Parliamentary Budget Office

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

Quarterly Economic Brief

May 2018 No. 15

Contents

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 May 2018, and was released during the second term of the 2018 Parliament term, on the 30 May 2018. Stats SA only releases GDP and the Quarterly Employment Survey for the first quarter in June.

Overview

The economy appears to be recovering after several years of poor growth, benefitting from higher commodity prices, buoyant growth in major trading partners, and improved domestic consumer and investor sentiment following recent political developments.

The improved domestic growth outlook, implies that government's fiscal projections and objectives are more likely to be realised. Key risks to their realisation include slower economic growth due to the fragile position of mining and manufacturing, as well as expenditure pressures emanating from the outcome of the public sector wage negotiation, and additional obligations on the fiscus from state-owned enterprises.

Gross domestic product[1]

The South African economy grew by 1.3 per cent over 2017, an improvement from the 0.6 per cent recorded for 2016. There was a marked acceleration in growth in the fourth quarter of 2017, where the economy grew by 3.1 per cent, up from the 2.3 per cent recorded for the third quarter. The improved domestic economic performance occurred in a context of a synchronised global economic recovery - advanced economies, emerging market and developing economies are expected to record stronger growth over the medium term, supporting increased trade, higher and decreased vulnerabilities.

Figure 1: Annual GDP growth

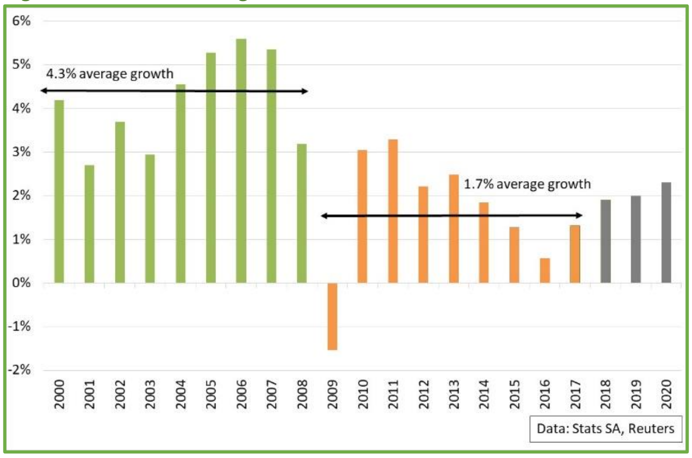


Table 1: Annual sector performance

% change y/y	Agriculture	Mining	Manufacturing	Utilities	Construction	Trade	Logistics	Business services	Government	Personal services	GDP
2017	17.7%	4.6%	-0.2%	0.2%	-0.3%	-0.6%	1.5%	1.9%	0.3%	1.2%	1.3%
2016	-10.2%	-4.2%	0.9%	-2.3%	1.1%	1.7%	0.8%	2.3%	1.4%	1.5%	0.6%
2015	-6.4%	3.1%	-0.4%	-1.7%	1.8%	1.9%	1.4%	2.6%	1.0%	1.0%	1.3%
2014	6.8%	-1.7%	0.3%	-1.0%	3.5%	1.4%	3.5%	2.7%	3.2%	1.8%	1.8%

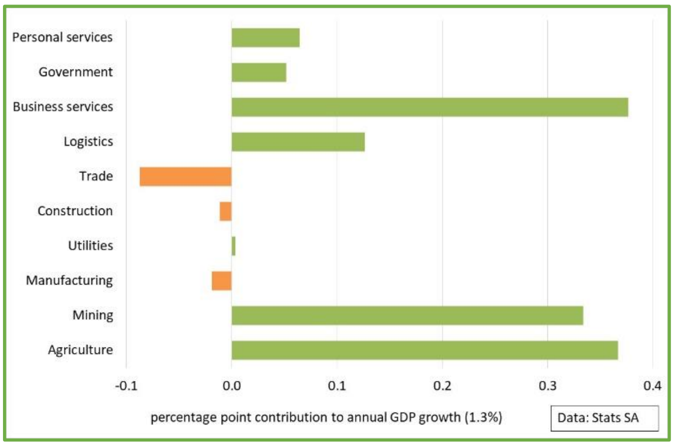
Data: Stats SA

The stronger annual domestic performance was primarily due to the agriculture, mining and businesses-services sectors, which cumulatively contributed to 1.1 percentage points to the year's growth of 1.3 per cent. The agriculture sector, recovering from two years of contraction due to the drought, grew by 17.8 per cent over the year. After contracting in 2016, the mining and the business services sectors also recorded strong growth. Despite an improvement in the overall growth performance, the trade, construction, and manufacturing sectors experienced contractions in 2017, subtracting from

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

overall growth, indicating the recovery in the economy is not broad-based.

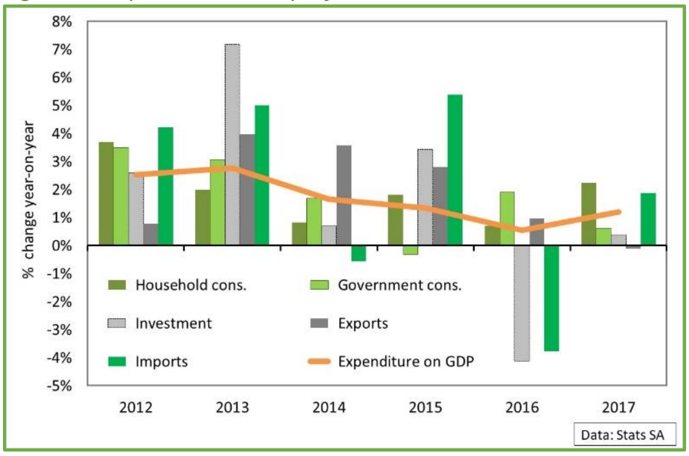
Figure 2: Sector contribution to annual growth



Expenditure on GDP

Measured from the expenditure side, the economy grew by 1.2 per cent over 2017, an improvement from the 0.6 per cent recorded for 2016. The improved performance over the year was primarily due to stronger growth in household consumption (2.2%), slower growth in government consumption expenditure (0.6%), and a modest recovery in overall investment (0.4%) following the contraction recorded for 2015. Over the year, exports declined by 0.1 per cent, whilst imports increased by 1.9 per cent, resulting in net exports subtracting 0.6 percentage points from the year's overall growth.

Figure 3: Improved annual performance

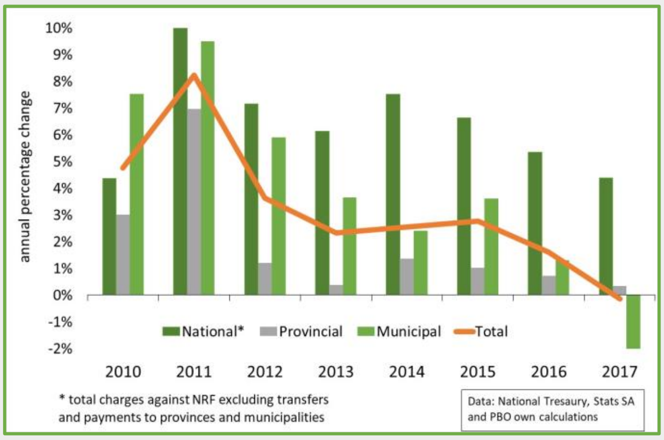


Government consumption expenditure grew by 0.6 per cent, slower than recorded for 2016 (1.9%). The slower growth, in part, reflects government's efforts to reduce the primary deficit, and stabilise debt as a share of GDP over the medium-term through smaller increases to national budgets, including transfers to provincial and local governments, as part of government's policy of fiscal consolidation.

Whilst overall investment increased over the year (0.4%), when considered at the sector level, only private sector investment recorded positive growth during 2017 (1.2%). General government and investment by public corporations contracted by 0.7 per cent and 1.3 per cent respectively.

Municipalities and economic growth

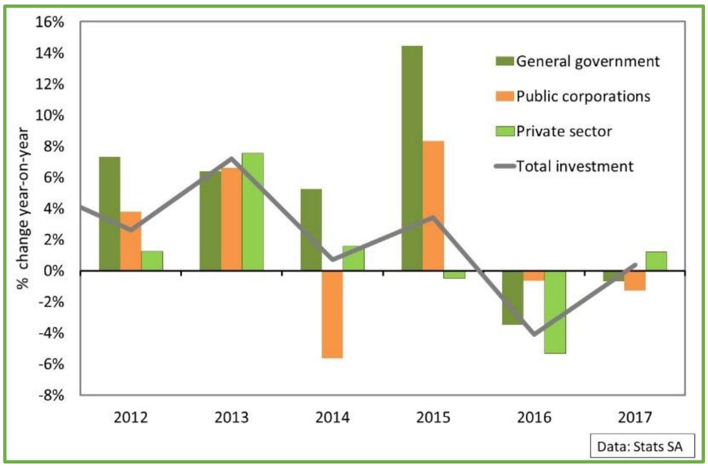
Figure 4: Operating and capital expenditure of national, provincial and local government



Government spending, including operating and capital expenditure, has been slowing across all three spheres of government over the last 7 years. Of particular concern for GDP growth as well as the service delivery is the financial position and performance of municipalities. In 2017 total spending by municipal governments contracted by 2.5 per cent, resulting in an overall decrease in government spending. As municipal spending accounts for more than 37 per cent of total government spending, the reduction in local government spending in 2017 subtracted about 0.2 percentage points from overall economic growth.

The real reduction in municipal spending is, in part, due to slowing growth in municipal revenue collection. In 2017 municipal revenue grew by a mere 3.4 per cent, compared to the average over the previous 5 years of 10 per cent. Slower revenue collection on the part of municipalities is due to a significant decrease in the growth of rates collected, as well as revenue from the sale of electricity. This has contributed to the deteriorating financial health of municipalities.

Figure 5: Investment by sector



Employment

According to the Quarterly Labour Force Survey (QLFS), the official unemployment rate decreased in the first quarter of 2018 to 26.7 per cent from 27.7 per cent recorded for the first quarter of 2017. The number of people officially unemployed decreased by 233 711 (3.8%). The reduction in the official unemployment rate is due to the net increase in the number of employed of 165 273 (1%), and a significant increase in the number of discouraged job seekers (510 057 – 22.4%) over the 12 month period.

Table 2: Key labour statistics – Quarterly Labour Force Survey

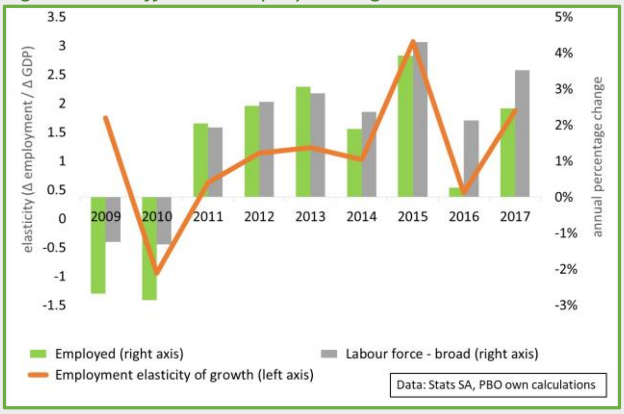
	1Q 2017	4Q 2017	1Q 2018
Labour force ('000s)	**22 426**	**22 051**	**22 358**
Employed	16 212	16 171	16 378
Unemployed - official	6 214	5 880	5 980
Unemployed - broad*	9 291	9 216	9 481
Not economically active ('000s)	**14 634**	**15 474**	**15 320**
Discouraged job-seekers	2 277	2 538	2 787
Other (not economically active)	12 357	12 936	12 533
Rates			
Official unemployment rate (narrow)	27.7%	26.7%	26.7%
Broad unemployment rate*	36.4%	36.3%	36.7%
Youth unemployment** (narrow)	38.6%	38.2%	38.2%
Youth unemployment** (broad*)	48.8%	49.1%	49.7%

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

Economic growth and employment

Whilst economic growth allows for employment creation and a reduction in unemployment, the relationship between growth and employment is not linear. Economic growth may be associated with an increase or decrease in overall levels of employment and unemployment.

Figure 6: Insufficient employment growth



Over the year 2017, the growth in the number of people employed in the economy (2.5%) exceeded economic growth (1.3%), a significant improvement from 2016 where the growth in the number of people employed (0.3%) was lower than GDP growth (0.6%). The employment elasticity of growth – a measure of the degree to which economic growth translates into employment growth – for 2017 (1.9) was the second highest recorded in 10 years. Over the last 10 years, the employment elasticity of growth has averaged 1.1 – for every 1 per cent growth in the economy employment increased by 1.1 per cent. Whilst above zero, this has been insufficient to reduce unemployment.

Over the last 10 years, the labour force has grown by an annual average of 1.9 per cent (broad definition: 2.3%) whilst employment has only grown by an annual average of 1.3 per cent. This has resulted in the unemployment rate increasing from 22.5 per cent (broad: 29.7%) in 2008 to 26.7 per cent (broad: 36.7%) in 2017. To reduce the country's high levels of unemployment, employment growth that is faster, and with a considerably higher employment intensity is required.

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 to 36.4 per cent over the last 12 months to 36.7 per cent. Broadly defined, the number of people unemployed increased by 2 per cent to about 9 481 000.

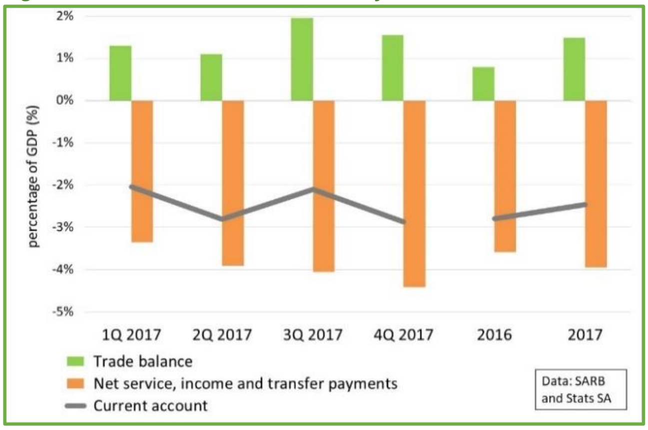
Over the 12-month period, the total number of youth in employment declined by 2 per cent (133 892). The youth unemployment, rate, officially defined, decreased by 0.4 percentage points to 38.2 per cent as the number of discouraged youth job-seekers increased. Youth unemployment, broadly defined, increased to an all-time high of almost 49.7 per cent (3 794 650).

According to the Quarterly Employment Survey for the fourth quarter of 2017 – which surveys formal-sector firms and is therefore a more accurate reflection of formal sector employment than the QLFS – the economy added 18 000 net formal non-agricultural jobs over the year. Four of the eight sectors experienced job losses over the 12-month period. These included logistics, community, social and construction, utilities, manufacturing, and mining.

Current account

South Africa's current account, held in deficit by the persistent net outflow of service, income and transfer payments, improved over 2017 from a deficit of 2.8 per cent recorded for 2016, to 2.5 per cent. The improvement in the current account balance was due to a larger annual trade surplus, yet it was weighed-down by a larger deficit on the net service, income and current transfer payments account. The trade surplus increased over the year from 0.8 per cent in 2016 to 1.5 per cent, as the annual growth in exports (4.8%) exceeded the growth in imports (1.4%). The larger deficit on the net service, income and current transfer payments account was due to a large increase in interest and dividends paid to foreign investors on non-direct investments, and a reduction in income receipts. Over the first quarter of 2018 the current account deficit increased, with growth in imports (9%) exceeding export growth (0.2%). This is likely to place additional pressure on the rand.

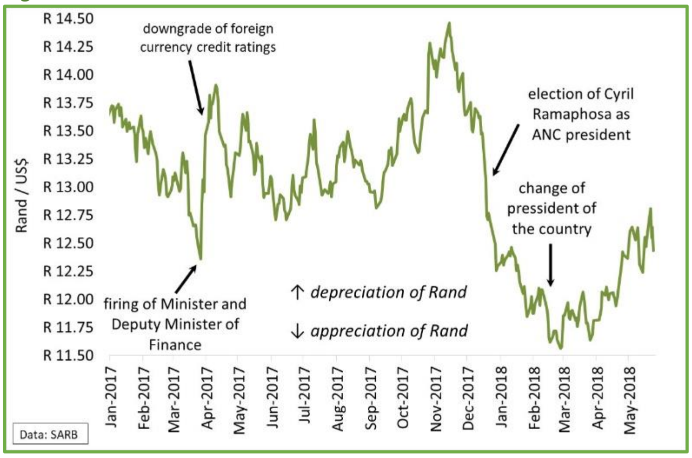
Figure 7: Lower current account deficit



Exchange rate

After weakening against the US dollar in the second quarter of 2017 following the cabinet reshuffle and a credit ratings downgrade, the rand traded in a narrower band until the third quarter of 2017. The rand strengthened significantly against the US dollar along with other emerging market currencies from the fourth quarter of 2017. The rand strengthened by 18 per cent against the US dollar between November 2017 and February 2018, and reached its strongest level against the US dollar in over three years, following the change in the president of the ruling party and subsequently the president of the country. The rand has weakened against the US dollar since March 2018 as portfolio flows to South Africa and other emerging-market economies fell significantly, whilst the US dollar strengthened against most currencies. The rand is likely to experience further weakness later in the year following the likely hike by the US Federal Reserve of its policy rates. Further increases to the oil price, and the effects of South Africa failing to gain an exemption from US steel and aluminium tariffs, and a widening current account deficit will place additional pressure on the rand.

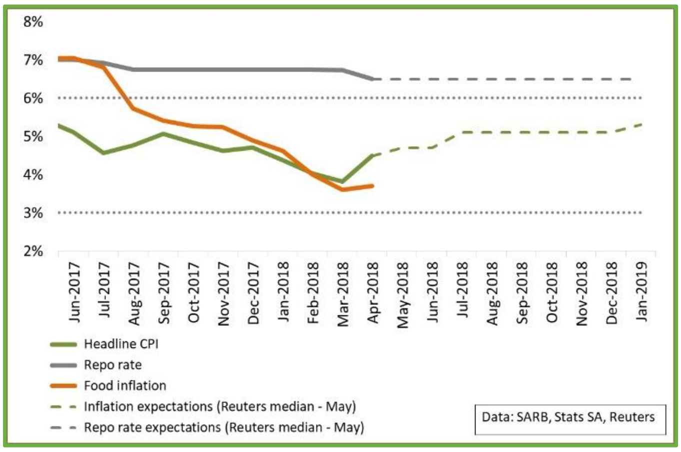
Figure 8: Rand vs US dollar



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, reaching a six-year low in March 2017 (3.8%).

Figure 9: Headline inflation within the target range



The sustained decrease in inflation since April 2017 is due primarily to lower food and fuel prices, the strengthening rand, and depressed demand pressures. Food price inflation, which fell as the agriculture sector recovered from the 2015-2016 drought, has fallen to beneath the upper bound of the headline CPI target range. Inflation is expected to remain below 6 per cent over the next two years. Upside risks to inflation include a higher outlook for the oil price and rand weakness. The impact to date on CPI inflation of the increase in the value-added tax rate and the sugar-tax appear to have been modest.

After keeping the repo rate fixed at 6.75 per cent at its January 2018 meeting, the Monetary Policy Committee of the South African Reserve Bank decreased the repo rate by a modest 25 basis points at its March 2018 meeting, citing the improved inflation and growth outlook. At its May 2018 meeting, the Monetary Policy Committee kept the repo rate fixed at 6.5 per cent, despite headline inflation being expected to remain within the target range over the next 30 months. The Monetary Policy Committee noted increased up-side risks to inflation, including decreased demand for emerging-market assets, a higher oil price, and a strengthening dollar.

Outlook

The 2018 Budget Review presented an upwardly-revised growth outlook from the 2017 MTBPS, combined with additional revenue-raising and expenditure-reducing measures to realise the government's stated medium-term objective of stabilising debt as a share of GDP. Since the tabling of the 2018 Budget Review, the outlook for the South African economy has improved, along with consumer and investor sentiment.

Table 3: Improved growth outlook

GDP growth outlook - calender year*	2018	2019	2020
National Treasury - MTBPS 2017	*1.1%*	*1.5%*	-
National Treasury - Budget 2018	*1.5%* ↑	*1.8%* ↑	2.1%
South African Reserve Bank - September 2017	1.2%	1.5%	-
South African Reserve Bank - January 2018	1.4% ↑	1.6% ↑	-
South African Reserve Bank - May 2018	1.7% ↑	1.7% ↑	2.0%
World Bank - October 2017	1.1%	1.7%	-
World Bank - January 2018	1.1% →	1.7% →	1.7%
World Bank - April 2018	1.4% ↑	1.8% ↑	1.9% ↑
International Monetary Fund - October 2017	1.1%	1.2%	-
International Monetary Fund - January 2018	0.9% ↓	0.9% ↓	-
International Monetary Fund - April 2018	1.5% ↑	1.7% ↑	-
Reuters econometer (median) - October 2017	1.2%	1.5%	-
Reuters econometer (median) - January 2018	1.3% ↑	1.6% ↑	2.0%
Reuters econometer (median) - May 2018	1.8% ↑	2.0% ↑	2.3% ↑

*Growth projections correspond to publication date and not forecast date

Higher economic growth, coupled with a potential improvement in the tax collection following the changes to SARS leadership, may allow for the country to realise and exceed its revenue and fiscal projections over the current year and the medium-term. Risks to realising the country's fiscal projections include slower growth, as well as expenditure pressures emanating from the public sector wage negotiation, and additional obligations on the fiscus from state-owned enterprises. Uncertainty surrounding the global recovery coupled with a widening current account deficit, present risks to the rand and the performance of the economy.