Volume.1 | Issue No.2 ISSN: 2706-896X

QUARTERLY ECONOMIC CHRONICLES

2019/Q4

ABOUT THIS PUBLICATION

The Quarterly Economic Chronicles is Vindilac Analytics' economic flagship, highlighting a series of economic events taking place at the national, regional and global levels. It is highly driven by the need for economic literacy and financial journalism in the African continent. South Africa in particular, is characterised by a poor savings culture, with a household income to debt ratio of 72%. Thus, by providing an economic report that is clear to a non-economist, we unintentionally create an enabling environment for citizenry to make informed economic decisions. It is worth noting, however that this report is not aimed at competing with but rather complementing existing economic reports in South Africa.

ISSN: 2706-896X

All queries should be addressed to: info@vindilac-analytics.co.za

For more information on Vindilac Analytics' services, please visit the website below:

www.vindilac-analytics.co.za

Table of Contents

ACKNOWLEDGEMENTS

We would like to acknowledge and give special thanks to our team members who contributed significantly to this material work. The contributors for this material work are as follows:

Associate Consultant
Mr Baneng Naape

Associate Consultant
Mr Marius Masoga

Strategic Relations Advisor
Ms Thando Mkhombo

Seasonal Writer
Ms Tumelo Matlhako

Seasonal Writer
Mr Thabang Kumalo

Project Manager
Ms Olwethu Shedi

Ambassador
Ms Mahlatse Magongoa

Ambassador
Mr Laurence Letsoalo

We would further like to sincerely thank our editor **"Ndivhuwo Doctor Sundani"** for working tirelessly on the final draft, and not forgetting all the reliable secondary data servers that have made their data freely and easily accessible. As the team, we thank the Almighty God for giving us the strength and guidance to write this material work.

1. EXECUTIVE SUMMARY

- Thabang Kumalo

Global economic growth remained subdued and slowed slightly further from an annualized rate of 2.9% in the second quarter of 2019 to 2.8% in the third quarter 2019. The slowdown reflected weaker economic activity in both advanced and emerging market economies. Real economic growth in the emerging markets decelerated marginally to 4.1% in the third quarter of 2019 from 4.2% in the second quarter, amid slower growth in emerging Europe and Latin America. Growth in emerging Europe moderated slightly to 4.0% in the third quarter following a rebound in the previous quarter. The moderation in emerging markets was driven mainly by slower growth in Turkey, where real output growth decelerated sharply from 4.0% in the second quarter to 1.7% in the third quarter.

Meanwhile, growth performance in South Africa remained weak due to muted demand coupled with low consumer confidence. However, monetary policy has been broadly accommodative in 2019. As such, consumer inflation was contained within the target range of 3 – 6 percent. Moderate inflation rates were seen in most economies (such as Japan and United Kingdom). In the UK for instance, inflation was below 2% target in November 2019. Nevertheless, in the US inflation moved a bit higher to 2.05% from 1.76% in November and October respectively. In the domestic economy, public finances suffered revenue shortfalls. While fiscal austerity has been at the heart of policymaking, the result has been a widening fiscal deficit and deepening debt levels amid continued bailouts of cash scrapped State-Owned Enterprises.

South Africa experienced great economic sorrows in the last quarter of 2019 because of the dilemmas at the state-owned enterprises. On one hand, Eskom had implemented several stages of load shedding, which affected normal business activities. On the other hand, South African Airways (SAA) was also on the spotlight due to protests that threatened to put normal operations of the airline to be inoperative. These have remained to be issues that pose risks to the fiscus. As far as the repurchase rate (repo rate) is concerned, the risk to the inflation outlook is one of the determining factors for monetary policy conduct. In September and November 2019, the SARB kept interest rates on hold as it expected balanced risks to the inflation rate (Q4-SARB Quarterly Bulletin, 2019). The good news in this regard came when Statistics South Africa (Stats SA) released inflation figures for November 2019. According to the statistics thereof, annual inflation was 3.6% in November 2019, down from 3.7% recorded in October 2019.

However, the International Monetary Fund (IMF) revised South Africa's economic growth projection for 2019 downward to 0.7% in October 2019. This growth rate was slightly higher than the estimate of 0.5% by the National Treasury of South Africa in the 2019 Medium Term Budget Policy Statement (MTBPS). Meanwhile, in November 2019, the South African Reserve Bank (SARB) also revised its growth projection for real Gross Domestic Product (GDP) for 2019 lower to 0.5%. All of these projections are lower than the actual outcome of real GDP growth of 0.8% in 2018. The exchange value of the rand depreciated sharply in late October 2019 after the release of the 2019 MTBPS, which reflected a marked deterioration in South Africa's fiscal situation. This triggered renewed concerns regarding further credit rating downgrades as Moody's Investor Services (Moody's) revised South Africa's sovereign rating outlook from stable to negative, followed by Standard and Poor's on the 22nd of November 2019.

World trade volumes contracted at a year-on-year rate of 1.0% in September 2019, reflecting the ongoing trade tensions. Export volumes in emerging markets fell even more over this period, mainly due to lower exports from Africa, the Middle East, China as well as the rest of emerging Asia. Further, exports from advanced economies contracted by a lesser 0.4% in September 2019, largely due to lower exports from the Euro area. South Africa's net exports in particular, made the largest contribution to growth in real GDP in the third quarter of 2019 at 3.2%. The real exports of goods and services increased by 0.9% during 2019 quarter three, following contraction of 0.4% registered in the second quarter.

2. MONETARY FRAMEWORK

- **Marius Masoga**

South Africa experienced great economic sorrows in the last quarter of 2019 because of the dilemmas at the state-owned enterprises. On one hand, Eskom had implemented several stages of load shedding, which affected normal business activities. On the other hand, South African Airways (SAA) was also on the spotlight due to protests that threatened to put normal operations of the airline to be inoperative. These have remained to be issues that pose risks to the fiscus. In the Medium-Term Budget Policy Statement (MTBPS) exacerbating debt profile was outlined, and as a result, the rand exchange rate lost the momentum during the last week of October 2019. Furthermore, Moody's Corporation outlook for South Africa's credit rating turned from stable to negative, while growth outlook on the other hand remained under pressure.

In the global economy, growth prospects in 2019 have generally proved to be weak. In October 2019, the IMF has captured 3% as its forecast for global growth for the year. Factors that threatened growth included the US-China trade war, which escalated at the time thereof, and also uncertainty amid Brexit. In addition, the SARB have also indicated that growth in global trade volumes persisted to be on the downside, affected by trade tensions which then spillover to market confidence. The SARB's forecast for 2019 GDP growth in South Africa as of September 2019 was 0.6%. For 2020 and 2021, the forecast was for the GDP growth of 1.5% and 1.8%, respectively.

Inappropriately, the downward revisions to global growth and lower than expected growth in the third quarter of 2019 have prompted the SARB to lower their GDP growth forecast for 2019, 2020 and 2021. Therefore, during November Monetary Policy Committee (MPC) meeting, the governor of the SARB has communicated that forecast for 2019 GDP growth decreased to 0.5% (from 0.6%), while forecast for 2020 and 2021 also declined to 1.4% and 1.7%, respectively. The headwinds to growth remained likely to persist as a result of geopolitical risks, escalating trade tensions, and sustained increase in oil prices.

The Monetary Policy Snapshot in the Fourth Quarter of 2019

As commonly known and understood, monetary policy is concerned with how money supply is being managed in the country. The aim is to ensure the achievement of macroeconomic objectives. For instance, when money supply in the economy is well managed, that could bode well for liquidity, inflation, consumption, and growth amongst other things. The SARB is responsible for conducting monetary policy in South Africa, just like many other reserve banks across the world. Through policy interest rates (commonly known as Repo rate), the SARB is able to influence the level of inflation rate (and ultimately consumption) in the economy.

The risk to the inflation outlook is one of the determining factors for monetary policy conduct, as far as the repurchase rate (repo rate) is concerned. In September and November 2019, the SARB kept interest rates on hold as it expected balanced risks to the inflation rate (Q4-SARB Quarterly Bulletin, 2019). The good news in this regard came when Statistics South Africa (Stats SA) released inflation figures for November 2019. According to the statistics thereof, annual inflation was 3.6% in November 2019, down from 3.7% recorded in October 2019. This rate is the lowest in 9 years as Fin24 reported that last time annual Consumer Price Index (CPI) was at these low levels was in 2010 December when it recorded 3.5%.

Economic growth is also supposed to enjoy the benefits of interest rate policy adjustments to some extent. However, that doesn't often happen because of the unfortunate arena of less policy coordination in South Africa. At the current moment, the existing policies in South Africa do not seem beneficial for economic growth, at least in the near term. Nevertheless, the implementation of monetary policy has been observed to be fully functional domestically and internationally. One may give it a guess that no one would like to see the history of financial crisis repeating itself. However, uncertainties about tomorrow may be unknown.

While on the monetary policy stance, it should be noted that US Fed has decided to cut the Federal Funds rate 3 times in 2019. This has resulted in the target range of 1.5% to 1.75% in October 2019. The Fed was mostly concerned about global economic conditions and less vibrant inflation. Other key international monetary policy highlights were as follows:

Bank of England

- Policy interest rate was kept at 0,75% during November 2019 at the MPC meeting.
- The inflation rate remained below the target of 2% and would most likely drop further in the future.
- The BoE have become cautious and reduced its GDP forecast for the next three years. This is ascribed to a weak global economy and expected higher costs of trade between the United Kingdom and the European Union.
- The initial Brexit deal proposed by Prime Minister Boris Johnson does not bode well for economic growth.

Bank of Japan

- Interest rate remained unchanged at -0.1%. Deflationary monetary policy of the past prompts the bank to maintain accommodative monetary policy.
- Since consumption tax increase in October, the economy slowed down. But the circumstances couldn't suffice to influence any interest rate adjustments.
- The BOJ is concerned about increased amount of risks in the global economy. This is despite the almost truce concerning trade deals between US and China.

In general, the international monetary policy was accommodative, despite low growth prospects in the global economy. Moderate inflation rates have driven such easing of the monetary policy. Refer to Figure 1 to see graphical comparison for the selected banks.

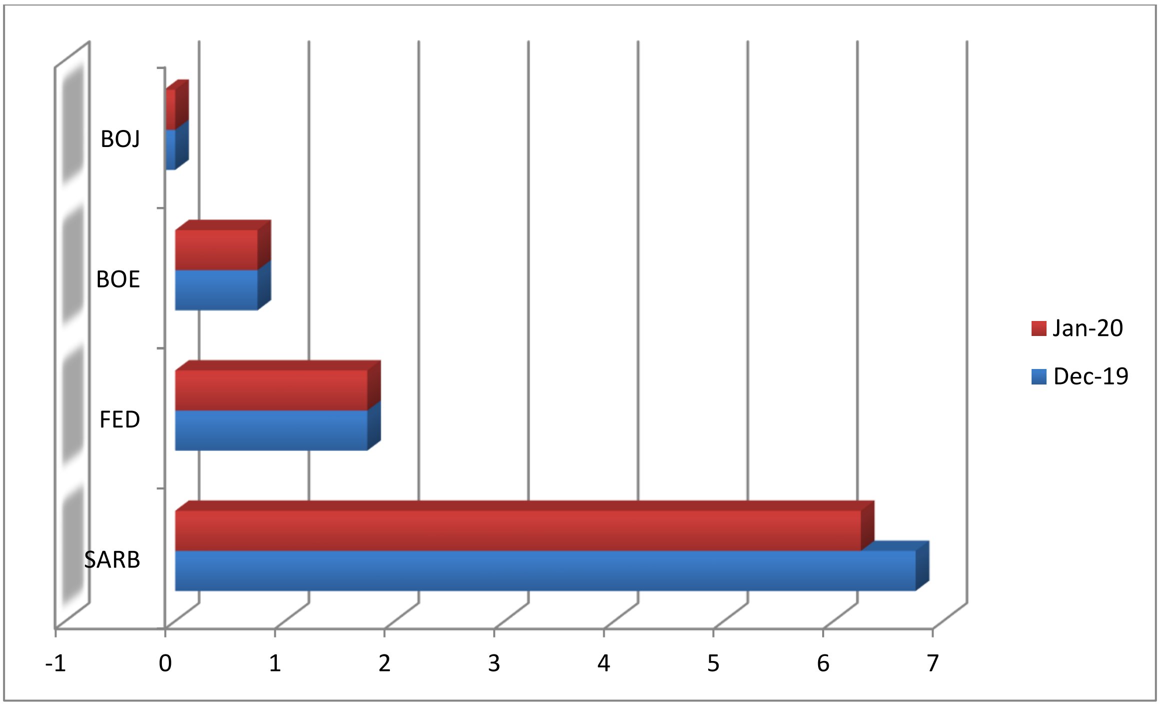

Figure 1: Policy Interest Rates in key Reserve Banks
Sources: SARB, BoJ, BoE, Fed, (2019)

Are you low on Cash? Credit can be your solution now, but be alert that your future credit record may be affected

Due to the presence of rough economic times, Fin24 reported that consumers have increased their credit purchases. While this may be seen as a solution for consumers to satisfy their daily expenses, if not well informed about the best alternative options to survive during tough times, some South Africans may find themselves in heavy debts. Therefore, financial advice is very important for those with limited economic and financial literacy. The cost of credit can however determine how much one can afford to borrow. Recently, the SARB have reduced the cost of borrowing as we have seen that repo rate was cut to 6.25% in January 2020. Additionally, there is one more interest rate cut forecasted for 2020. Therefore, those consumers who like to make credit purchases may be relieved from high cost of loan this year. Nonetheless, the economic activity still remains subdued, and most institutions like IMF, SARB, etc. have cut down growth forecasts.

3. FISCAL FRAMEWORK

- **Baneng Naape**

The South African fiscal framework has, in recent years, been characterised by deteriorating public finances and revenue shortfalls. While fiscal austerity has been at the heart of policymaking, the result has been a widening fiscal deficit and deepening debt levels amid continued bailouts of cash scrapped State-Owned Enterprises. Chief among the risks to the fiscal framework is the poor performance of the state utility "Eskom" and national airline "SAA". The lackluster economic performance has likewise undermined the revenue-generating potential of the country as evidenced by the projected revenue shortfall of R53 billion for the 2019/20 fiscal year (Budget Review, 2019). On the upside, however tax authorities have managed to recover R2.6 billion from the illicit economy since April 2019 (Fin24, 2020). The trends in tax revenue performance are illustrated in Figure 2 below.

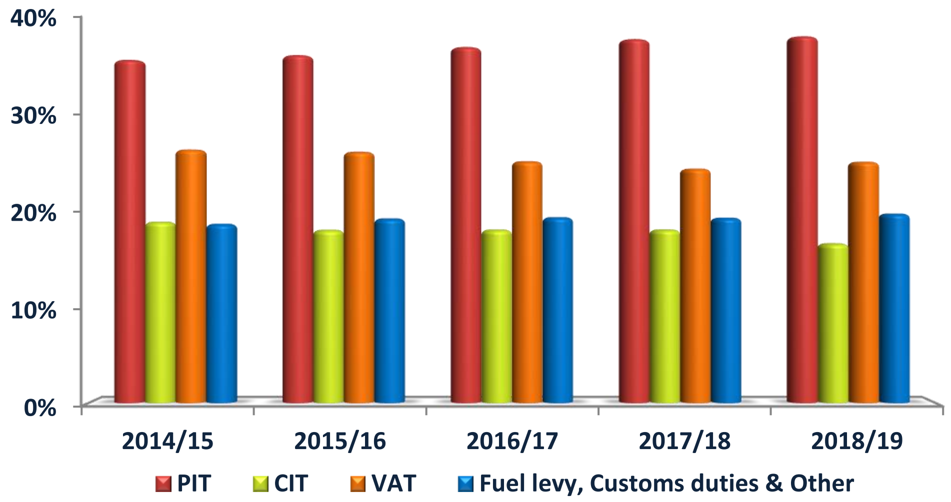

Figure 2: Composition of tax revenue by tax type

Source: SARS Statistics (2019)

The South African tax revenue system comprises of a number of taxes, including Personal Income Tax[1] (PIT), Company Income Tax[2] (CIT), Value-Added Tax[3] (VAT), fuel levy[4] and custom duties[5] among others. Trends in tax revenue performance indicate that PIT, being the biggest contributor, has performed relatively well than other sources of tax revenue. For example, PIT as a fraction of total tax revenue increased from 35.9 percent in 2014/15 to 38.3 percent in 2018/19. Fuel levy and custom duties have likewise been resilient towards shocks. On the downside, VAT and CIT remain suppressed amid weak domestic demand and sluggish business growth. CIT made up 16.6 percent of total tax revenue in 2018/19, lower than the 18.1 per cent achieved in 2017/18. VAT on the other hand, made up 25.2 percent of total tax revenue in 2018/19, slightly higher than the 24.5 percent obtained in 2017/18, albeit lower than the 26.5

[1] *Personal Income Tax is tax paid by an individual on the income they earn.*

[2] *Company Income Tax is a direct tax imposed by a jurisdiction on the income or capital of companies*

[3] *Value Added Tax is a consumption tax placed on a product whenever value is added at each stage of the supply chain, from production to the point of sale*

[4] *Fuel levy is an excise tax imposed on the sale of fuel, paid by any individual or firm who purchases fuel*

[5] *A custom duty is a tax paid by individuals for importing goods and the main aim is to protect the local market*

percent in 2014/15. Notwithstanding, tax revenue buoyancy[6] improved from 1.00 in 2017/18 to 1.23 in 2017/18 (Budget Review, 2019). The total tax revenue collected in 2018/19 amounted to R1 287.7 billion (SARS, 2019) despite sluggish growth. Some of the macroeconomic indicators are presented in Table 1 below.

	2014/15	2015/16	2016/17	2017/18	2018/19
Real GDP growth (%)	2.0	0.5	0.8	1.3	0.6
Expenditure (%GDP)	30.2	29.5	29.9	30.6	32.3
Revenue (%GDP)	26.1	25.7	25.5	25.9	26.1
Fiscal balance (%GDP)	-4.1	-3.8	-4.4	-4.4	-4.2
Gross Debt (%GDP)	48.9	50.5	53.0	55.6	56.2
Primary balance (%GDP)	1.3	1.0	0.5	1.0	1.0

Table 1: Main Budget Fiscal indicators
Source: MTBPS and Trading Economics (2019)

Main budget expenditure has, for the longest time, outpaced main budget revenue as evident in Table 1. While government expenditure increased from 30.2 per cent as a ratio of GDP in 2014/15 to 32.3 per cent in 2018/19, government revenue remained stagnant at 26.1 percent during the same period. Even worse, the growth of the population has been much higher than the growth of the economy. As such, per capita[7] income levels made a downturn in the previous year, decreasing from $7476 in 2017 to $7434 in 2018 (World Bank, 2019).

In the wake of financial distress faced by State-Owned Enterprises and numerous requests for financial support, the government had to revise its macroeconomic forecasts. The 2018 Medium Term Budget Policy Statement (MTBPS)[8] had projected the gross loan debt to stabilize at 59.6 percent by 2023/24. Unfortunately, the gross loan debt is now expected to stabilize at 60.2 percent by 2023/24 as per 2019 MTBPS. While the government has taken several steps to curb government spending by revising its baseline expenditure down by R9 billion in 2019/20, R19.7 billion in 2020/21 and R21.6 billion in 2021/22, such reductions are offset by provisional allocations for Eskom, the new infrastructure fund and the 2021 Census (Budget Review, 2019). Further to this, the primary balance[9] realized by the government has not been sufficient to stabilize the fiscal balance[10] and consequently, gross loan debt. This place public finances on an undesirable path and threatens fiscal sustainability.

[6] *Revenue buoyancy measures the responsiveness of tax revenue to the growth of the economy. A value of one implies that the growth in tax revenue matches the growth of the economy while a value below one implies that tax revenue growth is at a slower pace than the growth of the economy*

7 Per capita income/ GDP per capita is obtained by dividing the country's gross domestic product, adjusted for *inflation, by the total population.*

8 The Medium-Term Budget Policy Statement is a mini-budget document that sets out the government's priorities over the next three years and proposes allocations to different departments.

9 The primary balance is the overall fiscal balance excluding net interest payments on public debt.

10 The fiscal balance is the difference between general government revenues and expenditures.

4. TRADE & FINANCIAL MARKETS

- Thabang Kumalo

World trade volumes contracted at a year-on-year rate of 1.0% in September 2019, reflecting the ongoing trade tensions. Export volumes in emerging markets fell even more over this period, mainly due to lower exports from Africa and the Middle East, China as well as the rest of emerging Asia. Meanwhile, exports from advanced economies contracted by a lesser 0.4% in September 2019, largely due to lower exports from the Euro area. After contracting for five consecutive months, US exports remained unchanged in September 2019.

The international prices of metals and minerals as well as agricultural products decreased modestly in the third quarter of 2019, while the decline in energy prices was more pronounced. The price of Brent crude oil fell from a market boom of US$74 per barrel in May 2019 to a trough of US$59 per barrel in early September 2019 amid concerns about slowing global economic growth. In mid-September 2019, attacks on Saudi Arabia's oil facilities caused oil prices to surge by around US$10 per barrel, but production was restored in early October 2019, allowing prices to decline to levels prevailing before the attack. Oil prices have since trended somewhat higher, reaching US$61 per barrel in early December 2019 (see figure 3).

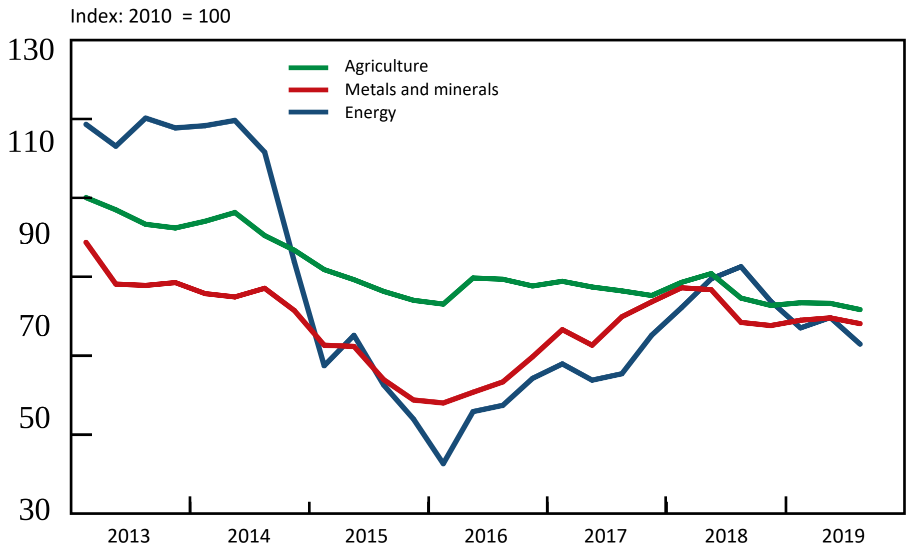

Figure 3: International commodity prices in US dollars

Source: World Bank (2019)

South Africa's net exports made the largest contribution to growth in real GDP in the third quarter of 2019 at 3.2%. Real exports of goods and services increased by 0.9% in the third quarter of 2019, from a contraction of 0.4% in the second quarter. In addition, the increase in foreign demand for vehicles and transport equipment as well as machinery and electrical equipment boosted manufacturing exports while vegetable products contributed to a substantial rise in agricultural exports. The decrease in overall mining exports reflected lower export volumes of mineral products and base metal articles. Nevertheless, real imports declined by 1.8% in the third quarter, following an increase in the second quarter of 2019. The contraction was driven by lower volumes of mining imports, mainly mineral products as well as base metals and articles. Strong growth in the imports of vehicles and transport equipment as well as machinery and electrical equipment outweighed lower import volumes of chemical products as well as prepared foodstuffs, beverages and tobacco. The real value of agricultural imports rose marginally due to an increase in domestic demand for imported vegetable products. Amid persistent weak domestic economic outcomes and increased global risk aversion, the rand traded at an average of R14.70 against the US dollar in the third quarter of 2019, substantially weaker than in the first half of the year. However, this trend was also evident among other emerging market currencies, largely due to geopolitical factors. Nonetheless, the rand, as well as other emerging market currencies were to a large extent influenced by global developments and risk aversion in the third quarter.

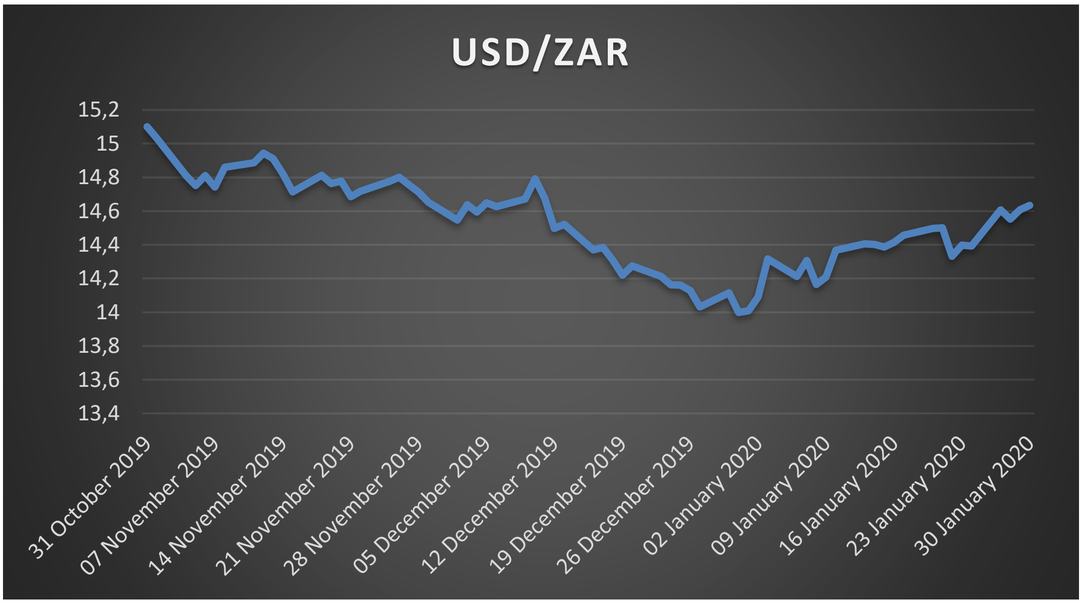

Figure 4: Fluctuations in USD/ZAR exchange rate
Source: Investing.com

The exchange value of the rand depreciated sharply in late October after the release of the 2019 MTBPS, which reflected a marked deterioration in South Africa's fiscal situation. This triggered renewed concerns regarding further credit rating downgrades as Moody's revised South Africa's sovereign rating outlook from stable to negative, followed by Standard and Poor's on 22nd of November 2019. However, the exchange value of the rand stabilized towards the end of November 2019 (see figure 4). Further, the real effective exchange rate (REER) of the rand decreased by 0.3% from December 2018 to September 2019, reflecting an improvement in the external competitiveness of domestic producers in foreign markets.

Moreover, the value of forex transactions against the rand within the monetary sector remained broadly unchanged at US$1.9 billion from the second to the third quarter of 2019. Similarly, the value of forex transactions against the rand with other resident counterparties remained unchanged at US$2.2 billion over the same period. Forex transactions in third currencies within the monetary sector remained unchanged at US$0.1 billion in the third quarter of 2019, while forex transactions in third currencies with other resident counterparties declined marginally from US$0.4 billion in the second quarter of 2019 to US$0.3 billion in the third quarter.

5. ENERGY & TECH

- Tumelo Matlhako

South Africa supplies around 40% of Africa's power and approximately 90% of the power to its population (Eskom, 2019). The power is divisional through the national utility named Eskom. Eskom sells power to approximately 2 703 modern, 51 848 business, 81 638 rural and 6 million private clients. Moreover, through Regional Electricity Distributors (REDs), which purchase power from Eskom, electricity is dispersed. In the 2019/20 financial year, Eskom held a 9.41% tariff increase after a 4.5% increase in 2018. This means that consumers saw bills increasing by approximately 14% in 2019. In this regard, the national utility proposed to the National Energy Regulator of South Africa (NERSA) to grant them a 16% increment for the year 2020 after NERSA proposed an 8% increase in tariffs for the year 2020 (see table 2 below).

	Total expected revenue from all customers	Revenues from tariff-based sales	Standard average tariff
Tariffs for 2020 (at NERSA 8.1% rate)	R221.8 billion	R205.1 billion	110.93 cents / R1.10 (per kilowatt-hour)
Tariffs for 2020 (at Eskom's proposed 16% rate)	R237.3 billion	R219.3 billion	119.03 cents / R1.19 (per kilowatt hour)

Table 2: Revenue and Tariffs for Customer

Source: Own compilation from Eskom website

The renewed implementation of electricity load shedding in October 2019 further aggravated the situation. Eskom experienced delays in the return to service of units that were on planned maintenance, while additional generation capacity at the Medupi Power Station was lost due to the failure of a coal-supplying conveyor belt. Limited diesel supplies also reduced the generation capacity of the utility. Consequently, the average level of real output in the electricity, gas and water sector in the first three quarters of 2019 was 1.4% lower than in the corresponding period of 2018. The National Development Plan (NDP), states that South Africa will have an energy sector that promotes economic growth and development through adequate investment in energy infrastructure by 2030. Additionally, the plan anticipates that South Africa will have an adequate supply of electricity and liquid fuels to ensure that economic activities and welfare are not disrupted and that at least 95% of the population will have access to grid or off-grid electricity.

While the energy sector is disrupting the South African economy, technological advancements are also disrupting and recreating industries. The so-called "Fourth Industrial Revolution" (4IR) is a developing environment in which disruptive technologies and trends such as the Internet of Things (IoT), robotics, virtual reality (VR) and artificial intelligence (AI) are changing the way we live and work. The objective of 4IR is to create an opportunity for skills development and job creation. South Africa has been preparing for the 4IR for the past few years across its private and public sectors. The rapid rise of (4IR), creates a need to equip young people with the necessary knowledge and essential skills in order to adjust to this developing environment.