PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

Quarterly Economic Brief

October 2014

Parliamentary Budget Office

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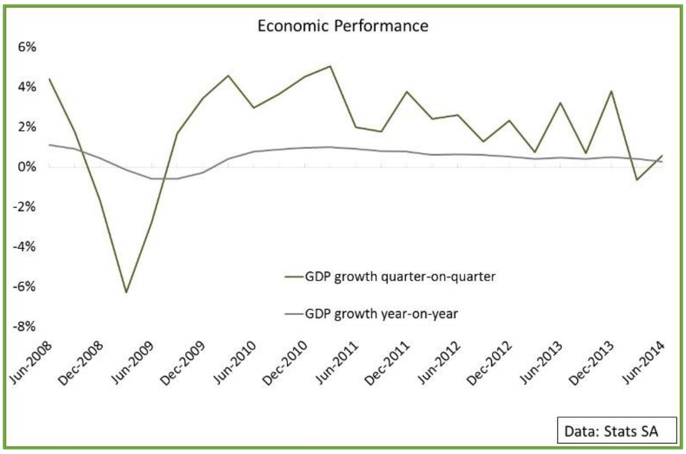
Growth

The first half of 2014 saw the global economic recovery remain uneven and fragile. Key global developments affecting the South African economy over the period included signs of a recovery in the US economy, a slowdown in China, stagnating growth in Europe, and lower overall commodity prices.

Figure 1: Quarterly economic performance



South Africa's economy grew marginally by 0.6 per cent in the second quarter of 2014, compared to the first quarter, where it contracted by 0.6 per cent. The marginal growth recorded for the second quarter meant that the country avoided a technical recession – defined as two consecutive quarters of contraction (negative growth). In the first half of 2014, the South African economy grew by 1.3 per cent compared to the first half of 2013.

On a quarterly basis, declining output was observed in 4 of the 10 sectors for the second quarter of 2014, declining sectors include mining (-9.4%), manufacturing (-2.14%), retail (-0.16%) and electricity, gas and water (-0.65%).

The 9.4 per cent second quarter contraction in the mining sector, follows a larger contraction of 24.7 per cent recorded in the first quarter. This was largely due to the five month labour strike in the platinum sector which started on the 23rd of January. Industry has estimated the loss in platinum output due to the strike to be 424 000 ounces – almost 20 per cent of annual production.

As mining has strong backward and forward linkages with the manufacturing sector, the prolonged platinum mining strike is likely to have affected output in the manufacturing sector, which recorded a decline in output of 2.14 per cent.

In contrast, the agricultural sector experienced strong second quarter growth of 4.9 per cent compared to the previous quarter. This reflects growth in crop production - especially in maize - which was estimated to be more than 20 per cent higher than the previous year.

South Africa's poor economic performance and outlook and its impact on the fiscus, prompted ratings agencies S&P and Fitch to downgrade the country's sovereign credit rating in June 2014. S&P reduced South Africa's sovereign credit rating to BBB – with a stable outlook – whilst Fitch revised their outlook from stable to negative suggesting that a further downgrade in the future is possible.

Employment

Statistics South Africa estimates the official unemployment rate at 25.5 per cent in its Quarterly Labour Force Survey - a nationally representative household survey- for the second quarter of 2014. Using the broad definition of unemployment – which counts discouraged job-seekers amongst the unemployed – unemployment is estimated to be 37.4 per cent.

Table 1: Key labour statistics

	2Q 2013	2Q 2014	Change
Labour force ('000s)	**19663**	**20248**	**3.0%**
Employed	14692	15094	2.7%
Unemployed - official	4972	5154	3.7%
Unemployed - broad	7397	7573	2.4%
Not economically active ('000s)	**15049**	**15084**	**0.2%**
Discouraged job-seekers	2425	2419	-0.2%
Other (not economically active)	12624	12665	0.3%
Rates			
Official unemployment rate (narrow)	25.3%	25.5%	0.2%
Broad unemployment rate*	37.6%	37.4%	-0.2%

*The broad unemployment rate includes discouraged job seekers

Data: Quarterly Labour Force Survey, Stats SA

Whilst there has been an increase in the number of people employed, this has roughly kept up with the increase in the labour force. The Quarterly Labour Force Survey (QLFS), and the Quarterly Employment Survey (QES) – a firm level survey, for the second quarter of 2014, both estimate a 2.7 per cent increase in the total number of people employed between 2013 and 2014.

Although there has not been a significant change in overall levels of unemployment, it is important to note the changes in the composition of employment.

Both the QES and QLFS indicate a notable increase in government employment, and a decline in employment in the rest of the economy. According to the QLFS, agricultural employment decreased by almost 10 per cent (73 000) since 2013, whilst the manufacturing sector shed 5 per cent (93 000) of its jobs. The QES, providing a more accurate estimate of mining employment, estimates that the mining sector shed 4 per cent of its employment (21 000 jobs) over the last year. In contrast, government employment (excluding SOEs) increased by 9.2 per cent (220 000 jobs).

Figure 2: Contribution to employment

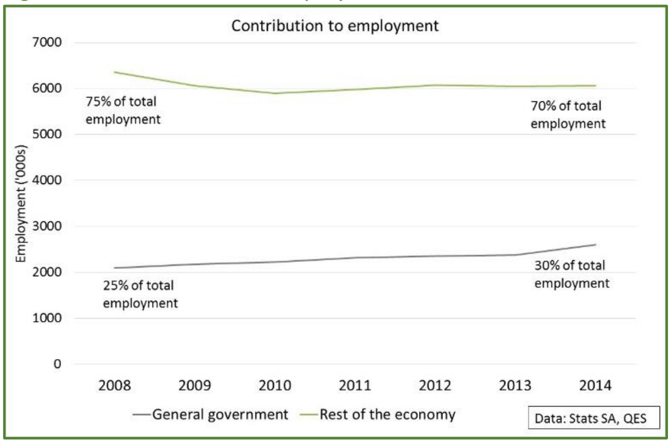
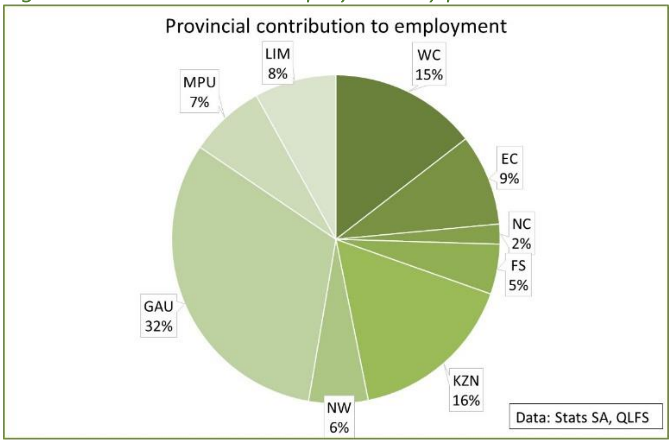


Figure 2 above, using QES data, shows the actual number of people employed by general government compared to the rest of the economy since 2008. General government employment has grown by 24 per cent since 2008, at an average of 3.7 per cent a year, whilst the rest of the economy shed 4.5 per cent of jobs since 2008. According to the QES, general government's share of employment has grown from 25 per cent of total employment in 2008 to 30 per cent today. This indicates the country's increased reliance on the government, and therefore the fiscus, to maintain employment levels. This is a concern, especially in the context of South Africa's constrained fiscal environment.

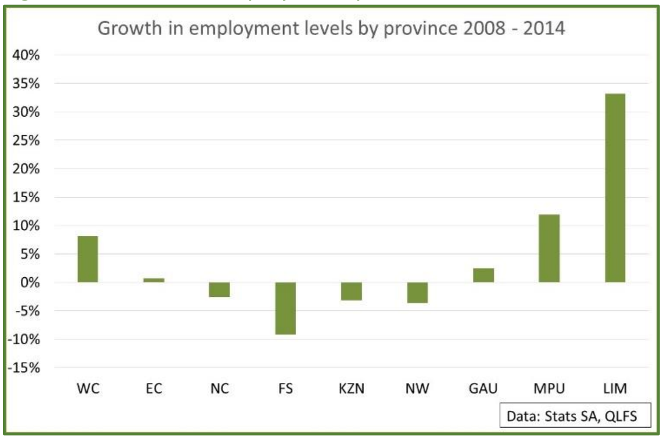
Figure 3: Contribution to employment by province



Decomposing employment by province, Figure 3 above, shows the contribution of the nine provinces to total employment. Although roughly as populous as KwaZulu Natal and the Western Cape, Gauteng has twice as many employed people.

Figure 4 below shows the growth in employment levels per province since 2008 – the beginning of the financial crisis. It shows that 4 provinces, namely the Northern Cape, Free State, KwaZulu Natal and the North West have lost jobs over the past six years. The significant 9 per cent reduction in employment estimated for the Free State, was due to a fall in employment in the province's agriculture (18%) and manufacturing (30%) sectors.

Figure 4: Growth in employment province

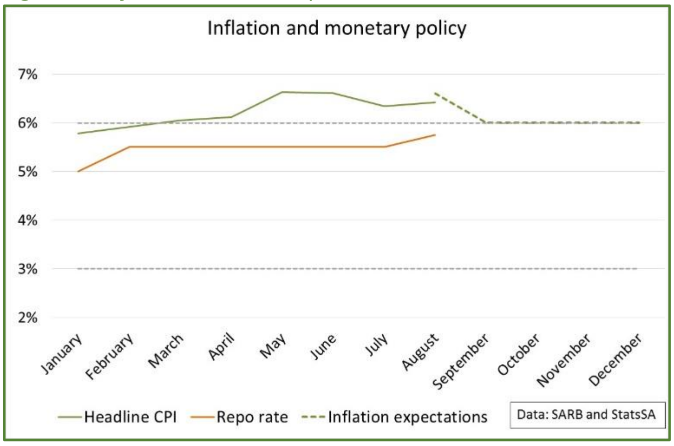


Significant growth in employment levels were observed for Mpumalanga and Limpopo. However this is largely due to growth in government employment - 30% in Mpumalanga and 44% in Limpopo.

Inflation

Inflation, as measured by the consumer price index (CPI), has breached the South African Reserve Bank's upper bound target of 6 per cent since March – peaking at 6.6 per cent in May – its highest level since July 2009. The high inflationary outcomes are driven by higher food and fuel prices, as well as pass-through effects from the relatively weaker Rand.

Figure 5: Inflation and the repo rate



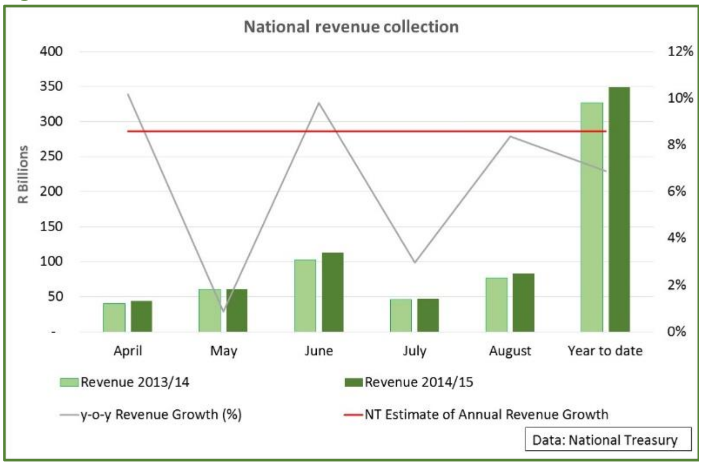
Expectations of rising inflation, combined with higher actual inflation, has prompted the South African Reserve Bank's Monetary Policy Committee (MPC) to hike the repo rate twice since the beginning of the year. In January, the MPC hiked the repo rate by 50 basis points to 5.5 per cent. The MPC cited the risk to inflation arising from a depreciating Rand as a result of both domestic and international factors. This included the US tapering of its policy of quantitative easing – which decreases demand for South African assets. The MPC also cited South Africa's poor economic outlook which places further pressure on the Rand. The MPC in August again hiked the Repo rate, this time by 25 basis points to 5.75 per cent. The MPC has stated that South Africa has entered "a moderate hiking cycle".

Inflation expectations for the rest of the year and next year are generally anchored around the SARB target upper-bound of 6 per cent, whilst the SARB expects inflation to fall below 6 per cent in the first half of 2015.

Revenue

The 2014 Budget Review estimates that national revenue for the 2014/15 financial year will grow by 8.59 per cent. This is indicated by the red dotted line in Figure 6 below.

Figure 6: National revenue collections



However, to date revenue collection for the 2014/15 financial year has grown by 6.88 per cent year-on-year. If national revenue collected were to grow by 6.88 per cent for the current financial year, the shortfall in estimated revenue collection for 2014/15 would amount to R15.11 billion. This would increase the main budget deficit from an estimated R179.78 billion to R194.89 billion.

Table 2: Revenue shortfall and budget balance

Impact of a shortfall in revenue collection for 2014/15 financial year		
	NT Estimate (assumed 8.59% Revenue Growth)	Implied by current 6.88% Revenue Growth
Main Budget Revenue	962 781 758	947 669 295
Main Budget Balance	(179 780 641)	(194 893 104)
		Data: National Treasury, PBO own calculations

The reduction in national revenue collected is partly a function of slower than expected economic growth. A reduction in anticipated national revenue collection coupled with slower than expected economic growth has implications for the budget deficit, generally reported as a percentage of GDP.

The table below presents four possible budget deficit outcomes for 2014/15. The outcomes are based on two possible revenue collection scenarios and two possible real GDP growth scenarios.

The revenue collection scenarios are derived from table 2 above, whilst the real GDP growth scenarios represent National Treasury's growth forecast presented in the Budget Review in February, versus the IMF's most recent revision to its forecast.

Table 3: Revenue collection and main budget deficit

Main Budget Deficit for 2014/15 (% of GDP at current prices)		
	Real GDP growth of 2.9%	Real GDP growth of 1.4%
Revenue collection of R179.78bn	4.85%	4.92%
Revenue colleciton of R194.89bn	5.26%	5.34%
		Data: National Treasury, IMF, PBO calculations

If the South African economy were to grow by 1.4 per cent in real terms and national revenue collected were to grow by 6.88 per cent for the financial year, the main budget deficit would be 5.34 per cent. This equates to an increase in the expected main budget deficit of approximately half a per cent of GDP.

Outlook

When National Treasury presented the Budget Review in February it forecast GDP growth of 2.7 per cent for 2014 and 3.2 per cent for 2015, this marked a downward revision from its forecast in the 2013 MTBPS. However, to date economic growth has disappointed even further. This has prompted widespread downward revisions to South Africa's growth outlook (see table 4 below). In line with this, National Treasury is expected to downwardly revise its growth forecast for 2014 and 2015 when it presents the 2014 MTBPS. As PBO calculations show, lower revenue may be expected In line with a lower growth outlook. This will place strain on the current fiscal framework and may require additional borrowing or drawing on contingency reserves – as National Treasury has done in the past.

Table 4: Change in SA growth outlook

	2014	2015
National Treasury MTBPS 2013	3.0%	3.2%
National Treasury Budget Review 2014	2.7%	3.2%
IMF World Economic Outlook - April 2014	2.3%	2.6%
IMF World Economic Outlook - October 2014	1.4%	2.3%
South African Reserve Bank - January 2014	2.8%	3.3%
South African Reserve Bank - September 2014	1.5%	2.8%
Bureau of Economic Research - January 2014	2.6%	3.0%
Bureau of Economic Research - September 2014	1.5%	2.9%

Whilst a recovery in the US economy presents South Africa with opportunities for export, it places pressure on the Rand in the short-run. As the US Federal Reserve tapers off its policy of quantitative easing, this reduces demand for South African assets. As Europe and China are two of South Africa's main trading partners, slower growth in these regions will affect demand for South African exports – commodities in particular in the case of China.

Electricity supply continues to present a constraint to growth as Medupi's first unit will not generate at full capacity until 2015. South Africa's current account and budget deficit will weigh heavily in December as Fitch and S&P update the country's sovereign credit rating.