

***The current state and short term (2011/12) 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
FNB: First National Bank
RMB: Rand Merchant Bank
SA: South Africa
SARB: South African Reserve Bank
Stats SA: Statistics South Africa
WC: Western Cape

Executive summary

Global GDP growth is expected to have moderated to below 3% quarter-on-quarter (q-o-q) during 2011Q2 from above 4% in Q1. Indications are that the growth easing was fairly broad based with both developed and emerging countries losing momentum, albeit that emerging market growth continues to outperform advanced countries.

SA GDP for the first quarter of 2011 grew at 4.8% q-o-q saar, up from a revised 4.5% q-o-q saar during 2010Q4. The key driver of economic growth during 2011Q1 was the manufacturing sector, which rose by 14.5% q-o-q saar, and contributed 2.2 percentage points to overall GDP growth.

According to Stats SA, 18 000 jobs were created in the Western Cape during 2010Q4 and a further 12 000 during 2011Q1 (+0.7% q-o-q). At the same time, employment in the rest of South Africa (excluding the Western Cape) increased by an estimated 139 000 jobs during 2010Q4, but recorded job losses of approximately 26 000 (-0.2% q-o-q) during 2011Q1.

The RMB/BER business confidence index declined from 55 points during 2011Q1 to 48 during 2011Q2. Business confidence in the Western Cape also declined but at a more pronounced pace shedding 15 points to record a level of 41.

Overall, the Western Cape economy is likely to grow at least as fast as the national economy during 2011.

The Global economy

- Following a robust start to the year, global GDP growth is expected to have moderated to below 3% quarter-on-quarter (q-o-q) during 2011Q2 from above 4% in Q1. Indications are that the growth easing was fairly broad based with both developed and emerging countries losing momentum, albeit that emerging market growth continues to outperform advanced countries.
- The US economy expanded for a seventh consecutive quarter in 2011Q1, but the growth rate slowed to 1.9% q-o-q from 3.1% during 2010Q4. US growth remains too weak to ensure sufficient jobs for new entrants into the job market, resulting in the US unemployment rate remaining stubbornly high at above 9%. The IMF expects the US economy to grow by 2.5% in 2011 and 2.7% in 2012 (from 2.9% in 2010).
- Regarding the European outlook, the second quarter of 2011 was characterized by renewed investor concern about excessive sovereign debt in periphery European countries, most notably Greece. Despite the debt concerns, private forecasters as well as the IMF have recently upgraded the Euro-zone GDP growth forecast for 2011 (2.0% y-o-y¹). The improved outlook is to a large degree in reaction to much stronger than expected German growth of almost 5% y-o-y in 2011Q1. The IMF expects Euro-zone growth to moderate to 1.7% y-o-y in 2012 as growth in core European economies slows and periphery economies struggle on the back of increased fiscal austerity measures.
- Growth in key emerging economies such as China and India continues to outperform the developed world. The Chinese economy expanded by a still robust 9.5% y-o-y in 2011Q2. The moderation can be explained by monetary policy tightening in China – the policy interest rate has been raised by 125bps since 2009, while the Chinese central bank has also increased bank reserve requirements by 450bps over the same period.

There are significant risks to the global economic outlook. High levels of fiscal debt remain the key risk factor as Greece and others are forced to adhere to strict austerity measures in order to continuously access IMF/EU funding. Also, in the US, the slow growth in employment is a concern as employment growth is crucial to sustaining private demand, especially amidst increased fiscal tightening.

¹ IMF Global economic outlook, June 2011

The South African economy

- GDP growth surprised on the upside during the first quarter of 2011, increasing by 4.8% q-o-q saar², up from a revised 4.5% q-o-q saar during 2010Q4. The key driver of economic growth during 2011Q1 was the manufacturing sector, which rose by 14.5% q-o-q saar, and contributed 2.2 percentage points (%pts) to overall GDP growth. This was mainly on the back of increased production of petroleum, chemical products, and rubber and plastic products. However, it was the growth in the finance, real estate and business services sector which was the most surprising. After registering growth of only 1.4% and 1.7% in 2010Q3 and 2010Q4 respectively (both q-o-q saar), the sector expanded by a robust 4.8% q-o-q saar, contributing 1.0 percentage point to overall GDP growth in 2011Q1.

Table 1: 2011Q1 GDP higher than expected...

Sectoral breakdown of GDP: q-o-q saar				
	2010Q2	2010Q3	2010Q4	2011Q1
Agriculture, forestry and fishing	13.6	16.3	12.5	-2.6
Mining and quarrying	-22.2	33.7	17.1	1.8
Manufacturing	5.0	-4.9	4.1	14.5
Electricity, gas and water	-1.7	-2.2	5.6	3.3
Construction	1.0	0.8	0.2	0.0
Wholesale-, retail-, motor trade and accommodation	6.0	3.3	3.5	4.4
Transport, storage and communication	4.5	3.0	4.2	3.6
Finance, real estate and business services	3.8	1.4	1.7	4.8
General government services	4.6	0.4	5.7	1.8
Personal services	3.6	3.1	3.3	2.7
GDP at market prices	2.8	2.7	4.5	4.8

Source: Stats SA

- From the demand-side perspective, household consumption remained the most important driver of overall GDP growth during 2011Q1. According to the June SARB Quarterly Bulletin, real consumer spending increased by an impressive 5.2% q-o-q saar in Q1, up from 4.8% q-o-q during 2010Q4. Real household consumption expenditure is expected to rise by 4.5% during 2011, marginally higher than the 4.4% recorded in 2010.
- Real fixed investment activity accelerated during 2011Q1, as private business enterprise and public corporations increased outlays, while the decline in general government fixed investment continued to moderate. Overall, fixed investment

² Seasonally adjusted annualized rate

increased by 3.1% q-o-q (saar) from 1.5% in 2010Q4 with the y-o-y rate accelerating to 1.7% from only 0.2% in the final quarter of 2010. Overall real fixed investment growth is projected to increase by 2.3% and 4.1% during 2011 and 2012 respectively.

- On the inflation front, the most recent estimates for CPI released by Stats SA showed that consumer inflation continued to accelerate in June, rising by 5.0% y-o-y and 0.4% m-o-m. The category housing and utilities contributed 0.2%pts to the monthly change, followed by food (+0.1%pts) and transport (+0.1%pts). Consumer inflation is expected to continue rising and is likely to breach the 6% upper target later this year, and to stay above the upper target before moderating towards the second half of 2012.
- After averaging R7/\$ in the first quarter of 2011, the rand exchange rate strengthened to an average of R6.77/\$ during 2011Q2. The rand continued to be supported by robust foreign appetite for investing in SA bonds and equities, a weaker US dollar and relatively high commodity prices. These factors are expected to remain in place over the short-term. Therefore, the rand is projected to remain below R7/\$, on average, for 2011.

In sum, GDP growth for 2011 is expected to be higher at 3.8% y-o-y as a result of continued consumer spending and a moderate recovery in fixed investment. GDP growth for 2012 is forecast to be moderately lower at 3.7% y-o-y.

Table 2: Selected SA economic indicators

	Actual	Projections	
	2010	2011	2012
Real GDP growth (real y-o-y %)			
Final household consumption expenditure	4.4	4.5	4.1
Government consumption expenditure	4.6	4.5	4.3
Gross fixed capital formation	-3.7	2.3	4.1
Real GDE	4.2	4.9	4.4
Total exports	4.5	5.0	5.5
Total imports	9.6	8.6	7.7
Real GDP	2.8	3.8	3.7
Inflation (annual averages)			
CPI (Headline)	4.3	5.2	5.9

PPI (All items)	6.0	7.5	5.4
Exchange rates (fourth quarter averages)			
R/US\$	6.91	6.98	7.45
R/Euro	9.40	9.84	10.06
R/Pound sterling	10.92	11.17	11.66

Source: BER

The Western Cape economy

Economic activity in the Western Cape declined by 1.4% y-o-y in 2009, slightly lower than the 1.5% contraction registered by the national economy (at basic prices).

Table 3: Western Cape economic growth per sector – at basic prices (2005 - 2009)

Sector	2009	5-years annual average growth	Relative size (%) - 2009
Agriculture, forestry & fishing	3.9	3.6	4.0
Mining & quarrying	0.8	0.9	0.2
Manufacturing	3.1	2.8	16.9
Electricity, gas & water	3.2	2.8	1.5
Construction	6.8	5.1	4.7
Wholesale & retail trade, catering & accommodation	3.2	3.0	14.6
Transport, storage & communication	6.5	6.2	10.1
Finance, insurance, real estate & business services	5.1	5.1	32.5
Community, social & personal services	2.8	2.5	5.3
General government	1.4	1.4	10.1
Total	4.2	4.0	

Source: Stats SA; Quantec

Regional GDP in the Western Cape grew at an average of 4.3% per annum for the period 2005 - 2009. However, this average was pulled down by the 1.4% y-o-y contraction in economic activity registered in 2009. The sectors which recorded the fastest growth in economic activity (on average) over the 5-year period were: construction (10.5%); finance, insurance, real estate and business services (6.0%); and transport, storage and communication (4.6%). Economic activity in the latter two sectors slowed to below 1% in 2009. The biggest sector in the economy remains the finance, real estate and business services sector, accounting for 32.5% of total economic activity in the province during 2009.

During 2010, the manufacturing sector made the biggest contribution to national economic growth, adding 0.7%pts. This was followed by finance and government services each adding 0.4%pts. The trade, transport and mining sectors all contributed 0.3% pts. That being said, the Western Cape economy likely underperformed the national economic growth rate of 2.8% y-o-y in 2010 as a result of its relatively small mining sector.

Employment in the Western Cape

Job creation in the Western Cape has slowly picked up since the end of last year. According to Stats SA, 18 000 jobs were created in the Western Cape during 2010Q4 and a further 12 000 during 2011Q1 (+0.7% q-o-q). At the same time, employment in the rest of South Africa (excluding the Western Cape) increased by an estimated 139 000 jobs during 2010Q4, but recorded job losses of approximately 26 000 (-0.2% q-o-q) during 2011Q1.

Table 4: Employment in the Western Cape per sector ('000)

Industry	2010Q4	2011Q1	Change from 2010Q4
Agriculture	122	121	-1
Mining	3	2	-1
Manufacturing	283	290	7
Utilities	10	11	1
Construction	130	124	-6
Trade	379	388	9
Transport	112	113	1
Finance	244	239	-5
Community and social services	377	390	13
Private households	113	105	-8
Total	1 772	1784	12
Unemployment rate		22%	

Source: Stats SA, QLFS first quarter 2011

During 2011Q1, most jobs in the Western Cape were created by the community and social services sector (+13 000), followed by the trade sector (+9 000). Private households recorded the biggest number of job losses during the quarter, approximately 8 000. This was followed by the construction sector in which 6 000 jobs were lost during the first quarter of 2011. The unemployment rate in the Western Cape remains one of the lowest in the country.

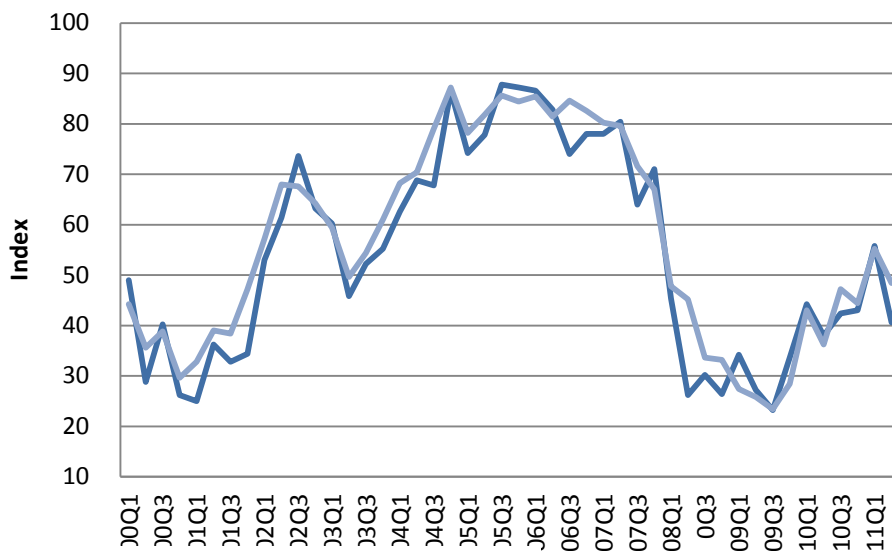
Business confidence in the Western Cape

Western Cape business confidence³ declined during 2011Q2, in line with national business confidence. However, the decline from an index value of 56 in 2011Q1, to 41 in 2011Q2

³ 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.

(15 points), was more pronounced than that recorded for the national economy (from 55 to 48 index points). Looking at the sub-sectors in the Western Cape, all of them registered a decline in business confidence during 2011Q2.

Figure 1: Western Cape business confidence registers sharp decline in 2011Q2



Source: BER

Table 5: Business confidence; SA vs WC

	2011Q1	2011Q2
Building		
Western Cape	12	7
National	18	21
Manufacturing		
Western Cape	54	33
National	51	51
Retail		
Western Cape	62	56
National	58	47
Wholesale		
Western Cape	69	43
National	65	47
Motor		
Western Cape	82	64
National	84	76
Ernst and Young Financial Services Index	63	71
Western Cape Business Confidence Index	56	41
RMB/BER Business Confidence Index	55	48
WC Consumer Confidence Index	-15	-6
FNB/BER Consumer Confidence Index	9	11

Source: BER

- National **retailer confidence** declined by 11 index points from 58 to 47 during 2011Q2. Business confidence amongst retailers in the Western Cape was also lower, shedding 6 points to record a level of 56 during 2011Q2. Overall, it can be said that the majority of retailers in the Western Cape are satisfied with current business conditions, whereas this is not true of retailers at national level.
- **Wholesaler confidence** also recorded a value of 47 index points during 2011Q2 (from 65 in 2011Q1). The drop in confidence amongst Western Cape based wholesalers was more pronounced, from 69 to 43 during 2011Q2.
- After receding to a level of +9 points during 2011Q1, the **FNB/BER consumer confidence** index for South Africa gained 2 points to reach a level of +11 during 2011Q2. Similarly, consumer confidence in the Western Cape improved by 9 index points to -6 during 2011Q2.
- **Building confidence** in the Western Cape reached a record low of 7 index points during 2011Q2. Nationally however, business confidence within the building sector improved marginally to 21 index points (from 18 in 2011Q1). According to the BER's Western Cape survey respondents, demand for building activity remains weak and profit margins remain low. This, despite an easing in tendering competition during 2011Q2.
- **Manufacturing confidence** remained unchanged at 51 index points during 2011Q2. In contrast, manufacturer confidence in the Western Cape shed 21 points, moving from 54 in 2011Q1 to 33 during 2011Q2. Declining domestic and export sales volumes contributed to the fall in confidence. There is also evidence that profitability amongst manufacturers in the Western Cape is under strain.
- The Ernst and Young **Financial Services confidence** index rose significantly to 71 index points during 2011Q2, from 63 during 2011Q1. Confidence amongst life insurers and asset managers in particular remained high, whilst a resurgence in confidence amongst retail banks was registered during 2011Q2.

Economic growth in the Western Cape

- The global economic recovery remains fragile as fiscal debt concerns in parts of Europe and the United States persist. World growth is now much more dependent on developments within emerging market economies such as China and India.
- Economic growth in South Africa for 2011Q1 surprised on the upside with a strong surge in activity coming from the manufacturing sector in particular. From the demand-side however, household spending is still the main contributor with fixed investment (although improving during 2011Q1) lagging.
- During 2009, the Western Cape economy performed slightly better than the national economy. In 2010, this is likely to have been reversed given base effects and strong growth coming from the mining and quarrying sector which is very small in the Western Cape.
- A number of positive and negative factors will affect the economic outlook for the Western Cape:

Negatives

- The global economic recovery which remains fragile, especially in the European countries which feature among the Western Cape's top export destinations.
- The relative strength of the Rand exchange rate, which makes our export sectors less competitive.
- Business confidence in the Western Cape registering a sharp decline in 2011Q2, with all the sub-sectors recording lower confidence.

Positives

- Business confidence in the financial sector remains high and should bode well for economic activity in the Western Cape given its relative size in the regional economy.
- Western Cape Retail sector confidence higher than national.
- Employment growth continued during 2011Q1, although at a slow pace. The unemployment rate in the Western Cape is lower than in other provinces.

- An improvement in sentiment amongst consumers (Western Cape CCI gained 9 points during 2011Q2) should result in continued spending.

Given the factors mentioned above, the Western Cape economy is likely to grow at least as fast as the national economy during 2011.

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