Parliamentary Budget Office

PARLIAMENT OF THE REPUBLIC OF SOUTH AFRICA

Quarterly Economic Brief

March 2016

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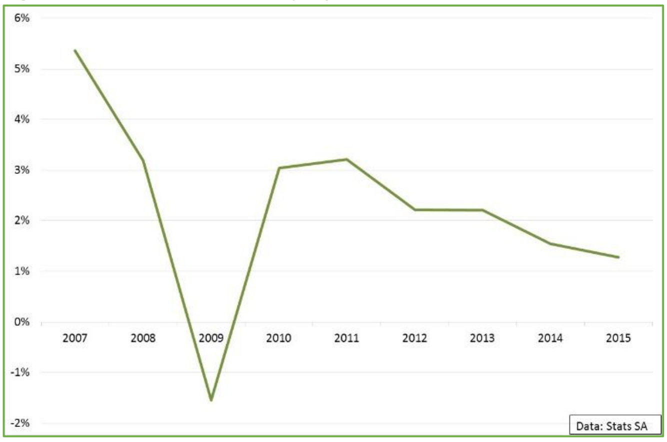
Growth

The South African economy grew by a modest 1.3 per cent in 2015 according to Stats SA's March 2015 GDP data release. This marks the slowest growth rate in 17 years, apart from the contraction in 2009 as a result of the financial crisis. The relatively poor growth was due to lower domestic and international demand, a fragile global recovery, and the effects of the country-wide drought.

Figure 1: Annual economic performance



Agriculture and the drought

The country-wide drought severely affected the field crop, horticulture and animal production of the agriculture sector. This contributed to agriculture sector contracting by a significant 8.3 per cent over the year, subtracting 0.18 of a percentage point from the year's growth.

According to Agri SA the agricultural products that are under the most strain from the drought include maize, wheat, beef and sheep, and sugar. While the sectors experiencing moderate levels of strain include oil seeds, other livestock, wool and cotton, citrus, vegetable and tobacco.

South Africa is likely to import white maize and yellow maize to make up for the shortfall in domestic production due. This will likely result in higher domestic white maize prices, as well as meat prices – as yellow maize is used as animal feed. The effects of the drought have already been seen in higher food price inflation since the beginning of 2016.

Figure 2: Economic performance by sector

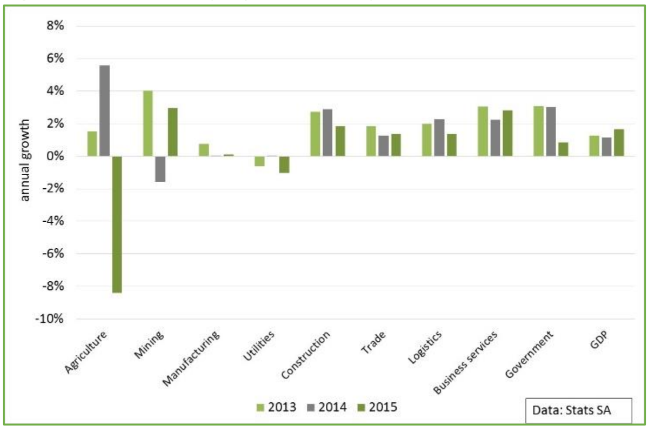
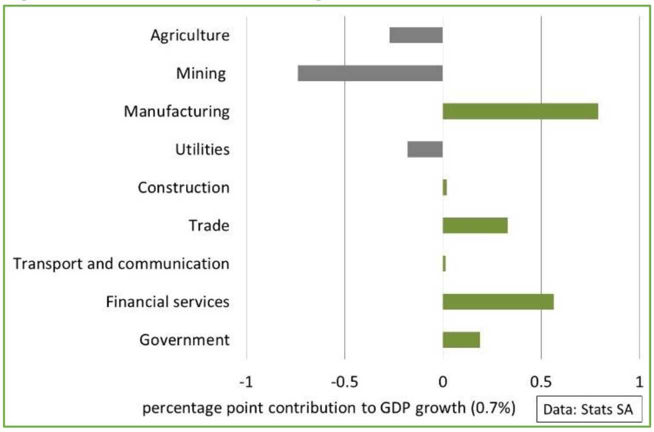


Figure 3: Sector contribution growth



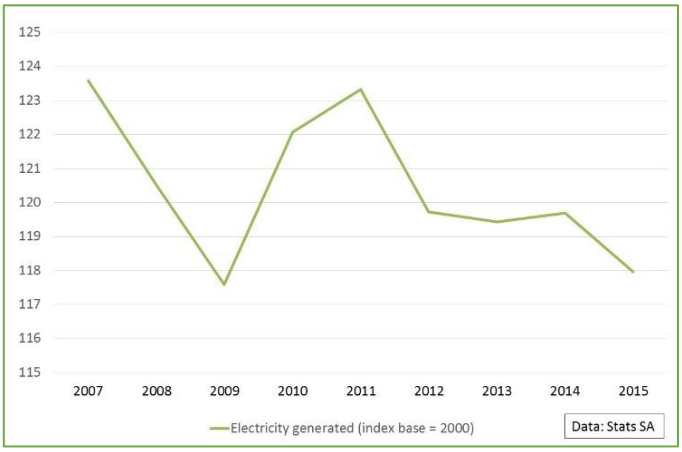
Mining

The 2.9 per cent growth in the mining sector, which added 0.22 to the year's growth, was due to increased platinum production as well as a recovery from the contraction in the sector in 2014 due to prolonged strikes. Over the past 5 years, the sector has only managed to grow at an annual average of rate 0.3 per cent.

Electricity

The utility sector – comprised of the electricity, gas and water industries – contracted by 0.01 per cent, subtracting 0.02 of a percentage point from the year's growth. The sector's contribution to growth has been in decline over the last five years, contracting by an average of 0.1 per cent per year since 2010. This is largely due to a reduction in the electricity produced in the country.

Figure 4: Electricity available for consumption

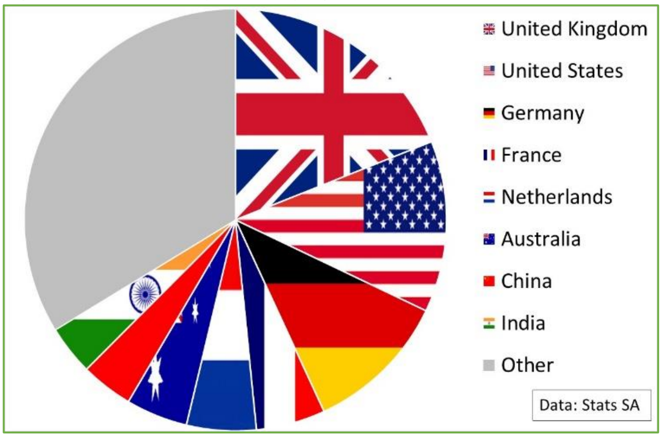


Electricity available for distribution in the country decreased by an annual average of 0.7 per cent a year since 2010. This is despite the economy having grown by 2.09 per cent a year since then. This indicates lower dependence of the economy on electricity for growth. This is in part due to increased energy efficiency, and energy-intensive sectors such as mining and manufacturing growing slowly. Lower overall demand for electricity has, in part, allowed Eskom to avoid load shedding since the second half of 2015. The total amount of electricity production is yet to recover to 2007 levels.

Tourism

According to Statistics South Africa, the total number of foreign tourists visiting South Africa declined by 577 000 (4%) in 2015 to 13.9 million compared to the previous year. This marks the lowest level in three years. The decline occurred despite the weaker rand, and may reflect the effects of changes in the country's visa requirements for minors, as well as slower global growth.

Figure 5: Tourists by country of residence (2009 – 2015)



Foreign tourists visiting the country are primarily from a few countries. About 50 per cent of tourists are from Europe, while 8 countries account for almost two thirds of total visitors. In recent years, there has been an increase in the number of tourists from Asia and the middle-east.

In line with a reduction in foreign visitors, occupancy rates in tourist accommodation also fell by 2.4 per cent. This, however reflects demand from both local and foreign tourists. Despite lower overall demand, real income from tourist accommodation grew by 4.5 per cent over the year.

Fiscal consolidation and growth

The effects of the government's policy of fiscal consolidation on the economy – including slower expenditure growth since the 2015 MTBPS – can be observed in the 2015 data. The South African Reserve Bank's statistics on expenditure in the economy showed that general government spending on goods and services grew by only 0.3 per cent in 2015, compared to the average growth of 3.3 per cent a year since 2005. In terms of contribution to GDP, the government sector grew by a modest 0.9 per cent in 2015. This is a significant slow-down from the average growth of 3.4 per cent experienced over the last 10 years. Government spending on goods and services in the economy accounts for over 20 per cent of total expenditure in the economy. In real terms, national government expenditure was lower for the 2015/16 fiscal year compared to the 2014/15 fiscal year.

Household consumption and growth

Spending by households on goods and services – which accounts for over 60 per cent of domestic expenditure – grew by 1.6 per cent in 2015, a slight improvement from the 1.4 per cent recorded for the previous year. Although this is an improvement from 2014, growth in household spending is still below the average of 3.5 per cent recorded since 2005. Low growth in household spending is in part due to persistent high unemployment, higher interest rates and overall higher household indebtedness.

Capital investment

Real capital investment in the economy grew by a modest 1.4 per cent in 2015, compared to 2014 where it contracted by 0.4 per cent. Although investment by general government grew by 5.9 per cent, it only accounts for about 16 per cent of total investment. The private sector and public corporations account for 85 per cent of investment. Investment by public corporations (about 20% of total investment) grew by 0.8 per cent over the year, while private sector investment (about 65% of total investment) grew by a modest 0.4 per cent. This accounts for the overall low level of capital investment.

Exchange rate

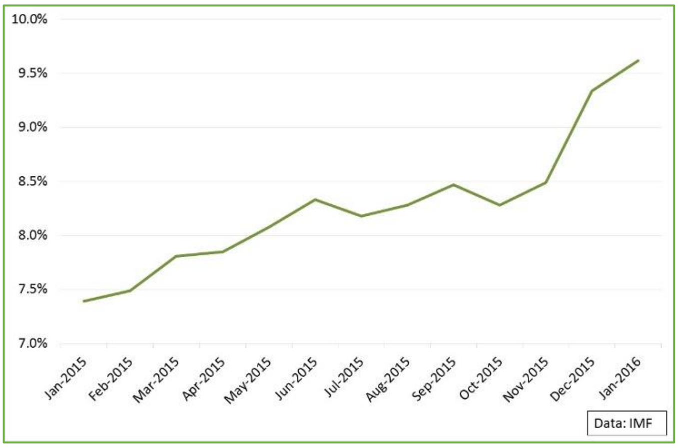
Figure 6: Rand vs US dollar

The rand depreciated by 34 per cent against the US dollar over 2015, losing 8 per cent of its value in December alone. International factors were key determinants in the performance of the rand. These included declining commodity prices, slow global growth, and policy normalisation by the US Federal Reserve – which decreases demand for South African assets. Domestically, the prospect of a ratings downgrade of South Africa's debt and recent political developments placed pressure on the rand.

Sovereign risk

The yield on South Africa's 10 year benchmark bond – an indicator of the riskiness of South African government bonds – increased over the year from 7.4 to 9.3 per cent. While part of the increase was due to external factors including lower appetite for emerging market assets, local factors also affected investors' decisions. Higher bond yields increase the costs governments face when they issue new debt.

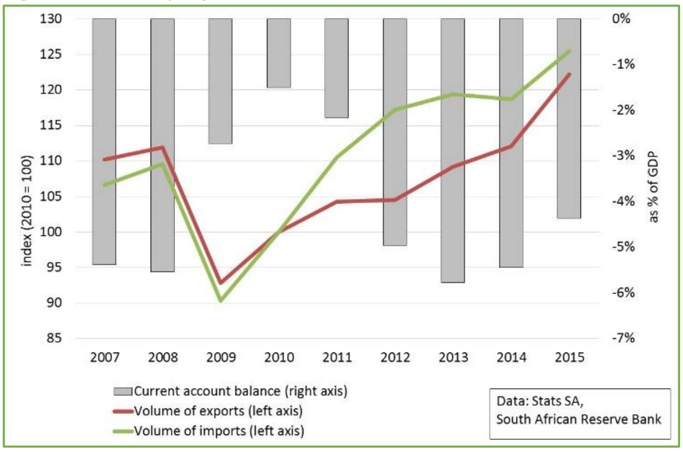
Figure 7: Yield on SA 10-year bond



Trade

South Africa's current account balance (which includes the total value of imports less exports) improved from a deficit of 5.4 per cent of GDP in 2014, to a lower deficit of 4.4 per cent in 2015, the lowest deficit since 2012.

Figure 8: Trade performance



The total volume of South Africa's exports increased by 10.1 per cent in 2015. While export earnings benefitted from the weaker rand, the benefit of the weaker rand was partially offset by lower commodity prices. The price of South Africa's main commodity exports, including platinum, iron ore, coal, copper and nickel fell through the year. Consequently, the average price the country received for its exports decreased by 6.8 per cent in 2015.

While the total volume of South Africa's imports increased by 6.8 per cent in 2015, the price paid for imports decreased by 5.9 per cent. This was in part due to the sustained lower oil price, the price of oil averaged US$ 53 in 2015, compared to US$ 99 the year before.

Employment

The Quarterly Labour Force Survey (QLFS) for the fourth quarter of 2015 indicated the official unemployment rate was 24.5 per cent. This was a percentage lower than the third quarter (25.5%), and marginally lower than recorded for the same quarter in 2014[1]. The broad – or expanded – unemployment rate, which includes discouraged job-seekers, is estimated to be 33.8 per cent, 0.6 per cent lower than the previous quarter.

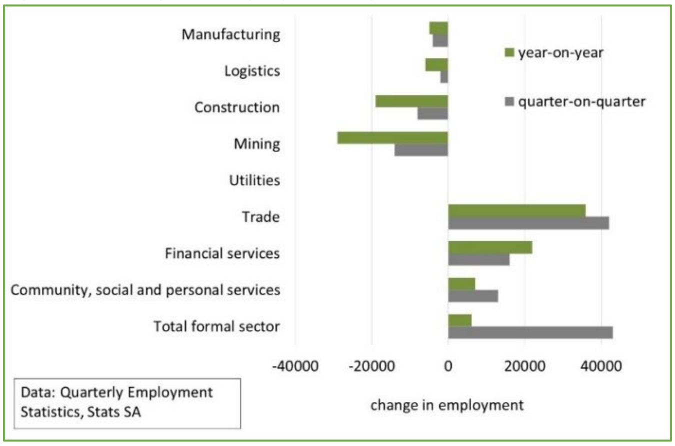
Table 1: Key labour statistics - QLFS

	4Q 2014	3Q 2015	4Q 2015
Labour force ('000s)	**20 228**	**21 246**	**21 211**
Employed	15 320	15 828	16 018
Unemployed - official	4 909	5 418	5 193
Unemployed - broad*	8 096	8 304	8 187
Not economically active ('000s)	**15 415**	**14 867**	**15 061**
Discouraged job-seekers	2 403	2 226	2 279
Other (not economically active)	13 012	12 641	12 782
Rates			
Official unemployment rate (narrow)	24.3%	25.5%	24.5%
Broad unemployment rate*	34.6%	34.4%	33.8%

*The broad unemployment rate includes discouraged job seekers
Data: Quarterly Labour Force Survey, Stats SA

Compared to the previous quarter, the formal sector is estimated to have added 250 000 jobs, while the informal sector lost 37 000 jobs. Compared to the same quarter in 2014, the formal sector added 269 000 jobs, while the informal sector added 236 000 jobs to the economy.

Figure 9: Change in employment by sector - QES



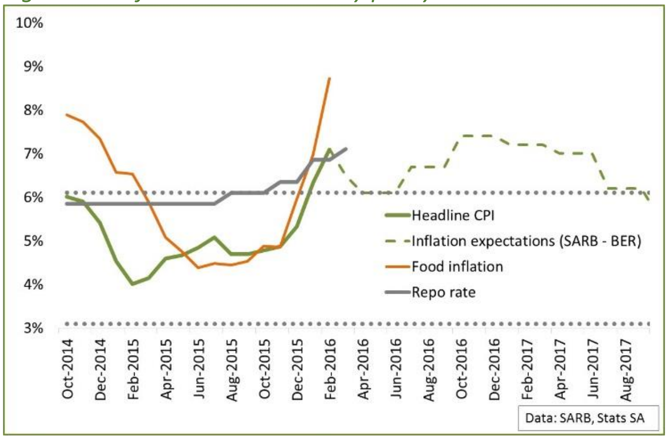
The results from the Quarterly Employment Survey (QES) for the fourth quarter of 2015 support the findings of the QLFS of increased employment in the formal sector. The QES – which surveys formal sector firms – found an overall increase in the level of formal sector employment. However, the manufacturing logistics, construction and mining sectors all shed jobs when compared to the previous quarter and the previous year. These job losses were exceeded by the increase in employment from the other sectors, particularly the service oriented sectors.

While the results of both the fourth quarter surveys indicate an improvement in the labour market, it should be noted that survey data is subject to certain errors[2]. More than one reading of the QLFS and QES is necessary to conclude that the labour market is strengthening.

Inflation and monetary policy

Headline inflation – as measured by the consumer price index (CPI) for all urban areas – remained beneath the 6 per cent upper bound of the South African Reserve Bank's (SARB), inflation target, averaging 4.9 per cent in 2015. Inflation however increased in the third quarter of 2015, and has breached the 6 per cent mark since the beginning of 2016 (January: 6.2%, February: 7%). The sharp increase in inflation is due to both the effects of a weaker rand – particularly in December 2015 – and higher overall food prices due to the drought. Food inflation accelerated to 6.9 per cent in January and to 8.6 per cent in February. Inflation is expected to remain outside the SARB's target range for the next 18 months.

Figure 10: Inflation and monetary policy



The SARB increased the repo rate four times since the beginning of 2015, from 5.75 per cent to its current rate of 7 per cent (the prime lending rate is 10.5%). Key factors informing the MPC's decisions (to hike) included the rand's weakness, monetary policy normalisation in the US, and the recent high food price inflation. The MPC has however noted that the increases to the repo rate may negatively affect growth. Market analysts surveyed by Reuters expect at least one additional rate hike this year.

Feature: Credit ratings

What is a credit rating?

A sovereign credit rating is an opinion about the relative credit risk of a national government. It provides investors with information about the probability that the country will be unable to repay its debt obligation (default risk). Credit rating agencies use grades to denote the credit risk, the higher the grade the lower the credit risk. Rating agencies consider country specific risks to determine the rating, such as economic and political risks.

Countries with a non-investment grade credit rating pay substantially higher interest in exchange for the perceived higher level of risk assumed by the investor. In addition, many institutional investors are unable to invest in non-investment grade debt because their investment mandates do not allow it. A non-investment grade sovereign rating would make it considerably more difficult and costly for National Treasury to raise capital to fund government expenditure.

South Africa's credit rating

In December 2015 credit ratings agency Fitch downgraded South Africa's foreign currency debt to one level above non-investment grade status from BBB to BBB-. In the same month, fellow credit ratings agencies Standard and Poor's, and Moody's both revised their outlook on South African foreign denominated debt from stable to negative – indicating their growing concern over the risk of South African debt and their preparedness to move the country's rating to non-investment grade status. The three ratings agencies cited poor growth prospects, the risk of fiscal slippage, and limited room for fiscal responsiveness as key in their decisions.

Table 2: South Africa's debt outlook

Fitch	Moody's	S&P		Countries (selected)	
A+	A1	A+	Upper medium grade	Botswana	Malaysia
A	A2	A		Czech Rep.	Poland
A-	A3	A-		Japan	Slovakia
BBB+	Baa1	BBB+	Lower medium grade	India	Mexico
BBB	**Baa2**	BBB		Italy	Spain
BBB-	Baa3	**BBB-**		**South Africa**	Turkey
BB+	Ba1	BB+	Non-investment grade speculative	Bangladesh	Namibia
BB	Ba2	BB		Brazil	Portugal
BB-	Ba3	BB-		Indonesia	Russia

Figure 11: Change in SA debt maturity profile (local currency)

Given the serious consequences and significant costs associated with a downgrade to the country's credit rating, the 2016 Budget provided some measures to address the risk of a downgrade.

- At present, only 11.3 per cent of SA government debt is foreign-currency denominated. This is projected to reduce to 9.8 per cent over the MTEF. This reduces the costs associated with a potential downgrade to the country's foreign-currency denominated debt.
- The credit rating of SA's local-currency debt is about two levels above non-investment grade. This provides the country with a buffer.
- Treasury have been changing the maturity profile of its debt. It has been replacing shorter maturity debt – debt that needs to be repaid sooner – with longer-maturing debt. This relieves the short-term pressure on the fiscus from having to repay debt

Outlook

In the 2016 Budget National Treasury presented its lowest growth forecast for the current year (2016) in 17 years. It cited lower commodity prices, slow global growth and weakened domestic confidence as key factors influencing its outlook. It assumed lower prices for oil, platinum, iron ore and coal – in line with recent developments. Its forecast is marginally higher than the most recent forecasts of other agencies.

The South African Reserve Bank estimates the country's potential growth for 2016 at 1.5 per cent.

Table 3: Growth outlook

GDP Growth Outlook	2016	2017	2018
National Treasury - Budget 2016	0.9%	1.7%	2.4%
South African Reserve Bank - March 2016	0.8%	1.4%	1.8%
Bureau of Economic Research - first quarter 2016	0.8%	1.5%	-
IMF World Economic Outlook - January 2016	0.7%	1.8%	-
World Bank Global Economic Prospects - January 2016	1.4%	1.6%	1.6%
Reuters Econometer poll - March 2016	0.7%	1.4%	1.9%

International factors that are likely to affect South Africa's growth performance include commodity prices, the performance of the global economy and the country's major trading partners, as well as the timing and extent of policy normalisation by the US Federal Reserve.

Domestically, the effects of the drought, higher interests rates, slowing government spending and flat consumer and investment spending are likely to negatively affect the country's growth this year. Multi-year wage negotiations in the mining sector also pose a risk to the output of mining. Slower than anticipated GDP and revenue growth will affect the country's ability to meet its fiscal targets and service its debt. Ratings agencies have identified these as risks to the country's credit rating. A further downgrade to the rating of South Africa's foreign denominated debt will result in depreciation of the rand, and increase government's financing costs.

[1] Stats SA began using a new master sample since the first quarter survey. Based on the 2011 Census data, the new master sample is intended to provide a more accurate picture of the labour force.

[2] These include sampling errors and non-sampling errors. A sampling error occurs when the sample surveyed does not accurately represent the entire population. Non-sampling errors include data entry errors, biased questions in a questionnaire, biased processing/decision making, inappropriate analysis conclusions and false information provided by respondents.