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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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Introduction

This nineteenth edition of the PBO's *Quarterly Economic Brief* (QEB) forms part of the regular outputs of the PBO based on its ongoing research and analysis in support of the oversight work of the Members of Parliament and their Committees. This QEB focuses on the key macroeconomic trends of the second quarter of 2019.

Global economy

The International Monetary Fund's (IMF) World Economic Outlook (WEO) report of October 2019 revised their global growth forecast to 3 per cent for 2019. This global growth estimate is a downward revision of 0.3 per cent from the April 2019 WEO and, if correct, would be its lowest level since the global financial crisis of 2008–09. The WEO report projects growth to increase to 3.4 per cent in 2020 (a 0.2 per cent downward revision compared with the April WEO).

The slowdown in global economic growth can largely be attributed to weaker economic activity in China and India and among advanced economies, in particular the United States (US), the United Kingdom and countries of the euro zone. Despite improvements in employment, the US recovery remains restricted by low aggregate demand and the negative impact of tariffs on exports. Prolonged trade tensions between the United States and China continue to exacerbate the slowdown in global economic activity, which has remained weak since the global financial crisis of 2008. The poor performance of Germany and other European countries, signal warnings that there is a possibility of a recession in the euro area.

Economic growth among emerging economies has anchored global growth for much of 2019. The IMF's October 2019 WEO forecasted that emerging economies would grow by 3.9 per cent in 2019 and above 4.5 per cent in 2020, 2021 and 2022. Growth in emerging Asia, particularly the giants China and India that have been amongst the fastest growing economies of the world, decelerated. Real output growth in China declined from 6.9 per cent to 5.5 per cent in the second quarter of 2019, marking it as the slowest expansion the country has experienced since the fourth quarter of 2008. Real growth in India slowed down further in the second quarter of this year due to a slump in manufacturing output, weaker consumer demand and a drop in private investment growth.

Research by the International Labour Organisation (ILO) sheds light on current global demand constrained, poor economic growth. According to the ILO more than half of the countries of the world have embarked on fiscal consolidation and austerity since 2010. This continued widespread global constraint on government expenditure has no doubt had a synchronous cumulative negative effect on global demand and economic growth.

Table 1: Trends and forecasts in real global growth for the World, selected regions and South Africa

Country/Group Name	2017	2018	2019 Projection	2020 Projection	2021 Projection	2022 Projection
World	3.8	3.6	3.0	3.4	3.6	3.6
Advanced economies	2.5	2.3	1.7	1.7	1.6	1.6
Emerging market and developing economies	4.8	4.5	3.9	4.6	4.8	4.8
South Africa	1.4	0.8	0.7	1.1	1.4	1.8
Source: International Monetary Fund, World Economic Outlook Database, October 2019						

Gross domestic product[1]

Table 2: Quarter-on-quarter percentage change in sectoral performance

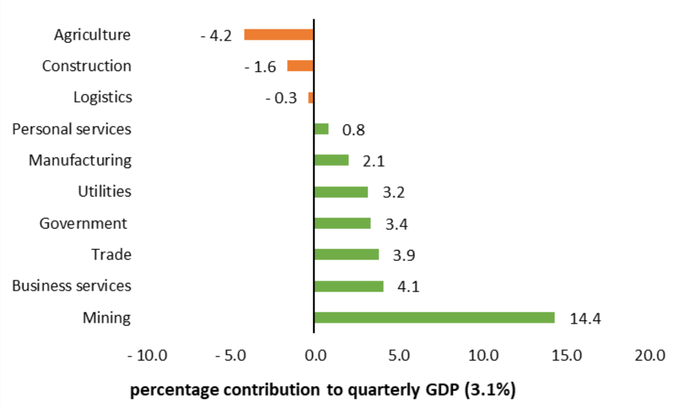
% change q/q	Agriculture	Mining	Manufacturing	Utilities	Construction	Trade	*Logistics	*Business services	Government	Personal services	GDP
2018 - Q1	-33.7	-9.1	-8.4	1.0	-2.3	-3.0	1.4	1.0	2.1	1.2	-2.7
2018 - Q2	-42.3	8.1	1.4	0.7	1.5	-1.2	-3.8	1.7	0.2	0.8	-0.5
2018 - Q3	13.7	-8.9	7.5	0.8	-1.7	3.4	6.8	2.1	1.9	0.6	2.6
2018 - Q4	7.9	-3.8	4.5	0.2	-0.7	-0.7	7.7	2.7	-0.6	1.7	1.4
2019 - Q1	-13.2	-10.8	-8.8	-6.9	-2.2	-3.6	-4.4	1.1	1.2	1.1	-3.2
2019-Q2	-4.2	14.4	2.1	3.2	-1.6	3.9	-0.3	4.1	3.4	0.8	3.1

Data: Stats SA
*Logistics refers to transport, storage and communication
*Business Services refers to finance, real estate and business services

After a sharp contraction in the first quarter of 2019, the South African economy grew from that very low base to 3.1 per cent in the second quarter of the year. In the past five years, a distinct annual cycle has emerged in the seasonally adjusted growth data. For four out of five of these years, the country's growth during the first quarter of each year declined and then grew during the rest of the year.

Mining, finance, trade and government were the main contributors to growth from first quarter 2019 to second quarter 2019. Three industries, namely construction, agriculture and transport, registered a decline in production over the period. Mining was the strongest performer across the quarter, registering a 14.4 per cent increase in value added. due to positive growth in value added in the iron ore, manganese and coal mining subsectors. They increased by 11.8 per cent, 21.2 per cent and 3.6 per cent respectively *(non-annualised numbers)*. Gold value added shrunk by 4.1 per cent *(non-annualised) during the second quarter*.

Figure 1: Sector percentage contribution to the second quarter GDP increase



Finance, real estate and business services- at present the largest services sector in the South African economy, grew by 4.1 per cent. Most of the growth was due to increased value-added in the banking and insurance subsectors. With respect to the trade sector (which includes wholesale and retail trade), wholesale, retail and motor trade sales lifted the economy by 3.9 per cent after the decline of 3.6 per cent last quarter. Government services also experienced its largest increase (3.4 per cent) since the second quarter of 2014. An increase in contract employment in the public sector, particularly during general elections in May, was the main driver of the increase. Electricity, gas and water stimulated by the rise in electricity distributed, increased by 3.2 per cent; manufacturing grew by 2.1 per cent, stimulated by higher output in food, transport and machinery; while personal services increased by 0.8 per cent.

Not all industries fared well however. Logistics dropped slightly by 0.3 per cent and agriculture declined by 4.25 per cent, on the back of lower production of field crops and horticultural products. The construction industry remains gripped in recession, contracting for the fourth consecutive quarter by 1.6 per cent.

Expenditure on GDP

South Africa's household and government consumption each grew by 2.8 per cent in the second quarter of 2019 following a first quarter decline in household consumption (0.6 per cent) and a moderate increase in government consumption (2.0 per cent). Expenditure on gross fixed capital formation (GFCF) in South Africa grew by 6.1 per cent in the second quarter of 2019. This increase in fixed

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

investment was its first positive growth since the fourth quarter of 2017.

Figure 2: Quarterly sector performance

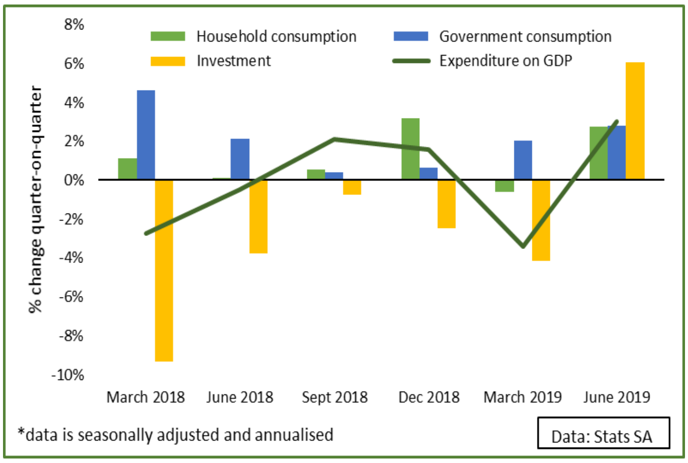
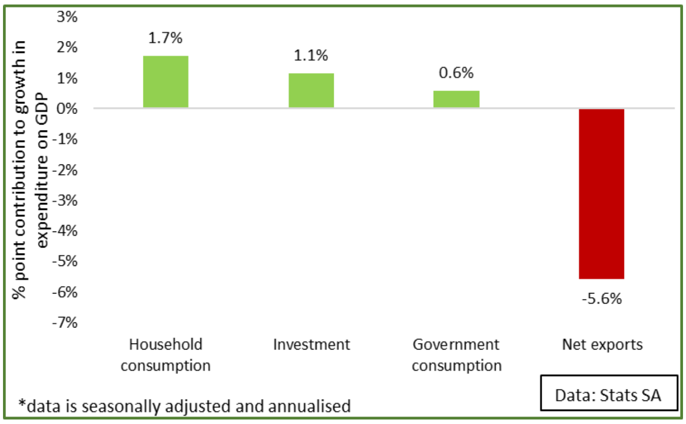


Figure 3 shows the percentage contribution of different expenditure categories to the 3.0 per cent gross domestic expenditure (GDE) expansion in the second quarter of 2019. Household consumption (1,7 per cent) was the largest contributor to real GDE, while net exports made a negative contribution of 5,6 per cent in the second quarter.

Figure 3: Sector contribution to positive second quarter GDP growth



Large inventory build-ups were recorded in mining and trade. While the stock held by firms contribute positively to GDP growth, it may not be a good thing for future growth. Large inventory could be a sign of constrained demand driving lower sales and accumulation, therefore, accumulation of inventory. Firms that have high inventory could lower future outputs while they use up or sell off existing stocks. It may lead to deferment of investment and in the short-run cutting employment.

Investment

Real GFCF by private business enterprises increased by 15.2 per cent in the second quarter of 2019, subsequent to two quarters of decline. The improvement arises from a very low base and mainly reflected increased capital spending on machinery and other equipment, despite weak manufacturing and civil construction business confidence. After an extensive delay, construction is now under way on the majority of projects approved under the Independent Power Producer (IPP) programme.

Table 3: Percentage change in real gross Fixed Capital Formation as per organisation

	2018					2019	
Sector	Q1	Q2	Q3	Q4	*Year	Q1	Q2
General government	-14.1%	-4.3%	-9.0%	-4.1%	-4.4%	-2.1%	-17.3%
Public Corporations	-15.5%	-13.8%	-7.9%	-5.6%	-12.5%	9.6%	-6.7%
Private business	-6.7%	-1.3%	2.9%	-1.4%	2.1%	-7.2%	15.2%
Total fixed investment	-9.3%	-3.8%	-0.7%	-2.5%	-1.4%	-4.1%	6.1%

*Percentage change over the year Source: SARB

Real GFCF by public corporations contracted during the second quarter by 6.7 per cent, following a sizeable increase of 9.6 per cent in the first quarter. Minor increases in capital outlays on construction works and transport equipment were dwarfed by lower capital spending on non-residential buildings and on machinery and equipment. Real GFCF by general government declined further by 17.3 per cent in the second quarter of 2019.

Employment

According to Statistics South Africa's Quarterly Labour Force Survey, which measures formal and informal employment, the official unemployment rate increased again during the second quarter of 2019. Unemployment worsened by 1.4 per cent, from 27.6 per cent in the first quarter of this year to 29 per cent in the second quarter. The number of people who are unemployed (in terms of the narrow definition of unemployment grew by 455 000 in the second quarter, which means that at the end of the second quarter there were 6.7 million people officially classified as unemployed in South Africa.

Overall, compared to a year ago, unemployment increased by 9.4 per cent (573 000), whilst those employed increased by only 0.2 per cent (25 000).

The number of people considered not economically active increased by 3000. The official unemployment rate among the youth also increased in the second quarter to 41.1 per cent, compared to 39.6 per cent in quarter one.

The unemployment rate for females remains higher than that of males. The unemployment rates for both genders increased in the second quarter from their first quarter numbers. The unemployment rate for females increased from 29.1 per cent to 31 per cent, while the unemployment rate for males edged upwards from 25.7 per cent in the first quarter of 2019 to 26.8 per cent.

Table 4: Key labour statistics – Quarterly Labour Force Survey

	2Q 2018	1Q 2018	2Q 2019
All absolute values are in thousands			
Labour force	**22 370**	**22 492**	**22 968**
Employed	16 288	16 291	16 313
Unemployed - official	6 083	6 201	6 655
Unemployed - broad*	9 634	9 994	10 226
Employment by Gender			
Male	9 154	9 100	9 180
Female	7 134	7 192	7 133
Employment by Race			
Black African	12 172	12 201	12250
Coloured	1 716	1 711	1687
Indian/Asian	547	524	530
White	1 853	1 855	1845
Not economically active	**15 462**	**15 791**	**15465**
Discouraged job-seekers	2 864	2 997	2749
Other (not economically active)	12 598	12 793	12716
Unemployment Rates			
Official unemployment rate (narrow)	27.2%	27.6%	29%
Broad unemployment rate*	37.2%	38.0%	38.5%
Male - official	25.0%	25.7%	26.8%
Female - official	29.3%	29.1%	31.0%
Black African - official	30.5%	31.1%	32.7%
Coloured - official	23.3%	22.2%	22.5%
Indian/Asian - official	10.4%	11.4%	11.2%
White - official	8.0%	6.6%	7.4%
Youth**			
Unemployed - official	3 855	3 933	4166
Unemployed - broad	6 160	6 369	6450
Unemployment rate - official	38.8%	39.6%	41.1%
Unemployment rate - broad*	50.4%	51.5%	52.0%

** Youth is defined as age 15 - 34
* The broad unemployment rate includes discouraged job seekers
** Youth is defined as age 15 - 34

Data: Quarterly Labour Force Survey, Stats SA

Employment changes with respect to race in the second quarter: All races experienced an increase in their unemployment rate in the second quarter except for Indian/Asians. Black Africans still have the highest number of unemployed individuals (32.7 per cent), and also have the highest increase in unemployed individuals quarter-on-quarter (1.6 per cent increase). They are followed by Coloureds (22.5 per cent), and then Indian/Asians (11.2 per cent). Whites have the lowest unemployment rate but have experienced the second largest increase in unemployed persons since the first quarter. The unemployment rate increased from 6.6 per cent to 7.4 per cent. The year-on-year unemployment rate, from the second quarter of 2018 to the second quarter of 2019, declined for Coloureds and Whites but increase for Black Africans and Indian/Asians.

TEXTBOX: Average monthly earnings paid to employees in the formal non-agricultural sector

Changes in average formal sector earnings provide one indication of potential changes to the welfare of households. Since, informal sector earnings are difficult to assess, formal sector earnings provide a useful, if incomplete, indication of an important influence on aggregate demand in the economy.

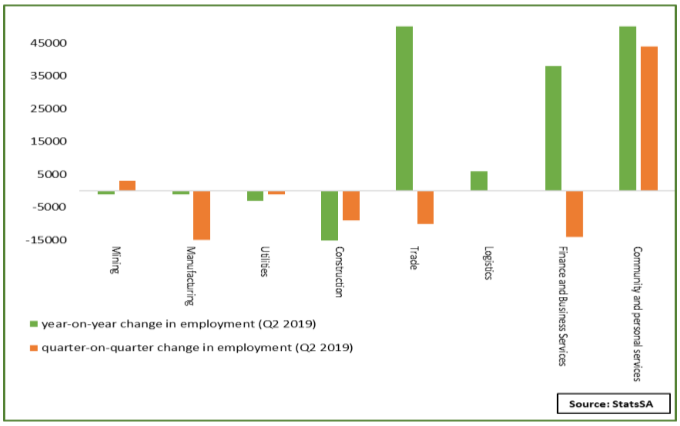
The graph below shows monthly average nominal and real earnings (including bonuses and overtime) per employee in the formal non-agricultural sector.

In real terms, the monthly earnings (which takes into account inflation) per worker grew faster in the public sector compared to the private sector. The public sector real monthly earnings per employee increased by 14.2 per cent (R3 215) from R22 649 in 2010 to R25 864 in 2018. An average annual increase of 2.1 per cent. The private sector real monthly earnings per employee increased by 16.5 per cent (R2 645) from R16 013 in 2010 to R18 659 in 2018. An annual average increase of only 1.3 per cent.

The average annual increases have not provided adequate upward pressure on aggregate demand in the economy. In turn low levels of aggregate demand influences overall employment, investment and economic growth rates. While public sector employees may make up between approximately one-fifth to one-quarter of formal sector employees the average earnings of these workers put upward pressure on aggregate demand while that of private sector employees put downward pressure on

Statistics South Africa's June 2019 QES survey showed that approximately 10 172 000 people were employed in the formal non-agricultural sector of the South African economy. This indicated a total quarter-on-quarter decrease of 2000 employees between March 2019 and June 2019. This decrease was largely due to formal job losses in the following industries: manufacturing (15 000), Business services (14 000), trade (10 000), construction (9 000), and utilities (1000). While the transport industry remained unchanged, there were a few industries that registered increases in formal employment: community services (16 000), mining (3000) and transport (2 000).

Figure 4: Sectoral contribution to employment – Quarterly Employment Survey (QES)

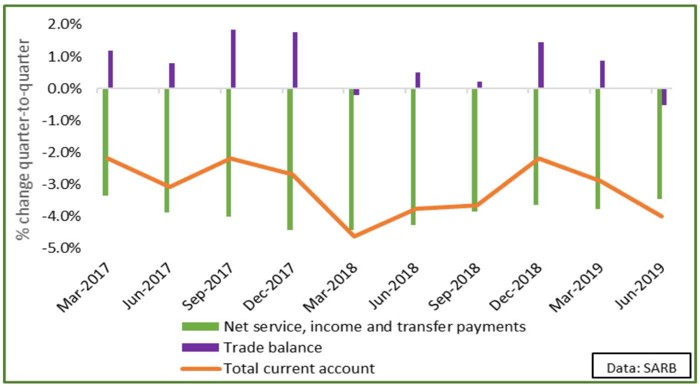


Current Account

The deficit on the current account of the balance of payments increased by R60.5 billion from R143.5 billion in the first quarter of 2019 to R204.1 billion in the second quarter. As a ratio of gross domestic product (GDP), the current account deficit worsened by 1.1 per cent from 2.9 per cent in the first quarter of 2019 to 4.0 per cent in the second quarter.

The current account consists of the trade balance (which is the difference between exports and imports) and financial transfers, including net service, income and transfers payments. The trade balance switched from a first quarter's surplus of R41.9 billion to a deficit of R27.2 billion in the second quarter of 2019. The increase in the value of merchandise imports relative to exports deteriorated the country's trade balance. The higher value of merchandise imports reflected increases in volumes and prices, while the increase in the value of exported goods was driven by higher prices. However, net service, income and transfers payments remained by far the largest component of the current account deficit (approximately 86.8 per cent).

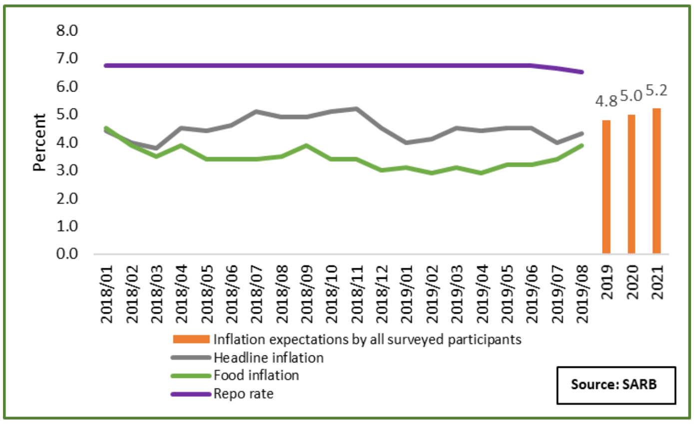
Figure 5: Change in the balance of the current account (as a percentage of GDP)



Inflation and monetary policy

In September 2019, the South African Reserve Bank's Monetary Policy Committee (MPC) kept the repo rate unchanged at 6.5 per cent. The MPC highlighted weaker global economic indicators and low inflation due to weaker economic activity among advanced economies. They said that they remained concerned about medium term growth and employment prospects. They cited escalation in global trade tensions, further domestic supply constraints and/or sustained higher oil prices could generate headwinds to domestic growth. They also said public sector financing needs remain high, exerting pressure on the currency.

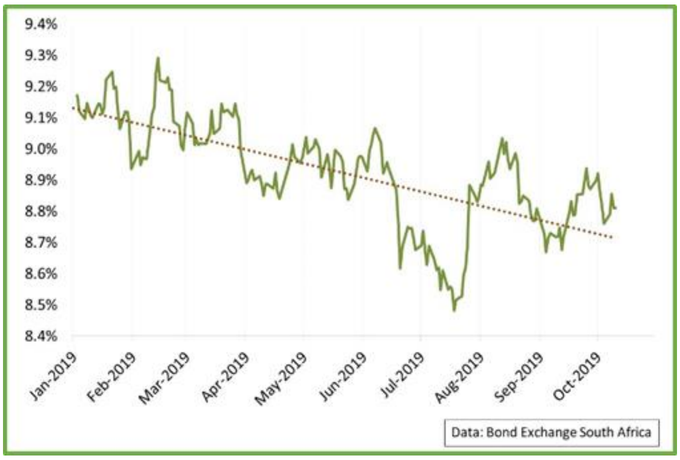
Figure 6: Inflation beneath mid-point of the target range



Sovereign risk and debt outlook

The yield on South Africa's 10-year benchmark bond – an indicator of market sentiment about the riskiness of South African government debt – has generally improved since the beginning of the year. Poor global growth prospects in advanced economies has sustained demand for emerging market assets – including the SA government bonds. Sustained lower domestic inflation – averaging around the mid-point of the SARB's target range – may have also contributed to lowering of yields.

Figure 7: Yield on SA 10-year bond



TEXTBOX: **Monetary and fiscal adjustments and the balance of payments**

The balance of payments (BoP) has a finance account and a current account. If the finance account has a surplus then the current account has to have a deficit, and vice-versa, in order to maintain the country's BoP.

South Africa has been running a current account deficit since 2004. The main contributor to this current account deficit has not been the trade balance but the amounts of financial transfers out of South Africa on the current account. South Africa received relatively large levels of short-term financial inflows on its financial account during the 5 years before the global financial crisis of 2008 and again since the crisis. These short-term inflows on the financial account required the payments of dividends and interest abroad that were financial transfers out of the country on the current account.

One of South Africa's unspoken but potentially serious macroeconomic problems that poses a constraint on sustained economic growth is the likelihood of BoP problems. The constraint to sustained growth is the use of both monetary and fiscal policy to adjust the economy downward when the current account deficit begins to grow. Lowering interest rates and higher government spending could stimulate the economy. Increased real economic activity could lead to a larger BoP deficit as payment for more imports would be added to the outflows of financial transfers that already exist on the current account. In other words, South Africa wants more real economic activity but the possibility of a constrained BoP means that the Reserve Bank and Government puts brakes on growth.

A growing current account deficit indicates potential balance of payments problems in the form of shortages of foreign exchange. As a result of inadequate regulation and management of cross-border financial flows, South Africa now has a catch-22 situation where it is dependent on inflows on the financial account of the balance of payments to cover deficits on the current account, that are largely due to inflows on the financial account.

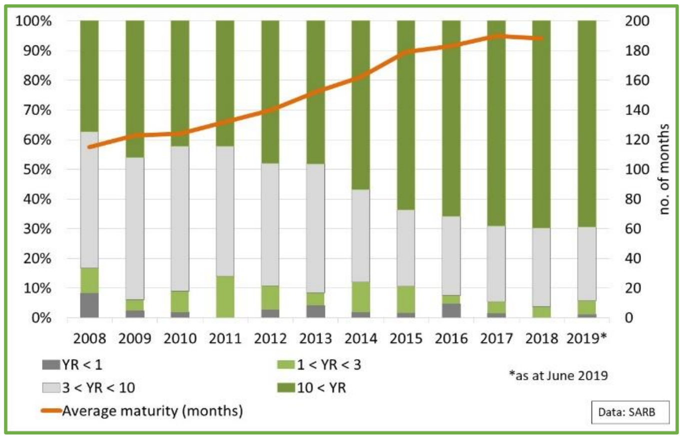
The results from government bond auctions since the beginning of 2019 reflect sustained demand for emerging market assets and the improved domestic inflation outlook, and a change in global appetite for emerging market debt.

Clearing yields on government's 20-year fixed rate bonds averaged around 9.8 per cent since the beginning of 2019, with the average bid-to-cover ratio – an indicator of market appetite for a country's bonds – remaining above 2. Clearing yields increased by about 20 basis points since June, with average bid-to-cover ratios falling as the quantum of domestic debt issued increased along with the announcement of increased fiscal support to financially distressed state owned companies.

Figure 8: Sustained demand for new bond issuance

Government has taken steps to mitigate risks associated with increasing borrowing costs through issuing debt with longer maturity. Since 2008, the weighted average maturity of government debt has increased from 9.6 years to 15.7 years. This means that a smaller share of debt needs to be re-financed over the short term, where borrowing costs are high and uncertain.

Figure 9: Debt maturity profile reduces short-term risk



At present, S&P and Fitch both rate South Africa's foreign and local currency sovereign debt at sub-investment grade. Moody's, which is scheduled to update its rating after the tabling of the 2019 MTBPS, currently rates government's local currency debt at one notch above sub-investment grade.

Bloomberg News reported on 1 October 2019 that foreign ownership of South African government debt had declined to 37 per cent by the end of August 2019, down from 43 per cent of in March 2018. One of very many possible reasons for the decrease in foreign holding of government debt may be that some foreign financiers may be pre-empting a credit rating downgrade.