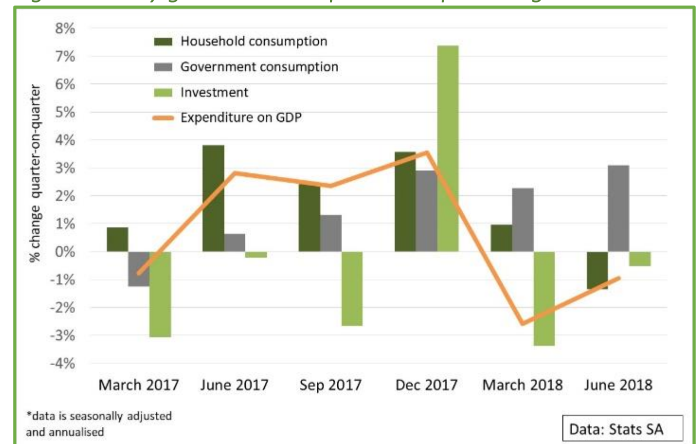
A recession refers to a period of decline in economic activity. In practice, an economy is said to be in a "technical recession" if it experiences two consecutive quarters of contracting GDP growth - the real value of all the goods and services it produces declines over consecutive quarters. Very short periods of decline are not considered recessions (i.e. on a month-to-month basis).

Although this definition is a useful rule-of-thumb, it has some limitations. A focus on GDP alone doesn't adequately convey how wide-spread the economic slow-down is, or how the well-being of the average person in the country has changed. Other indicators such as real income, per capita income, employment, industrial production, investment, and wholesale-retail sales should also be considered. For example, although South Africa only entered a "technical recession" in the second quarter of 2018, measured on a per capita basis the country has actually been in recession since 2014 as the economy grew slower than the population.

Expenditure on GDP

Measured from the expenditure side, the economy contracted by 0.9 per cent over the second quarter of 2018, following the 2.6 per cent contraction experienced in the first quarter.

Figure 3: Only government experienced positive growth



Investment (gross fixed capital formation) contracted for the second consecutive quarter, subtracting 0.1 percentage points from the quarter's overall growth. Investment has contracted on a quarterly basis over nine of the last twelve quarters. Only private investment recorded positive growth over the quarter, following a contraction in the previous quarter. General government and public corporation investment contracted over the third and second quarter respectively.

Figure 4: Second successive quarter of contracting investment

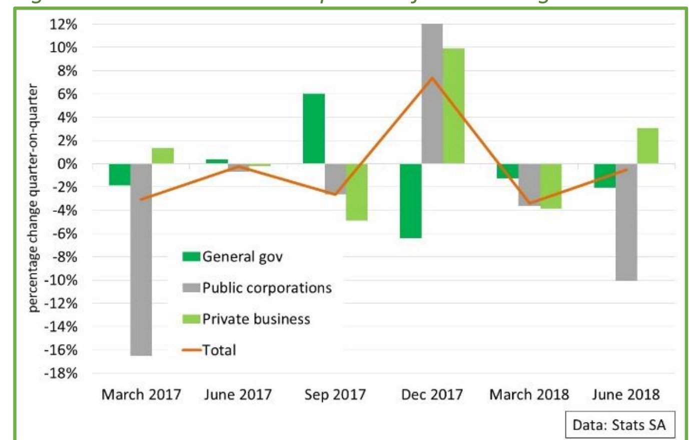
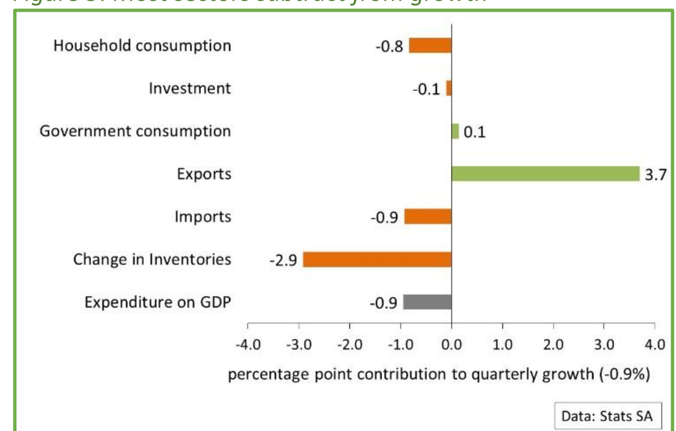


Figure 5: Most sectors subtract from growth



Government consumption expenditure grew by 3.1 per cent, its highest level of quarterly growth in two years, contributing 0.1 percentage points to the quarter's overall growth. The overall public sector's contribution to growth over the quarter – which includes government consumption, government investment and public corporation investment – subtracted 0.34 percentage points from the quarter's overall growth.

Net exports contributed to 2.8 percentage points to growth over the quarter, as exports grew by 13.7 per cent following a large contraction in the previous quarter (17.4%), whilst imports grew by a 3.1 per cent.

Employment

According to the Quarterly Labour Force Survey (QLFS), the official unemployment rate decreased over the second quarter of 2018 to 27.2 per cent from 27.7 per cent recorded for the second quarter of 2017. The number of people officially unemployed decreased by 93 372 (3.2%). The reduction in the official unemployment rate is due to the net increase in the number of employed of 188 096 (1.7%), and a significant increase in the number of discouraged job seekers (503 475 – 18.1%) over the 12-month period.

Table 2: Key labour statistics – Quarterly Labour Force Survey

	2Q 2017	1Q 2018	2Q 2018
Labour force ('000s)	**22 277**	**22 358**	**22 370**
Employed	16 100	16 378	16 288
Unemployed - official	6 177	5 980	6 083
Unemployed - broad*	9 304	9 481	9 634
Not economically active ('000s)	**14 941**	**15 320**	**15 462**
Discouraged job-seekers	2 361	2 787	2 864
Other (not economically active)	12 580	12 533	12 598
Rates			
Official unemployment rate (narrow)	27.7%	26.7%	27.2%
Broad unemployment rate*	36.6%	36.7%	37.2%
Youth unemployment** (narrow)	39.2%	38.2%	38.8%
Youth unemployment** (broad*)	49.5%	49.7%	50.4%

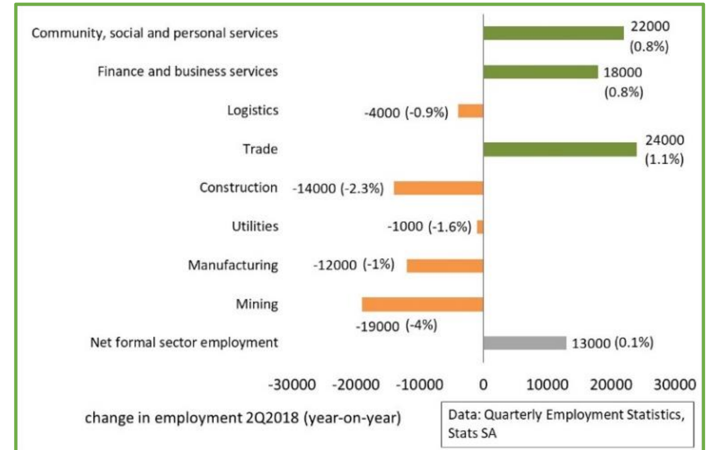
* The broad unemployment rate includes discouraged job seekers
** Youth is defined as age 15 - 34
Data: Quarterly Labour Force Survey, Stats SA

The large increase in discouraged job-seekers – individuals who would ordinarily been searching for employment but are discouraged from doing so due to a range of factors including high job-search costs and a low probability of finding employment - underscores the importance of considering the broad definition of unemployment, as it counts discouraged job-seekers as part of the unemployed. The broad unemployment rate increased from 36.6 per cent over the last 12 months to 37.2 per cent. Broadly defined, the number of people unemployed increased by 1.9 per cent to about 9 634 000.

Over the 12-month period, the total number of youth in employment declined by 1 per cent (64 280). The youth unemployment rate, officially defined, decreased by 0.4 percentage points to 38.8 per cent as the number of discouraged youth job-seekers increased. Youth unemployment, broadly defined, increased to an all-time high of almost 50.4 per cent (6 159 558).

According to the Quarterly Employment Survey for the second quarter of 2018 – which surveys formal-sector firms and is therefore a more accurate reflection of formal sector employment than the QLFS – the economy added 13 000 net formal non-agricultural jobs over the year. Five of the eight sectors experienced job losses over the 12-month period, including mining, construction and logistics which have experienced three quarters of successive job losses.

Figure 6: Most sectors experienced net-job losses



Current account

South Africa's current account – generally held in deficit by the persistent net outflow of service, income and transfer payments – improved slightly over the second quarter largely due to improved export performance. The current account deficit fell from 4.6 per cent of GDP in the first quarter, to 3.3 per cent in the second quarter. The improvement in the current account balance was due to the trade balance swinging from a deficit of 0.3 per cent of GDP in the first quarter to a surplus of 0.8 per cent in the second quarter, as quarterly export growth (7%) exceeded import growth (1%) in rand terms. The improved current account balance was also in part due to a smaller deficit on the net service, income and current transfer payments account.

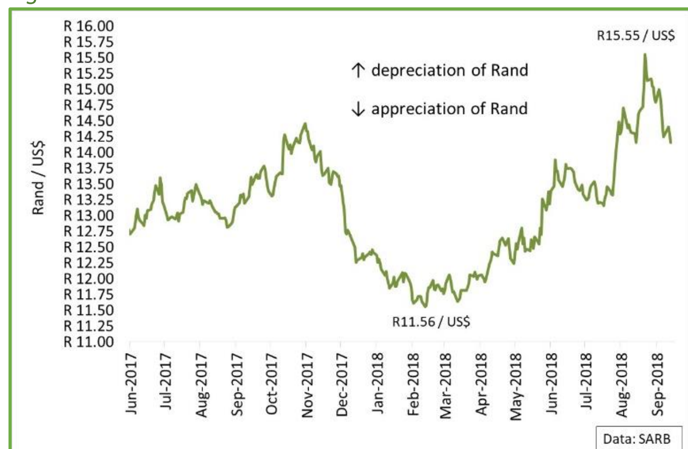
Figure 7: Trade surplus improves current account deficit

Exchange rate

After strengthening consistently against the US dollar from the last quarter of 2017 through the first quarter of 2018 by over 13 per cent, the rand has depreciated by 20 per cent against

the US dollar since April. The primary reasons for rand weakness include a higher oil price, the US dollar strengthening against most major currencies, as well as a global sell-off of emerging market assets – including South African assets – in response to domestic economic challenges in Argentina and Turkey.

Figure 8: Rand vs US dollar



Sovereign risk

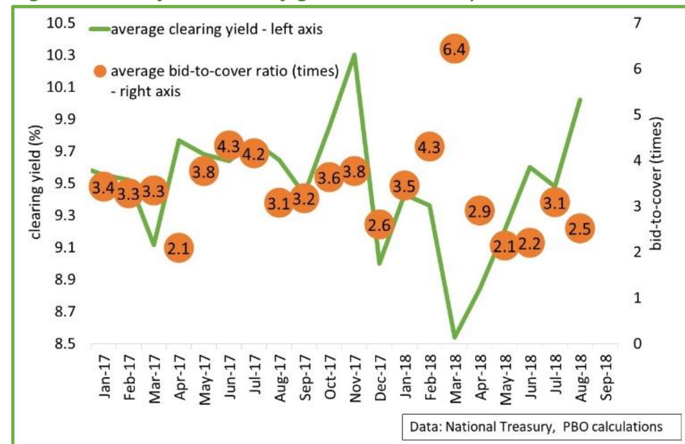
The yield on South Africa's 10-year benchmark bond – an indicator of market sentiment about the riskiness of South African government bonds – worsened since the second quarter of 2018, increasing by over 100 basis points between March and September to above 9.4 per cent. The higher yields, indicating increased risk perception of South African bonds, was in part due to aversion towards emerging-market assets.

Figure 9: Yield on SA 10-year bond

The results from government bond auctions for the past twelve months show a marked change in risk perception of South African bonds combined with a slight upward revision in the inflation outlook.

From the fourth quarter of 2017 to the first quarter of 2018 average clearing yields on government's 20-year fixed-rate bonds – the interest rate government has to pay – decreased consecutively, from an average of 10.3 per cent in October 2017 to 8.5 per cent in March 2018. This improving trend has reversed since March 2018, with average clearing yields again increasing to above 10 per cent in September. The average bid-to-cover ratio – an indicator of market appetite for a country's bonds – has similarly fallen over the last six months. The increase in average clearing yields means higher interest costs on government debt.

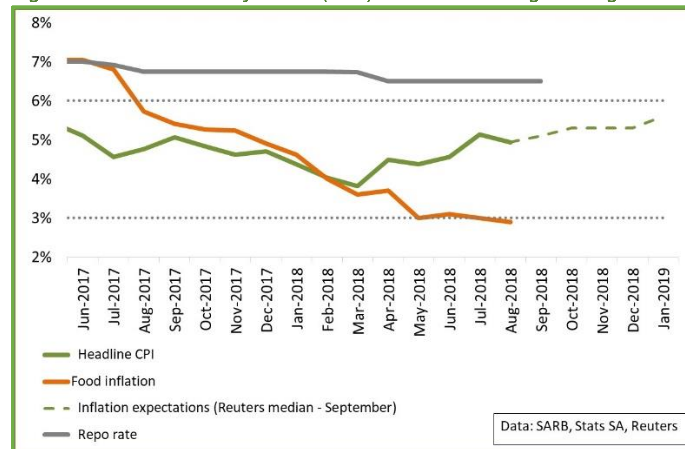
Figure 10: Performance of government 20-year bond auctions



Inflation and monetary policy

Headline inflation – as measured by the consumer price index (CPI) for all urban areas – has remained below the upper bound of the South African Reserve Bank's (SARB) 3 to 6 per cent target range since April 2017. The year-on-year CPI rate for August fell to 4.9 per cent, from 5.1 per cent recorded for July. Lower increases in food prices have moderated the impact of a weaker currency, higher oil prices and administered prices. The SARB expects inflation to remain within the target range over its forecast horizon, averaging 4.8 per cent in 2018, 5.7 per cent in 2019 and 5.4 per cent in 2020.

Figure 11: Headline inflation (still) within the target range



After reducing the repo rate by a modest 25 basis points at its March 2018 meeting, the Monetary Policy Committee of the South African Reserve Bank has since kept the repo rate fixed at 6.5 per cent at its May, July and September meetings despite low inflation and weak growth. The Monetary Policy Committee noted that whilst inflation is expected to remain within its target range, inflation is expected to move above the mid-point of the range (4.5%). This suggests the mid-point has become an additional target-guide within the MPC's official target range. The MPC also noted that current risks to inflation are primarily supply-side, over which monetary policy has limited control.

Outlook

The economy is expected to grow slower than government projected in February in the National Budget. Weak investment and slow household consumption are expected to continue to weigh-down domestic economic activity. The potential impact on the economy of the proposed “fiscal stimulus” is not known.

Table 3: Most analysts downwardly revised SA growth outlook

GDP growth outlook - calender year*	2018	2019	2020
National Treasury - Budget 2018	*1.5%*	*1.8%*	2.1%
South African Reserve Bank - January 2018	0.9%	1.4%	1.6%
South African Reserve Bank - September 2018	0.7% ↓	1.9% ↑	2.0% ↑
Bureau for Economic Research - February 2018	1.4%	1.9%	-
Bureau for Economic Research - September 2018	0.9% ↓	1.9%	-
Reuters econometer (median) - February 2018	1.4%	1.7%	2.0%
Reuters econometer (median) - September 2018	0.8% ↓	1.7%	2.0%
GDP growth outlook - fiscal year*	**2018/19**	**2019/20**	**2020/21**
National Treasury - Budget 2018	*1.5%*	*1.9%*	*2.1%*
Reuters econometer (median) - February 2018**	1.8%	-	-
Reuters econometer (median) - September 2018**	1.0% ↓	1.8%	-

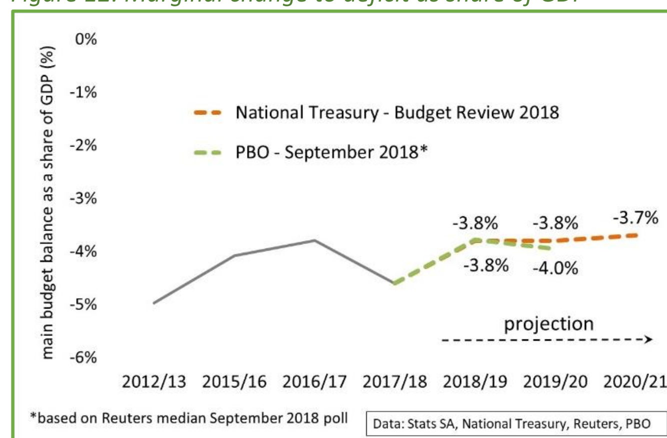
*Growth projections correspond to publication date and not forecast date
** Fiscal year projections are computed using quarterly growth rates

Despite the economy entering a technical recession in the second quarter, revenue growth has been surprisingly buoyant in the current year-to-date. Over the first five months of the current fiscal year, several revenue items have grown close to or marginally faster than annual projected growth rates. One notable exception to this is corporate income tax, which is expected to grow slower than projected at the beginning of the year.

Based on the actual outcomes for the first five months of the current fiscal year, and historical monthly revenue profiles, the PBO’s In-year revenue and expenditure model estimates main budget revenue marginally lower (R2.19 bn) than projected by government in the Budget Review for the current year (2018/19). A significant uncertainty in these projections are the payments of VAT refunds by SARS. It is not clear whether the current growth in VAT refunds reflects delays in repayments. The marginally lower revenue projected has a negligible impact on the budget deficit projected in the 2018 Budget Review, assuming expenditure outcomes are as projected by government.

The downwardly revised nominal growth projections translate into slightly revised estimates of the main budget deficit and net debt as a share of GDP.

Figure 12: Marginal change to deficit as share of GDP



It should be noted that PBO’s projections are not policy-adjusted and thus do not reflect any steps that may be taken by government to raise revenue and/or decrease expenditure to reduce the in-year budget deficit, or the budgetary and growth implications of the President’s stimulus plan for the economy.

Figure 13: Lower growth implies higher debt-to-gdp outlook

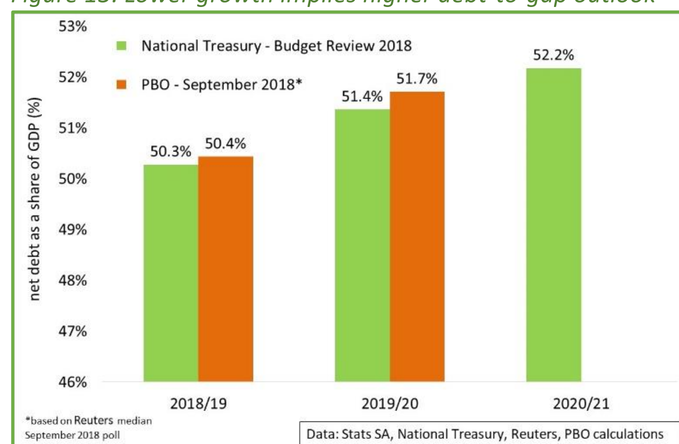


Table 4: Buoyant revenue growth, despite slower GDP growth

R million	Year-to-date actual (April - August 2018)	As % of Budget Review estimate[1]	NT Budget Review 2018	PBO Pre-MTBPS (September 2018)[2]	Surplus (shortfall) compared to NT Budget projections	
Taxes on income and profits[3]	285,286	36.9%	772,991	762,430	(10,562) ↓	-1.4%
of which:						
Personal income tax	194,458	38.4%	505,845	507,119	1,275 ↑	0.3%
Corporate income tax	76,991	33.3%	231,219	219,382	(11,837) ↓	-5.1%
Skills development levy	6,850	40.5%	16,929	17,812	883 ↑	5.2%
Taxes on property	6,368	36.8%	17,311	16,431	(880) ↓	-5.1%
Domestic taxes on goods and services	185,697	38.3%	484,826	495,979	11,153 ↑	2.3%
of which:						
VAT	132,343	38.0%	348,110	358,369	10,259 ↑	2.9%
Health promotion levy	1,011	60.0%	1,685	2,867	1,182 ↑	70.2%
Taxes on international trade and transactions	19,244	35.6%	54,050	55,359	1,309 ↑	2.4%
Other	(8)	0.7%	(1,143)	(1,143)	-	-
Gross tax revenue	**503,437**	**37.4%**	**1,344,965**	**1,346,868**	**1,903** ↑	0.1%
Non-tax revenue[4]	9,925	40.6%	24,470	24,470	-	-
Less: SACU payments	(24,144)	50.0%	(48,289)	(52,301)	(4,012) ↓	8.3%
Main budget revenue	**489,218**	**37.0%**	**1,321,146**	**1,319,037**	(2,109) ↓	-0.2%
Main budget expenditure	**620,645**	**41.0%**	**1,512,200**	**1,512,200**	-	-
Main budget balance	**(131,427)**	**-**	**(191,054)**	**(193,163)**	(2,109) ↓	1.1%
Main budget balance (% of GDP)	**-**	**-**	**-3.8%**	**-3.8%**	-	-
Tax buoyancy[5]	**-**	**-**	**1.51**	**1.76**	-	-

1. Monthly revenue and expenditure generally do not follow a smooth profile, therefore year-to-date growth rates are not reliable predictors of annual growth rates.
2. Projections are from PBO's in-year revenue and expenditure model. PBO uses historical monthly profiles of revenue data available in Section 32 reports to project full-year main budget outcomes. PBO's model is based on methodologies employed by other independent fiscal institutions.
3. Includes secondary tax on companies/dividend and interest withholding tax, interest on overdue income tax and business tax amnesty levy
4. Includes mineral royalties, mining leases, departmental revenue and sales of capital assets
5. Percentage change in gross tax revenue divided by percentage change in nominal GDP. PBO estimate is based on actual nominal GDP for 2017/18 and revised projection for 2018/19