

***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
EU: European Union
FNB: First National Bank
GDP: Gross Domestic Product
GDPR: Gross Domestic Product Regional
IMF: International Monetary Fund
MPC: Monetary Policy Committee
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

The first half of 2012 saw mixed results on the international front. The first quarter was characterised by rising optimism regarding global growth with both Europe and the US outperforming expectations. The second quarter however saw a sharp reversal in this optimism triggered mainly by political events and the resurfacing of banking sector bailouts.

Domestically, economic growth slowed during the first quarter of 2012, rising by 2.7% q-o-q saar from 3.2% in 2011Q4. Growth during 2012Q1 came from the secondary and tertiary sectors whereas economic activity within the primary sector contracted.

The slowdown in household consumption expenditure which started towards the latter part of last year continued during 2012Q1. This is consistent with some of the underlying drivers of consumer spending which have also come in more negative. At the same time, public sector led investment saw the growth in overall fixed investment spending accelerate marginally during the quarter.

After contracting by 1.3% y-o-y during 2009, economic activity in the Western Cape picked up to register growth of 3.1% y-o-y during 2010. This is again higher than the national economy which grew at 2.9% y-o-y in 2010. This trend is expected to continue with regional GDP growth for 2011 likely to be higher than that recorded nationally.

The RMB/BER business confidence index shed 11 points to register a value of 41 during 2012Q2. Western Cape business confidence also fell, from 49 in 2012Q1 to 45 index points during 2012Q2. Western Cape manufacturers in particular remained confident with the growth in domestic demand and production continuing at a reasonable pace.

Overall, the baseline view is that economic growth in the Western Cape likely outpaced that of the national economy during 2011 and 2012Q1, but should move in line with the national economy during 2012Q2. Regional GDP for 2012 is likely to be lower than that recorded during 2011 with significant downside risks stemming from adverse global economic conditions.

The Global economy

- The first half of 2012 saw mixed results on the international front. The first quarter was characterised by rising optimism regarding global growth prompted by increasingly positive data coming from the US and specific efforts from the European Central Bank to provide cheap loans to EU banks to help stave off a renewed credit crunch. The second quarter however saw a sharp reversal in this optimism, triggered by the political fallout in many EU countries against austerity measures (in Greece and France in particular) as well as a renewed slowdown in demand and industrial output. This was compounded by the resurfacing of difficulties within the banking sector as highlighted by the Spanish government's bailout of banking conglomerate Bankia in May. Signs that growth in US employment and personal income were again starting to ease also added to the more pessimistic Q2 outlook.
- Although economic growth in emerging markets remains significantly higher than in advanced markets, it is also expected to slow as these economies start to feel the pinch of weaker demand in the developed world. Hence, the global slowdown is becoming more broad-based (with growth in both advanced and emerging markets expected to be lower than in 2011). In China for example, economic growth eased to 7.6% year-on-year (y-o-y) in 2012Q2 as the impact of lower demand from Europe, previous monetary policy tightening and conscious efforts to stem fixed investment took effect. At the current rate, Chinese GDP growth for 2012 could come in at below 8% for the first time since 1999. Other prominent emerging market economies such as India and Brazil also face internal difficulties on top of what is happening in Europe.

Overall, the IMF's July update to the World Economic Outlook sees the global economy growing by 3.5% in 2012 (this is 0.1 percentage points lower than their April forecast), slightly down from 3.9% in 2011. Growth is expected to accelerate to 3.9% in 2013, but for both years the risks to the outlook are tilted to the downside.

The South African economy

- After accelerating by 3.2% q-o-q (saar¹) in the final quarter of 2011, SA GDP growth eased to 2.7% during 2012Q1. While the moderation was in line with expectations, the number came in better than the consensus forecast of just below 2.5%.
- The secondary and tertiary sectors were the biggest contributors to domestic economic growth in 2012Q1. Within the secondary sector, the manufacturing industry in particular recorded strong growth with economic activity increasing by 7.7% quarter-on-quarter (q-o-q). As for the tertiary sector, it was the finance industry which recorded the fastest growth of 4.1% q-o-q. However, a

¹ At a seasonally adjusted and annualized rate.

decline of 16.8% q-o-q in the mining and quarrying industry saw the overall primary sector (which includes agriculture) weigh down on growth during the quarter. This decline in the mining and quarrying sector was largely due to the extended strike at a prominent platinum mine in Rustenburg during Q1.

Table 1: National GDP growth slows during 2012Q1...

	2011Q2	2011Q3	2011Q4	2012Q1
Agriculture, forestry and fishing	-9.5	-6.9	-5.0	3.4
Mining and quarrying	-4.5	-17.8	0.7	-16.8
Manufacturing	-8.8	-0.7	4.2	7.7
Electricity, gas and water	1.0	-2.6	1.2	-0.1
Construction	0.8	1.8	1.9	3.8
Wholesale and retail trade, motor trade and accommodation	5.2	6.1	5.2	3.0
Transport, storage and communication	4.3	2.3	2.9	2.5
Finance, real estate and business services	2.7	4.5	2.3	4.1
General government services	5.1	4.2	4.4	2.3
Personal services	2.8	2.5	3.0	1.7
GDP	1.0	1.7	3.2	2.7

Source: Stats SA

- The slowdown in household consumption expenditure which started towards the latter part of last year, continued during 2012Q1. According to the SARB, growth in consumer spending moderated to 3.7% y-o-y during the first three months of 2012, from 4.6% y-o-y in 2011H2. The moderation in consumer spending is consistent with some of the underlying drivers which have also come in more negative. Lower nominal income and employment growth, coupled with higher inflation yielded less robust real disposable income growth during 2012Q1 (compared to 2011Q1). However, the relatively low interest rate environment and robust growth in unsecured credit should provide some support to consumer spending during 2012.
- After lagging for most of the recovery, fixed investment has started growing at a reasonably robust rate. During 2012Q1 fixed investment rose by 5.8% y-o-y from 5.3% during 2011H2. However, most of the growth in Q1 came from the public sector with investment by parastatals (Eskom, Transnet etc.) growing by 9.4% y-o-y, whilst growth in capital spending by general government rose to 5.5% from 2.7% in 2011Q4. Private enterprise fixed investment - which is by far the largest contributor to overall investment - disappointed with a lackluster performance during the first quarter. Growth in private sector fixed investment moderated to 4.7% y-o-y from 5.3% during 2011H2. The slowdown in private sector investment is reflective not only of the heightened levels of global uncertainty, but also of local developments regarding economic policy uncertainty.

Given the uncertain global environment which will hamper export performance as well as local constraints on investment and the expected continuation of the slowdown in consumption expenditure, GDP growth is likely to remain modest. The BER expects GDP growth of 2.5% for 2012, down from 3.1% in 2011. Growth is expected to recover slightly in 2013 to 3.3% y-o-y. However, as with the global economy, the risk to the outlook remains on the downside.

Table 2: Selected SA economic indicators

	Actual	Projections	
	2011	2012	2013
Real GDP growth (real y-o-y %)			
Final household consumption expenditure	5.0	3.3	3.9
Government consumption expenditure	4.5	4.2	4.3
Gross fixed capital formation	4.4	4.9	5.1
Real GDE	4.3	3.9	4.4
Total exports	5.9	3.0	4.7
Total imports	9.7	7.7	8.3
Real GDP	3.1	2.5	3.3
Inflation (annual averages)			
CPI (Headline)	5.0	5.7	5.3
PPI (All items)	8.4	5.9	4.8
Exchange rates (fourth quarter averages)			
R/US\$	8.09	8.03	7.65
R/Euro	10.91	10.16	9.83
R/Pound sterling	12.72	12.64	12.01

Source: BER

- The rand exchange rate has moved in line with global sentiments. During 2012Q1 as markets were reinvigorated by rising risk appetite the rand strengthened and averaged R7.76/\$. As soon as sentiment changed (on the back of the factors mentioned earlier) and risk aversion returned, the rand depreciated, averaging R8.12/\$ in Q2 - reversing all of the gains of the first quarter. The BER expects the rand to end the year around R8.03/\$ and strengthen into 2013.
- On a more positive note, the past few months have seen CPI inflation consistently surprise on the downside. CPI inflation slowed further to 5.5% y-o-y in June, down from 5.7% in May. This marked the fifth consecutive month in which consumer price inflation has surprised on the downside. The slowdown in headline CPI was mainly driven by moderation in goods prices which slowed from 6.5% in January to 5.2% in June. Food inflation in particular has been falling sharply from a peak of 11.6% in December to just 6.0% in June. Transport inflation also fell

sharply following the 55c/litre decrease in the petrol price. CPI inflation is expected to average 5.7% in 2012 and slow further to 5.3% next year.

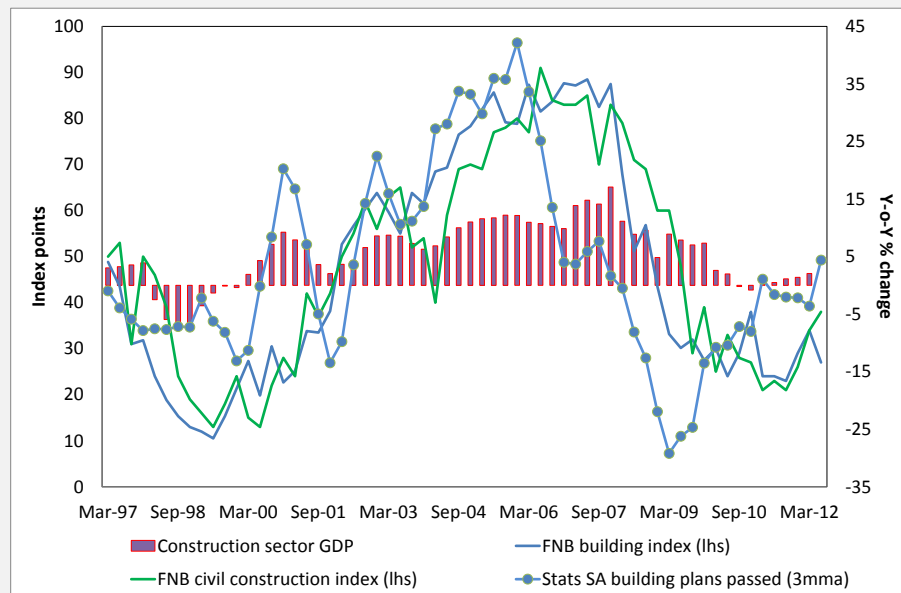
- Given the more benign inflation outlook, global growth uncertainties (which have now become more broad-based) and signs that growth in the local economy may be slowing, the SARB in their July MPC meeting saw it fit to reduce the prevailing interest rate by 50 basis points (0.5%). This brings the prime interest rate to 8.5%, a multi-decade low.

Short note on the SA Construction Sector

The South Africa building sector registered robust real growth of 12.2% on average over the period 2003 – 2007. Thereafter a prolonged period of negative growth followed, led by the residential sector and prompted by high mortgage lending rates and the National Credit Act (NCA) in 2007 which led to a general tightening in lending standards since. A much milder slowdown in building investment into the non-residential sector soon followed. Overall, the period since 2007 (2008 – 2011) has seen investment into the building sector decline by an average of 3%, with residential building investment falling by an average of 9.2%, while non-residential investment registered moderate growth of 2.5% on average.

By contrast, the growth in civil construction has remained relatively high, growing by 17.5% on average between 2003 and 2011. There was a brief contraction in 2010, but off an extremely high base. Investment in the earlier part of the recovery was on the back of World Cup related activity, but since 2010 there has been increased emphasis on eliminating infrastructure backlogs and improving service delivery.

Figure 1: Construction sector in for protracted recovery...



Source: BER, Stats SA, SARB

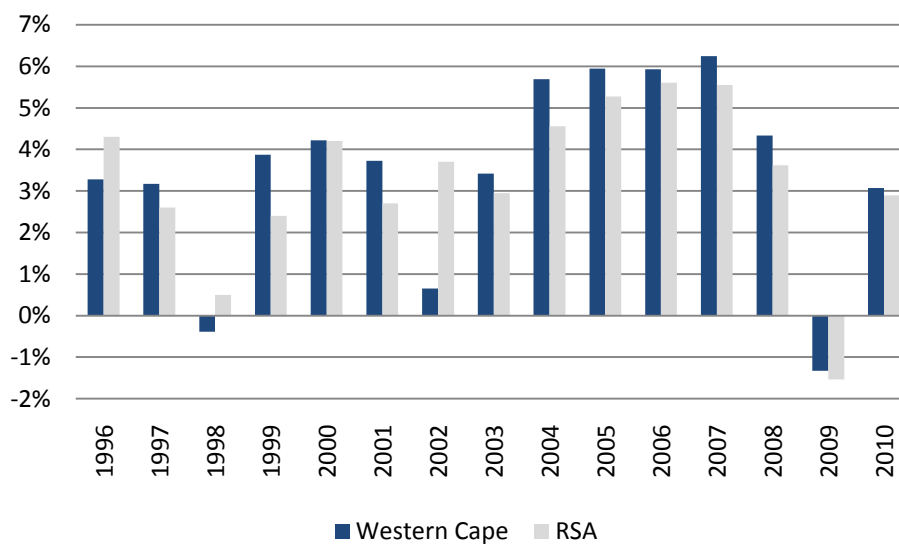
The past few quarters have seen a more improved performance from the building and construction industries (see figure 1); with confidence (especially civil confidence) recovering and building plans passed and completed showing a positive trend. In fact, most of the data confirms that the sector has indeed reached the lower turning point and is on the path to recovery.

Nevertheless, this recovery is likely to be very protracted with certain spheres of government continually under spending substantially on their budgets and private sector investors which, from 2012Q1 data, seem to be more hesitant given the current international economic climate and slowing domestic demand.

The Western Cape economy

- After contracting by 1.3% y-o-y during 2009, economic activity in the Western Cape picked up to register growth of 3.1% y-o-y during 2010. This is again higher than the national economy which grew at 2.9% y-o-y in 2010.
- Growth during 2010 was boosted by increased activity in the manufacturing (+5.0% y-o-y), finance² (3.6%) and retail³ (3.3%) sectors. Overall, economic activity in the Western Cape continues to be more tertiary/services sector driven relative to the rest of the country.

Figure 2: SA vs Western Cape growth (1996 - 2010)



Source: Stats SA

- Estimates for 2011 suggest that Western Cape economy continued to outperform the national economy, which registered growth of 3.1% y-o-y during 2011. Western Cape economic growth in 2011 is likely to have been driven by the retail and finance sectors which at a national level performed well and which contribute significantly to regional economic activity. However, the agricultural sector likely weighed on regional growth in line with the contraction in national agricultural output recorded in 2011.

² This includes business services and real estate.

³ This includes wholesale and motor trade, catering and accommodation.

Employment in the Western Cape

- The Western Cape economy created 5 000 jobs during 2012Q1, this translates into a 0.3% increase q-o-q. Compared to 2011Q1, employment was up by 63 000 or 3.5% y-o-y.
- The agricultural sector created the most jobs during the quarter (+33 000). However, employment growth in this sector is influenced by a number of seasonal factors (such as harvesting patterns etc.) and is traditionally higher during the first quarter in the Western Cape. This was followed by the finance sector where approximately 12 000 more people were employed during 2012Q1 than in 2011Q4. Other sectors to record job gains were the community and social services as well as the transport sectors, where the number of people employed increased by 8 000 and 4 000 respectively.
- Job losses were recorded in the manufacturing (-26 000), retail (-15 000) and the construction (-9 000) sectors. Employment in the retail sector usually takes a knock in the first quarter of the year due to the seasonal slowdown in sales following the surge in spending during the festive season.

Table 3: Employment in the Western Cape, 2012Q1

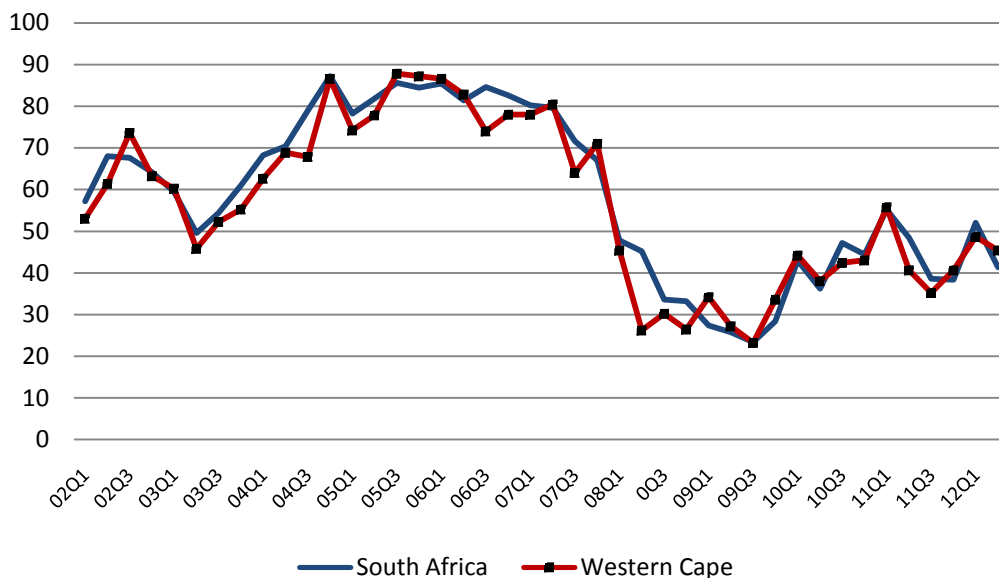
Thousands	Jan - March 2011	Oct - Dec 2011	Jan - March 2012	Difference between Oct - Dec 2011 and Jan - March 2012	% Change between Oct - Dec 2011 and Jan - March 2012
Population 15-64 years	3 417	3 457	3470	13	0.4
Labour Force	2 295	2 349	2 393	44	1.9
Employed	1 784	1 842	1 847	5	0.3
<i>Agricultural</i>	121	94	127	33	35.1
<i>Mining</i>	2	4	3	-1	-25
<i>Manufacturing</i>	290	320	294	-26	-8.1
<i>Utilities</i>	11	6	4	-2	-33.3
<i>Construction</i>	124	144	135	-9	-6.3
<i>Trade</i>	388	406	391	-15	-3.7
<i>Transport</i>	113	96	100	4	4.2
<i>Finance</i>	239	281	293	12	4.3
<i>Community and social services</i>	390	374	382	8	2.1
<i>Private households</i>	105	117	117	0	0
Unemployed	510	507	546	39	7.7
Not economically active	1 122	1 108	1 077	-31	-2.8
Discouraged work-seekers	19	46	28	-18	-39.1
Other	1 102	1 062	1 049	-13	-1.2
Rates (%)					
Unemployment rate	22.2	21.6	22.8	1.2	
Employed/population ratio (absorption)	52.2	53.3	53.2	-0.1	
Labour force participation rate	97.1	67.9	69.0	1.1	

- The recorded gains in employment remain modest when compared to the growth in the labour force (those willing to participate in employment) which was 4.3% higher y-o-y (+98 000). In other words, the increase in employment between 2011Q1 and 2012Q1 was not enough to even cater for the new and re-entrants into the job market. Hence unemployment remained high, increasing by 1.2 percentage points to 22.8% during 2012Q1. This is lower than the national unemployment rate of 25.2%.

Business confidence in the Western Cape

- After rising to 52 index points during 2012Q1 from 38 during 2011Q4, the **RMB/BER business confidence**⁴ index shed 11 points to register a value of 41 during 2012Q2.

Figure 3: Western Cape business confidence eases further in 2012Q2



Source: BER

- Business confidence in the Western Cape fell to 45 index points from 49 during 2012Q1, in line with national confidence. However, the drop in regional confidence was less pronounced than that recorded nationally, resulting in confidence in the Western Cape being higher than that of South Africa. Much of this difference can be explained by significantly higher confidence amongst Western Cape manufacturers than is the case nationally.

⁴ 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.

Table 4: Business confidence; SA vs WC

	2012Q1	2012Q2
Building		
Western Cape	25	23
National	31	24
Manufacturing		
Western Cape	47	58
National	47	29
Retail		
Western Cape	77	34
National	61	39
Wholesale		
Western Cape	38	58
National	48	50
Motor		
Western Cape	56	54
National	73	65
Ernst and Young Financial Services Index	82	74
Western Cape Business Confidence Index	49	45
RMB/BER Business Confidence Index	52	38
WC Consumer Confidence Index	-12	-16
FNB/BER Consumer Confidence Index	5	-3

Source: BER

- **Building contractors'** confidence in the Western Cape remained largely unchanged during the second quarter, moving from 25 to 23 index points. At the same time national contractors' confidence shed 7 points to register a value of 24 during 2012Q2. Building activity levels in the Western Cape, which over the past few quarters have gradually picked up, seemed to slow during the quarter whilst tendering competition eased – similar to that recorded nationally.
- National **manufacturing confidence** fell sharply during 2012Q2, as conditions disappointed. However, confidence amongst Western Cape manufacturers rose to 58 index points, from 47 during 2012Q1. The increase in provincial manufacturing confidence is as a result of domestic demand and production which accelerated during the second quarter (while foreign demand slowed). Nevertheless, the sustainability of this trend is doubtful against the backdrop of slowing final consumption demand.
- **Wholesaler confidence** in the Western Cape registered a significant increase, rising by 20 index points to reach 58 during 2012Q2. The increase in national wholesale confidence was more restrained, moving from 48 to 50 index points during 2012Q2.

- National **retail confidence** registered a 22 index decline during 2012Q2 whilst confidence amongst Western Cape retailers fell by 43 index points to record a value of 34 over the same quarter. This is in line with developments from the demand side where there has been an easing in the growth momentum of household consumption expenditure during 2012Q1 (and likely to continue for the rest of the year). Western Cape retailers saw profitability, sales volumes and sales orders fall significantly, prompting the much lower confidence.
- Further confirmation of the slowdown in household consumption can be found in the consumer confidence data. The 2012Q2 **FNB/BER consumer confidence index** reached its lowest level in two years falling to -3 from 5 index points during 2012Q1. Consumer confidence, which is an important indicator of consumers' willingness to spend, declined as consumers became more pessimistic about the state of the SA economy and the state of their own finances over the next 12 months as well as their view on the current time as appropriate to buy durable goods. Western Cape consumer confidence, which is traditionally lower than the national index, also deteriorated, from -12 to -16 index points during 2012Q2.
- The **Ernst and Young Financial Services confidence index** lost 8 points to record a value of 74 during 2012Q2, from 82 during 2012Q1. However, at these levels, the majority of respondents remain satisfied with business conditions, so despite the decline in confidence, activity within the industry is unlikely to have deteriorated to any significant degree. Importantly for the Western Cape is that confidence amongst investment bankers (which declined from 91 to 86 index points during 2012Q2) and life insurers (from 93 to 81 index points) remains higher than the overall index. These two sectors feature more prominently in the Western Cape economy than they do nationally.

Outlook for economic growth in the Western Cape

- After outperforming the national economy in 2010, the Western Cape is expected to have continued growing at a faster pace than the national economy during 2011, underpinned by growth in the tertiary sector. Consumer spending averaged 5% y-o-y during 2011, which is likely to have benefitted the services based Western Cape economy.
- Looking forward, continued uncertainty in the Eurozone is likely to exacerbate the current economic situation of slowing local demand. The forecast of a mild recession in the Eurozone for 2012 will impact on Western Cape exports as this remains an important destination for WC produced goods - with around 40% of the province's exports going to the European Union.
- The moderation in SA economic growth recorded in 2012Q1, although exacerbated by a sharp contraction in the mining and quarrying sector (a sector which contributes minimally to Western

Cape economic activity), is likely to continue into the second quarter, with the BER/RMB business confidence index which falling sharply.

- A number of positive and negative factors likely affected and will continue to impact the performance of the Western Cape economy:

Negatives

- A global economic environment which remains uncertain and now even more so with political challenges in Europe also surfacing.
- Western Cape business confidence which was lower, moving from 49 to 45 index points.
- Household expenditure which is showing signs of slowing. The Western Cape has a vibrant services sector of which the retail and related sectors are significant contributors. Lower levels of consumer spending will therefore no doubt negatively influence the province's economic outlook.
- Job creation which is not keeping pace with the number of new and re-entrants into the labour market. This could keep unemployment levels relatively high and further depress consumer spending.

Positives

- Confidence in key financial services sectors in the province remains at relatively high levels. This should see continued growth in the finance sector, which in the Western Cape is a significant contributor to overall economic activity.
- Western Cape manufacturing confidence, which rose from 47 to 58 index points during 2012Q2, is high even amid slowing global demand.
- CPI inflation which continues to surprise on the downside should provide some relief to consumers and offer support to spending.
- The weaker rand should support WC exports; however, it may not be enough to offset the effects of a more generalised slowdown in global demand.

Given the factors mentioned above, the baseline view is that economic growth in the Western Cape likely outpaced that of the national economy during 2012Q1 given the fact that the specific mining sector contraction will not be relevant to the province, but should move in line with the national economy during 2012Q2. In all, as is the case for the national economy, it is expected that the

province is likely to record lower GDP growth this year than in 2011. Moreover, given the global economic environment and the strong bias of Western Cape exports to the European Union, the risks are tilted to the downside.

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