Parliamentary Budget Office

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

Quarterly Economic Brief

December 2016

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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 development for Members of Parliament following the release of quarterly economic data by Stats SA and the South African Reserve Bank.

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This report incorporates data available up to and including 14 December 2016.

Gross domestic product

Statistics South Africa's GDP data released in December showed that the South African economy grew by a modest 0.24 per cent in the third quarter on an annualised basis. This modest performance follows the 3.5 per cent growth recorded for the second quarter. Compared to the same quarter in 2015, the economy grew by 0.7 per cent. Contractions were observed in the agriculture (3.5%), manufacturing (0.4%) and utilities sectors (1.8%). Compared to the first 9 months of 2015, the economy grew by a mere 0.4 per cent.

The electricity, gas and water sector (utilities) contracted by 2.9 per cent compared to the first 9 months of 2015. This contraction was largely due to lower electricity demand, which is currently at an eight-year low.

The contraction in agricultural output – its sixth consecutive contraction – was due to the effects of the country-wide drought. Over the first 9 months of the year, the agricultural sector contracted by 7 per cent compared to the same period in 2015. The Crop Estimates Committee of the Department of Agriculture, Forestry and Fisheries estimates that the commercial maize crop for the 2015/16 season was about 24 per cent lower than the previous season. Weather conditions across the country are expected to improve in 2017, which may lead to a recovery in the agricultural sector.

Figure 1: Quarterly economic performance

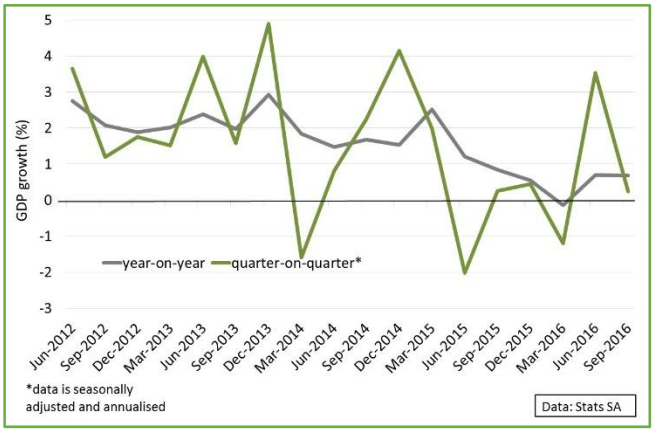
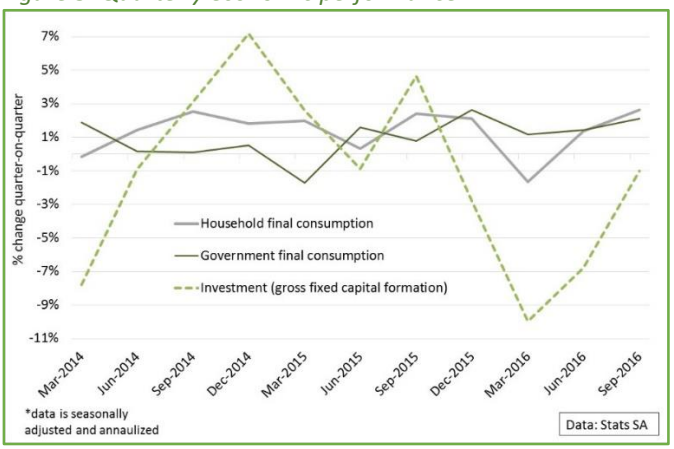


Figure 2: Quarterly economic performance by sector

Gross domestic expenditure

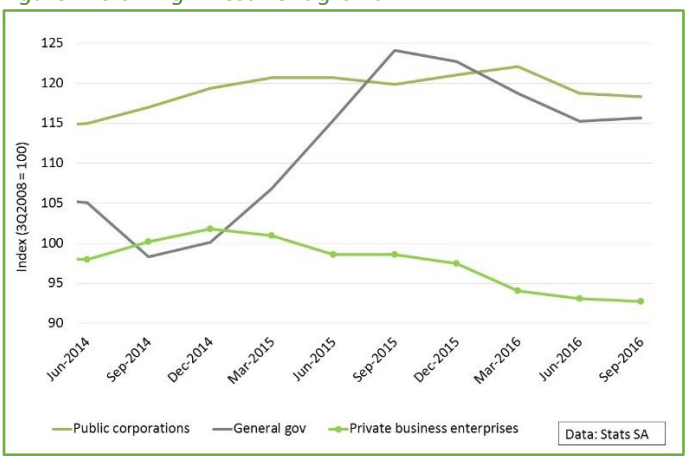
After contracting over the first two quarters of 2016, real gross domestic expenditure grew by 8.1 per cent in the third quarter of 2016. Modest growth was recorded for government consumption expenditure (2.1%) and final household consumption (2.6%). The increase in government consumption expenditure was in part due to increased spending by the Independent Electoral Commission (IEC) for the 2016 municipal elections held in August. The significant decline in exports (26.4 per cent) subtracted from the quarter's growth.

Figure 3: Quarterly economic performance



Total investment in the economy contracted by 1 per cent - its fourth consecutive contraction. Investment by private corporations has been slowing over the past two years. While investment by general government and public corporations compensated for the slow-down in private sector investment, government spending has been slowing over the past 12 months, possibly due to the effects of fiscal consolidation.

Figure 4: Slowing investment growth



Employment

Rising unemployment indicates continued weakness in the South African economy. The Quarterly Labour Force Survey (QLFS) for the third quarter of 2016 showed that unemployment in South Africa is at its highest level since the Survey started in 2008. The Survey estimated the official rate of employment at 27.1 per cent - a 1.6 per cent increase. Over the four quarters, 454 873 individuals joined the ranks of the unemployed. The broad unemployment rate, which includes discouraged job-seekers, is estimated at 36.3 per cent, 1.9 per cent higher than recorded a year ago. Broadly defined, the number of people unemployed increased by 711 816. Youth unemployment, officially defined, increased by 2.5 per cent over the year to 38.2 per cent. Broadly measured, youth unemployment is 48.6 per cent.

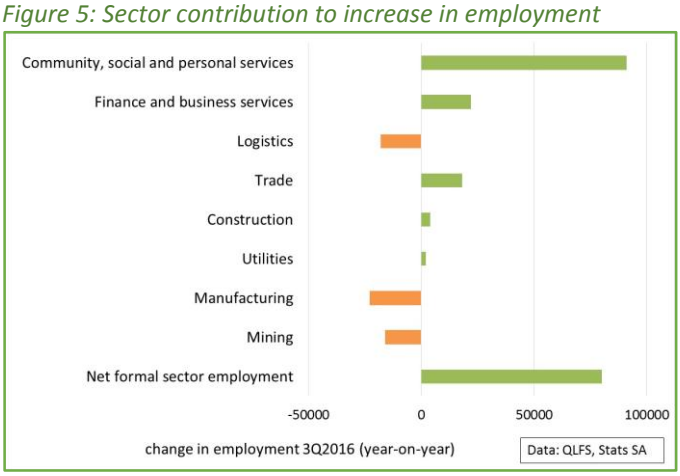
Compared to last year, the formal sector added 98 900 jobs, however the informal sector shed 79 500 jobs, resulting in a net employment increase of only 4 755 jobs. The Quarterly Economic Survey (QES) for the third quarter of 2016 indicated a similar increase in formal sector employment. The Quarterly Economic Survey for the third quarter indicates that the economy added 80 000 formal non-agricultural jobs. The logistics, manufacturing and mining sectors all shed jobs, while the other sectors added jobs. The significant increase in employment from "community, social and personal services" was due to the increase in temporary employment from the IEC for the 2016 municipal elections which took place in August.

Table 1: Key labour statistics - QLFS

	3Q 2015	2Q 2016	3Q 2016
Labour force ('000s)	**21246**	**21179**	**21706**
Employed	15828	15545	15833
Unemployed - official	5418	5634	5873
Unemployed - broad*	8304	8880	9016
Not economically active ('000s)	**14867**	**15412**	**15044**
Discouraged job-seekers	2226	2526	2291
Other (not economically active)	12641	12886	12753
Rates			
Official unemployment rate (narrow)	25.5%	26.6%	27.1%
Broad unemployment rate*	34.4%	36.4%	36.3%
Youth unemployment** (narrow)	35.8%	37.5%	38.2%
Youth unemployment** (broad*)	46.1%	48.8%	48.6%

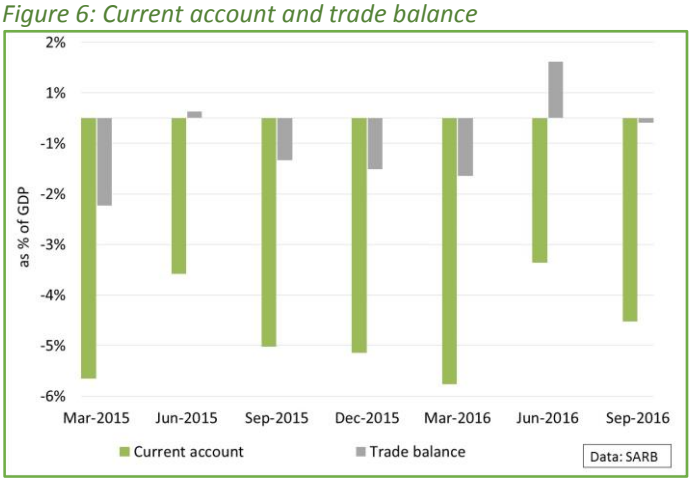
* The broad unemployment rate includes discouraged job seekers
** Youth is defined as age 15 - 34
Data: Quarterly Labour Force Survey, Stats SA

Figure 5: Sector contribution to increase in employment



Current account

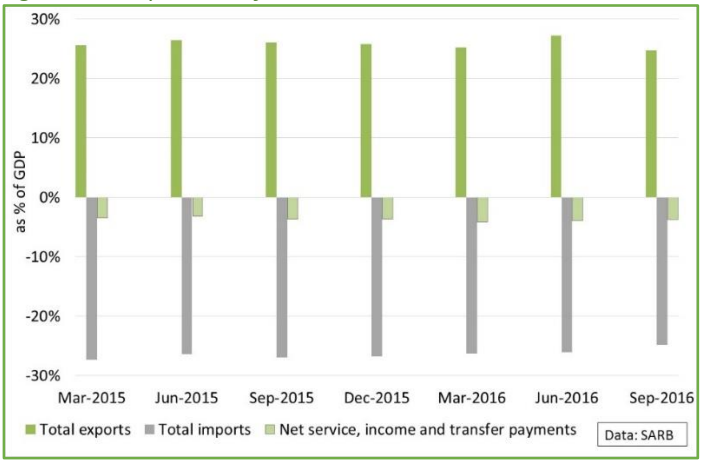
Figure 6: Current account and trade balance



South Africa's current account deficit increased during the third quarter to 4 per cent from 2.9 per cent of GDP recorded in the second quarter. The deterioration in the current account was largely due to a decline in exports. Total exports over the

quarter fell by 7.5 per cent (R87.5 bn) compared to the second quarter. Although imports also decreased (3.2% : R35.9 bn), the decrease in exports was larger, resulting in the trade account swinging from a surplus to a deficit. While dividend and interest payments were the sole cause of the current account deficit in the previous quarter, the trade deficit contributed to the current account deficit during the third quarter. Dividend and interest payment remained largely unchanged compared to the previous quarter.

Figure 7: Components of the current account



Exchange rate

Exchange rate volatility remains an important concern for South Africa's economic performance. Like other commodity exporting countries South Africa experienced strengthening of its currency during 2016. The rand strengthened 10.5 per cent against the US dollar over the first 11 months of the year. Although the improvement is significant, it came off a low base due to the large depreciation in the rand following changes in the Ministry of Finance in December 2015. The rand strengthened from the January high of R16.90 to around R14.00 at the end of November. It reached its 2016 peak against the US dollar in mid-August (R13.27), however this was short-lived due to renewed uncertainty over the position of the Minister of Finance.

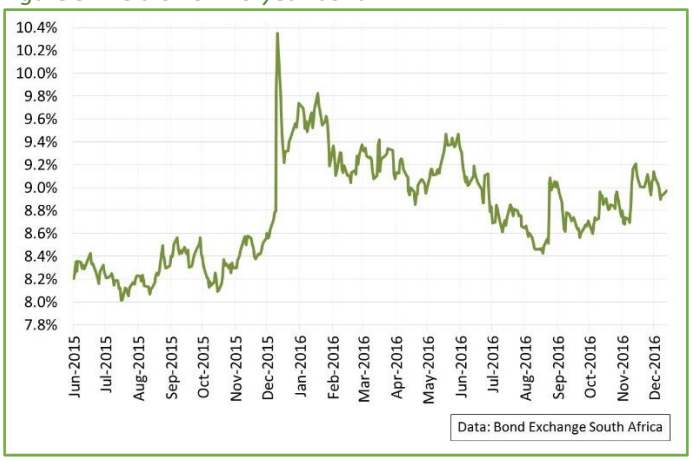
Figure 8: Overall rand improvement against US dollar

Improved growth in the second quarter, increased mining output, and the decision of credit-ratings agencies to not downgrade the country's foreign currency rating provided support to the rand. Global factors, which remain uncertain seemed to support the rand. These factors include, partial recovery in commodity prices, and speculation in financial markets that central banks will remain accommodative for longer, allowing for a continuation of capital flows into emerging market economies.

Sovereign risk

The yield on South Africa's 10 year benchmark bond – an indicator of the riskiness of South African government bonds – decreased from the January high of 9.5 per cent to a 2016 low of 8.4 in mid-August. Part of this improvement was due to increased investor appetite for emerging market assets, especially due to looser monetary policy in advanced economies, and the US Federal Reserve delaying rate hikes. Bond yields have increased since August, influenced by global and domestic political uncertainty.

Figure 9: Yield on SA 10-year bond



South Africa's credit rating

Following the 2016 MTBPS, which identified measures already taken and proposed additional measures to maintain the country's investment-grade status, the three main credit-ratings agencies affirmed the country's credit-ratings at an investment grade.

- In November Fitch affirmed the country's long term debt rating at BBB-, one notch above non-investment grade, but revised its outlook from stable to negative.
- In December S&P affirmed the country's foreign currency debt rating (BBB-) one level above sub-investment grade, with a negative outlook.
- Also in December. Moody's left the country's foreign currency long term and short term debt ratings unchanged – two notches above sub-investment grade.

The credit ratings agencies noted political instability, weak growth, increasing debt-to-gdp level, and risks presented by SOEs as key reasons for the negative outlook.

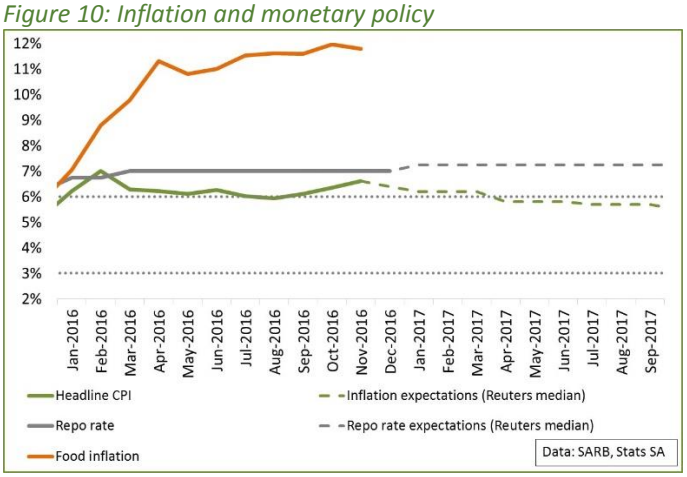
Table 2: South Africa's foreign currency credit rating

Fitch	Moody's	S&P		Countries (selected)	
A+	A1	A+	Upper medium grade	Slovakia	Japan
A	A2	A		Ireland	Peru
A-	A3	A-		South Korea	Botswana
BBB+	Baa1	BBB+	Lower medium grade	Thailand	Mexico
BBB	**Baa2**	BBB		Indonesia	Colombia
BBB-	Baa3	**BBB-**		**South Africa**	Kazakhstan
BB+	Ba1	BB+	Non-investment grade speculative	Turkey	Russia
BB	Ba2	BB		Brazil	Croatia
BB-	Ba3	BB-		Bangladesh	Bolivia
B+	B1	B+	Highly speculative	Armenia	Honduras
B	B2	B		Ethiopia	Angola
B-	B3	B-		Mongolia	Iraq
CCC	Caa1	CCC+	Substantial risks	Venezuela	Mozambique
	Caa2	CCC	Extremely speculative	Cuba	Greece
	Caa3	CCC-	In default with little prospect for recovery	Puerto Rico	Ukraine

Inflation and monetary policy

After reaching a seven year high in February (7%), headline inflation – as measured by the consumer price index (CPI) for all urban areas – fell within the South African Reserve Bank's (SARB) 3 to 6 per cent target range in August (5.9%) for the first time in eight months. Inflation has since started to increase again. Headline inflation measured 6.4 per cent in October and 6.6 per cent in November, which is below the year-to-date average of 6.3 per cent. The higher inflation is in part due to high food price inflation. Food price inflation, due to the effects of the drought, has averaged 10.6 per cent since the beginning of the year, and increased to a high of 12 per cent in October. The SARB forecasts inflation to peak at 6.6 per cent in the fourth quarter of the year, and to fall below the 6 per cent upper bound of the it's inflation target in the second quarter of 2017. This is in line with market expectations. Results from the November Reuters poll, indicate that CPI is expected to fall below 6 per cent in the second quarter of 2017.

Figure 10: Inflation and monetary policy



After increasing the repo rate at its January and March meetings, the Monetary Policy Committee kept the repo rate fixed at 7 per cent at its May, July, September and November meetings. Since the beginning of the current hiking cycle the Monetary Policy Committee has increased the repo rate by a cumulative 200 basis points. The Monetary Policy Committee cited the relatively stronger rand, continued low exchange rate pass through, as well as an improved outlook for food prices in its decision not to increase the repo rate. The Monetary Policy Committee have also signalled that the current hiking cycle may end soon.

Outlook

Eight years since the global financial crisis, the global economy still struggles to build momentum with growth prospects remaining weak. Political uncertainty and continued financial market instability in developed economies may lead to continued volatility and risk in global financial markets that worsen conditions for developing countries. The IMF expects the global economy to grow by 3.1 per cent in 2016, and by 3.4 per cent in 2017. Slower global growth has put further downward pressure on global interest rates, as monetary policy is now expected to remain accommodative for longer. Increased global liquidity, combined with the decision of credit ratings agencies to maintain South Africa's foreign currency credit ratings at investment grade, offers the South African economy some respite. Low commodity prices and slow growth in advanced economies have negatively affected emerging-market economies. The IMF expects emerging market and developing economies to grow by 4.2 per cent in 2016, and 4.6 per cent in 2017. There is however considerable divergence in the performance of and prospects for emerging-market and developing countries. For example, China and India are expected to continue subdued growth of between 6 and 7 per cent respectively, while Russia and Brazil are in recession, with some signs of improvement.

Table 3: Revised SA growth outlook

GDP growth outlook	2016	2017	2018
National Treasury - MTBPS 2016	*0.5%*	*1.3%*	*2.0%*
South African Reserve Bank - September 2016	0.4%	1.2%	1.6%
Bureau of Economic Research - 4Q 2016	0.3%	1.1%	1.9%
International Monetary Fund - October 2016	0.1%	0.8%	-
World Bank - September 2016	0.4%	1.1%	1.8%
Reuters econometer (median) - November 2016	0.4%	1.1%	1.8%

The South African economy will experience its slowest growth rate in seven years in 2016. Updated forecasts indicate that the economy will grow between 0.1 and 0.5 per cent in 2016, and between 0.8 and 1.3 per cent in 2017. The 2016 MTBPS, in a bid to prevent a downgrade of the country's credit ratings to sub-investment grade, proposed expenditure and revenue measures to realise the country's fiscal consolidation targets. These measures appear to have prevented a credit ratings downgrade at this stage. However, the MTBPS's proposed expenditure and revenue measures are likely to have a dampening effect on investment and economic growth.