

***The current state and short-term prospects for the
South African & Western Cape economies***

*Quarterly Report for
The Western Cape Department of Economic Development & Tourism*

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ABBREVIATIONS

CPI: Consumer Price Index

FNB: First National Bank

GDP: Gross Domestic Product

GDPR: Gross Domestic Product Regional

RMB: Rand Merchant Bank

SA: South Africa

SARB: South African Reserve Bank

Stats SA: Statistics South Africa

US: United States

WC: Western Cape

Executive summary

Initial hopes that the 2011Q2 global growth moderation would be transitory were dashed when panic returned to financial markets across the globe in August. This panic was driven by a range of developments including worse than expected global growth data in early Q3, fears that the sovereign debt problems would spread to larger countries such as France and Italy, as well as the Standard & Poor's downgrade of the US credit rating.

Domestic economic growth momentum weakened significantly during the second quarter of 2011. Stats SA reported that growth moderated to 1.3% quarter-on-quarter (q-o-q) seasonally adjusted and annualized (saar) compared to a downwardly revised 4.5% (4.8% initially reported) in 2011Q1.

GDP growth in the Western Cape has traditionally outperformed that of the rest of the country. However, because the mining sector recovery played a significant role in driving national economic growth during 2010 and given base effects (the 2009 contraction was less pronounced in the Western Cape so the "bounceback" is likely to be more contained), this is unlikely to have been the case in 2010.

The RMB/BER business confidence index for 2011Q3 fell by 9 index points from 48 to 39. Similarly, business confidence in the Western Cape was 6 index points lower in 2011Q3, registering a value of 35.

According to Stats SA, only 1 000 jobs were created in the Western Cape during 2011Q3. However, compared to 2010Q3 the net increase in jobs totalled 52 000.

Overall, the baseline view is that the Western Cape will likely grow at the same pace as the national economy. However, the Western Cape's exposure to Europe via exports is much greater than the rest of South Africa; therefore the downside risks are higher.

The Global economy

- Initial hopes that the 2011Q2 global growth moderation would be transitory were dashed when panic returned to financial markets across the globe in August. This panic was driven by a range of developments including worse than expected global growth data in early Q3, fears that the sovereign debt problems would spread to larger countries such as France and Italy, as well as the Standard & Poor's downgrade of the US credit rating.
- The biggest threat to the global economy remains the European debt crisis. In the absence of a more significant Greek debt restructuring, the country's debt dynamics remain unsustainable with a future (disorderly) default remaining a risk. The concern is not only that a default will spill over to other debt stricken countries in Europe, but also that it will pose systematic risk to the entire European banking system. Politicians are currently scrambling to find a workable plan to contain the problem. However, GDP in the Eurozone is set for a sharp slowdown during 2012 as a result of the confidence shock from the debt rumblings and the severe austerity measures faced by numerous European countries.
- In the US, 2011Q3 growth of 2.5% q-o-q saar seems to have allayed fears of another recession in the world's largest economy. However, this comes after a rather slow start to the year with growth of only 0.4% and 1.3% recorded during Q1 and Q2 respectively. There are a number of factors which would likely weigh on US growth in the near future. Most notably, the persistently high level of unemployment and the threat of a recession in Europe - which accounts for 20% of US exports.
- The divergence between growth in advanced and emerging market economies remains a prominent feature of global economic growth. In China for example, annual economic growth of 9.1% was recorded for the third quarter, slightly down from the 9.5% registered in the second quarter of 2011. Policymakers in emerging markets are forced to strike a delicate balance between maintaining growth given heightened downside risks, while at the same time containing goods and asset inflation

As a result of these mostly negative developments, the IMF has downwardly adjusted their forecast for global growth in September to 4.0% for both 2011 and 2012 (from 4.3% and 4.5% respectively, forecast in June).

The South African economy

- Domestic economic growth momentum weakened significantly during the second quarter of 2011. Stats SA reported that growth moderated to 1.3% q-o-q (saar) compared to a downwardly revised 4.5% (4.8% initially reported) in 2011Q1.
- The biggest positive contributor to growth in 2011Q2 was the general government sector (weighting of almost 14% in total GDP during 2011Q2), which added 0.8 percentage points (%pts) to overall growth. The other key growth drivers included finance (0.6%pts), trade (0.5%pts) and transport (0.4%pts). Following a largely unexplained strong 2011Q1 performance, growth in the financial sector slowed sharply to 2.9% from almost 5%.

Table 1: GDP growth slows in 2011Q2...

Sector	2010Q3	2010Q4	2011Q1	2011Q2
Agriculture, forestry and fishing	16.3	12.5	-3.7	-7.8
Mining and quarrying	33.7	17.1	-4.0	-4.2
Manufacturing	-4.9	4.1	14.5	-7.0
Electricity, gas and water	-2.2	5.6	3.3	0.9
Construction	0.8	0.2	0.0	0.5
Wholesale-, retail-, motor trade and accommodation	3.3	3.5	4.4	4.1
Transport, storage and communication	3.0	4.2	3.6	4.1
Finance, real estate and business services	1.4	1.7	4.8	2.9
General government services	0.5	5.7	1.8	5.7
Personal services	3.1	3.3	2.7	2.8
GDP	2.7	4.5	4.5	1.3

Source: Stats SA

- Household consumption expenditure slowed somewhat during 2011Q2. According to the SARB Quarterly Bulletin, real consumer spending grew by 3.8% q-o-q (saar), down from 5.2% during 2011Q1. This easing in growth momentum is likely to continue over the short term as real income growth is unlikely to continue at the same pace as during 2009/10 and employment growth remains muted. Coupled with this are global economic uncertainties which may see consumers delay purchases, particularly durable goods. This holds important consequences for overall GDP growth as household consumption expenditure has been the backbone of the domestic recovery thus far.
- Fixed investment however, continues to underperform during the current recovery despite the most recent Quarterly Bulletin statistics indicating that growth had picked up on the back of improved outlays from the public sector in 2011Q2. Again, the uncertain global environment is likely to result in the corporate sector holding off on fixed investment decisions over the short term. On the plus side, capital investment from public corporations and government is expected to continue rising, albeit at a moderate pace.

- Over the past few months, the rand, along with many other emerging market currencies, has fallen victim to the heightened level of global economic uncertainty which has resulted in investors flocking towards US treasuries and other traditional safe-haven assets. The extent of these adverse economic conditions on the local currency was seen during mid-September when the currency reached a low of around R8.50/\$, this after averaging R6.90/\$ during the first half of the year. Since then, the rand has gradually moved higher but is still subject to the whims of the global economy. Under these conditions the rand is likely to remain weaker, strengthening again once global conditions (hopefully) improve.
- Inflation, as measured by the CPI, accelerated to 5.7% year-on year (y-o-y) during September. The major drivers of local price pressures remain the food and transport categories which contributed 1.3 and 1.1%pts to overall CPI in September respectively. The BER expects that the relatively high international oil price and the weaker rand exchange rate will continue to place upward pressure on the CPI over the next few quarters. The forecast is that CPI will breach the 6% upper target during 2011Q4 and only moderate to just below the level of 6% from mid-2012.

In light of global and local events, GDP growth for 2011 has been downwardly revised to 3.1% y-o-y (from 3.8% forecast in July) and is then expected to moderate to 2.8% y-o-y in 2012 (from 3.7% forecast previously).

Table 2: Selected SA economic indicators

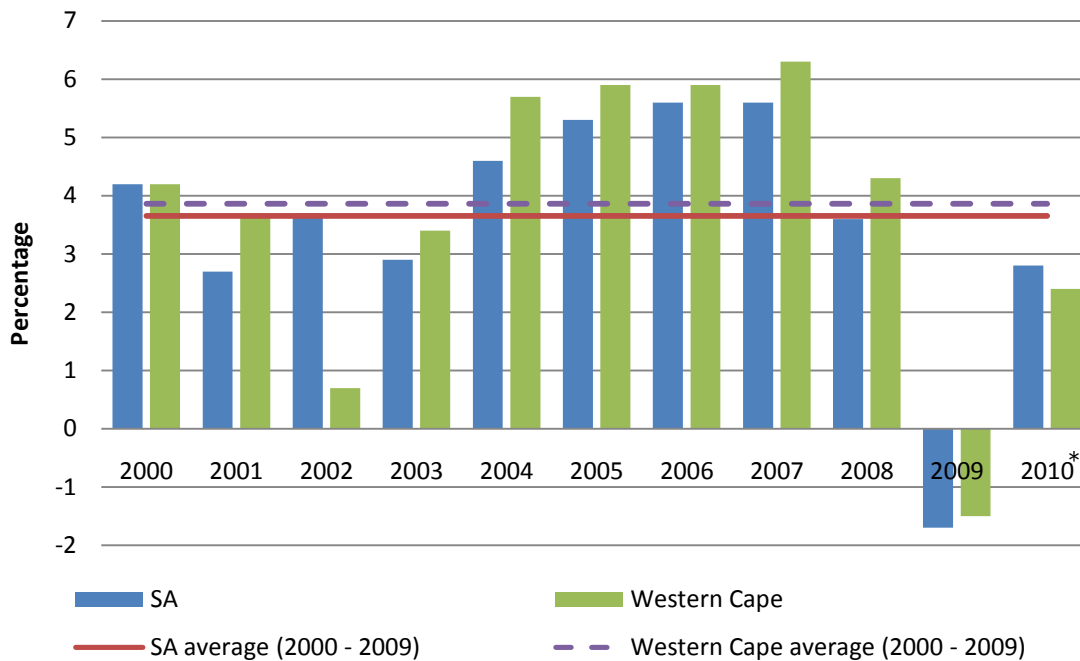
	Actual	Projections	
	2010	2011	2012
Real GDP growth (real y-o-y %)			
Final household consumption expenditure	4.4	4.3	3.3
Government consumption expenditure	4.6	4.0	4.3
Gross fixed capital formation	-3.7	2.3	3.2
Real GDE	4.2	4.3	3.6
Total exports	4.5	4.3	3.9
Total imports	9.6	8.7	6.2
Real GDP	2.8	3.1	2.8
Inflation (annual averages)			
CPI (Headline)	4.3	5.0	6.0
PPI (All items)	6.0	8.0	5.7
Exchange rates (fourth quarter averages)			
R/US\$	6.91	8.05	7.45
R/Euro	9.40	10.87	10.06
R/Pound sterling	10.92	12.88	11.66

Source: BER

The Western Cape economy – current and historic trends

- GDP growth in the Western Cape has traditionally outperformed that of the rest of the country, primarily due to robust growth in the services sector which represents a bigger portion of Western Cape economic activity than in the case for the rest of South Africa. Between 2000 and 2009 the Western Cape economy grew at an average of 3.9% per annum (p.a) compared to 3.7% p.a for the national economy.

Figure 1: Western Cape vs SA growth (2000 - 2010)



Source: Stats SA; Quantec; *denotes estimate for Western Cape

- However, because the mining sector recovery played a significant role in driving national economic growth during 2010 and given base effects (the 2009 contraction was less pronounced in the Western Cape so the “bounceback” is likely to be more contained), the regional economy is unlikely to have outperformed the national economy during 2010. BER/Quantec estimates for GDP growth in 2010 is therefore lower, at 2.4% y-o-y than the growth recorded by the national economy (2.8% y-o-y).
- Looking ahead, global economic factors are also likely to have a more pronounced impact on the Western Cape economy. Trade statistics show a greater reliance by the Western Cape on demand from European countries than is the case for exports from the rest of the country.

Figure 2: Western Cape exports much more linked to Europe than the rest of South Africa...

	Rest of South Africa		Western Cape	
	Value (Rbn)	Percentage of total	Value (Rbn)	Percentage of total
Europe	135.6	25.8	22.1	43.8
European Union	115.1	21.9	20.5	40.7
United States	49	9.3	2.4	4.8
Rest of the world	340.7	64.9	25.9	51.4
Total	525.3	100.0	50.4	100.0

Source: Quantec; based on data for 2010

- During 2010, almost half (48.6%) of Western Cape exports went to the US and Europe. In fact, almost 41% of total Western Cape exports went to countries within the European Union. This is a significantly higher proportion than the 21.9% of exports from the rest of South Africa which are destined for the European Union. Therefore, at least from an export perspective, the Western Cape is much more exposed to the heightened global economic uncertainty and the developments within Europe in particular.

Employment in the Western Cape

- Employment growth in the Western Cape showed a very marginal improvement during 2011Q3, creating a net 1 000 jobs. However, compared to the same period last year a total of 52 000 jobs were created in the province, reflecting a growth rate of 3.0% y-o-y. At the same time, the number of jobs created by the rest of South Africa increased by 192 000 compared to 2011Q2.
- The unemployment rate in the Western Cape worsened from 21.8% in Q2 to 23.3% in Q3, given an increase in the labour force participation rate in the province. This is also 0.2%pts higher when compared to 2010Q3.

Table 3: Employment in the Western Cape (per sector)

Thousands	Jul-Sep 2010	Apr-Jun 2011	Jul-Sep 2011	Difference between Jul-Sep 2011 and Jul-Sep 2010	% Change between Jul-Sep 2011 and Jul-Sep 2010
Population 15-64 years	3 390	3 430	3 444	54	1.6
Labour Force	2 281	2 309	2 356	75	3.3
Employed	1 754	1 805	1 806	52	3.0
<i>Agricultural</i>	136	100	113	-23	-16.9
<i>Mining</i>	3	4	6	3	-
<i>Manufacturing</i>	261	277	276	15	5.7
<i>Utilities</i>	11	12	10	-1	-9.1
<i>Construction</i>	141	118	129	-12	-8.5
<i>Trade</i>	369	406	397	28	7.6
<i>Transport</i>	107	106	105	-2	-1.9
<i>Finance</i>	252	286	288	36	14.3
<i>Community and social services</i>	364	382	364	0	0.0
<i>Private households</i>	110	113	119	9	8.2
Unemployed	527	504	550	23	4.4
Not economically active	1 109	1 121	1 087	-22	-2.0
Discouraged work-seekers	38	34	30	-8	-21.1
Other	1 071	1 087	1 057	-14	-1.3
Rates (%)					
Unemployment rate	23.1	21.8	23.3	0.2	
Employed/population ratio (absorption)	51.7	52.6	52.4	0.7	
Labour force participation rate	67.3	67.3	68.4	1.1	

Source: Stats SA, QLFS third quarter 2011

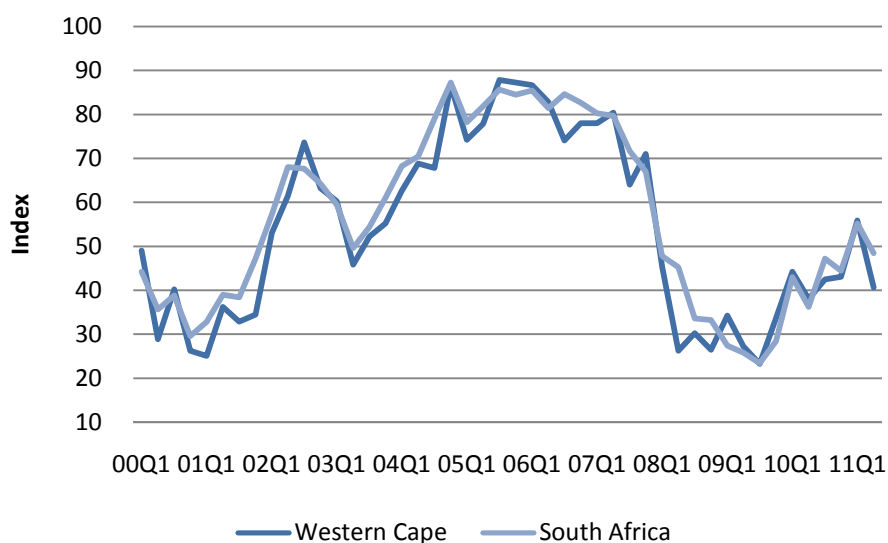
- The sectors which created the most jobs during 2011Q3 were; agriculture (+13 000 jobs), construction (+11 000 jobs) and private households (+6 000 jobs). This was partly offset by job losses in the community and social services (-18 000 jobs) and trade (-9000 jobs) sectors.

Business confidence in the Western Cape

- Business confidence¹ in the Western Cape declined for the second consecutive quarter to record a value of 35 in 2011Q3, from 41 during 2011Q2. This trend mirrors that of the national economy which also experienced a decline in confidence from 48 during 2011Q2 to 39 during 2011Q3.

¹ The business confidence index is the average of business confidence as measured across a range of sectors, these are: the retail, wholesale and motor trade, construction and manufacturing sectors.

Figure 3: Western Cape business confidence eases further in 2011Q3



Source: BER

- Both the provincial and national business confidence indices seem to suggest a further easing in economic activity during 2011Q3 following the moderate growth recorded for 2011Q2. Table 4 gives a breakdown of business confidence amongst the different sectors.

Table 4: Business confidence; SA vs WC

	2011Q2	2011Q3
Building (Contractors)		
Western Cape	7	20
National	21	20
Manufacturing		
Western Cape	33	29
National	51	36
Wholesale		
Western Cape	43	22
National	47	31
Retail		
Western Cape	56	51
National	47	48
Motor		
Western Cape	64	54
National	76	58
WC Consumer Confidence Index	-6	-16
FNB/BER Consumer Confidence Index	11	4
Ernst and Young Financial Services Index	71	61
Western Cape Business Confidence Index	41	35
RMB/BER Business Confidence Index	48	39

Source: BER

- Confidence amongst Western Cape **builders** rose by 13 index points to 20 during 2011Q3. This is the same level registered by the national index; however, on the national front a marginal (1 index point) drop was recorded. Western Cape based respondents indicated that overall profitability had improved during 2011Q3, however, activity levels and demand for new work remains weak.
- **Manufacturing business confidence** in the Western Cape dropped for the second consecutive quarter – from 33 during 2011Q2 to 29 index points in 2011Q3. A decline in domestic and export demand indicators drove the deterioration in business conditions. On a national level, manufacturer confidence dropped sharply from 51 to 36 during 2011Q3.
- **Wholesaler confidence** also fell, from 47 to 31 index points in 2011Q3 (a decline of 16 index points). In the Western Cape, wholesaler confidence fell by an even bigger margin, from 43 to 22 (21 index points). This is the second consecutive quarter that provincial wholesaler confidence has dropped by more than 20 points.
- Confidence amongst Western Cape **retailers** fell from 56 index points in 2011Q2 to 51 during 2011Q3. However, this still suggests that a small majority of retailers in the Western Cape are satisfied with current business conditions. In contrast, retailer confidence at a national level registered a very small (1 index point) improvement to reach a level of 48 during 2011Q3. Retailers in the Western Cape indicated that sales volumes and profitability remained well supported; however, they are more pessimistic regarding the global and national economic outlook than during 2011Q2. Retailer confidence in the Western Cape remains higher than national retail confidence.
- Consumer confidence as measured by the **FNB/BER consumer confidence** index declined for the second consecutive period, from +11 to +4 during 2011Q3. In the Western Cape, consumer confidence declined to -16 from -6 index points in 2011Q2. The decline in confidence amongst consumers in the Western Cape was underpinned by increasing concerns regarding the national economic outlook and household financial prospects. Both these can be linked to the deteriorating global economic outlook.
- The Ernst and Young **Financial Services confidence** index shed 10 points to register a value of 61 during 2011Q3. Confidence declined amongst retail bankers, investment bankers and asset managers whilst confidence amongst life insurers remained unchanged. This bodes well for the Western Cape which has a large concentration of life insurers relative to the rest of South Africa. Respondents also indicated that global conditions are worrying, especially investment banks.

Outlook for economic growth in the Western Cape

- Uncertainty regarding the global outlook remains high as the Eurozone scrambles to find a solution to the sovereign debt crisis. At the same time, the US economy remains under pressure.
- In South Africa, 2011Q2 economic growth also surprised on the downside. The RMB/BER business confidence index suggests that 2011Q3 is likely to see a continuing of this growth “soft patch”.
- Although the estimates for GDP for 2010 have not yet been released, BER/Quantec analysis expects it to have increased by 2.4% y-o-y, lower than the 2.8% recorded by the national economy. This is on the back of higher growth within the mining sector – which represents a very small portion of Western Cape economic activity – and possible base effects (the 2009 contraction was less pronounced in the Western Cape so the “bounceback” is likely to be more contained).
- Looking to 2011Q3, a number of positive and negative factors likely affected the performance of the Western Cape economy:

Negatives

- The outlook for the global economy, especially the European Union, remains uncertain. This poses significant risks to the outlook for Western Cape exports given that exports to this region make up almost 41% of total Western Cape exports.
- Business confidence in the Western Cape fell by 6 index points to 35 during 2011Q3, in line with the trend in national business confidence.
- Consumer confidence also fell sharply, from -6 to -16 during 2011Q3 as consumers become more concerned with the national economic outlook and the prospects for their own financial positions.

Positives

- Retailer business confidence remains above the crucial 50 index point mark (although marginally). This signifies that some growth within the sector can be expected for 2011Q3.
- Employment growth continues with a net 52 000 jobs created in the Western Cape between 2010Q3 and 2011Q3.
- The weaker rand should be supportive of exports, however, this may not fully compensate for a likely slowdown in demand from Europe.

Given the factors mentioned above, the baseline view is that the Western Cape will likely grow at the same pace as the national economy. However, the Western Cape's exposure to Europe via exports is much greater than the rest of South Africa; therefore the downside risks are higher.

Craig Lemboe

BUREAU FOR ECONOMIC RESEARCH

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