2018 | 19

ECONOMIC UPDATE

QUARTER 2

Together, Moving Gauteng City Region Forward

GAUTENG PROVINCE
TREASURY
REPUBLIC OF SOUTH AFRICA

Introduction

The International Monetary Fund (IMF) current forecasts that global growth will reach 3.9 per cent in 2018, driven by the continued expansion in advanced economies. However, overall global economic outlook remains mixed with the key risk being the global trade tensions which have caused uncertainty in global markets, particularly for emerging markets. The full impact of this remains uncertain, but will be key over the medium term.

In this context, emerging markets such as South Africa, continue to face significant shocks such as those emanating from the latest crisis (the “Turkey Crisis”) which have caused depreciation in their currencies. For South Africa specifically, this depreciation is coupled with a Gross Domestic Product (GDP) recession, and continuing high unemployment. This recession was driven mainly by contractions in mining and agriculture industries’ GDP. However, GDP is expected to recover with economic growth for 2018 and 2019 expected to be positive.

Although at a lesser magnitude, Gauteng GDP also entered recession in the second quarter. The Gauteng recession was as a result of contractions in government services and trade GDP. For this reason, Gauteng is expected to lead the overall recovery for the country. The province still faces significant challenges with high levels of unemployment.

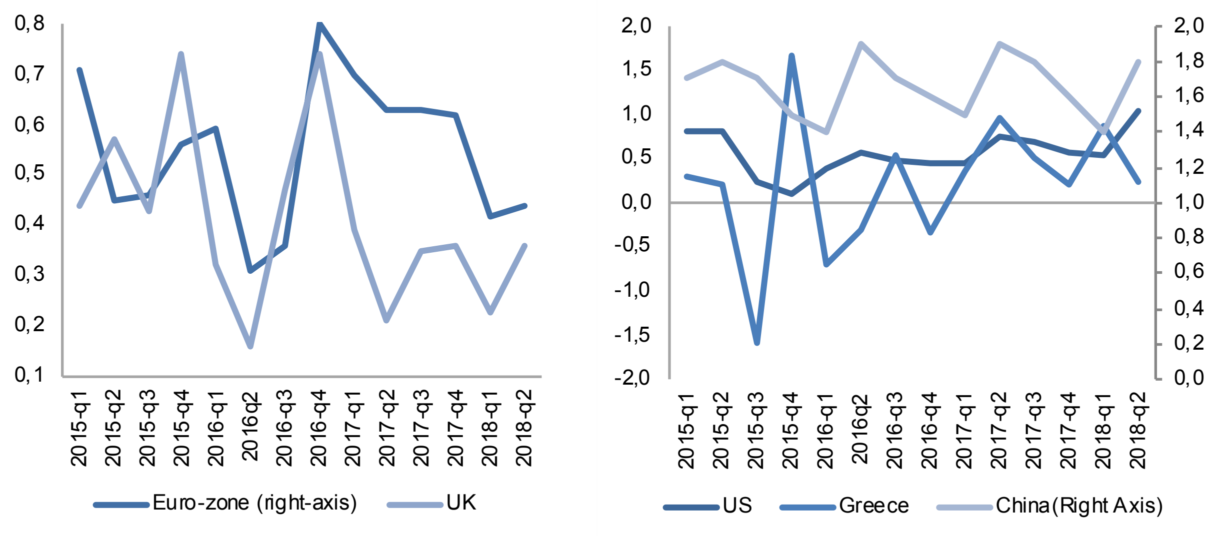
This edition of the Economic Update is separated into three parts. First, current global economic developments are discussed, followed by the South African economic developments. Finally, a discussion on the Gauteng economy follows.

Global Economic Developments

Global Growth on the Up

The IMF projects that the global economy will grow by 3.9 per cent in 2018 and 2019. The current global cyclical upswing is approaching a two year-mark. However, the growth is expected to be less broad than initially expected in the forecasts made in the first quarter of 2018. The less even forecasted growth, is hinged by downside global risks which developed in the beginning of the year.

Figure 1: Global Major Economies GDP (%)



Source: OECD, 2018

Figure 1, shows that most the major global economies, recovered from the 2018 first quarter knock which was seen across in most parts of the global economy. The leaders of this growth being China and the United States (US).

US Growth Improves

The US economy is growing steadily, despite the slight fall in the first quarter of 2018. US growth is in the longest expansion on record since the financial crisis.[1] However, like with other countries, the productivity growth is below that which was recorded in the previous expansions. This is due to weak investment growth. Private consumption remains robust, given strong labour market conditions, wealth gains, and high levels of consumer confidence and business confidence. Given these factors, the US economy is expected to grow further in the upcoming quarters of 2018 and growth will be further boosted by tax reforms that will increase real disposable income, which will further support consumption growth.

Greece in Recovery

Although the economic growth in Greece fell from 0.85 per cent in the first quarter to 0.22 per cent in the second quarter, Greece is on a recovery path after a deep depression between 2008 and 2016. This is as the pace of reforms has accelerated and broadened in the last two years.[2] There has been major fiscal adjustment to Greece's finances and this has strengthened the fiscal credibility and reduced uncertainty. The recovery is underpinned by strong competitive exports,

[1] Organization for Economic Cooperation and Development. (2018). *OECD Economic Surveys: USA.* France. Paris
[2] Organization for Economic Cooperation and Development..(2018). *OECD Economic Surveys:Greece.* France. Paris

resulting from labour market reforms. There is also an increase in employment and labour force participation, which is boosting the household income.

Brexit Continues to Unfold

The withdrawal process of United Kingdom (UK) from the European Union (EU) which is known as Brexit, is gaining momentum. This is as EU diplomats are more optimistic that the deal of this exit can be made possible.[3] However, this transition is not considered to be a major macro-economic risk for the EU, but the impact will be more pronounced in the UK.[4] It is expected that UK GDP will be reduced by an estimated 3.3 per by 2020. The reduction on EU's GDP is expected to be a 1 percentage point(pp) by 2020. Furthermore, the impact of Brexit will differ across member countries, with countries like Ireland expected to experience severe impact.

The transition period will last until the 31st of December 2020. Key to the transition are the setting out transitional arrangements, developing a framework for future relationships, and the preparing of EU institutions for the UK's withdrawal. Brexit will also have significant consequences for the EU's finances, as the UK is one of the biggest net payers to the EU budget. Nevertheless, UK has committed itself to pay its contributions until 2020, to ensure financial stability of the EU. When UK stops their contributions to the EU, the EU's budget will have a gap of about 7 per cent (EUR 10 billion).

Global Trade Tensions

The US president Donald Trump decided to strike a trade deal with Mexico, after he had sparked bilateral tensions with several US trade partners.[5] These tensions have increased the risk of countries imposing tariff barriers on US-imports, and vice versa. This is likely to have a negative effect on global economic growth through the reduction of trade, and lower demand for goods as a result of higher prices. However, the Mexico deal was accompanied by threats from the US president, that he will be scrapping North American Free Trade Agreement (NAFTA) with Canada by imposing tariffs on Canada's imports.

According to Bloomberg estimates, if the US raises its import costs by 10 per cent and the rest of the world retaliates by raising tariffs on imports received from US, the cost will be 0.5 per cent of the global GDP by 2020[6]. This is about USD 470bn. The US import tariffs hike alone will result in

---

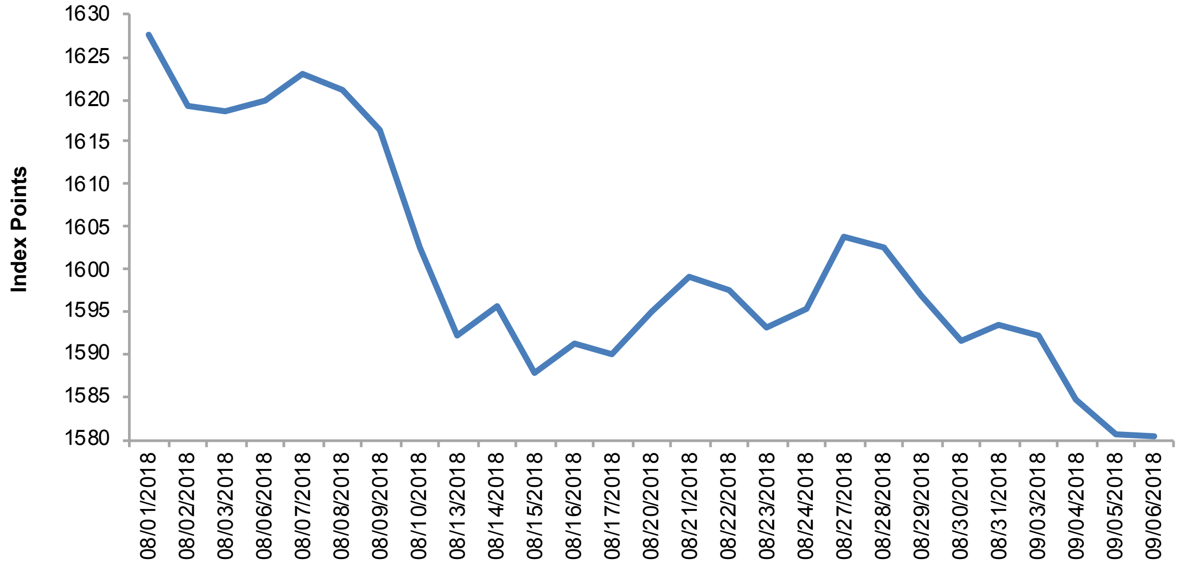
3 Bloomberg.(2018). *Brexit Bulletin: Momentum Is Growing*. Accessed(September 2018). Available at: https://www.bloomberg.com/news/articles/2018-09-13/brexit-bulletin-momentum-is-growing
4 Organization for Economic Cooperation and Development.. (2018).*OECD Economic Surveys: European Union*. France. Paris
5 The Guardian. (2018). *Trump announces US-Mexico trade deal, setting stage for Nafta overhaul*. Accessed(September 2018). Available at: ttps://www.theguardian.com/us-news/2018/aug/27/trump-nafta-us-mexico-trade-understanding-latest
6 Bloomberg. (2018).*How bad could it get? Counting the cost of a global trade war*. United States. New York

higher US import costs and thus negatively affect US demand. Consequently, business investment will decline, due to lower demand. Lower demand will also negatively affect the US's trading partners. Therefore, causing US trading partners to retaliate by also imposing tariffs on US imports and this will affect global value chain.

Emerging Markets' Currencies Under Pressure

On the 10th of August, the Turkish currency (Turkish Lira) fell by 13 per cent, this was its largest one-day fall since the global financial crisis and this sparked fear amongst investors, who reacted by selling off emerging markets' assets.[7] Consequently, the currencies of most emerging markets also fell in August. The Morgan Stanley Capital International (MSCI) emerging market currency index fell by 2.2 per cent in August. Figure 2 below shows daily performance of the MSCI emerging market currency index.[8]

Figure 2:MSCI Emerging Market Currency Index



Source Bloomberg, 2018.

Figure 2, shows that the MSCI emerging market currency index also fell on the 10th of August when the Turkish Lira took a knock; the index fell by 13.59 index points (ip).[9] This came after the US President Donald Trump, announced that he had approved metals tariffs to be doubled.

---

[7] Reuters. (2018). *Emerging market contagion back with a vengeance as Turkey pops.* Accessed(September 2018). Available at: https://www.reuters.com/article/us-turkey-markets-emerging-contagion-ana/emerging-market-contagion-back-with-a-vengeance-as-turkey-pops-idUSKBN1KV218

[8] Bloomberg News. (2018). *August Turns Ugly for Emerging Markets as Currency Crises Spread*. Accessed(September 2018). Accessed at: Bloomberg Terminal

[9] CNBC.(2018). Turkish lira collapse continues, hits new record low as central bank takes steps to ease pain. Accessed(September 2018). Accessed at: https://www.cnbc.com/2018/08/13/turkish-lira-turkey-currency-hits-new-record-low.html

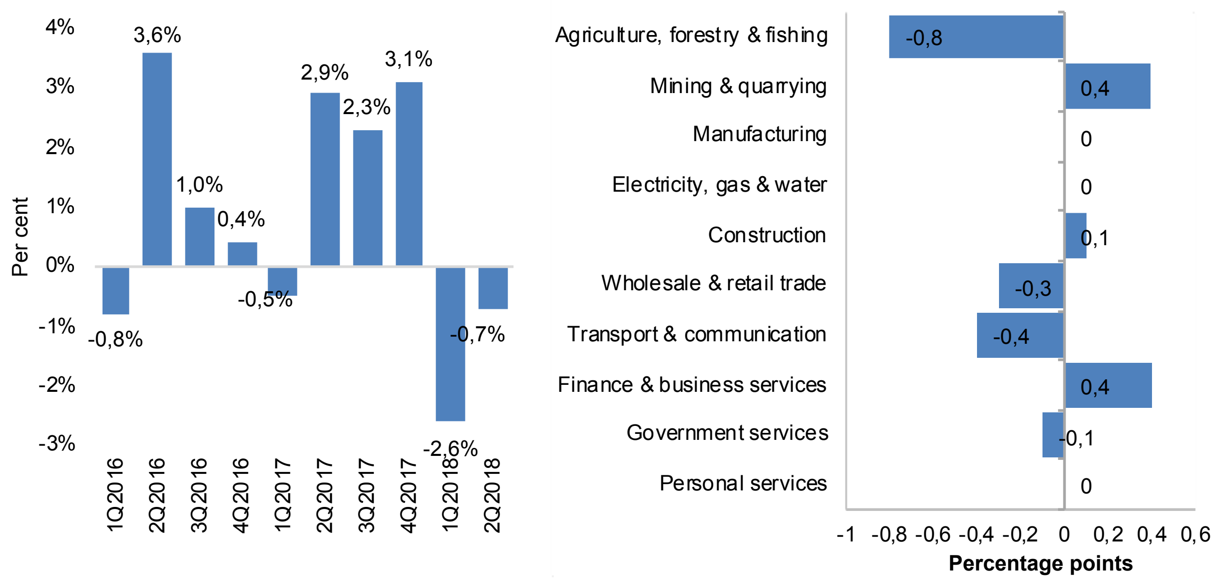
However, Trump's announcement was just a trigger for economic troubles for Turkey. These include President RecepTayyip Erdogan, taking control of the central bank and the high foreign currency dominated debt. MSCI emerging market currency index was not only affected by the Turkish Lira, as it further went down by 10.56ip in the wake of other emerging market currencies falling, following the Turkish knock. In Asia, the Indonesian Rupiah fell to its lowest since 1998 and Indian Rupee had its first monthly low in three years. This has also affected the global financial markets with main stocks such as Dow-Jones Industrial and Standard and Poor's 500 index declining significantly.

South African Economic Developments

GDP in Recession

South Africa's GDP declined by 0.7 per cent quarter-on-quarter (q-o-q) seasonally adjusted and annualised in the second quarter of 2018.[10]This was after it had a revised contraction of 2.6 per cent q-o-q in the first quarter of 2018. As per consensus in the field of economics, two consecutive negative growths in the GDP could be signalling a recession. In these two quarters of 2018, South Africa's economy was exposed to both global and domestic factors which suppressed growth. These factors include drought, global trade tensions, weaker domestic exchange rate and higher global oil price.

Figure 3: GDP Growth Rate and contributions



Source: Statistics South Africa, 2018

[10] Statistics South Africa. (2018). *Gross Domestic Product-second Quarter 2018.South Africa.* Pretoria

Figure 3, shows that agriculture subtracted from GDP most, with negative 0.8 pp, this sector had a contraction of 29.2 per cent in the second quarter. It was affected by the drought in the western parts of South Africa. The transport sector was the second largest GDP subtractor (-0.4pp), this was due to the rising global oil prices which placed an upward pressure on domestic fuel prices. The other sectors which subtracted from GDP were, trade (-0.3pp) and government services (-0.1pp).

A rebound in mining after being one of the main contributors to the contraction of the economy in the first quarter, lifted the economy in the second quarter by 0.4pp. Finance also contributed the same amount. The mining sector was boosted by the weaker rand-dollar exchange rate and higher commodity prices. The construction sector's contribution of 0.1pp was supported by the rise in the construction of non-residential buildings.

South Africa is Likely to Avoid Credit Downgrade in the Medium term

In September, Moody's suggested that the South African economy is gradually recovering and this will be a positive factor in the consideration of South Africa's credit rating for future credit rating reviews.[11] Despite two quarters of negative economic growth, growth for the year is expected to be positive, but below one per cent. The current positive business confidence in South Africa is expected to be sustained until next year, simply because South Africa will use the growing global economy to offset the sluggish domestic activity.

However, the risks remain as the fiscus was under pressure before the recession and this could worsen given the recent growth. The budget deficit is expected to be 4 per cent for this financial year. This is higher than its initial budget, but is lower than last year. Moreover, the government debt-to-GDP is expected to remain broadly stable at 55 per cent.

Unemployment Slightly Higher in the Second Quarter

The unemployment rate slightly increased to 27.2 per cent in the second quarter of 2018, after it remained unchanged between the fourth quarter of 2017 and the first quarter of 2018 at 26.7 per cent. The rise in unemployment rate resulted from an increase of 102 thousand in the number of unemployed people. Given the lack of employment growth in the second quarter of 2018, 77 thousand more people were discouraged to look for work which then contributed to a sizeable

[11] Business Day. (2018). *'Worst is behind us': Moody's expects slow recovery for SA.* Accessed(September 2018). Available at: https://www.businesslive.co.za/bd/economy/2018-09-13-worst-is-behind-us-moodys-expects-slow-recovery-for-sa/

amount to those who are Not Economically Active (NEA). However, on a year-on-year basis, the number of unemployed people declined by 1.5 per cent and number of employed increased by 1.2 per cent.

The working age population increased by 154 thousand, with a portion of this number contributing to the increase of 12 thousand in the labour force. However, the inability of the economy to absorb new population to the labour market, caused the labour absorption rate to decline by 0.4pp in the second quarter of 2018.[12] There was also a lesser participation in the labour market, as the labour participation rate decreased by 0.2pp to 59.1 per cent in the same period.

Table 1: Labour market indicators

	2018Q1	2018 Q2	Quarter-on Quarter Change
	Thousands		**Per Cent (%)**
Labour Force	22358	22370	0.1
Employed	16378	16228	-0.5
Unemployed	5980	6083	1.7
Discouraged Work Seekers	2787	2864	2.8
			Percentage Points
Unemployment rate (%)	26.7	27.2	0.5
Labour Absorption rate (%)	43.5	43.1	-0.4
Labour Participation rate (%)	59.3	59.1	-0.2

Source: Statistics South Africa, 2018

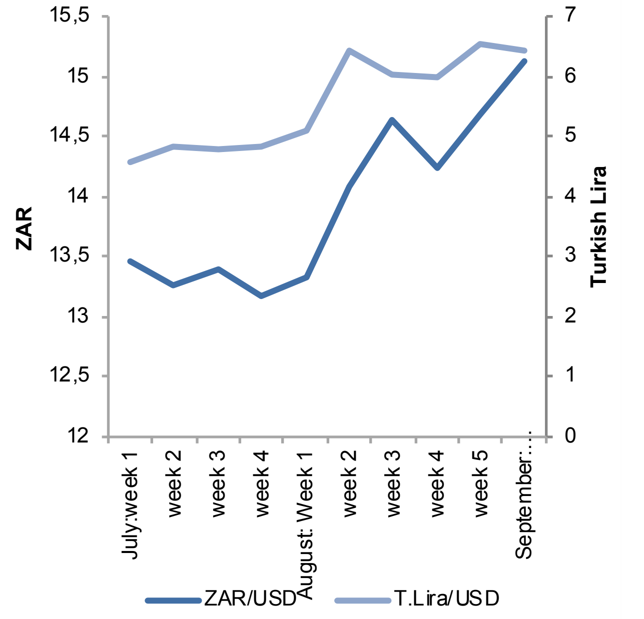
As shown above, employment decreased by 0.5 per cent between the first quarter and second quarter. This was due to job losses in the formal sector, informal sector and agriculture, shedding 35 thousand, 73 thousand and 3 thousand jobs respectively. Private households was the only employment category which gained jobs (22 thousand). There could be more job losses in agriculture, since the economic performance in this sector declined in the first and second quarter due to droughts in the western parts of South Africa.[13]

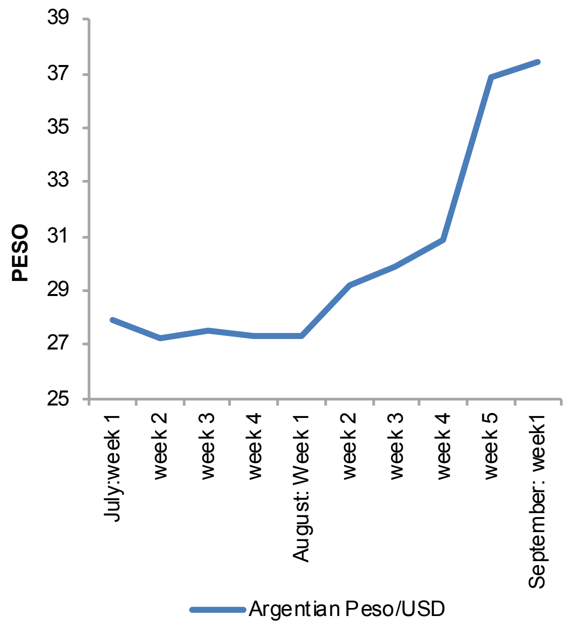
[12] South African Statistics. (2018).Quarterly Labour Force Survey-Quarter Two:2018. South Africa. Pretoria
[13]Statistics South Africa. (2018). Gross domestic product - Second quarter 2018. www.statssa.gov.za

Rand Performing in-line with Currencies in other Emerging Markets

The South African rand (ZAR) depreciated in August as investors sold off emerging assets, fearing losses as a result of the Turkey crisis.[14] The rand has reached its lowest level in nine months. In addition, the strengthening of the US dollar (USD) also did not assist, as it put more pressure on the ZAR, as investors seek higher returns by speculating higher yields in the US and Europe.

Figure 5: Emerging Market Currencies





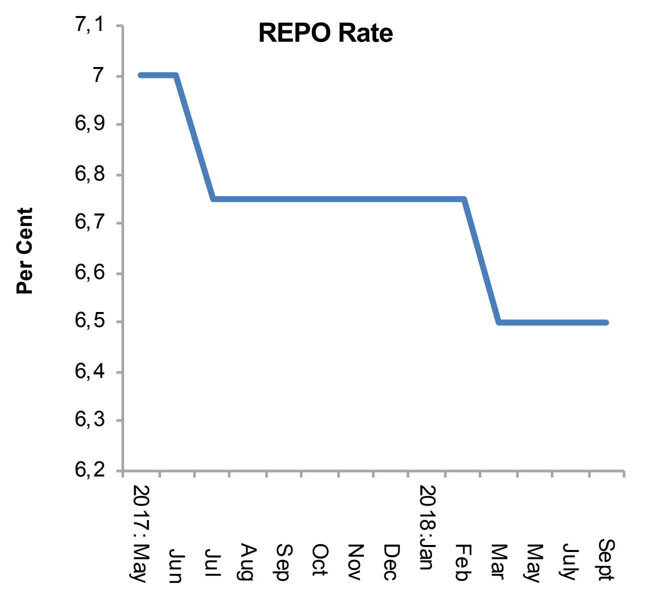
Source: Bloomberg, 2018.

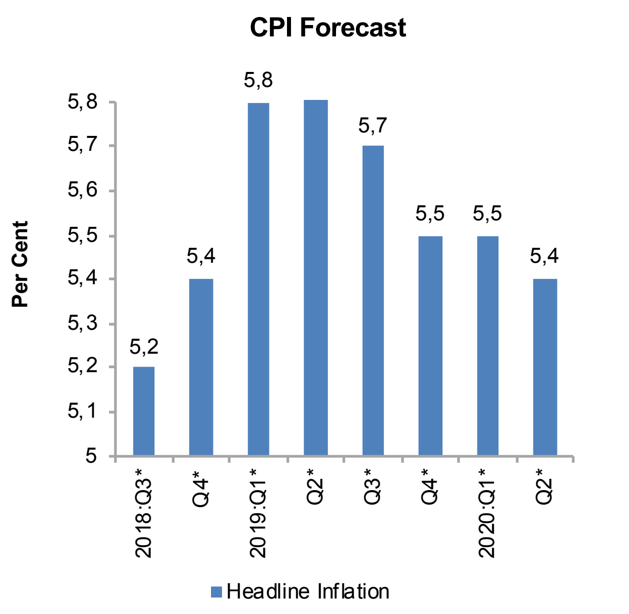
Figure 5, shows the three most affected emerging market currencies. The weakening of the ZAR was not only affected by the Turkish developments, there are also domestic factors which are economic and political. The global oil prices are also weighing on the weaker ZAR, which is evident by the high domestic petrol prices. Furthermore, with discussions around the land redistribution, this has sparked some fears in investors, also the less room South Africa's government have to ignite the economic growth has compromised the ZAR.

Monetary Policy on a Stable on Path with Pressures Emerging

The Monetary Policy Committee (MPC) decided to keep the repurchase rate (REPO) unchanged at 6.5 per cent in September, this a third consecutive decision of keeping the rate unchanged in 2018. According to the MPC, risks to inflation outlook have been worsened since the last MPC meeting, due the impact of high oil prices and weaker ZAR on domestic fuel prices. However, the Consumer Price Inflation (CPI) forecast for the third quarter has been revised down from 5.4 per cent to 5.2 per cent. This suggest that the MPC's view of looming risks are not in the immediate term.

Figure 6: REPO Rate and CPI





Source: South African Reserve Bank, 2018. * Indicates Forecasts

Inflation will remain contained within the target of 3-6 per cent. The South African Reserve Bank (SARB) forecasts headline inflation at 4.8 per cent in 2018 and 5.7 per cent in 2019.[15] However, the current 2019 estimate is higher than the previous estimate, which brings it closer to the upper end of the inflation target. Inflation is expected to moderate in 2020. The implied path of policy rates generated by the Quarterly Projection Model is for five rate hikes of 25 basis points by the end of 2020. However, the extent of effect of fiscal consolidation on the inflation outlook remains uncertain.

Gauteng Economic Developments

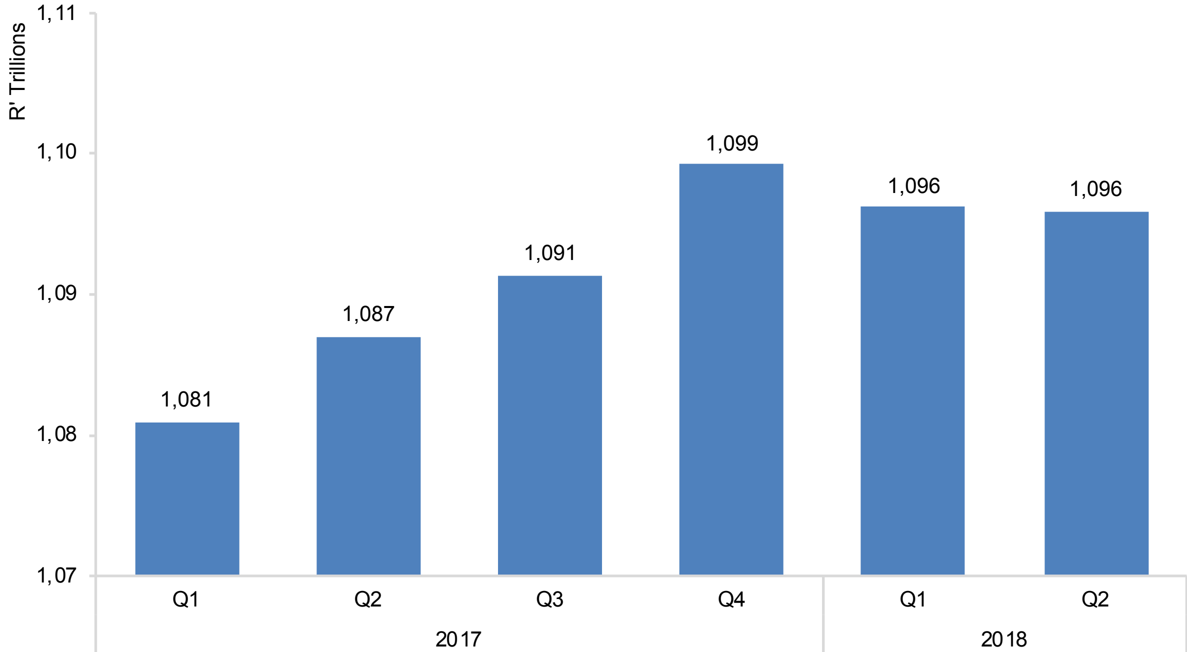
Regional Gross Domestic Product

The GDP-R of Gauteng increased in 2017, from ZAR1 081 billion (bn) in the first quarter, to ZAR1 100bn in the fourth quarter. However, it has declined so far in 2018, falling to ZAR1 096bn in the second quarter of 2018. The main cause of the national q-o-q decrease in GDP-R was the resurgence of drought conditions, which resulted in a significant decline in the agriculture, forestry

[15] South African Reserve Bank. (2018). *Statement of Monetary Policy September 2018*. South Africa. Pretoria

and fishing industry.[16] The impact was not as major in Gauteng as nationally, but the province was also not entirely spared, with the Gauteng agriculture industry declining by 4.3 per cent q-o-q. Year-on-year (y-o-y), the industry recorded a 7.8 per cent increase because production levels were even lower in the second quarter of 2017.

Figure 7: GDP-R



Source: Quantec Research, 2018

Another major contributor to the q-o-q decrease in GDP, both nationally and in the province, was the transport and communication sector. In Gauteng in the second quarter of 2018, the sector decreased by 1.2 per cent q-o-q. One of the sub-sectors that contributed the most to the decline in transport and communication was land transport, which may suggest that higher petrol prices could have encouraged consumers to make less use of transport services. A 0.4 per cent decrease in the wholesale and retail trade further suggests that consumers are under pressure due to increases in Value-Added Tax (VAT) and the price of petrol. The overall decrease was offset by increases in finance and business services, electricity, gas and water, and construction industries.

[16] Statistics South Africa. (2018). *Gross Domestic Product – Second Quarter 2018*. Accessed (www.stassa.gov.za) August 2018

Table 2: Economic Sectors (Share and Growth Rates)

	2Q2018 Share	Q-o-Q Growth	Y-o-Y Growth
Agriculture, forestry and fishing	0,4%	-4,3%	7,8%
Mining and quarrying	2,7%	-0,5%	-3,8%
Manufacturing	15,5%	-0,1%	0,1%
Electricity, gas and water	2,0%	0,5%	-0,2%
Construction	3,7%	0,5%	-0,8%
Wholesale and retail trade	13,6%	-0,4%	0,0%
Transport and communication	10,1%	-1,2%	0,1%
Finance and business services	27,7%	0,6%	2,3%
Government, social and personal services	24,4%	0,0%	1,1%

Source: Quantec Research, 2018

In regards to the relative sizes of the sectors, the comparatively modern and sophisticated economy of Gauteng results in the resource extraction of the primary sector accounting for only a small portion of Gross Value Added by Region (GVA-R), at 0.4 per cent for agriculture, forestry and fishing and 2.7 per cent for the mining and quarrying industry. However, both of these industries provide important inputs for other industries and mining and quarrying accounts for a significant share of exports.

The largest industry was the financial and business services, at 27.7 per cent of GVA-R. The provincial finance sector is robust and provides services to other African countries in addition to its domestic operations. As the administrative arm of government is largely based in Gauteng, it is natural that the government, social and personal services sector contributed greatly to the provincial Gross Value Added by Region (GVA-R), at 24.4 per cent in 2017. The third and fourth largest industries were manufacturing, at 15.5 per cent, and the wholesale and retail trade, at 13.6 per cent.

Gauteng Unemployment Rate Declines Slightly

Employment in Gauteng rose by 5 thousand workers, y-o-y, in the second quarter of 2018.[17] This was a 0.1 per cent increase. The number of unemployed persons decreased by 0.5 per cent, or 11

[17] Statistics South Africa. (2018). *Quarterly Labour Force Survey – Quarter 2: 2018*. Accessed (www.stassa.gov.za) August 2018

thousand. Together, these factors resulted in the unemployment rate declining from 29.9 in 2Q2017 to 29.7 per cent in the second quarter of 2018.

Table 3: Labour Profile

	2Q2017 ('000)	2Q2018 ('000)	Y-o-Y change	Y-o-Y % change
Working-age population	9 957	10 159	202	2,0
Labour force	7 201	7 195	-7	-0,1
Employed	5 050	5 055	5	0,1
Unemployed	2 151	2 140	-11	-0,5
NEA	2 756	2 965	209	7,6
Discouraged work-seekers	252	428	176	69,9
Other	2 504	2 537	33	1,3
Unemployment rate	29,9%	29,7%	-0,2	

Source: Statistics South Africa, 2018

There was a 2 per cent increase in the working-age population of Gauteng from second quarter of 2017 to the second quarter of 2018. This was driven in large part by strong inflows of migrant work-seekers into the province. In spite of this, the provincial labour force decreased by 0.1 per cent over the same period due to a 7.6 per cent increase in the number of Not Economically Active (NEA) persons. This was, in turn, primarily a result of a 69.9 per cent rise in the number of discouraged work-seekers.

The economic sector that contributed the most to the overall decline in employment was manufacturing, where employment decreased by 54 thousand, y-o-y. The second-largest decline was in the government, social and personal services, at 24 thousand. The sectors which most offset the overall decline was construction and transport and communication, where employment increased by 32 thousand and 31 thousand, respectively.

Table 4: Employment by Economic Sector

	2Q2018('000)	Q-o-Q change	Y-o-Y change
Agriculture, forestry and fishing	32	4	-2
Mining and quarrying	72	-2	-14
Manufacturing	612	-37	-54
Electricity, gas and water	51	12	11
Construction	419	1	32
Wholesale and retail trade	975	-29	12
Transport and communication	405	22	31
Finance and business services	1 063	46	16
Government, social and personal services	1 040	-29	-24
Private households	378	2	-9

Source: Statistics South Africa, 2018
Note: Columns do not sum to final totals due to rounding

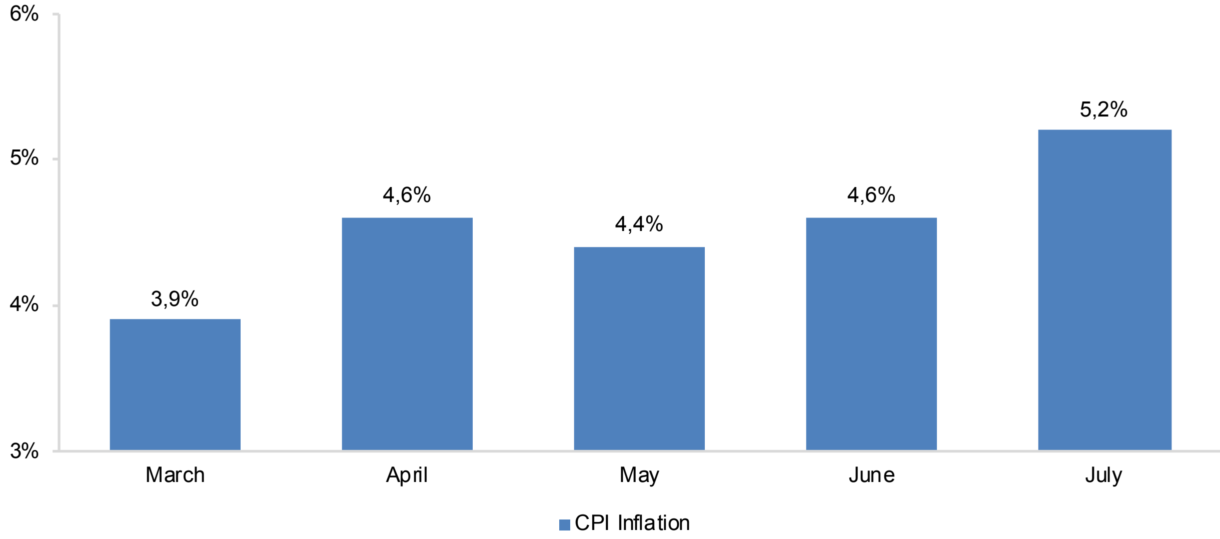
The largest employers in Gauteng are the finance and business services, at about 1.1 million (mn) persons employed, and government, social and personal services, at 1mn. The smallest employers are agriculture, forestry and fishing, at 32 thousand, and electricity, gas and water, at 51 thousand.

Consumer Price Inflation Increases Marginally

The inflation experienced by consumers in Gauteng has increased from 3.9 per cent, y-o-y, in March to 5.2 per cent in July.[18] As with the rise in the national CPI rate, this is largely due to the rising international oil price, a weaker rand exchange rate and the VAT increase.

[18] Statistics South Africa. (2018). *Consumer Price Index – July 2018*. Accessed (www.stassa.gov.za) August 2018

Figure 8: CPI



Source: Statistics South Africa, 2018

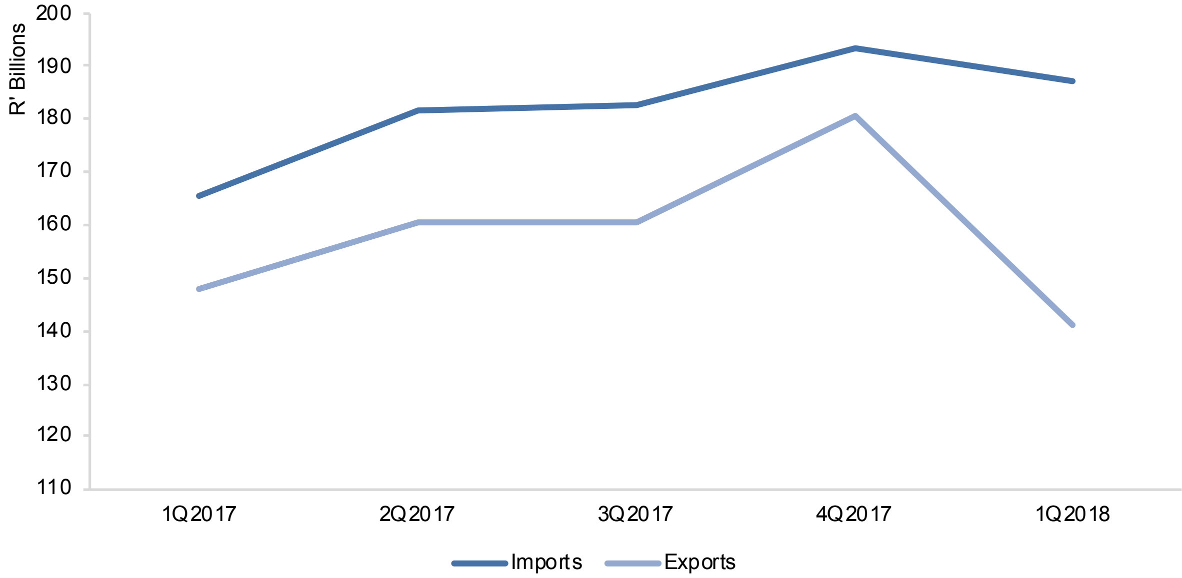
While inflation caused by increased demand can be a sign of a growing economy, the current rise in inflation is driven more by increasing cost of production and producers responding by passing these cost increases on to consumers. This is more likely to place downward pressure on economic growth, as consumers' buying power is eroded and spending declines as a result.

Trade Shows an Upward Trend

Changes in Gauteng's imports and exports tended to mirror one another in 2017. They were on an upward trend, rising from ZAR165.5bn and ZAR148.2bn, respectively, in the first quarter, to ZAR193.5bn and ZAR180.7bn in the fourth quarter.[19] However, in the first quarter of 2018, imports decreased slightly, to ZAR187.5bn, while exports declined significantly more, to ZAR141.1bn. This decrease in exports was driven primarily by decreases in exports of coal, oils derived from coal and road vehicles.

[19] Quantec Research. (2018). *EasyData by Quantec*. Accessed (www.easydata.co.za) August 2018

Figure 9: Imports and Exports



Source: Quantec Research, 2018. Note: Data only available up to the first quarter of 2018.

The type of good that accounted for the largest share of exports from Gauteng in the first quarter of 2018 was ores, slag and ash, at 19 per cent. Of this category, 41 per cent was iron ore, while manganese ore and chromium ore accounted for over 20 per cent each. Mineral fuels accounted for 16.9 per cent of overall exports from Gauteng. This was 68.7 per cent coal, 17.7 per cent oil obtained from bituminous minerals such as coal and 9.1 per cent electricity. The third-largest overall category was road vehicles, at 12.2 per cent. Of this, 63.3 per cent was motor cars and other motor vehicles principally designed for the transport of persons, 25.8 per cent was motor vehicles for the transport of goods and 6.5 per cent was parts and accessories.

The largest import category for Gauteng in the first quarter of 2018 was road vehicles, at 17.1 per cent. Motor vehicles principally designed for the transport of persons accounted for a smaller share of road vehicle imports into Gauteng than exports from the province, at 49.3 per cent of imports. Motor vehicles for the transport of goods accounted for a larger share of imports than exports, at 32 per cent. The second-largest overall import category was boilers and mechanical machinery, at 15.4 per cent. Its largest sub-category was automatic data processing machines and magnetic or optical readers, which accounted for 16.7 per cent of this category.

Conclusion

The global economy remains supportive to a domestic recovery. However, the outlook may be shifting to the downside as a result of trade tensions. Despite this, the local economy continues to underperform, as a result of low business and consumer confidence after years of policy uncertainty. Therefore, a sustained recovery is likely to be slow and gradual.

The Gauteng economy is likely to be a key indicator of this recovery, as it constitutes a significant proportion of the South African economy. Although marginal, the decline in the number of unemployed persons in Gauteng in this second quarter is encouraging. On the downside, the inflow of migrant work-seekers into the province is continuing, leading to the increase in the working age population.

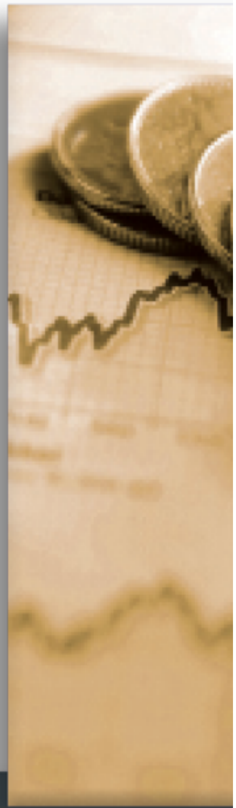
Contact Information

Physical Address:
75 Fox Street, Imbumba House,
Johannesburg

Postal Address:
Private Bag X12,
Marshalltown,
Johannesburg,
2107

Switchboard:
011 227 9000

Website Address:
www.treasury.gpg.gov.za



Together, Moving Gauteng City Region Forward

GAUTENG PROVINCE
TREASURY
REPUBLIC OF SOUTH AFRICA