



MEC's Foreword

Our province did not escape the ravaging impact of the 2008 global financial recession and is still reeling from its persistently stubborn effects in the form of low economic growth, high levels of unemployment, poverty and inequality. Guided by the National Development Plan and Free State Development Strategy, the journey towards Vision 2030 is undoubtedly a long and arduous one. Nevertheless, we remain steadfast in our resolve to continue moving forward.

Whilst our centrality as a province puts us at core of freight transport and passenger movements, it also makes our economy susceptible to shocks emanating from the national economy and surrounding provinces. The 2016 PERO captures in detail the inter-linkages between our provincial economy and the rest of the global, regional and national economy. It further highlights the impact of these on the provincial market and outlines some of the interventions that government has in store. The 2016 PERO remain a vital resource for planning in the province.

I wish to take this opportunity to call upon all our stakeholders and the private sector in particular, to join hands with us in unlocking the economic growth and development potential of this province. As a province, we derive strength from the Ethiopian proverb that says: “The elephant does not limp when walking on thorns.” We are adamant that we will not be defeated by the challenges of our economic and fiscal environment.

Ms. Elzabe Rockman

MEC for Finance

Executive Summary

The 2016 Free State Provincial Economic Review and Outlook (PERO) is released amid a challenging economic environment both locally and globally. The year 2015 proved to be a challenging year for the global economy. Uncertainty over a looming interest rate hike by the Federal Reserve, along with falling energy commodity prices, led to substantial volatility in the markets. The U.S. economy continued its solid growth and job creation, while Europe generally picked up speed and Japan remained a question mark. But with some exceptions (such as India), emerging and developing countries continued to slow in the face of falling commodity prices, tighter financial conditions, synchronized and sustainable global growth remained elusive.

GLOBAL AND NATIONAL MACROECONOMIC PERFORMANCE

The IMF estimated global economic growth at 3.1 per cent in 2015. The growth in global activity is projected to be more gradual than was initially projected at the beginning of 2015, especially in emerging market and developing economies. With global economic prospects repeatedly marked down over the last five years, there is a concrete risk of a world economy persistently mired in sub-par growth, with unacceptably high levels of poverty and unemployment

In advanced economies, a modest and uneven recovery is expected to continue, with a gradual further narrowing of output gaps. The picture for emerging market and developing economies is diverse, but in many cases challenging. The slowdown and rebalancing of China's economy, lower commodity prices, and strains in some large emerging market economies will continue to weigh on growth prospects in 2016/17. The projected upsurge in growth in the next two years, despite the ongoing slowdown in China, primarily reflects forecasts of a gradual improvement of growth rates in countries currently in economic distress, notably Brazil, Russia, and some countries in the Middle East, though even this projected partial recovery could be frustrated by new economic or political shocks.

Global growth remains fragile and could be derailed if transitions are not successfully navigated. In an environment of declining commodity prices, reduced capital flows to emerging markets, and higher financial market volatility, downside risks to the outlook remain elevated,

particularly for emerging economies. The three biggest risks to the global economy are seen as the normalization of monetary policy by the U.S. Federal Reserve, the slump in commodity prices and the slowdown in China. The Chinese economy has steadily slowed since 2010 and is seen continuing to do so, with economic growth forecast at 6.8 per cent in 2015 and 6.3 per cent in 2016.

The effects of the 2008/2009 global financial crisis on the South African economy continued to linger on unabated in 2014. This, combined with factors such as constrained electricity supply and labour unrest, has negatively impacted on the performance of the South African economy. The country continued to grow sluggishly with a growth rate of 1.3 per cent in 2015. Growth prospects for the South African economy look increasingly bleak with the National Treasury projecting the economy to grow by a mere 0.9 per cent in 2016.

FREE STATE PROVINCE'S ECONOMIC STRUCTURE AND PERFORMANCE

The Free State province is a land-locked economy that benefits from its centrality in South Africa. The province is not only endowed with natural resources in agriculture and mining, but has transformed together with other provinces to be dominated by services sector. However, negative external factors, more than internal factors, seem to have had an impact on the economic performance of the province in 2015.

The Free State economy is dominated by the tertiary industries, accounting for almost two-thirds of the provincial output. The primary industries have the second largest share and are increasing at the expense of the secondary industries. The community services sector is the largest single sector in the provincial economy, followed by finance and wholesale and retail services respectively. The heavy reliance on the government sector is still evident in the economy. The smallest sectors in the province are construction, electricity and water, and agriculture respectively.

The Free State's average annual real GDP growth between 2005 and 2014 was 2.4 per cent, which is below the national average of 3.0 per cent over the reference period. The province continues to grow below the national average unabated. In terms of economic growth projections, the Free State economy is projected to decelerate further in 2015 and grow by a mere 0.5 per cent. Some of the factors that are expected to impact negatively include, but not

limited to, shortage of electricity supply, drought and water supply shortages, labour unrest in mining sectors, increased production costs associated with. Over the forecast period (2015 to 2019), transport, finance and community services are expected to be the fastest growing sectors in the provincial economy, whilst electricity and water, construction, and agriculture are projected to be the slowest growing.

The Free State economy is forecast to continue with sluggish growth over the next five years and is unlikely to reach the 5 per cent growth set in the NDP, and thus have dire consequences for poverty, inequality and unemployment in the province. Robust policy interventions are therefore crucial to evade such horrendous outcomes and ignite growth in the province.

LABOUR MARKET PERFORMANCE

The world economy continues to expand at rates well below the trends that preceded the onset of the global crisis in 2008 and is unable to close the significant employment and social gaps that have emerged. The challenge of bringing unemployment and underemployment back to pre-crisis levels now appears as daunting a task as ever, with considerable societal and economic risks associated with this situation.

While employment levels in South Africa increased by 1.1 million since 2011, the unemployment rate continues to rise, while the absorption rate has not yet recovered to pre-recessionary levels. During the review period, the number of employed people increased by a mere 7.1 per cent, while the unemployed increased by a substantial 26.6 per cent, resulting in a 3.2 percentage point increase in the unemployment rate; from 23.2 per cent in 2008 to 26.4 per cent in 2015.

The Free State's labour force increased by an estimated 0.6 per cent over the past year, from 1 154 000 in Q3:2014 to 1 161 000 in Q3:2015. The working age population increased by 0.7 per cent over the same period. The number of people employed increased by a significant 5.3 per cent year on year, while the unemployed decreased by 8.2 per cent, resulting in a 3.1 percentage point decrease in the unemployment rate. The province has thus created 40 000 jobs during this period, whilst an estimated 33 000 were lost. The unemployment rate, consequently, decreased from 34.6 per cent in Q3:2014 to 31.5 per cent in Q3:2015. The number of discouraged work-seekers decreased by 8 per cent, indicating the positive outlook

of the unemployed to find employment. The province's absorption rate increased to 42.5 per cent in Q3:2015 from 40.6 per cent in Q3:2014, meaning the economy is increasingly absorbing more people into the labour market.

In 2014, the Free State had the highest annual unemployment rate in the country at 30.9 per cent, followed by Northern Cape (30.4 per cent) and Eastern Cape (30.0 per cent). The provinces with the lowest unemployment rates were Limpopo (21.5 per cent), KwaZulu-Natal (22.0 per cent) and Western Cape (22.2 per cent).

Youth unemployment remains a major concern in the province. Youth unemployment in the Free State increased substantially post the 2009 economic recession; increasing from 36.1 per cent in 2009 to 48.2 per cent in 2014 before decreasing to 39.4 per cent in 2015. Stronger efforts are necessary to accelerate employment creation and to support the enterprises that create jobs. Active labour market policies and skills development initiatives, along with investments in public infrastructure and in strong social protection systems should be prioritized as appropriate, given national and provincial circumstances and specificities.



Mr. Godfrey Mahlatsi
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Abbreviations

AGOA	African Growth and Opportunity Act
APAP	Agricultural Policy Acton Plan
ASEAN	Association of Southeast Asian Nations (Brunei, Burma, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, Vietnam)
BBL	Barrel
BRICS	Brazil, Russia, India, China and South Africa
CCMA	Commission for Conciliation, Mediation and Arbitration
CFA	Chad, Congo Republic Cameroon, Gabon and Equatorial Guinea, who share same currency
COSATU	Congress of South African Trade Unions
CPI	Consumer Price Index
ECB	European Central Bank
EU	European Union
FDI	Foreign Direct Investment
FDC	Free State Development Corporation
GDP	Gross Domestic Product
HLH	Harrismith Logistics Hub
ILO	International Labour Organisation
IMF	International Monetary Fund
LAC	Latin America and Carribean
LIC	Low Income Countries
MIC	Middle Income Countries
MOU	Memorandum of Understanding
MW	Mega Watt
NEET	Not in employment, education or training
NDP	National Development Plan
NERSA	National Energy Regulator of South Africa
OPEC	Organization of the Petroleum Exporting Countries
PWC	Price WaterHouse Coopers
QLFS	Quarterly Labour Force Survey
RGF	Regional Growth Forecast
SA	South Africa
SARB	South African Reserve Bank
SETA	Sector Education and Training Authority
SEZ	Special Economic Zone
SMMEs	Small, Micro and Medium Enterprises

SSA	Sub-Saharan Africa
STATS SA	Statistics South Africa
USA	United States of America

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CHAPTER 1: GLOBAL AND NATIONAL MACROECONOMIC PERFORMANCE

Key findings

- The Global economy will likely grow by 3.1 per cent in 2015, down from 3.4 per cent in 2014.
- Global and regional growth levels are weaker in 2015 in comparison with preceding years due to downside risks determined by slowing growth in emerging markets in contrast with recovering major economies. Overall, growth will be boosted by Low-income countries, which are estimated to grow by 4.8 per cent in 2015.
- Oil prices have dramatically declined since 2014, commencing at approximately \$50 per barrel at the beginning of 2015 and hovering around \$30 per barrel by end 2015, due to oversupply of oil in the market.
- Saudi Arabia, one of the biggest suppliers of oil globally, is determined to allow the market to determine floor prices of oil whilst the end of Iran's economic sanctions will ensure more supply of oil in the markets pushes oil prices further downwards.
- Lower oil prices have undermined the revenue, current accounts and fiscal position of many oil-exporting countries, including those in Sub-Saharan Africa, whilst providing relief for oil-importing countries such as South Africa and Japan.
- The anticipated and eventual rise of USA interest rates has led to capital flight from emerging markets deemed to carry risky assets, which became detrimental for these economies' exchange rates.
- Through China's restructuring from investment-led economy to a consumption-led economy, the era of commodity boom was ended and commodity demand and prices in many emerging economies have slipped, to the detriment of these commodity exporters.
- With an anticipated weaker growth of 6.9 per cent for China in 2015, the country de-valued its currency against the dollar in the 2nd half of 2015 to boost its exports, also creating panic and volatility in financial markets.
- The global El Nino episode, which has caused drought in countries such as South Africa and India as well as localized flooding in other parts of the world, threatens food prices at localized areas.
- Coupled with challenges listed above, South Africa's exchange rate has weakened in 2015, breaching R16/\$ in December 2015. In the context of drought and the need to import maize, this represents upside risks to food and overall inflation.

1.2 Introduction

The year 2015 has presented a few economic occurrences globally which leave analysts with a lot to think about. Flowing from 2014, oil prices remained low at approximately \$50 per barrel at the beginning of 2015 and reached below \$40 per barrel during December 2015, creating a disadvantage for oil-exporting countries in many emerging and low income economies such as Nigeria, whilst benefiting oil-importing countries such as South Africa through lower input costs to production and lower inflation. For oil-exporting countries whose economies are not widely diversified, the fall in oil prices has undermined their revenue and fiscus position, as well as brought havoc on government programmes and plans.

For the better part of 2015, the United States left many countries uncertain in anticipation of its lifting of quantitative easing, which is dependent on the improvement of the country's economic indicators (unemployment rate, domestic payrolls, inflation as well as other economic domestic and international data). The initial effects of this uncertainty resulted in a loss of appetite for risky financial assets (mainly from emerging economies), which had adverse effects on capital flow and exchange rates of these countries. By December 2015, the USA had increased interest rates by 25 basis points, which further played a part in deteriorating exchange rates for countries with "risky assets", making imports for these countries more expensive.

As the second largest economy, China is restructuring its economy from an investment-led economy to a consumption-led economy, which has a negative impact on global demand and bears negative consequences on resource-exporting countries (some of which are emerging market and developing economies). With a slower growing economy, China devalued its currency mid-2015 to create exports which are more competitive whilst making imports relatively expensive, causing wide-spread financial market volatility globally.

The slower growth of China's economy also brought the spotlight on another emerging economy, India, which is estimated to grow by 7.3 per cent in 2015. Low growth and inflation in Japan and Eurozone also bring challenges in the global landscape, whilst crisis in the Greek financial stability towards the middle of the 2015 put a spotlight on the Eurozone's ability to

mitigate the crisis. These are just a few of economic occurrences of 2015 and give some leeway to the world output discussed below.

1.6. Global Economic Performance

As illustrated in table 1.1 below, global economic output is projected to grow by 3.1 per cent in 2015, which is a 0.3 percentage point decrease from 3.4 per cent recorded in 2014. As economic conditions tightened global growth was revised twice in 2015, from 3.5 per cent in April 2015, to 3.3 per cent in July and subsequently to 3.1 per cent in October 2015. Most countries' growth rates (in Advanced, Emerging and Low income economies) have been revised downwards since April 2015, with exceptions of some European countries. However, global growth is expected to strengthen to 3.8 per cent in 2016.

According to the International Monetary Fund (IMF), the Advanced Economies' growth will remain lackluster (2.0 per cent) in 2015, whilst world output growth will be boosted mainly by Low-income Countries (LICs), which are projected to grow by 4.8 per cent in 2015. Although world commodity prices have taken a downturn, most of LICs will benefit from previous years' investment and exploration in mining as commodity exporters, whilst oil importing LICs will benefit from low oil prices and subsequent improvements in current account balances as well as lower inflation. Also, public expenditure in infrastructure, mining and consumer spending fueled by remittances will keep internal demand spurred and benefit economic growth by some margin. However, the large impact of falling commodity prices is visible, as reflected by slower growth of 4.8 per cent in 2015 in comparison to 6.0 per cent in 2014.

Table 1.1 Global economic performance

	Year-on-Year			
	Actual		Projections	
	2013	2014	2015	2016
World Output	3.4	3.4	3.3	3.8
Advanced Economies	1.4	1.8	2.1	2.4
United States	2.2	2.4	2.5	3
Euro Area	-0.4	0.8	1.5	1.7
Germany	0.2	1.6	1.6	1.7
France	0.7	0.2	1.2	1.5
Italy	-1.7	-0.4	0.7	1.2

Spain	-1.2	1.4	3.1	2.5
Japan	1.6	-0.1	0.8	1.2
United Kingdom	1.7	2.9	2.4	2.2
Canada	2	2.4	1.5	2.1
Other Advanced Economies	2.2	2.8	2.7	3.1
Emerging Market and Developing Economies	5	4.6	4.2	4.7
Commonwealth of Independent States	2.2	1	-2.2	1.2
Russia	1.3	0.6	-3.4	0.2
Excluding Russia	4.2	1.9	0.7	3.3
Emerging and Developing Asia	7	6.8	6.6	6.4
China	7.7	7.4	6.8	6.3
India 6/	6.9	7.3	7.5	7.5
ASEAN-5 7/	5.1	4.6	4.7	5.1
Emerging and Developing Europe	2.9	2.8	2.9	2.9
Latin America and the Caribbean	2.9	1.3	0.5	1.7
Brazil	2.7	0.1	-1.5	0.7
Mexico	1.4	2.1	2.4	3
Middle East, North Africa, Afghanistan, and Pakistan	2.4	2.7	2.6	3.8
Saudi Arabia	2.7	3.5	2.8	2.4
Sub-Saharan Africa	5.2	5	4.4	5.1
Nigeria	5.4	6.3	4.5	5
South Africa	2.2	1.5	2	2.1
Low-Income Developing Countries	6.1	6	5.1	6.2
World Growth Based on Market Exchange Rates	2.5	2.7	2.6	3.2

Source: IMF, World Economic Outlook, October 2015.

Emerging market and developing economies are expected to give support to world output, growing by 4.0 per cent in 2015, mainly as a result of growth in Emerging and developing Asia such as India (7.3 per cent) and China (6.8 per cent). In comparison with previous years, output in emerging market and developing economies grew by 5 per cent in 2013 and then dropped to 4.6 per cent in 2014, while it is forecast to decline further to 4.0 per cent in 2015. In previous years, the economic region benefited from high interest rates with higher yields in comparison with the USA. However, as depicted in table 1.1 above, major strain in the economic region will be mainly caused by Russia, whose economy is expected to contract by 3.8 per cent due to effects of economic sanctions imposed mainly by the USA and European Union over the Ukraine crisis. Previously boosted by commodity demand from China, the Brazilian economy is expected to be hard-hit and to contract by 3.0 per cent in 2015 as China restructures its

economic model (reduction in commodity demand and subsequent reduction in commodity prices) and investors refrain from investing in the country due to its political challenges.

1.6.1. Growth trends in Advanced economies

The growth of advanced economies, although lower in comparison with emerging markets and developing economies, is expected to rise from 1.8 per cent in 2014 to 2.1 per cent in 2015. Table 1.2 below depicts a set of economic indicators for some of the advanced economies with detailed explanation for the countries' economic performance.

Table 1.2 Advanced Economies Economic Data

Advanced Economies	Real GDP growth			CPI (% changes)		
	Actual	Expected		Actual	Expected	
	2014	2015	2016	2014	2015	2016
USA	2.4	2.6	2.8	1.6	0.1	1.2
Euro Area	0.9	1.5	1.6	0.4	0.2	1.0
Japan	-0.1	0.6	1.0	2.7	0.7	0.4
	Current Account balances (% of GDP)			Official unemployment rates		
	Actual	Expected		Actual	Expected	
	2014	2015	2016	2014	2015	2016
USA	-2.2	-2.6	-3.0	6.2	5.3	4.7
Euro Area	2.0	3.2	3.0	11.6	11.0	10.5
Japan	0.5	3.0	3.0	3.6	3.5	3.5

Source: International Monetary Fund, October 2015

United States

The economy of the USA is expected to slightly accelerate in comparison with the previous year, from 2.4 per cent in 2014 to 2.6 per cent in 2015. According to the IMF (July 2015), resultant wage growth, consumption growth (also fueled by low inflation rate of 0.1 per cent in 2015), favourable low interest rate, resultant investment, lower oil prices (in comparison with the first half of 2014) and strengthening housing market will boost the USA economy. Linked to the economy's performance is improvements in the labour market conditions, particularly the fall of the unemployment rate by 0.9 percentage points, from 6.2 per cent in 2014 to 5.3 per cent in 2015. The Federal Reserve Bank takes unemployment and inflation into consideration regarding interest rate movements and whilst improvements in employment in 2015 favored interest rate hike by 25 basis points in December 2015, the FED is expected to keep an eye on the current low inflation of the country.

The anticipation and eventual increase of USA interest rates may offset positive economic developments in the country and result in a negative impact on consumption, internal investment, recruitment and retail, amongst others.

Also, in the second half of 2015, China devalued its currency by 3 per cent against the US dollar, which has resulted in an appreciation of the US currency and which, in turn, will have negative consequences for exports and current account balance for the USA. Currently, USA's current account deficit is expected to deteriorate from 2.2 per cent in 2014 to 2.6 per cent in 2015.

Euro Area

The Euro Area is expected to grow by 1.5 per cent in 2015, an improvement from a growth of just 0.9 per cent in 2014. Support for growth is mainly by lower oil prices, expansionary monetary policy and the euro depreciation, with resultant slight narrowing of output gap. However, going forward, growth in the Euro Area will remain subdued by aging population and a consequent slowdown in total factor productivity. Countries within the Euro Area with the greatest positive growth in 2015 are Ireland (4.8 per cent), Luxemburg (4.4 per cent), Malta (3.4 per cent) and Spain (3.1 per cent). The region's most powerful economy, Germany, will grow by 1.5 per cent in 2015 whilst Greece's economy will decline by 2.3 per cent in 2015, flowing from its debt crisis in 2014. Improvements in economic conditions in the Euro Area might result in a reduction in the unemployment rate from 11.6 per cent in 2014 to 11.0 per cent in 2015.

However, improvements in economic growth may fail to uplift the region's low inflation, which is expected to decline to 0.2 per cent in 2015 from 0.4 per cent in 2014, which will result in subdued interest rates. With depreciating exchange rates, the current account surplus is expected to increase from 2.0 per cent in 2014 to 3.2 per cent in 2015.

Japan

After having registered growth of a meager 0.1 per cent in 2014, Japan is expected to grow moderately by 0.6 per cent in 2015 and further improve to grow by 1.0 per cent in 2016. IMF (October 2015) points to the country's quantitative and qualitative easing, which resulted in higher real compensation and equity prices as among contributors to better economic

performance; lower oil- and other commodity prices also assisted Japan's economic growth prospects. Together with improved economic conditions, unemployment is expected to decline from 3.6 per cent in 2014 to 3.5 per cent in 2015 and remain so in 2016.

Together with the Euro Area, the one challenge facing Japan is low inflation, which is expected to fall from 2.7 per cent in 2014 to 0.7 per cent in 2015. Low inflation leaves little room for quantitative easing, which would otherwise stimulate the economy. Also, relative prices and wages struggle to adjust whilst the incentive to invest by businesses remains muted. Furthermore, government revenue is also compromised through reduced income and subsequent reduced tax.

Japan's current account surplus is expected to improve from 0.5 per cent in 2014 to 3.0 per cent in 2015, boosted by a weaker Yen and cheaper imports of oil.

1.6.2. Growth trends in Emerging markets and developing economies

Emerging markets and developing economies are expected to collectively decline from a growth of 4.6 per cent in 2014 to 4.2 per cent in 2015, influenced mainly by a bust in commodity boom era which was mainly supported by China and India during the previous decade.

Table 1.3: Emerging Economies Economic Data

Emerging Economies	Real GDP growth			CPI (% changes)		
	Actual	Expected		Actual	Expected	
	2014	2015	2016	2014	2015	2016
China	7.3	6.8	6.3	2.0	1.5	1.8
India	7.3	7.3	7.5	6.0	5.4	5.5
Brazil	0.1	-3.0	-1.0	6.3	8.9	6.3
Russia	0.6	-3.8	-0.6	7.8	15.8	8.6
South Africa	1.5	1.4	1.3	6.1	4.8	5.9
Nigeria	6.3	4.0	4.3	8.1	9.1	9.7
	Current Account balances (% of GDP)			Official unemployment rate		
	Actual	Expected		Actual	Expected	
	2014	2015	2016	2014	2015	2016
China	2.1	3.1	2.8	4.1	4.1	4.1
India	-1.3	-1.4	-1.6	n/a	n/a	n/a
Brazil	-4.4	-4.0	-3.8	4.8	6.6	8.6
Russia	3.2	5.0	5.4	5.2	6.0	6.5
South Africa	-5.4	-4.3	-4.5	25.1	25.8	25.8
Nigeria	0.2	-1.8	-1.2	7.8	8.2	n/a

Source: International Monetary Fund, October 2015

China

The Chinese economy is expected to grow by 6.8 per cent in 2015, a drop of 0.5 percentage points from 7.3 per cent growth recorded in 2014. As the country tries to re-invent its economic structure from investment-led to consumption-led growth, many countries will be negatively affected by these changes implemented by the world's second largest economy. The first wave of changes imposed by China on its economy was a reduction in the demand for commodities which have hurt countries such as Brazil and South Africa. The country also devalued its currency (Yuan) by approximately 3 per cent against the dollar in 2015, which is expected to boost China's exports and its current account surplus, from 2.1 per cent in 2014 to 3.1 per cent in 2015. Emerging markets and possibly low income countries, which have exported raw material to the Chinese economy, will be hurt by both the devaluation of the Yuan and reduced demand from China; South Africa is facing tough competition in the steel industry due to cheaper imports from China. Some of the other possible consequences of the devaluation of the Yuan are discussed in table 1.4 below.

Inflation is expected to drop from 2.0 per cent in 2014 to 1.5 per cent in 2015, supported by decline in commodity prices and reduced internal demand, and thereafter rise to 1.8 per cent in 2016. The unemployment rate of China is expected to remain at 4.1 per cent for the period 2014 to 2016.

Table 1.4: Few possible effects of devaluation of Chinese Yuan

Consequence	Description of consequence	Secondary consequences for South Africa
1. Weaken other countries exports	Demand by China from emerging markets (e.g. Brazil) and as well as other countries which exported raw materials/commodities will decline (Weaker current account balances)	60% of SA's exports is in commodities. Exports in commodities will weaken and current account balance will be negatively affected
2. Disinflationary effects on Chinese imports	China is known for dominance in the clothing and textile industry, as well as other consumer goods. A devalued currency will cheapen imports of other countries and increased competition among Chinese competitors, therefore causing disinflationary effects on those goods exported by China and its competitors	Cheaper imports from China (and its competitors) might result in cheaper goods for SA citizens, which will boost consumer spending and retail. However, textile and clothing sector's competitiveness might be weakened further.
3. Reduced oil prices	Weak demand for commodities such as oil, based on restructuring of economy from investment-led to consumption-led economy, will have negative consequences on oil and other commodity prices	SA is net importer of oil. Reduced prices will reduce costs to production, avail additional cashflow for consumers and spur spending, savings or reduce consumer debt.
4. Possible future currency war	A devaluation of the yuan against the dollar might result in more demand and export of Chinese goods, which might trigger currency wars with countries such as USA in order to increase their share of global demand	SA's major trading partners in terms of exports include China and USA, amongst other countries. A devalued yuan will provide cheaper imports from China, increase competition in USA and undermine efforts to reduce unemployment. In the USA context, SA has a trade agreement with USA called African Growth and Opportunity Act (Agoa) which SA benefits in terms of quota of certain commodities exported to USA, and vice versa. Should the USA engage in a currency war by devaluing its own currency, the quota that is exported to SA will provide more competition in ailing sectors such as Agriculture (poultry) and undermine SA's efforts to reduce unemployment.

Source: The Guardian online, 2015.

India

According to forecasts by the IMF (2015), the Indian economy is forecast to grow by 7.3 per cent in 2015, similar to 2014's growth. It is likely to accelerate by 7.5 per cent in 2016. Expected to be the fastest growing emerging market economy in 2015, the Indian economy has made several strides to uplift its economic performance during global economic uncertainties. According to the IMF (2015), lower oil prices, improved confidence in the economy and consequent improvements in investment have played a key role in accelerated growth, whilst revised calculations of the country's economic output, to fall in line with international standards, have also favoured the country's economic standing. Such strong growth also reflects resilience in the services and manufacturing sectors, with the latter sector partly promoted by the country's campaign called "Make in India" and improvements in the business climate.

The IMF has further indicated that in the recent history, inflation in India was hovering at approximately 10 per cent. However, tighter monetary policy stance during the 2013/14 financial year resulted in an inflation of 6.0 per cent in 2014. By releasing buffer stocks of cereal and exercising oversight over agricultural procurement prices, food inflation has also

been contained. As a result, and in the presence of lower global oil prices, inflation level is expected to decline to 5.4 per cent in 2015, before slightly rising to 5.5 per cent in 2016 (IMF, 2015).

From a current account deficit of 1.3 per cent of GDP in 2014, India's current account deficit is expected to slightly deteriorate to 1.4 per cent in 2015, although it will be contained by a decline in gold imports and reduced commodity prices. The current account deficit is expected to deteriorate further to 1.6 per cent in 2016. Unfortunately, unemployment rates of India are unavailable. However, the country will have to continue to enhance efforts to create jobs for its growing working population, as young Indians who will enter the job market by the next decade are expected to reach 100 million. The IMF has listed several structural bottlenecks which need to be addressed for faster economic growth and macroeconomic stability in India, which are:

- Addressing bottlenecks in the energy, mining and power sectors;
- Increasing investment to help close India's major infrastructure gaps;
- Taking further steps to simplify and expedite the process of acquiring land and obtaining environmental clearances;
- Reforming the agriculture sector to ensure greater efficiencies in the public system for food procurement, distribution, and storage;
- Making labor markets more flexible, to encourage young job-seekers and boost presently low female labor force participation; and
- Improving education to meet rising shortages of skilled labor.

Brazil

Among the six emerging market and developing economies listed in table 1.3 above, Brazil grew the slowest in 2014 at 0.1 per cent. Its economy is expected to contract by 3.0 per cent in 2015, and remain in recession with a contraction of 1.0 per cent in 2016. Like many other oil exporting countries, Brazil's economic performance in 2015 is undermined by low commodity prices and a decline in commodity demand from China. Also, the increase of USA interest rates might result in capital flows in most emerging economies, including Brazil, where investor sentiment is currently low.

Inflation is expected to accelerate from 6.3 per cent in 2014 to 8.9 per cent in 2015, before reverting to 6.3 per cent in 2016. In August 2015, China unexpectedly devalued its currency by approximately 3 per cent and subsequently other emerging economies have allowed their currencies to fall to ensure exports remain competitive. However, imports and increased borrowing costs through weaker exchange rates are likely to add inflationary pressures, even in the presence of relatively low global oil prices.

The current account deficit is expected to narrow from 4.4 per cent in 2014 to 4.0 per cent in 2015, partly due to a consistent plunge in the country's currency which has assisted exports. However, the unemployment rate is likely to increase, from 4.8 per cent in 2014 to 6.6 per cent in 2015, and then deteriorate further to 8.6 per cent in 2016, in the context of a recession in 2015 and 2016 (IMF, 2015).

Russia

Whilst growth of the Russian economy was weak at 0.6 per cent in 2014, the economic performance is expected to further disappoint by a contraction of 3.8 per cent 2015, before slightly improving in 2016. According to the IMF (2015), a recession in Russia is expected in 2015 due to economic sanctions imposed on the economy (mainly by USA and Euro Area) due to the Ukraine conflict, which created a currency crisis in 2014. Also, as a major oil exporter, plunging oil prices dampened export proceeds. As a result, the economy had a decline in internal demand and real wages, as well as higher costs of capital and weaning investor confidence. Inflation is expected to accelerate from 7.8 per cent in 2014 to 15.8 per cent in 2015 (flowing from the effects of the currency crisis in 2014 and reduced oil prices) and improve to 8.6 per cent in 2016.

However, the current account surplus will widen, from 3.0 per cent in 2014 to 5.0 per cent in 2015 and 5.4 per cent in 2016. Whilst the Russian economy depends largely on exports, it is weaker imports (based on a weaker currency and high inflation) that will ensure increasing surpluses amidst recession effects. Lastly, one of the recession effects in an economy is loss of jobs. Therefore, unemployment rate is anticipated to rise from 5.2 per cent in 2014 to 6.0 per cent in 2015 and worsen to 6.5 per cent in 2016.

South Africa

The South African economy grew by 1.5 per cent in 2014 and according to estimates by National Treasury and the IMF, it is expected to grow between 1.4 per cent and 1.5 per cent in 2015. The estimated growth was revised downward from an initial estimate of 2.5 per cent in 2015 based on key internal and external risks for the country such as lower growth in China, shifts in market and elevated volatility in financial markets, possible rising of USA interest rates during monetary policy normalization, strengthening dollar, slow growth and low inflation for Europe and Japan, electricity shortages, labour disruptions and the likes. South Africa's inflation is expected to decline from 6.1 per cent in 2014 to 4.8 per cent in 2015, as consumer and business confidence continue to dwindle, but increase to 5.9 per cent in 2016, due to upside risks in internal food inflation as well as imported inflation through a weakened exchange rate.

The country's current account deficit will slightly improve from 5.4 per cent in 2014 to 4.3 per cent in 2015, before deteriorating to 4.5 per cent in 2016. The current account deficit in 2015 will be strengthened by sharp decline in global oil prices, although poor terms of trade based on China's demand and a weaker rand might offset this improvement from an import perspective. According to the National Treasury (2015), since South Africa is one of the biggest contributors to foreign direct investment (FDI) in Africa, proceeds from these assets will assist the current account balance in the near future. However, in 2016, a weakened exchange rate, a greater weight of food inflation in comparison with transport weight and the need to import food will play a key role in current account balance of South Africa

As one of the biggest socio-economic hurdles faced by South Africa, the unemployment rate is estimated to increase from 25.1 per cent in 2014 to 25.8 per cent in 2015 and 2016. The country faces short term challenges of electricity shortages, which compromise business and job creation directly and indirectly, labour market disruptions which compromise profits and consequently jobs, an ailing economy as well as structural bottlenecks such as shortage of the right skills mix and labour regulation red tapes.

Nigeria

As recently declared the biggest economy in Africa, Nigeria grew by 6.3 per cent in 2014. However, the country's economic performance is expected to decelerate to 4.0 per cent in 2015,

mainly due to its heavy reliance on oil export in the midst of a decline in commodity prices and demand. The economy is further forecast to grow by 4.3 per cent in 2016.

Inflation in Nigeria is expected to continuously climb from 8.1 per cent in 2014 to 9.1 per cent in 2016 and further to 9.7 per cent in 2016, compromised by weak exchange rate and deteriorating terms of trade. The current account balance, which was a surplus of 0.2 per cent in 2014, is expected to deteriorate to a deficit of 1.8 per cent in 2015, thereafter improve to a deficit of 1.3 per cent in 2016. Both commodity demand and prices and net capital outflows might compromise the current account balance in 2015. Compromised by failing profits, revenue and weaker performance of the economy, unemployment in Nigeria is expected to increase from 7.8 per cent in 2014 to 8.2 per cent.

Globally, whilst upside risks to growth for commodity importers exist due to lower oil prices, downside risks remain greater for commodity exporters and greater global economy. According to the International Monetary Fund (July, 2015), slow improvements to full employment, limited consumption, disruptive asset price shifts, volatility in financial markets and the appreciation of the dollar are some of the factors which may present negative consequences for global growth.

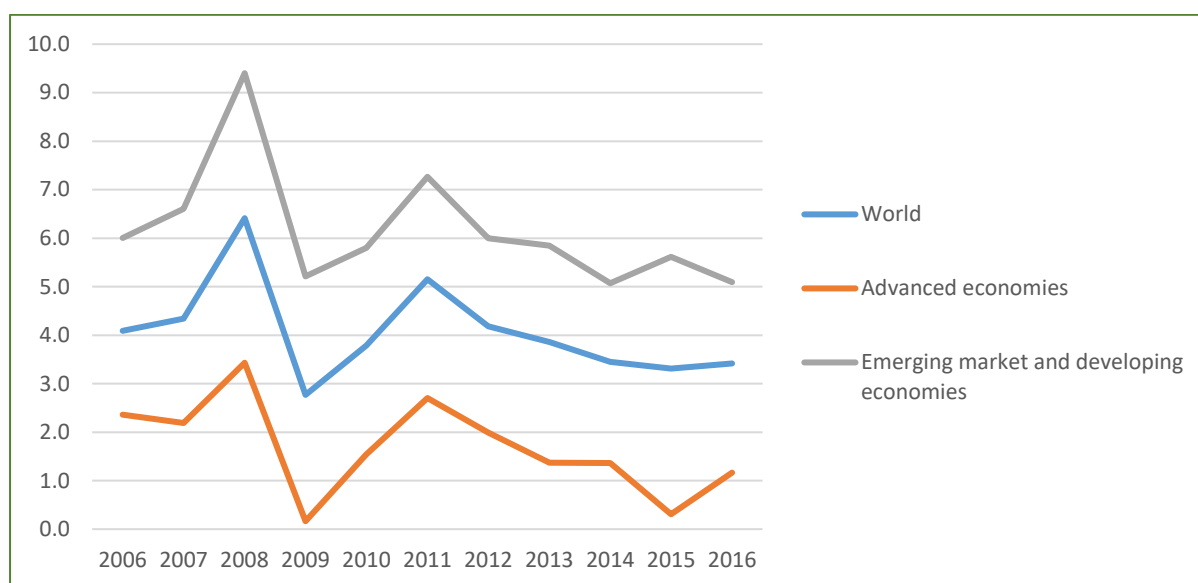
1.6.3. Global Inflation Outlook

A review of the global level shows that it peaked at 6.4 per cent in 2008, mainly supported by 9.4 per cent inflation in emerging market and developing economies, whilst inflation rate in advanced economies reached only 3.4 per cent. This rise in inflation in 2008 was mainly due to robust growth globally before the recession. As the global economic growth rate started deteriorating in 2009, inflation declined as unemployment rose and consumer and investor confidence dived. Although inflation rates rose between 2010 and 2011, inflation has taken a downward trajectory since 2011.

In 2015, global inflation is expected to reach 3.3 per cent, its downside risk mainly supported by advanced economies (0.3 per cent) due to lower commodity prices whilst inflation in emerging market and developing economies will reach 5.6 per cent (exaggerated by 100 per cent inflation rate in Venezuela and 50 per cent inflation rate in Ukraine). Inflation will continue to be subdued due to lower oil prices as well as reduced global and domestic demands,

but upside risks remain in emerging markets with depreciating exchange rates. In 2016, the global inflation rate is expected to slightly rise to 3.4 per cent as inflation in advanced economies rises to 1.2 per cent, supported by improvements in economic conditions such as employment and wages, as well as decline in output gaps. According to the IMF (2015), the inflation rate of emerging markets is expected to decline to 5.1 per cent in 2016, as output gaps begin to rise from 2015.

Figure 1.1: Global Inflation (% Change)



Source: IMF, October 2015

An output gap is an economic measure defining the difference between actual output of an economy and its potential output when the economy is most efficient or operating at full capacity (IMF, 2013). Although output gap data is unavailable for emerging markets and developing economies, advanced economies' output gap has been narrowing from 2.3 per cent in 2013 to 1.5 per cent in 2015, and is expected to narrow further to 1.0 per cent in 2016. Although improvements in output gap exist, risks remain in potential growth remaining lower than expected. Productivity is threatened by demographic trends such as an aging population. Also, high public debt ratios and private debt are a concern. In countries where inflation remains critically low, leaving little room for monetary policy easing, real interest rate become higher and dampen economic activity and worsen output gaps. Overall, as output gaps narrow, unemployment rates are also anticipated to decline. In advanced economies, the unemployment rate fell from 8.0 per cent in 2011 to an anticipated 6.8 per cent in 2015, falling further to 6.5 per cent in 2016.

Table 1.5: Output gaps and unemployment rates in Advanced economies

	2011	2012	2013	2014	2015	2016
Output gap	-1.9	-2.1	-2.3	-1.9	-1.5	-1.0
Unemployment rate	8.0	8.0	7.9	7.3	6.8	6.5

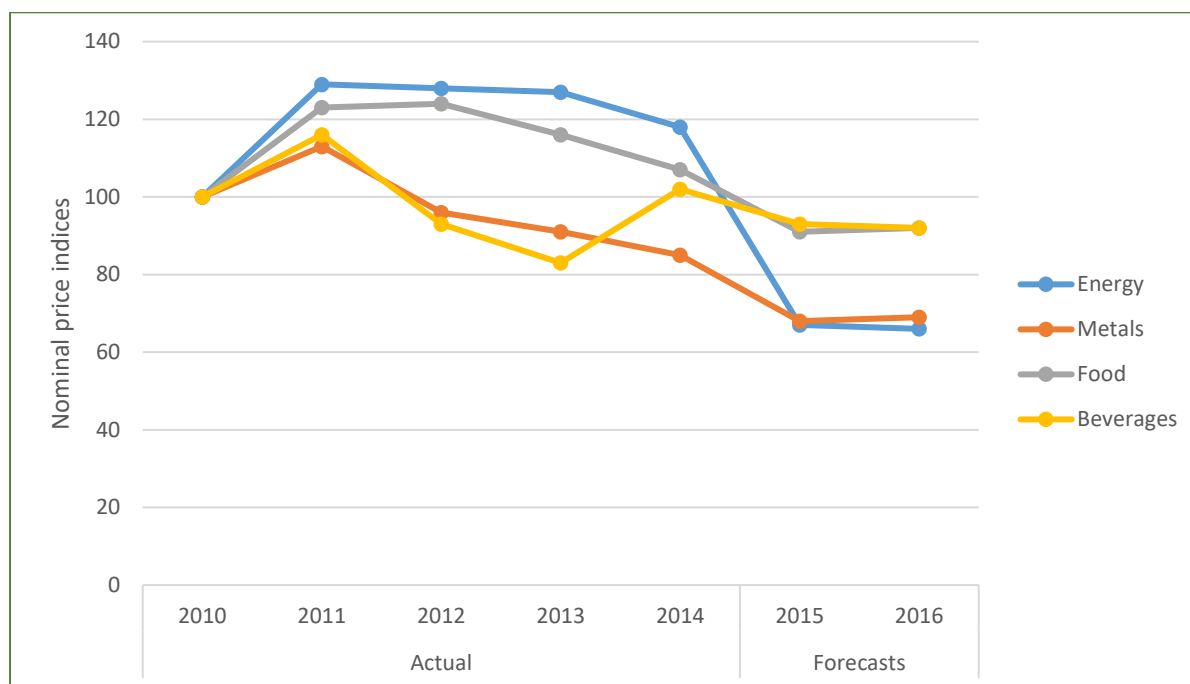
Source: IMF, October 2015

1.6.4. Commodity Prices

The World Bank (2015) has characterized the surge of commodity prices in early 2000s as a super cycle, where commodity prices are driven by demand and rise over a decade and not typically over the years. Between 2002 and 2012, as growth of emerging markets and developing economies accelerated, so too did the performance of commodity prices. In particular, the commodity price boom over the period is attributed to rising demand from China and India, particularly for metals and energy (coal). The two economies' energy consumption had been mainly coal, with China's consumption half of global consumption and whilst India's consumption a tenth of global consumption. Collectively, these two economies account for 28 per cent of global energy consumption.

Between 2000 and 2014, China's consumption growth of metals accounted for almost all global consumption, although the country's metal consumption has declined in recent years, which explains the declining metal index in figure 1.2 below. In terms of food price increases, the growing population, GDP rate and income of China and India have largely attributed to surge of food prices since 2007, although the two countries' agricultural consumption is in line with global consumption.

Figure 1.2 Global Trends in Commodity Prices (2010 = 100)



Source: World Bank, October 2015

According to the IMF, commodity price movements are largely correlated with economic performance globally, as determined by first principal components of commodity prices and economic and market conditions, therefore commodity prices are best discussed in the context of economic and market conditions.

In advanced economies, the USA is making slight economic recovery, as also indicated by its growth in GDP rate and decline in unemployment rates. The introduction of tax hikes in Japan in the 2nd quarter of 2015 has influenced the direction of consumption and GDP growth in the first two quarters of 2015, with large consumption and economic growth of 6.7 per cent in first quarter and decline of 7.0 per cent in GDP growth rate in 2nd quarter. The euro zone has not shown growth in the 2nd quarter of 2015. In emerging markets, China's growth is expected to slow down in 2015 whilst India is expected to perform exceptionally. Russia is expected to enter a recession due to economic sanctions imposed on the country by USA and Euro Zone, as well as capital flight. Amid slow demand for commodities from China, Brazil is expected to slide into a recession in 2015 whilst South Africa GDP growth rate slid by 1.3 per cent in 2nd quarter of 2015. Overall, most advanced economies and emerging markets still face downside risks to their economies, although at varying degrees.

Most commodity prices declined in 2nd and 3rd quarters of 2015, amid weak demand and strong supply. Although crude oil rebounded slightly in the 2nd quarter due to demand, ample supply will keep its average price subdued at \$52/bbl for 2015.

Energy

According to the World Bank (2015), the price of crude oil is expected to drop by 43 per cent in 2015. The downside risks to price of crude oil are:

- Expectations for a slower global growth,
- Strong production of oil by OPEC and non-OPEC producers,
- Increased production and oil exports by Iran following the lifting of international sanctions imposed on the country,
- Large global crude inventories e.g. European crude stocks and Iran's 40 million barrels in floating storage of oil
- Falling production costs of US Shale industry

Also, an indication that crude oil prices will remain subdued in 2015 also came from Saudi Arabia, who as one of the most powerful oil producers in the world and who has kept production high, declared in the 2nd half of 2015 that prices of oil will be determined by forces of supply and demand. The World Bank (2015) expects the price of crude oil to rise in 2016 due to slower growth in oil production.

The performance of coal prices have mainly been affected by reduced coal demand from China, which according to the World Bank (2015), fell drastically in the first half of 2015, mainly as a result of weak demand for electricity demand, growing competition with and substitution of coal in power generation, the need to reduce carbon footprint from coal power station and restrictions to low quality coal imports. However, demand for coal could increase in other emerging economies such as India. Due to reduced demand from three main markets of natural gas (Japan, US and Europe), natural gas prices are expected to decline in 2015.

Metals

The prices of metals, particularly base metals, fell in the 2nd quarter of 2015, mainly due to subdued demand (from China), increasing supply and high stocks of some metals as well as the dollar strength (World Bank, 2015). China accounts for 50 per cent of global metal

consumption (mainly with regards to aluminum) and the country's influence on fall of metal demand and prices is primarily due to weaknesses in construction, manufacturing as well infrastructure spending. The rest of the globe's consumption of metal fell in the 2nd quarter. The surplus in the supply of metals, due to large investments as well as weaker currencies in production countries are ensuring output remain high whilst prices remain moderate, even in the 3rd quarter of 2015. Upside risks to the price of metal for the future include closure of high-cost mines and delays in provision of new capacity to produce metals.

Food

The World Bank food price index will drop from 107 in 2014 to 91 in 2015, as observed in figure 1.5 above, mainly due to adequate supplies of most grains, oilseeds and edible oils, as well as reduced oil and fertilizer prices, given that agriculture is energy intensive. Although El Nino weather conditions are being experienced in the Southern Hemisphere, the World Bank anticipates that its impact on agricultural prices will be localized in affected regions and not affect global food prices, as the global market is over supplied with agricultural commodities, hence local prices will have little impact on global prices. El Nino, in simplistic terms, is a rise in sea temperatures which can create hot weather conditions and droughts in affected areas. The economic risks it imposes is characterized by reduced agricultural output and subsequent increase in food price indices, as is being experienced in South Africa, where water shortages also exacerbate the problem. As of November 2015, four provinces in South Africa (Free State, North West, KwaZulu-Natal and Limpopo) have been declared agricultural disaster areas following the El Nino episode. Going forward, localized food prices in South Africa will be exaggerated by the need to import maize with a very weakened exchange rate.

Beverages

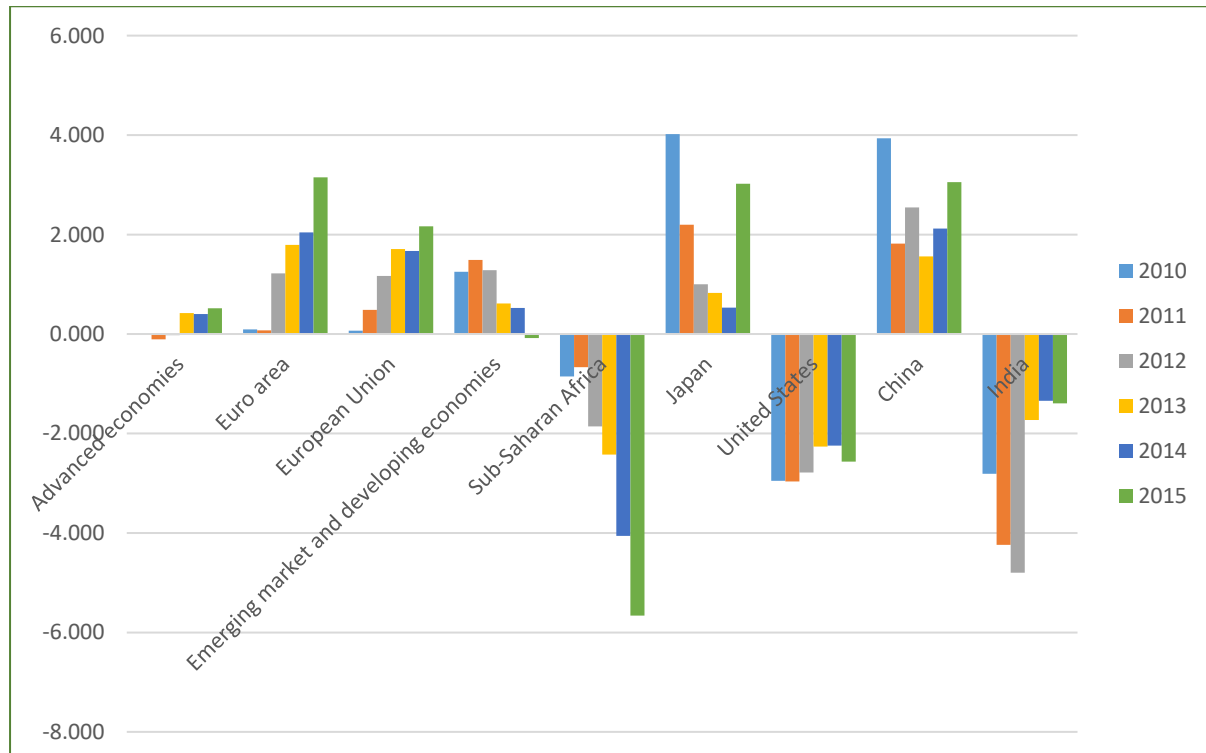
The Beverage Price Index is expected to slightly fall from 102 in 2014 to 93 in 2015. When Brazil experienced bad weather conditions in 2014, a shortfall of Arabica resulted in increased prices; this trend will be slightly reversed in 2015. Coffee market in Brazil will record surplus whilst robusta output will remain unchanged in 2015, which will result in decline in prices of both commodities. Tea and cocoa prices are expected to fall in 2015

1.6.5. Global (current account) Imbalances

The IMF (2015) defines current account imbalances as the difference between what a country spends abroad and what it receives from foreign sources and equates it to net capital flows. Under normal circumstances, countries are discouraged from having current account deficits which are too large, because this will discourage foreign investors' confidence. These deficits normally have to be "financed" through foreign currency, which can be a disadvantage for countries regarded to have risky assets, which have depreciating exchange rates, and which have little foreign reserves.

Phillip Mohr (2011) brings another angle to current account imbalances, that although current accounts deficits may indicate countries are living beyond their means, it may also indicate economies with strong potential growth, since other countries are willing to grant them credit to finance those imports. Also, whilst a current account surplus may indicate a competitive economy, it may also indicate an economy growing sluggishly or an economy whose government may have imposed import restrictions to maintain a surplus.

Figure 1.3: Global Imbalances (current account as percentage of GDP)



Source: IMF, 2015

Figure 1.3 above shows, post-recession, improvements in current account balances for advanced economies, the euro area and the European Union whilst emerging market current

account balance has recently deteriorated to a deficit and the deficit in Sub Saharan Africa continues to worsen towards 2015. Sluggish growth may have played a role in advanced economic areas whilst emerging markets may have recently suffered from expectations of looming increase of USA interest rates, encouraging capital outflows in that region considered to have risky assets. This consequently has weakened the exchange rate, which further worsens the affected countries' current account. The decline in commodity demand and commodity prices have also played a part in deteriorating current account balances for emerging markets, and also in particular, the Sub Saharan Africa. This economic region is also affected by what IMF (October 2015) notes as heavy reliance on development assistance, which over estimates the current account deficit; legacy effects from large past external borrowing in the presence low economic growth as well as natural disasters or political conflict, which temporarily affect production.

At country level, USA seems to have a sizable current account deficit and is estimated to deteriorate in 2015, with China's devalued currency likely to have played a role. In contrast, China's current account surplus will strengthen in 2015, due to its competitiveness as an economy, but more specifically, due to reduced commodity demand and devalued currency which supports exports. Japan's current account surplus may be strengthened by lower oil and other commodity prices whilst India's reduced demand for gold and reduction in commodity prices will contain its current account deficit in 2015.

Box 1.1: The other prominent global economic event in 2015: The Greek Financial Crisis explained

- The Greek Financial Crisis is a result of the Greece's unsustainable borrowing and spending of public funds and being unable to repay the public debt accumulated.
- The crisis was a buildup of many years of Greece allowing government payroll to balloon, by rewarding supporters of the biggest political parties with government jobs, resulting in one in every five working age person holding a government job.
- Raising wages for those already working for government and poor tax collection also exuberated the financial woe.

- Greece began borrowing from other countries, and these countries kept lending to Greece due to Greece misinforming all that its budget deficit still met EU requirements of around 3 per cent.
- Eventually, it was exposed that the budget deficit was approximately 15 per cent, which resulted in tighter borrowing conditions, and which resulted in Greece's borrowing costs to rise steeply and need for further loans to repay current loans.
- In essence, the Greek depression was triggered by sudden crisis in confidence by lenders, structural weaknesses in the economy and to some extent, the 2009 recession.
- The European Commission, the European Central Bank and the IMF (aka the Troika) intervened with a bailout of 110 billion euros in 2010, with the condition that Greece applies austerity measures to slashing government expenditure and wages, as well as privatization of government assets.
- By 2012, Greece required a 2nd bailout of 130 billion euros due to a recession and Greece's delay in implementing austerity measures; collectively, the 240 billion euros were to be dispatched to Greece in installments running from May 2010 to December 2014.
- The IMF also extended an extra relief bailout of 8.2 billion euros, which would run from January 2015 to March 2016.
- However, the newly elected Syriza-led government in 2014 refused to follow the bail-out conditions, which resulted in the suspension of further monetary tranches by the Troika and a resultant liquidity crisis for Greece.
- Greece rejected fresh agreement negotiated in 2015 and by June 2015, Greece became the first developed country to default repayment to IMF.
- What followed between June and mid-July was a threat on liquidity as Greek citizenry withdrew cash from banks for fear of implementation of capital control, whilst indices feel world-wide as potential for Greece to exit the EU seemed inevitable.
- Fresh negotiations took place again in July 2015 and the 13th of July, a provisional agreement between Greece and the lenders was reached.

Source: Education World, 2015; Wikipedia, 2015

1.7. Sub-Saharan Africa's economic performance

According to the World Bank (2015), Sub Saharan Africa (SSA) is expected to decelerate its growth from 4.6 per cent in 2014 to 4.2 per cent in 2015. SSA houses mostly middle income- as well as low income countries, which have not been exempted from external global economic shocks flowing from 2014 into 2015. The reduction of oil prices from above \$100 per barrel in the first half of 2014 to less an estimated average \$52 per barrel in 2015 benefitted net oil importers such as South Africa, due to lower oil prices which reduced inputs to production and inflation expectations. Oil exporters such as Nigeria and Angola, whose economies are heavily reliant on oil exports and aren't diversified, have had to put measures to restrain the negative effects of reduction in oil prices. It has even been speculated that Nigeria's imposition of fines on giants such as MTN Nigeria in 2015 are efforts to boost revenue following commodity price slumps. Fifty per cent of SSA countries are oil exporters.

Due to China's slowing economy and reduced demand, other commodity prices such as metals have plummeted in 2015, affecting mining in countries such as Zambia and South Africa. Also, due to reduced prices of commodities, the current accounts and foreign reserves of many SSA countries are expected to deteriorate.

Table 1.6: Sub Saharan Africa forecast summary

Annual percentage changes	2013	2014	2015	2016	2017
GDP at market prices	4.2	4.6	4.2	4.6	5
Private consumption	12.2	4.2	4.0	4.2	4.5
Public consumption	3.6	3.9	3.6	3.7	3.8
Fixed investment	5.6	6.7	6.7	7.3	7.8
Exports, GNFS	-7.3	3.4	2.8	3.1	3.3
Imports, GNFS	6.4	2.7	3.0	3.1	3.2
Net exports, contribution to growth	-4.3	0.1	-0.1	-0.1	0.0
Consumer prices, annual averages	8.1	9.0	N/A	N/A	N/A
Fiscal Balance (% of GDP)	-2.9	-2.4	-2.2	-2.2	-2.1
Memo item: GDP					
SSA excluding South Africa	6.0	5.7	5.0	5.4	5.8
Oil exporters	6.0	5.8	4.6	5.0	5.6
CFA countries	4.5	5.4	3.8	5.5	6.0
South Africa	1.9	1.5	2.0	2.1	2.4
Nigeria	5.4	6.2	4.5	5.0	5.5
Angola	6.8	4.4	4.5	3.9	5.1

Source: World Bank, Global Economic Prospects, June 2015

Private consumption is expected to decline from 4.2 per cent in 2014 to 4.0 in 2015, thereafter recover in 2016 and 2017 by 4.2 per cent and 4.5 per cent respectively. The recovery follows recovery patterns in economic growth of the region, as shown in table 1.6 above. Given the deterioration of commodity prices in the region, which will affect its revenue potential and thus the fiscus of oil exporters, cuts to subsidies will affect private consumption. Weakened purchasing power based on weakened currencies will affect consumption based on risen cost of imports. Low oil prices will increase purchasing power of oil importers and reduce their inflation, but depreciating currencies will offset this positive effect. Public consumption is expected to deteriorate from 3.9 per cent in 2014 to 3.6 per cent in 2015, based on the opposing forces of reduced fiscus of oil exporting countries whilst oil importing countries will continue to expand infrastructure implementation in electricity and roads. Public consumption is expected to recover to 3.7 per cent in 2016 and 3.8 per cent in 2017.

Exports are expected to deteriorate, from 3.4 per cent in 2014 to 2.8 per cent in 2015, although the export of CFA countries, who share a common currency Franc pegged to the Euro, are expected to benefit from depreciating euro against the dollar. Overall, exports of SSA region will recover to 3.1 per cent in 2016 and 3.3 per cent in 2017. Imports are expected to rise from a low base of 2.7 per cent in 2014, to 3.0 per cent in 2015, 3.1 per cent in 2016 and 3.2 per cent in 2017.

The fiscal balance of the SSA region, although negative, is expected to improve from deficit of 2.4 per cent in 2014 to 2.2 per cent in 2015, remain at the level in 2016, before recovering further to 2.1 per cent in 2017. The overall recovery of the fiscal balance is undermined by commodity price shocks in the region, which have undermined its fiscus and government's ability to spend.

When South Africa's data is excluded, growth in the SSA is higher, although it deteriorates in the immediate term. Economic growth declines from 5.7 per cent in 2014 to 5.0 per cent in 2015, thereafter recovers to 5.4 per cent in 2016 as countries make the necessary adjustments flowing from 2015 economic shocks. SSA is expected to grow by 5.8 per cent in 2017. The South African economy is expected to accelerate from 1.5 per cent in 2014 to 2.0 per cent in 2015, although recent global economic shocks and structural challenges such as shortage in electricity supply might weigh down on the economy's performance. The country is expected to recover in the medium term to 2.1 per cent in 2016 and 2.4 per cent in 2017.

Oil exporters will continue to support growth in the SSA region, although decline in oil prices will reduce growth from 5.8 per cent in 2014 to 4.6 per cent in 2015. Although countries such as Nigeria will follow similar growth pattern in the immediate term, Angola is expected to accelerate from 4.4 per cent in 2014 to 4.5 per cent in 2015. However, economic growth in Angola will decelerate to 3.9 per cent in 2016, at the back of reduced oil prices. Although CFA countries (Chad, Congo Republic Cameroon, Gabon and Equatorial Guinea) are expected to gain in export revenue through a depreciated Franc, their economic growth collectively is expected to decelerate from 5.4 per cent in 2014 to 3.8 per cent in 2015, and thereafter recover to 5.5 per cent in 2016.

The risks which are present in the SSA are largely downside. Internal risks as identified by the World Bank are conflicts such as those caused by Boko Haram, which can divert government funds away from real economic investments, depreciation of currency which increase the difficulty in repayment of foreign- currency loans and Ebola epidemic, which threatens confidence, investment and travel for the affected countries. The main external risk is in relation to China's growth and demand for commodities, which disadvantage SSA's commodity prices. Oil, as one of the commodities whose prices have plummeted, has increased the fiscal vulnerability as oil accounts for up to 90 per cent of the some oil exporters' fiscal revenue. Due to possible fiscal tightening, growth of Eurozone as SSA's biggest exporting market might stall, deteriorating export of the region. Fiscal tightening of USA may also hamper portfolio investments, exchange rate and inflation of some emerging economies of the SSA.

Box 1.2: Effects of China's dampened growth on SSA

China is in a process of restructuring its economy from investment –led to consumption-led. Therefore its need for raw inputs as part of its investment for grow the economy has been reduced, resulting in reduced commodity demand and prices, which affect countries whose exports are resource (commodity) based. Below is a summary of the influence China's major economic change has had on SSA countries, who rely on commodity export for revenue and economic growth

- China is the 2nd largest economy in the world

- China became the largest trading partner for SSA in 2009, accounting for 22 per cent of SSA's total trade globally
- Trade between SSA and China has been growing faster than United States and European Union
- SSA's exports to China are dominated by commodities, mainly fuel and chemicals as well as metals, whose volume and prices are largely influenced by China.
- A 1 percentage point increase in China's domestic investment results in 0.6 percentage point increase in SSA export growth
- SSA imports from China are mainly manufactured goods, as well as machinery and transport, although imports of manufactured goods from China are likely to decline as the country increases its global value chain
- Chinese foreign direct investment stock in Africa is doubled between 2009 and 2012 (\$21 billion in 2012)
- Africa is the largest recipient of Chinese development financing (almost 50 per cent) and its share is increasing
- Whilst OECD development assistance to Sub Saharan Africa is directed towards social infrastructure, China's development assistance is economical by nature (infrastructure).

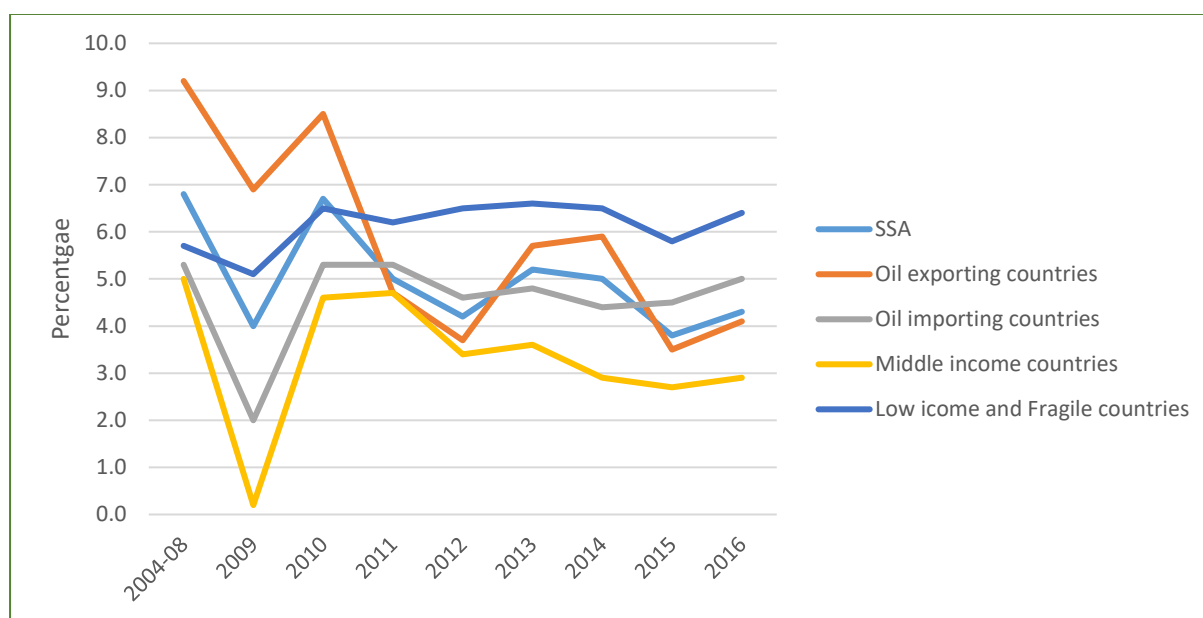
Source: World Bank, June 2015

The economic growth of Sub Saharan Africa averaged 6.8 per cent during 2004-2008, mainly due to growth of oil-exporting countries (9.2 per cent), in the context of strengthening commodity prices during that period. Low income countries grew at an average of 5.7 per cent due to strong commodity prices whilst oil-importing countries and middle-income countries grew by average of 5.3 per cent and 5.0 per cent respectively over the reference period. Post-recession, growth in SSA reached 6.7 in 2010 before declining to 5.0 per cent in 2014. Mainly due to reduced commodity demand and prices, growth in SSA will further deteriorate to 4.5 per cent in 2015. As countries restructure their expected revenue and budget, and the uncertainty surrounding the movement of interest rate of USA has disappeared, the growth of the economic region will recover to 5.1 per cent in 2016.

Post-recession, oil exporting countries grew by 8.5 in 2010, and subsequently declined to 5.8 per cent in 2014. Growth between 2010 and 2014 has been volatile. At the back of weakened oil prices and demand from China in the main, and currency depreciations which affect internal inflation and demand, growth of oil exporting countries will deteriorate to 4.5 per cent in 2015. Thereafter growth will slightly rise to 5.2 per cent in 2016. Oil importers are expected to positively gain from reduced oil prices, and although growth in this group has declined from 5.3 per cent in 2010 to 4.4 per cent in 2014, growth is expected to slightly accelerate to 4.5 per cent in 2015 and further improve to 5.0 per cent in 2016.

Middle income countries seem to grow the least among the different group highlighted in figure 1.4 below. Whilst these countries collectively grew by 4.6 per cent in 2010, growth deteriorated to 2.7 per cent in 2014. However growth of MICs will accelerate to 3.3 per cent in 2015 and 3.7 per cent in 2016. Low income countries have collectively grown above 6 per cent since the recession and are expected to grow by 6.3 per cent and 6.9 per cent in 2015 and 2016 respectively.

Figure 1.4: Real GDP Growth in Sub Saharan Africa



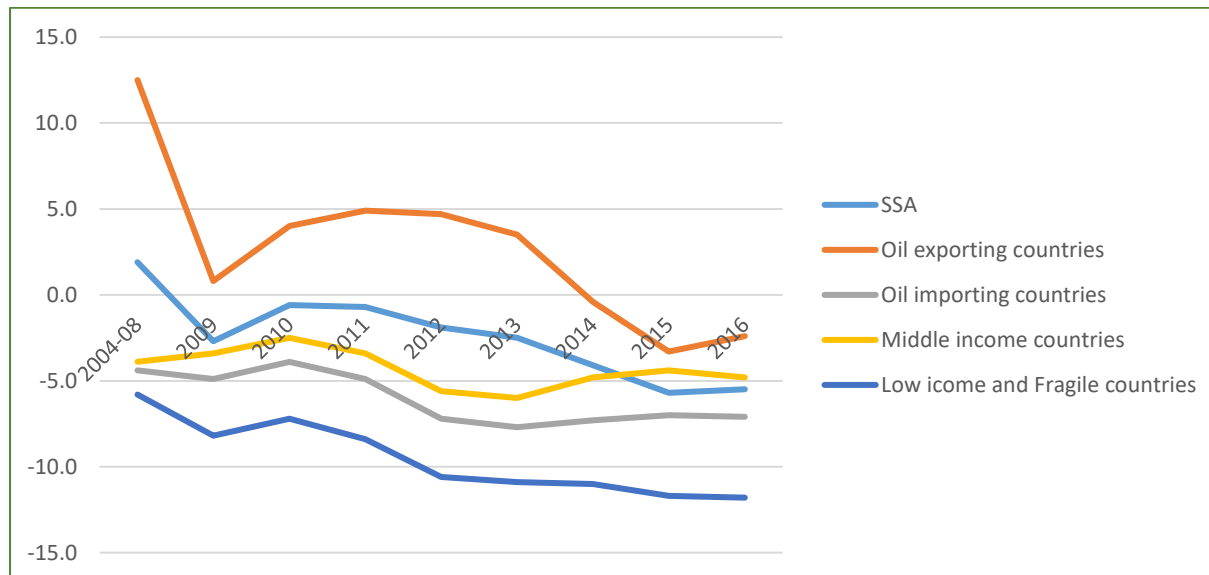
Source: IMF, 2015

Figure 1.5 below shows that although current account balance of SSA slightly rebounded post the recession, a deficit has existed since 2009 and has deteriorated since 2010. As expected,

oil exporting countries have benefited from large commodity demand and prices until recently, and recorded current account surplus of 4.0 per cent in 2010, which has subsequently declined to 1.0 per cent in 2014. In 2015, a current account deficit of 1.7 per cent is expected for oil exporting countries, which also indicates how these economies are not diversified and are vulnerable to external shocks in oil markets. The current account imbalance in oil importing countries is expected to deteriorate, from a deficit of 3.9 per cent in 2010 to 7.0 per cent in 2015; positive gains from reduced oil prices will be offset by weaker exchange rates and consequent increased inflation induced externally.

A lot of low income countries in SSA are rich in commodities but have few currency reserves, consequently due to reduced commodity demand and prices in oil and metals recently, current account deficits are expected to deteriorate from 7.2 per cent in 2010 to 10.9 per cent in 2015. Current account of middle income countries are expected to also be negatively affected by weaker exchange rates with a current account deficit worsening from 2.5 per cent in 2010 to 4.5 per cent in 2015.

Figure 1.5: Current account (% of GDP) in Sub Saharan Africa



Source: IMF, 2015

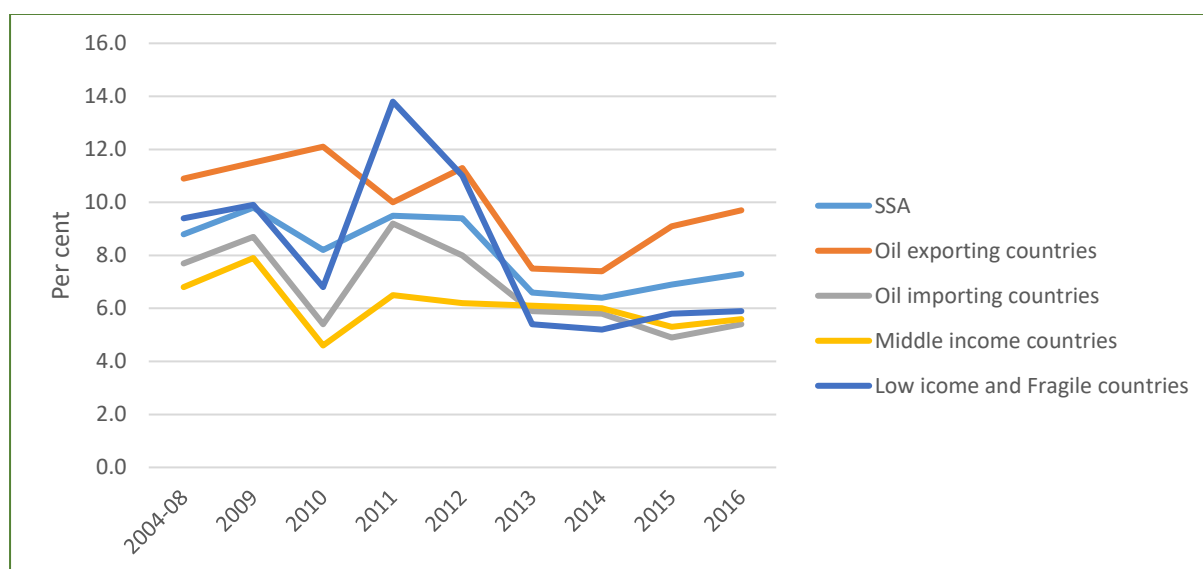
Inflation can be loosely described as an increase in prices, which is affected by internal factors such as private and public spending as well as external factors such as weak exchange rate and global price adjustments on commodities. From figure 1.6 below, inflation in SSA has slightly rose from 8.2 per cent in 2010 to 9.5 per cent in 2011, and thereafter pursued a downward

trajectory, reaching 6.3 per cent in 2014. Inflation is expected to slightly rise to 6.6 per cent and 7.0 per cent in 2015 and 2016 respectively based on imported inflation due to weakened exchange rates.

In 2010 and 2012, oil exporting countries experienced a surge in inflation, which reached 12.1 per cent and 11.3 per cent respectively and although inflation declined after 2012, it is expected to remain high at 8.8 per cent in 2015 due to reasons previously discussed. Inflation in oil importing countries swelled to 9.2 per cent in 2011, and thereafter declined and reached 5.8 per cent in 2014. Due to low oil prices which began to decline in 2014 and flowed into 2015, inflation in oil importing countries is expected to decline further to 4.9 per cent in 2015.

Inflation in low income countries increased drastically from 6.8 per cent in 2010 to 13.8 per cent in 2011, and it has subsequently declined to and reached 4.4 per cent in 2014. Inflation in these countries will remain subdued at 4.4 per cent and 4.9 per cent in 2015 and 2016 respectively. Although differentials in inflation of middle income countries have been minimal since 2011, an inflation of 5.3 per cent in 2015 is expected and will rise to 5.8 per cent in 2016.

Figure 1.6: Consumer prices in Sub Saharan Africa



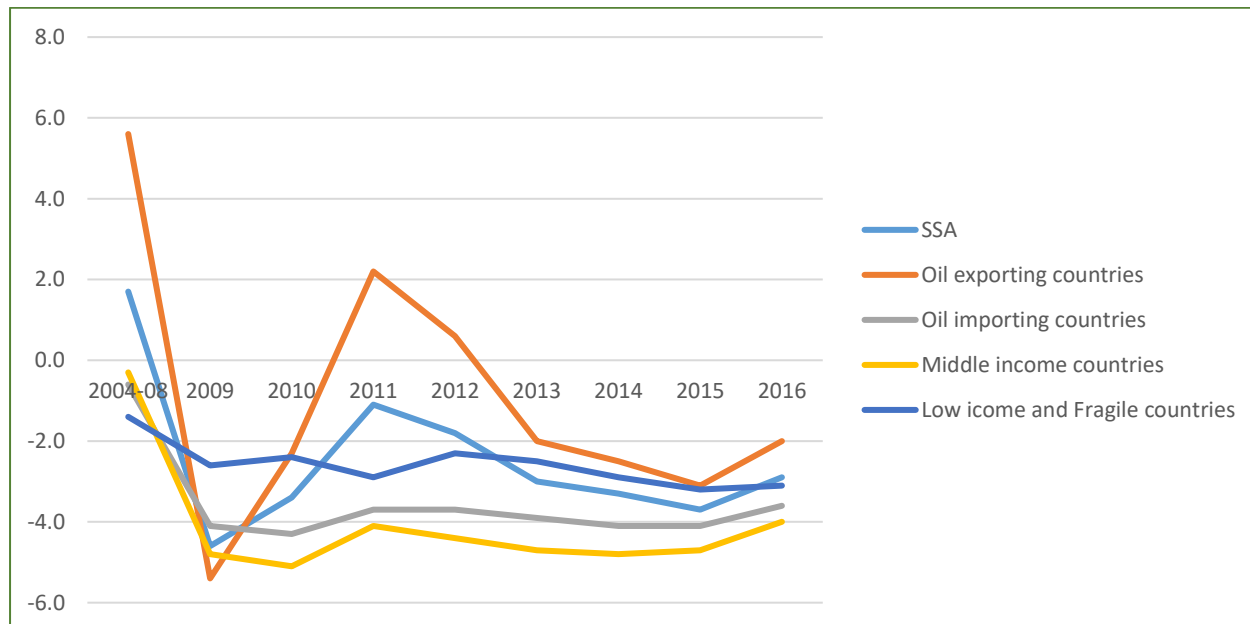
Source: IMF, 2015

Fiscal balance mainly indicates net effect between government revenue and government expenditure. The post-recession fiscal balance of SSA has always been deficit, although the deficit improved from 3.4 per cent in 2010 to 1.1 per cent in 2011, and thereafter deteriorated

to 3.3 per cent in 2014. This fiscal balance will deteriorate further to 3.7 per cent in 2015 in the context reduced revenue from commodities, weak economic growth in some countries, smaller appetite for risky assets from emerging markets, etc.

Post the recession, oil exporting countries in SSA were able to achieve brief fiscal surpluses of 2.2 per cent and 0.6 per cent in 2011 and 2012 respectively, before deteriorating and reaching deficit of 2.5 per cent in 2014. With oil revenue sources compromised by the commodity crises, the fiscal deficit of oil exporters will wane further to 3.1 per cent in 2015, with countries such as Nigeria already adjusting their budget for 2015 downwards. The fiscal balance of oil importing countries, although still compromised, will recover from a deficit of 4.3 per cent in 2010 to 4.1 per cent in 2015, as reduced oil prices result in reduced costs of production and favour economic growth and increased tax revenue. Middle income countries, which have large fiscal deficits, will have slight improvement from 5.1 per cent in 2010 to 4.7 per cent in 2015 whilst the fiscal balance of low income countries, which rely a lot on commodities for revenue, will deteriorate from 2.4 per cent in 2010 to 3.2 per cent in 2015.

Figure 1.7: Fiscal Balance (% of GDP) in Sub Saharan Africa



Source: IMF, 2015

1.8. The South African Economy

South Africa is the 2nd largest economy after Nigeria and is considered the continent's most advanced economy, with a gross domestic product of R762 billion as at 3rd quarter 2015. As

will be indicated in the successive sections below, the economy is diversified and like most maturing economies, has been restructuring from being primary sector based to service industry based. As a small open economy in the global context, South Africa has benefitted from strong economic policies which bolster trade. However, the economy faces temporary as well as structural bottlenecks which compromise growth prospects and these will be discussed in upcoming sections.

1.8.1. GDP growth in SA

Whilst the slow economic growth of 1.4 per cent in first quarter of 2015 for South Africa was worrisome, the decline of the country's economy by 1.3 per cent in the 2nd quarter of 2015 certainly caused a bit of a stir. Although few upside risks such as lifting of sanctions of Iran oil which will further reduce oil prices exists, the risks to the economy remain largely downwards. As indicated in previous sections above, reduction of commodity demand and prices will affect commodity exporters negatively in 2015, South Africa being among those affected due to mineral export. With the Chinese economy anticipated to decline further than what is currently stated, investors' appetite for risky assets (from emerging economies) also started waning in the 2nd half of 2015. Capital flights are anticipated from most emerging economies, the extent of such exodus depended on the expected and eventual liftoff of USA interest rate after keeping it at 0 per cent since 2006 in support of its economy. The State of China's economy also has a bearing on risk appetite for emerging market assets.

Internally, South Africa faces a scenario of low business and consumer confidence, whilst government has undertaken fiscal consolidation in an effort to keep credit ratings healthy. As a result, the economy is faced with reduced contribution towards GDP by both the public and private consumers. In the context of electricity supply shortages, labour market disruptions and weakened currency (which although supports exports and current account but increases inflation risks), downside risks for South African economy are further strengthened.

Table 1.7: GDP growth in SA (including sectors)

	2014:Q1	2014:Q2	2014:Q3	2014:Q4	2015:Q1	2015:Q2	2015:Q3
Primary Industries							
Agriculture	4.8	5.6	9.5	7.5	-18.0	-19.7	-12.6
Mining	-22.8	-3.0	3.9	15.2	10.2	-6.4	-9.8
Secondary Industries							
Manufacturing	-6.4	-4.0	-1.0	9.5	-2.4	-6.3	6.2
Electricity	0.2	-0.5	-1.1	0.3	2.5	-7.5	-8.0
Construction	3.7	2.1	2.2	3.5	2.0	0.8	0.5
Tertiary Industries							
Trade	1.5	-0.2	3.4	-0.3	2.7	-0.6	2.5
Transport	1.4	3.9	2.2	2.9	1.2	0.2	0.1
Finance	1.4	1.2	2.4	3.5	3.3	2.6	2.8
General government services	2.3	3.9	2.2	1.2	-0.8	0.6	1.2
Personal services	1.5	1.5	1.3	0.8	0.9	1.3	1.7
GDP at market prices	-1.6	0.5	2.1	4.1	1.4	-1.3	0.7

Source: Statistics South Africa, Second Quarter, 2015

Although South Africa's economy declined by 1.6 per cent in the first quarter of 2014, much of the external risks which exist in 2015 were not in play in 2014. The most prominent threats to economy in 2014 were five-month labour-market disruptions in platinum mining in the first half of 2014, which affected the sector as is shown by decline of 22.8 per cent in mining in first quarter of 2014. Manufacturing also failed to grow in the first three quarters of 2014, declining by 6.4 per cent, 4.0 per cent and 1.0 per cent respectively over the reference period, prominently affected by industrial action in the steel and engineering sector at the beginning of the 2nd half of 2014. The performance of manufacturing was also negatively affected by electricity supply shortages in the midst of electricity hikes (both mining and manufacturing are energy intensive) as well as lower demand and business confidence levels. The electricity industry performed poorly in the second and third quarter of 2014, declining by 0.5 per cent and 1.1 per cent respectively. The performance of the electricity industry was undermined by constrained growth in the mining and manufacturing industries, interruption in the supply of coal as well as diesel in some power plants as delays in completion of Medupi and Kusile Power plants; 794 MW from Medupi's unit 6 were added in 2015. Trade declined by 0.3 per cent in the last quarter of 2014, mainly affected by decline in gold and platinum prices as part of wholesale trade subsector.

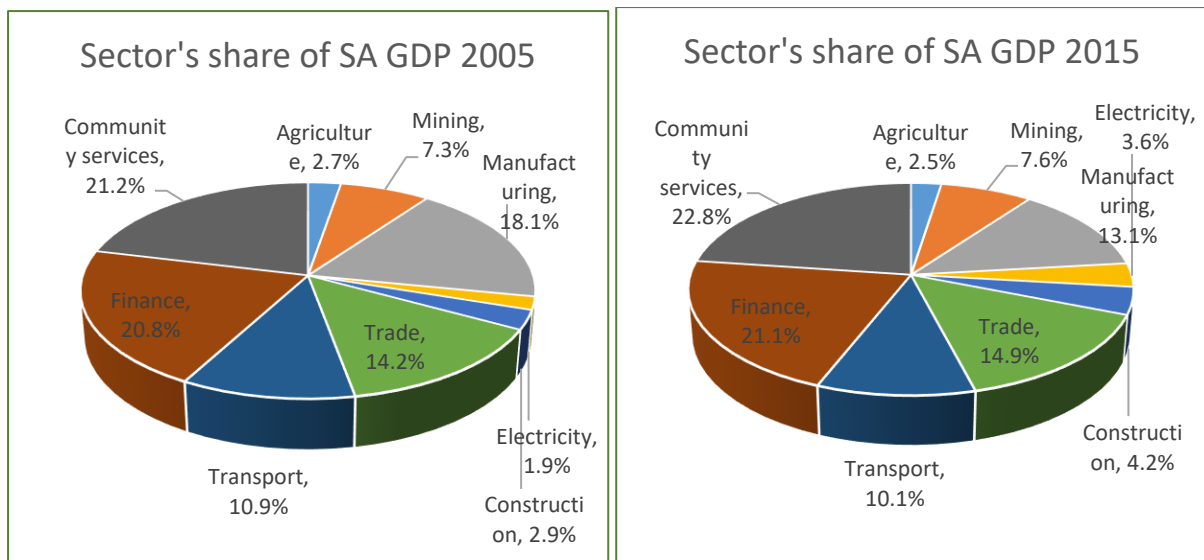
Whilst the South African economy grew by 1.4 per cent in the first quarter of 2015, a decline of the economy by 1.3 per cent occurred in the second quarter, affected by both domestic and international forces at play. The economy recovered slightly in the third quarter, and grew by

0.7 per cent. The worst performing industry in South Africa was agriculture, which declined by 18.0 per cent and 19.7 per cent in the first and second quarters of 2015 as a result of a drop in field crop production mainly, affected by dry weather conditions in the plant and growth season. This industry decelerated by 12.6 per cent in third quarter of 2015. Although mining grew well by 10.2 per cent in the first quarter of 2015, this pattern was reversed a contraction of 6.4 per cent and 9.8 per cent in second and third quarter of 2015 respectively, weighed down by electricity supply shortages, strike actions in the coal sector, weak global demand, subdued winter weather which affected domestic demand as well as reduced demand for iron ore which is heavily supplied international in the context of reducing prices for metals. The contraction of manufacturing industry since the beginning of the 2015 shows constraints in electricity supply, reduced demand and prices of iron ore as metal and steel imports from China are at low prices as well as higher production costs. However, manufacturing rebounded in the third quarter of 2015 and grew by 6.2 per cent, helped in part by motor industry.

Whilst electricity grew by 2.5 per cent in the first quarter of 2015, scheduled maintenance and power outages caused a decline of 7.5 per cent occurred in the second quarter of 2015, bearing in mind poor performance of the mining and manufacturing industries. The industry further decelerated by 8.0 per cent in third quarter of 2015. Although most other secondary and tertiary industries grew positively in the second and third quarters of 2015, the impact of declines in agricultural, mining, manufacturing and electricity industries were far greater.

What each industry contributes to the overall national GDP has changed over the past decade, as is evident in figure 1.8 below. Under the primary sector, agriculture's contribution to GDP fell from 2.7 per cent in 2005 to 2.5 per cent in 2015. However, the share of mining to national GDP has increased from 7.3 per cent in 2005 to 7.6 per cent in 2015, perhaps boosted by the effects of commodity price and demand booms from countries such as China and India between 2002 and 2012.

Figure 1.8: Sectorial contribution to GDP



Source: HIS Global Insight, Regional eXplorer, 2015

In the secondary sector, the performance of manufacturing has been dwindling and the industry's share has declined from 18.1 per cent in 2005 to 13.1 per cent in 2015, as higher production costs as well as declining demand and prices of metals began to undermine the industry. One of the casualties of manufacturing's poor performance in 2015 is the ArcelorMittal SA, which announced that two of its operations would be halted and review the viability of its largest of its largest steel mill. Of course, such a move has detrimental socio economic consequences in a form of lost income and jobs. However, government is intervening in the manufacturing industry to boost its performance.

In 2014, the Department of Trade and Industry announced plans to create 100 black industrialists in three years in South Africa and in the beginning of the second half of 2015, the Department of Small Business Development launched the National Gazelles programme, as a new type of SME support and development which will focus on value-adding and manufacturing enterprises as a way to support high-potential small businesses in South Africa (SEDA, 2015). The contribution of the electricity industry to the national output has increased from 1.9 per cent in 2005 to 3.6 per cent in 2015. In one way or the other, all industries play a role the significance of the electricity industry, although the manufacturing and mining sectors are the most energy intensive industries nationally. As technical glitches in existing operations are repaired and power supply expansion feeds into economic growth in the medium to long term, the contribution of the electricity sector will increase.

The construction industry's contribution to the South African economy has increased from 2.9 per cent in 2005 to 4.2 per cent in 2015. Not only is construction a tool used by government for countercyclical purposes in the economy, but the private sector also plays an active role in the performance of this industry. Given the fact that South Africa has not been able to grow at pre-recession rates, what the construction industry has also contributed towards national output is lower than what can be expected. According to 2nd edition of PWC report on SA construction (2014), public expenditure on infrastructure is a good indicator of construction industry's performance; however, allocation towards construction by public sector remains cautious through the fiscal consolidation process.

Under the tertiary sector, the contribution of trade to South Africa's GDP rose slightly from 14.2 per cent in 2005 to 14.9 per cent in 2015 whilst the transport industry's contribution has shrunk from 10.9 per cent in 2005 to 10.1 per cent in 2015. The contribution of the finance industry rose from 20.8 per cent in 2005 to 21.1 per cent in 2015, supported by sound financial system in South Africa. According to The Brookings Financial and Digital Inclusion Project (FDIP) report (2015), which measures financial access and usage in 21 emerging countries, South performs extremely well in terms of financial inclusion amongst emerging economies, scoring 80 per cent and 2nd behind Kenya. The contribution of community services to national GDP has increased from 21.2 per cent in 2005 to 22.8 per cent in 2015. Government plays an economic role in South Africa, not just infrastructure developments, but in allowing people to participate in its procurement processes.

1.8.2. Domestic expenditure

Table 1.8 displays gross domestic expenditure of South Africa as at end 3rd quarter of 2015, which slightly improved to 0.8 per cent as the economy recovered in the 3rd quarter, from a dismal decline of 7.2 per cent in 2nd quarter, also in line with reduction of economy in that quarter. Final household consumption rose noticeably by an annualized 2.4 per cent in 1st quarter, due to reduction in petrol prices flowing from 2014. However, slower real income growth and reduced consumer confidence resulted in slower growth in household consumption, by 1.2 per cent and 0.9 per cent in 2nd and 3rd quarters of 2015. This growth reflects reversals in petrol price reductions in the 2nd quarter.

Growth in final government consumption rose by 0.4 per cent and 1.0 per cent in 2nd and 3rd quarters of 2015, an improvement from a decline of 1.9 per cent in the previous quarter. The 2nd quarter of each year marks the beginning of the fiscal year for government institutions, and according to SARB (September, 2015), a rise in government consumption in the 2nd quarter reflected increase in compensation of workers and as well as goods and services, in line with new fiscal year needs. The faster pace of growth in the 3rd quarter of 2015 reflects the net effect of increase in compensation of employees outweighing the decline in real outlays on non-wage goods and services.

The deceleration of gross fixed capital formation from an annualized growth of 1.8 per cent in 1st quarter to 1.0 per cent in 2nd quarter is a reflection of slowdown in capital outlays by the private sector. Moreover, it is a reflection of a deteriorating economic environment (SA's economy declined by 1.3 per cent in the 2nd quarter) and declining business confidence. Growth of gross fixed capital formation was supported by public corporations as well as government capital expenditure. The deceleration of gross fixed capital formation to 0.6 per cent in 3rd quarter of 2015 reflects the contraction in capital investment by private enterprises and slower pace of capital outlays by general government.

Changes in inventory stock declined significantly by R38.9 billion in 2nd quarter of 2015, due to a reduction in platinum stock in the mining sector as well reduction in crude oil imports (due to scheduled maintenance of oil refineries). A further reduction of R31.6 billion in inventory stock took place in 3rd quarter of 2015, a reflection of de stocking in manufacturing sector (food and beverages) and less import of crude oil in petroleum sector.

Table 1.8: Percentage change in real gross domestic expenditure

	2014				2015		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Final consumption expenditure							
Final household consumption	1.0	1.0	1.1	1.6	2.4	1.2	0.9
Final government consumption	1.7	2.4	1.4	1.0	-1.9	0.4	1.0
Gross fixed capital formation	-9.2	-5.4	2.4	2.6	1.8	1.0	0.6
Domestic final demand	-1.0	0.0	1.5	1.7	1.4	1.0	0.8
Changes in inventories (R billions)	-4.1	-1.0	2.9	3.8	8.8	-38.9	-31.6
Gross domestic expenditure	3.8	0.9	3.2	0.3	2.7	-7.2	0.8

Source: SARB, macroeconomic database, 2015

As reflected by table 1.9 below, the South African economy contracted by 1.3 per cent in the 2nd quarter of 2015. Changes in inventories, whose contribution declined by 6.2 per cent, particularly for the mining and manufacturing sectors, played a key role in its contribution to economic growth. In the 3rd quarter of 2015, the economy recovered by 0.7 per cent, as changes in inventories also recovered and contributed 1.0 per cent to growth in real GDP.

Table 1.9: Contribution of expenditure components to growth in GDP

	2014				2015		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Final consumption expenditure							
Households	0.6	0.6	0.7	1	1.5	0.7	0.5
General government	0.3	0.5	0.3	0.2	-0.4	0.1	0.2
Gross fixed capital formation	-2	-1.1	0.5	0.5	0.4	0.2	0.1
Changes in inventories	4.1	0.4	0.5	0.1	0.7	-6.2	1.0
Net exports	-5.2	-0.4	-1.1	3.9	-1.4	6.1	-0.1
Gross domestic product	-1.6	0.5	2.1	4.1	1.3	-1.3	0.7

Source: SARB, Macroeconomic database, 2015

1.8.3. Inflation Trends in SA

Knowledge of how inflation is performing is important for South African Macroeconomic environment. The South African Reserve Bank utilizes inflation targeting, by explicitly using necessary tools such as interest rates to ensure inflation remains between 3-6 per cent. In 2015 thus far, inflation has remained within the target band, although it rose from 4.4 per cent in January 2015 and 4.8 per cent in November 2015, with an unstable pattern for months in between. The biggest rise in the components of inflation occurred under education, which rose by 9.3 per cent in November 2015 year-on-year, although its weight is minimal at 2.95. Items which carry the largest weight in the inflation basket is housing and utilities with a weight of 24.52, followed by transport (16.43) and food and non-alcoholic beverages (15.41). Year-on year, these items rose by 6.4 per cent, 0 per cent and 4.8 per cent respectively. House and utilities is normally fueled by actual rentals for housing and owner's equivalent rent.

Transport's growth continues to be muted by declining global oil prices whilst food inflation will be influenced not just by factors such as rising price of maize both domestically but also through imported inflation by means of weakened exchange rate; according to Stats SA (2015), fruit, fats and oil prices also fueled food inflation in November. Also, the temporary oversupply

of meat due to domestic drought and selling off of cattle due to insufficient feed is a counter force reducing meat prices and food inflation.

Table 1.10: Headline Inflation in South Africa (% change over 12 months)

	Weights	2015										
		January	February	March	April	May	June	July	August	September	October	November
All items	100	4.4	3.9	4.0	4.5	4.6	4.7	5.0	4.6	4.6	4.8	4.8
Food and non-alcoholic beverages	15.41	6.5	6.4	5.8	5.0	4.7	4.3	4.3	4.3	4.4	4.8	4.8
Alcoholic beverages and tobacco	5.43	7.4	8.2	9.0	9.6	9.7	9.7	8.9	8.8	8.7	7.4	7.0
Clothing and footwear	4.07	6.2	5.8	5.7	5.5	5.4	5.6	5.2	5.3	5.0	4.6	4.5
Housing and utilities	24.52	5.7	5.6	5.7	5.6	5.6	5.4	6.4	6.3	6.4	6.4	6.4
Household contents and services	4.79	2.4	2.3	2.1	2.3	2.6	2.3	2.3	2.7	2.7	3.0	3.1
Health	1.46	6.1	5.9	6.0	6.0	7.0	6.0	5.8	6.2	5.9	5.9	5.7
Transport	16.43	-2.5	-6.3	-5.0	-1.1	-0.7	0.7	0.8	-0.7	-0.8	-0.6	0.0
Communication	2.63	-1.7	-1.7	-1.6	-1.0	-0.4	-0.4	-0.7	-0.8	-0.7	-0.7	-0.7
Recreation and culture	4.09	2.5	2.9	2.4	2.0	1.8	2.0	2.5	2.4	2.3	2.9	3.1
Education	2.95	8.7	8.7	9.3	9.3	9.3	9.3	9.2	9.3	9.3	9.3	9.3
Restaurants and hotels	3.5	7.4	7	6.7	5.7	6.4	6.1	6.0	5.5	5.0	5.2	5.2
Miscellaneous goods and services	14.72	7.3	7.8	7.5	7.3	7.4	7.2	7.2	7.0	7.0	7.0	6.8

Source: Statistics South Africa, November 2015

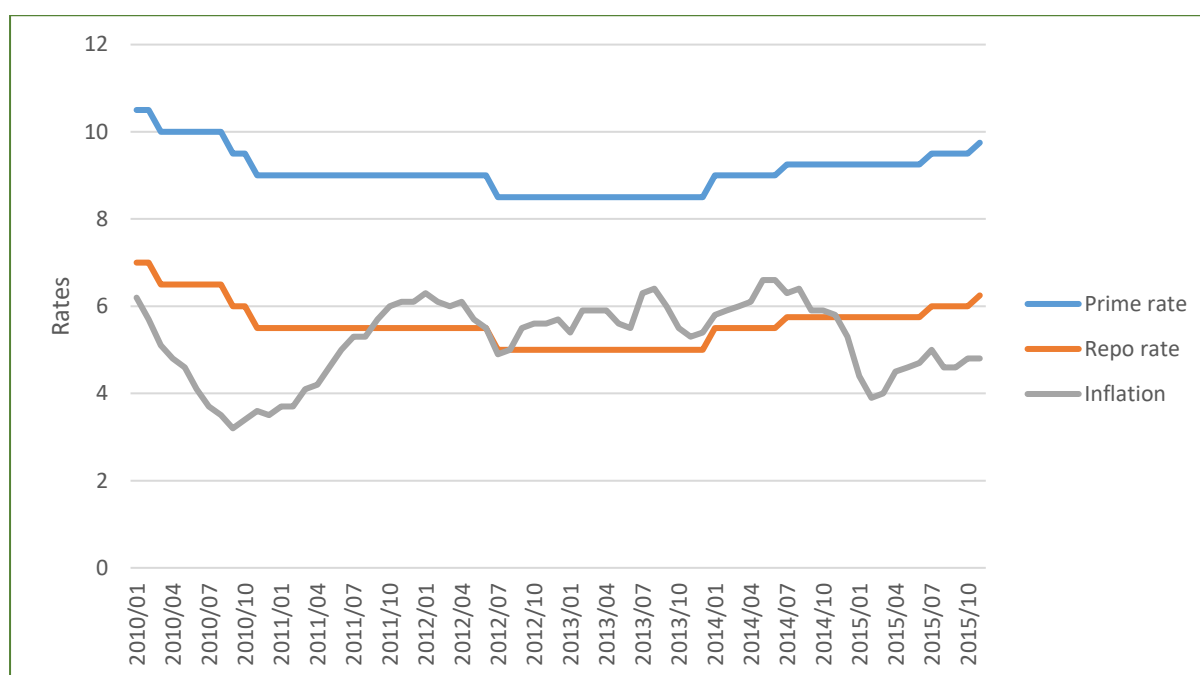
1.8.4. Interest Rates

Much has happened in the interest rate arena, with the South African Reserve Bank (SARB) increasing interest rates by 125 basis points between end 2013 and November 2015, influenced by future inflation expectations, anticipated and the actual increase of USA interest rate which took place in November 2015, as well as a weaker exchange rate. The expected and actual rise of USA interest rates by 25 basis points deteriorated capital flows in emerging markets, including South Africa, and weakened their exchange rates, based on narrower differential between interest rates between USA and these countries for investors.

From figure 1.9 below, it seems the upward cycle of interest rates in South Africa occurred at the beginning of 2014, when the repo rate increased to 5.5 per cent whilst the prime rate reached 9 per cent. Increases in interest rates were prompted by inflation, which rose above its upper target band of 6 per cent for several months in 2014. Although inflation has since returned within its target band and is 4.8 per cent as at November 2015, the South African Reserve Bank will likely continue on its upward cycle of interest rates based on future inflation, which is expected to rise above the upper target band in 2016. Interest rates have been increasing

gradually and as at 30 November 2015, the repo rate reached 6.25 per cent whilst the prime rate reached 9.75 per cent. Rising interest rates have increased the cost of repaying debt for consumers, the cost of doing business and may have dampened consumer and business confidence. However, a wider interest differential between USA and South Africa still makes investment in SA lucrative and is ideally good for the exchange rate. The main challenge that SARB is facing is that although its mandate is inflation targeting, when it should raise interests when inflationary pressures are not coming from an over-stimulated economy through consumption but rather from external forces.

Figure 1.9: South Africa's Repo and Prime Rates



Source: SARB, macroeconomic database, 2015

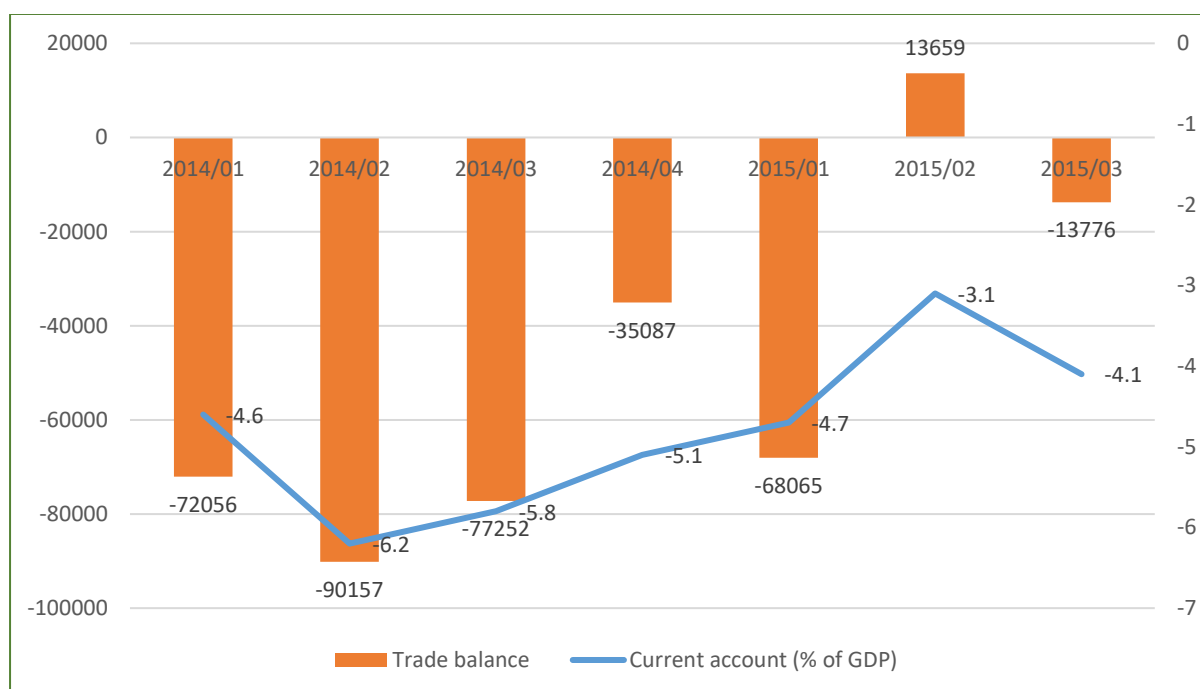
1.8.5. Current account and Trade balance

Whilst a weaker South African exchange rate and reduced commodity demand and prices would have compromised the trade balance as well as the current account ratio, figure 1.10 below displays the contrary as lower global oil prices flowing from 2014 and lower oil imports, together with increased exports of vehicles and machinery the favored the country's trade, particularly in the 2nd quarter of 2015.

According to the explanation by Phillip Mohr (2011) on current account balances and given the fact that South Africa's economy contracted by 1.3 per cent in 2nd quarter of 2015, the positive trade balance (of goods only) in the 2nd quarter may either be the result of competitiveness of some sectors in the economy (table 1.6 above proves to the contrary), or slower imports. Likewise, current account deficit ratio was reduced, from 4.7 per cent in the 1st quarter of 2015 to 3.1 per cent in the 2nd quarter of 2015. Old Mutual Investment Group (2015) estimates that the trade balance since the beginning of 2015 until July 2015 is R24.3 billion, which is a R31 billion improvement when compared to the same period in 2014. However in the 3rd quarter of 2015, the trade balance slide back to a deficit of R13.7 billion with a current account deficit ratio of 4.1 per cent.

Going forward, one of the possible downside risks to the trade balance and the current account ratio is the devaluation of the Chinese Yuan which occurred in August 2015, which offers competitive advantage to Chinese exporters. Also, with a generally weakened exchange rate, South Africa will "import inflation" and some of the gains from weaker oil prices will be overshadowed.

Figure 1.10: Trade balance (R' Million), Current account (% of GDP)

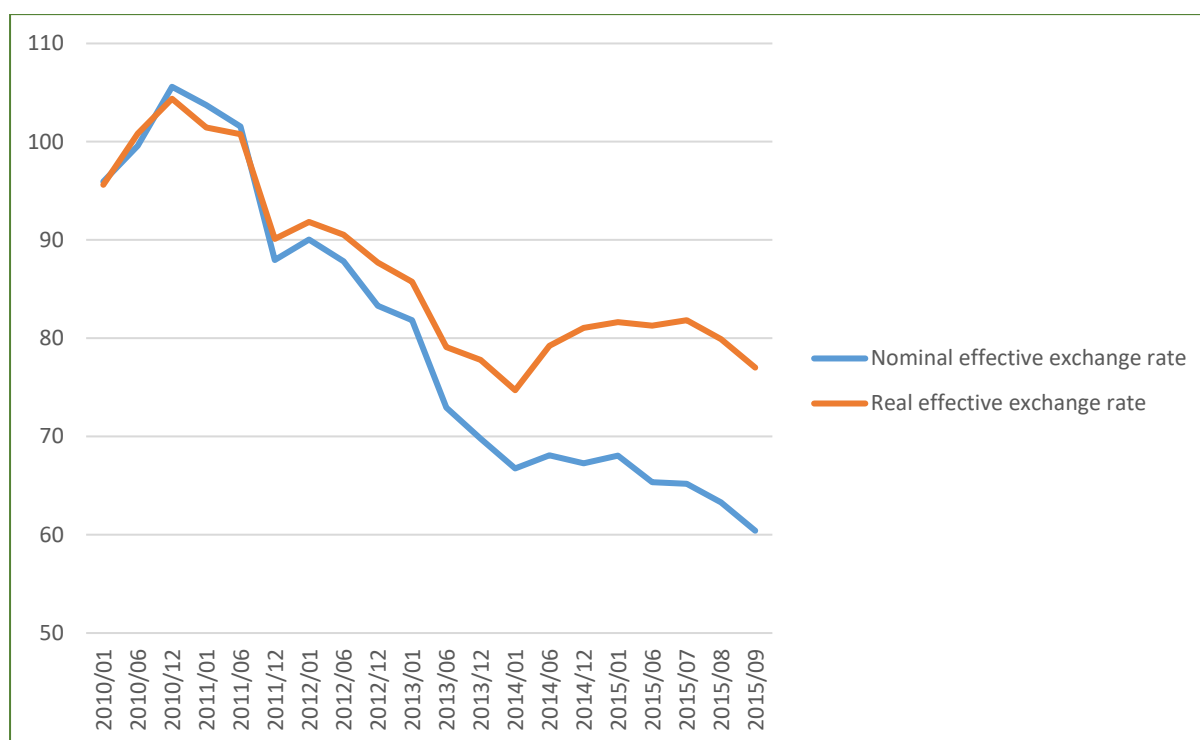


Source: SARB macroeconomic database, 2015

Related to the performance of the current account is the nominal and real effective exchange rates, which are an overall measure of the Rand's movement against major (trading partners') currencies, expressed as indices.

The effective exchange rates, both nominal and real, have followed a steep downward trajectory since 2010, showing a depreciation of the Rand's against other major currencies. For trade purposes, a depreciation of the Rand should result in a competitive export economy, but also result in inflation being imported. This would put pressure on household consumption, both from prices and resultant increase in interest rates, as well as sectors such as manufacturing which import production inputs. For the majority of the reference period in figure 1.11 below, the indices remain below 100, and the nominal effective exchange reached 60.41 in September 2015 whilst the real effective exchange rate reached 77.02 in the same month.

Figure 1.11: Nominal and Real Effective Exchange Rate



SARB macroeconomic database, 2015

In terms of trade, South Africa, one of the biggest beneficiary of the Africa's Growth and Opportunity Act (AGOA), has come under fire in 2015 for what is termed as unfair trade practices imposed by the country on America. In November, the American president gave South Africa two months to respond to its ultimatum to open up its market for American exports

(poultry and pork) and to ensure that South Africa remains eligible for the benefits contained in the ACT. Box 1.3 outlines what the AGOA Agreement is and its benefits for South Africa.

Box 1.3: Benefits of AGOA agreement between USA and SA

What is AGOA?

The Africa's Growth and Opportunity Act (AGOA) is an agreement between the USA and qualifying Sub Saharan exporter countries (including South Africa) to allow duty-free access to the USA market. In exchange, eligible countries must open up their economies for trade. The Act was passed as part of the Trade and Development Act of 2000 in the USA.

Benefits of AGOA

- AGOA covers over 7000 products (800 are agricultural).
- Exclusions in agricultural products are sugar, groundnuts and some alcoholic beverages.
- AGOA not only benefits some SSA countries through duty-free exports, but also through access to USA credit, technical skills and economic engagement through the AGOA Forum.
- The USA benefits through investment and partnership opportunities in the region through the Act.
- South Africa is the 3rd largest exporter towards USA amongst SSA w.r.t AGOA after Nigeria and Angola.
- South Africa's export revenue is equivalent to \$69 billion in 2014.
- South Africa's biggest benefits of the agreement remain in the citrus and automotive industry, including wine industry as well as minerals.
- SA's top five AGOA exports to the US in 2014 were worth \$1.5bn. Cars topped the list (\$1.3bn), followed by ferromanganese (\$183m), industrial fatty alcohols (\$46m), oranges (\$41m) and wine (\$31m).
- AGOA has resulted in 62 000 jobs created in South Africa in 2013.
- Latest dispute w.r.t AGOA involves USA exporters who seek greater access to SA's market in form of US chicken, beef and pork, to avoid re-imposing tariffs on SA products which include citrus and wine.
- SA banned all poultry imports from the US because of an outbreak of avian influenza in the American west.

- SA banned US beef products as part US ruminant products after an animal in Washington State was found with mad cow disease in 2003.
- Also, USA exporters also question SA eligibility in the AGOA Agreement due to its level of economic development.
- South Africa must respond by 4th January 2016 to the US president's ultimatum to open up its economy to US exporters to remain eligible to the benefits of the Agreement

Source: Department of Trade and Industry, 2015 & Department of Agriculture, 2009

1.8.6. Key risks and positive possibilities in the economy

The global economic growth is experiencing a slowdown in 2015, to the detriment of most economies, including South Africa. Whilst upside risks remain reduced oil prices, which was approximately \$37 per barrel at 17 December 2015, the country is mainly facing down side risks. Table 1.9 below depicts South Africa's main trading partners and how their share of our trade and their growth affect the country. As a main trading partner, Europe's share has increased from 24.8 per cent in 2014 to 25.8 per cent in 2015 whilst Africa's share has increased from 18.3 to 19.2 per cent over the same period. However, slow growth in these economic regions would imply less demand for South African goods and services. However, with the influx of refugees from war-torn Syria region into Europe presents possible immediate increase in demand for South African goods, provided that these refugees are integrated into the economy of the continent.

With other markets whose export shares are declining (China, USA, etc.), their slower growth will have an impact on South Africa's export performance. South Africa, which mainly exports primary goods including commodities, has not been exempted from the effects of slower growth from China and its declining demand for commodities and the subsequent decline in commodity prices.

Table 1.11: South Africa's Main Trading Partners

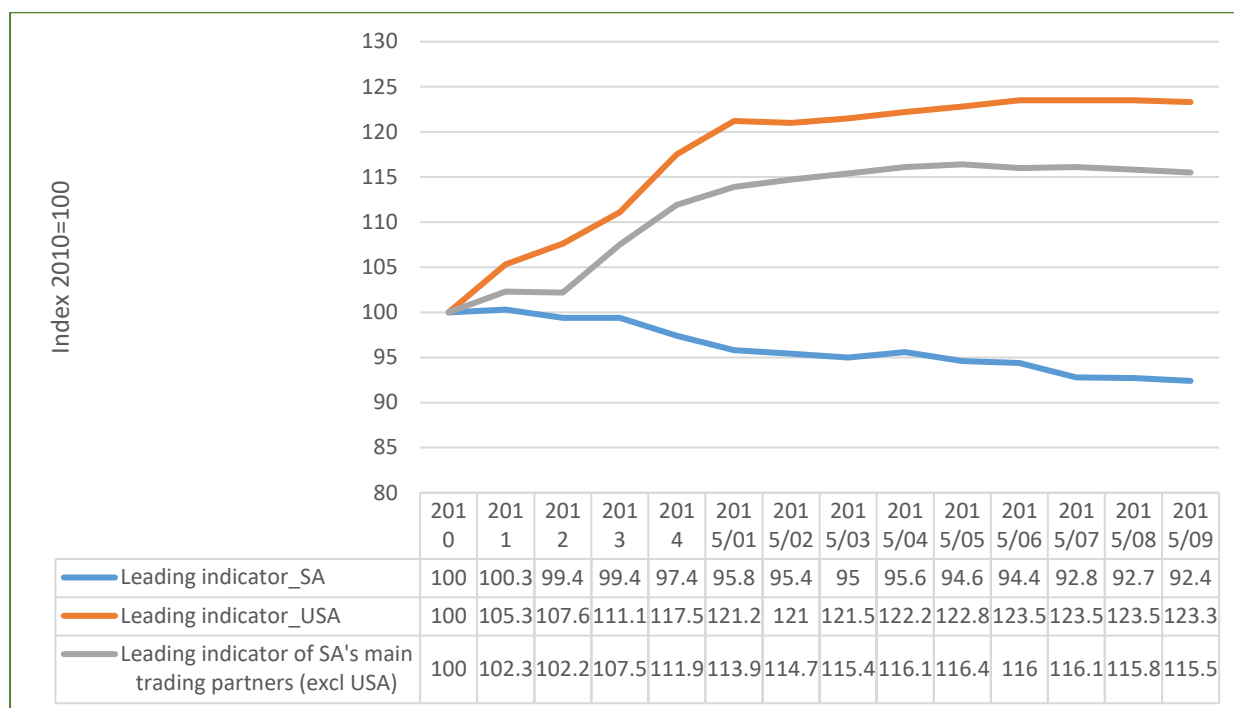
	2013	2014	2013	2014	2013	2014
	% Share		% growth		contribution to export growth (price preference system)	
Africa	18.3	19.2	19.1	11.0	3.3	2.0
<i>SADC</i>	13.6	14.2	21.1	10.4	2.7	1.4
Americans	10.6	10.8	2.6	7.6	0.3	0.8
<i>Brazil</i>	0.8	0.8	-0.1	5.5	0.0	0.0
<i>United States</i>	8.3	8.2	6.1	4.2	0.5	0.3
Asia	36.6	35.8	17.2	3.3	6.1	1.2
<i>China</i>	13.9	11.2	34.8	-15.0	4.0	-2.1
<i>India</i>	3.6	5.1	-6.9	50.3	-0.3	1.8
<i>Japan</i>	6.7	6.2	19.5	-2.7	1.2	-0.2
Europe	24.8	25.8	18.2	10.0	4.3	2.5
Other	1.2	1.3	6.6	17.5	0.1	0.2
Unallocated	8.5	7.2	-12.6	-10.7	-1.4	-0.9
Total	100	100	12.7	5.8	12.7	5.8

Source: National Treasury Review, 2015

The composite leading indicators compiled by SARB, provides a guideline for economic activity and growth for at least six months ahead, show expected economic activity in indices for South Africa, USA and other SA's main trading partners. South Africa composite leading indicator includes, but is not limited to indicators such as manufacturing orders opinion survey, inventory versus demand opinion survey, business confidence opinion survey, factory hours worked opinion survey, JSE all share index as well as job advertisement space in the Sunday Times newspaper.

The leading indicator for South Africa has been on a downward trajectory, and fell from 97.4 by the end of 2014 to 92.4 in September 2015, falling by 5.1 per cent. However, figure 1.12 below shows that the leading indicator for South Africa's main trading partners have risen since 2010 and overall since beginning of 2015, a good indication for South Africa's exports.

Figure 1.12: Leading indicator of SA, USA and other main trading partners



Source: SARB, macroeconomic database, 2015

Other key risk in South Africa is the increase in the interest rate of USA in December 2015, which has weakened the exchange rate of South Africa. That means South Africa will import inflation, including food inflation due to current drought being experienced in the country and the need to import the food differential which cannot be produced in the country. Due to higher expected inflation and weaker exchange rate, domestic interest rates are likely to continue to rise, putting pressure on consumer's disposable income and business activity, although capital flow into South Africa is likely to increase.

South Africa also remains under pressure from international lenders e.g. IMF, as well as credit rating agencies to remain on a sound fiscal path. As recent as December 2015, the credit rating of South Africa was reduced from BBB to BBB- by Fitch as well as Standard & Poor's, which is one level above sub investment level, whilst Moody's left the credit rating at Baa2 but changed the outlook from stable to negative. These three major credit rating's opinion have an impact in investment appetite of the country, as well as increase the cost of borrowing at an international level when the grading deteriorates, which affects capital flow for the country and subsequently, the exchange rate. These are some of the main challenges South Africa is facing, in the context of minute economic growth.

1.9. Interventions to mitigate key risks by the South Africa

The 2016 State of the Nation Address was tabled in February 2016 to highlight interventions to mitigate the current challenges faced by the South African economy. South Africa and the USA have reached an agreement on all outstanding issues regarding the parties' AGOA agreement and South Africa will continue to benefit from duty-free exports of the country's products into the USA market. These products mainly affect the agricultural industry. Also, the establishment of Agri-Parks will continue to be strengthened for the benefit of small holder farmers in agriculture. Disaster fund relief will also be distributed to provinces affected by the current drought in South Africa.

In response to dwindling investor confidence and to encourage investment by foreign and domestic investors, a One Stop Shop / Invest SA initiative will be developed and implemented. The initiative aims to remove red tape and create a more investor-friendly environment. The Black Industrialists Scheme will also be launched to encourage future black industrialists to participate in the manufacturing industry. Also, government will continue to implement incentive programmes for the automotive industry, which have already attracted foreign investment by companies such as Mercedes Benz, BMW and VW.

Based on the Nine-Point Plan established in 2015, R83 million has been invested in Medupi and Kusile power stations and additional units from Ingula power stations will be connected in 2017, in response to energy demands of the economy. Seven billion rand will also be invested in the development of new port facilities which boost the ocean economy and mining sectors, amongst others.

Given that South Africa's weaker exchange rate encourages foreign and domestic tourism, a multi-year R100 million will be invested by SA Tourism to boost the tourism sector. A centre of excellence for financial services and leadership training will be established by banks in South Africa, to maintain South Africa's strong competitiveness in financial services and to enable the country to become a financial centre for Africa.

1.10. Conclusion

The rate of growth for the global economy is decelerating and various factors are at play. Most notable in 2015 has been China's restructuring of its economy from an investment-led economy to a consumption –led economy, dragging down commodity demand and prices. Emerging markets, who are not diversified and rely heavily on commodity exports are suffering under these changes whilst advanced economies are somewhat making gradual recoveries. The USA created an expectation for increase in interest rate and eventually lifted them in December 2015, resulting in a decline for risky assets from emerging markets and causing their exchange rates to depreciate through capital flights. The emerging markets have had to mitigate the extent of depreciated exchange rates and imported inflation. The devaluation of Chinese Yuan also indicated that the state of the Chinese economy may be weaker than anticipated, which has negative bearings for overall global demand and economic performance going forward.

Sub Saharan Africa has been negatively affected by declining commodity markets, with countries that are heavily reliant on oil exports suffering the most. For the most part, the slump in commodity prices leaves room for SSA to diversify their economies and mitigate the negative impact of depreciating exchange rates.

South Africa has also not been exempted from slump in commodity prices, in particular, metal prices. With the rise in interest rates of USA began also South Africa's upward cycle of interest rates, which have further weakened consumer confidence. In the presence of a depreciating exchange rate and rising inflation due in part to drought, South Africa will need to find ways to reduce the negative impact of slow growing economy in a presence of high unemployment and subdued demand. As stated in the previous section above, the South African government intends to implement a number of interventions to boost the economic growth of the country. These interventions include, but are not limited to:

- the establishment of a One Stop Shop to boost foreign and domestic investment through the reduction of red tape and creation of a more investor-friendly environment,
- the creation of Black Industrialist Scheme to encourage participation by black businesses in manufacturing
- the extension of more Agri-Parks in South Africa which will likely benefit agriculture and agro-processing

- more investment in Medupi, Kusile and Ingula power plants to address energy demands in South Africa.

CHAPTER 2: FREE STATE PROVINCE'S ECONOMIC STRUCTURE AND PERFORMANCE

2.1. Introduction

Key findings

- The Free State provincial economy is mainly reliant on the tertiary industries, whose contribution has increased from 64.5 per cent in 2005 to 65.3 per cent in 2014.
- The contribution of the primary industries continues to grow, from 15.5 per cent in 2005 to 17.6 per cent in 2014, mainly supported by mining, whose contribution has increased from 11.5 per cent to 12.7 per cent over the same reference period.
- Secondary industries contribution towards the provincial economy is declining, from 20.1 per cent in 2005 to 17.1 per cent in 2014. Manufacturing dominated the secondary industries in the Free State, although its share to the provincial GDP has declined drastically from 15.7 per cent in 2005 to 10.8 per cent in 2014.
- Free State's economic contribution towards the national economy has declined from 5.2 per cent in 2005 to 5.0 per cent in 2014.
- In comparison with other provinces, the Free State economy is the second most diversified in the country after Mpumalanga.
- Free State's comparative advantage lies in agriculture, mining, community services, electricity, transport and trade, which all had a location quotient above 1 in 2014.
- The average real growth rate of the Free State between 2005 and 2014 was 2.4 per cent, which was below the South African average growth rate of 3.0 per cent.
- From an expected growth of 1.3 per cent for South Africa and 0.5 per cent for Free State in 2015, both economies are expected to recover over the medium term and reach growth rates of 3.3 per cent and 2.4 per cent in 2019 respectively.
- By 2019, the fastest growing industries in Free State are expected to be transport (3.4 per cent), finance (2.9 per cent), manufacturing (2.7 per cent) and trade (2.6 per cent).

The Free State province is a land-locked economy that benefits from its centrality in South Africa. The province is not only endowed with natural resources in agriculture and mining, but has transformed with other provinces to be dominated by services sector. However, negative external factors, more than internal factors, seem to have had an impact on the economic performance of the province in 2015.

The El Nino episode and the resultant drought have had a negative effect on the agricultural production, resulting in a need to import food as a country. A weakening exchange rate will make importing food expensive, which will also hurt consumers' pockets and have adverse effects on poverty in the province. The commodity slump experienced worldwide has had an effect on mining in the province, although positive and negative forces are at play simultaneously. Reduction in commodity prices negatively affects the profitability of mines, however, together with volatility in financial markets, some investors have sort gold as a safe haven, to the benefit of the industry. Improvements in consumer wellbeing in countries such as the USA have also seen a surge in diamond demand, to the benefit of economies such as the Free State.

The performance of the manufacturing sector in the province is not exempted from the effects of the commodity slump. Free State's manufacturing is heavily reliant on the company Sasol, which, although input costs are affected by coal, output prices are influenced by the price of oil. In the services sector, the Free State may have an advantage in the recent drought and the need to import food, through increased freight on the province's roads and rails as food gets transported to different provinces. Overall, 2015 presents a lot of economic challenges for the Free State economy, but with those challenges, opportunities to mitigate their effects on the province's residents.

2.2. Structural Composition of Free State Economy

Although Free State is well known for its primary sector produce (mineral and agricultural goods), the tertiary industries dominate the province's economic composition. Table 2.1 below illustrates the composition of Free State economy from 2005 until 2014.

In 2005, the primary industries accounted for 15.5 per cent of the provincial economy's output, largely due to mining and quarrying (11.5 per cent), but also supported by agriculture (4.0 per

cent). Both industries' contribution swelled and agriculture's contribution peaked at 6.4 per cent in 2008, whilst mining and quarrying's contribution peaked at 14.4 per cent in the same year; thereafter, both industries' contribution declined. Mining and quarrying's contribution, before its downward trajectory, coincided with a period of a boom in commodities process caused by China and India. Although agriculture's contribution has been affected by climatic changes in past few years, the improved contribution from 4.5 per cent in 2013 to 4.9 per cent in 2014 is a result of improved agricultural output nationally. The country's agricultural output benefited from maize crop of 14.3 million tons harvested in the 2013/14 production year, the largest since 1981 (SARB, 2015). The impact of the platinum labour strike in 2014 had no effect on Free State mining, which does not produce platinum. Instead, Free State mining may have been shielded by diamond production, by means of increased efficiency mining and processing of gravel by the introduction of new technologically advanced mining equipment.

The secondary industries collectively contributed 20.1 per cent in 2005 to the provincial output, but have since declined to 17.1 per cent in 2014. Manufacturing contributes the largest share to the secondary industries' output, but its size declined post the recession; the sector contributed only 10.8 per cent to the provincial economy in 2014. Although the electricity sector's contribution is minute in comparison with other sectors, its contribution has increased from 2.6 per cent in 2005 to 3.6 per cent in 2014. The share of the construction sector has increased from 1.8 per cent in 2005 to 2.7 per cent in 2014. This sector continues to benefit from increased construction activity by general government for the provision of social infrastructure (roads, hospitals, etc.), although real estate developments has also played a crucial role in recent years.

The tertiary industries' contribution has increased from 64.5 per cent in 2005 to 65.3 per cent in 2014; a rise of 0.8 of a percentage point. The community services contributes the largest to the Free State economy amongst the tertiary industry, although its contribution has decreased from 26.8 per cent in 2005 to 25.3 per cent in 2014, mainly due to general government activity (the contribution of the personal services industry has declined from 10.6 per cent in 2005 to 7.1 per cent in 2013).

The share of the wholesale and retail trade industry has increased drastically, from 11.8 per cent in 2005 to 14.5 per cent in 2014, which is the largest increase among all industries over the reference period. This could be a reflection of more retail stores being opened in the rural

province, or a sign of the positive impact of township revitalization encouraged by Free State government. The contribution of the transport industry has increased from 10.0 per cent in 2005 to 10.2 per cent in 2014, whilst the contribution of the finance industry declined from 15.9 per cent in 2005 to 15.3 per cent in 2014.

Table 2.1: Sectoral composition of the Free State economy (% , current prices)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Primary Industries	15.5	16.4	17.7	20.7	19.4	19.1	18.3	17.8	17.9	17.6
Agriculture	4.0	4.5	5.0	6.4	6.1	5.0	4.7	4.5	4.5	4.9
Mining and quarrying	11.5	12.0	12.7	14.4	13.3	14.2	13.5	13.3	13.4	12.7
Secondary Industries	20.1	18.4	19.1	18.4	18.4	17.1	17.2	17.0	17.3	17.1
Manufacturing	15.7	14.0	14.3	13.3	12.0	10.9	10.7	10.5	10.7	10.8
Electricity, gas and water	2.6	2.4	2.3	2.2	2.9	3.4	3.5	3.9	3.7	3.6
Construction	1.8	2.0	2.5	2.9	3.5	2.8	3.0	2.7	2.8	2.7
Tertiary industries	64.5	65.2	63.1	60.9	62.2	63.8	64.6	65.1	64.8	65.3
Wholesale and retail trade	11.8	13.6	12.2	13.5	14.6	16.9	16.2	15.8	14.8	14.5
Transport	10.0	11.4	10.9	10.0	9.4	8.7	9.3	10.0	10.1	10.2
Finance	15.9	16.2	16.9	15.8	15.5	15.3	15.2	14.9	15.0	15.3
Community services	26.8	23.9	23.1	21.6	22.7	22.8	23.9	24.4	24.9	25.3
GDPR at basic prices	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Statistics South Africa; Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

Table 2.2 depicts the contribution to each industry by all nine provinces of South Africa in 2014. In the primary sector, KwaZulu-Natal, Western Cape and Free State dominated in agriculture with contributions of 26.0 per cent, 22.0 per cent and 9.8 per cent respectively to the national sector. Limpopo dominated the mining and quarrying industry and contributed 23.4 per cent to the national sector through its diversified minerals such as diamonds, copper, and open-pit platinum mines, amongst others. The contribution of Limpopo mining was followed by Mpumalanga which contributed 22.5 per cent through coal mining, utilized for electricity generation in South Africa, but also exported to other countries, whilst North West contributed 21.4 per cent to the national mining sector through its platinum mines. Free State contributed 7.5 per cent to the national mining sector. The secondary and tertiary sectors were dominated by Gauteng, whilst Free State contributed less than 6 per cent in each of the secondary and tertiary industries; the province contributed higher to the national primary industries.

Table 2.2: Provincial distribution of economic activity, 2014

	WC	EC	NC	FS	KZN	NW	GP	MP	LP	SA
Agriculture	22.2	5.7	6.5	9.8	26.0	6.6	6.3	9.4	7.6	100
Mining and quarrying	0.4	0.3	6.0	7.5	3.5	21.4	15.0	22.5	23.4	100
Manufacturing	16.0	7.1	0.6	4.1	21.6	2.5	39.4	7.5	1.4	100
Electricity and water	10.3	4.7	2.2	4.9	17.2	5.8	30.5	15.3	9.1	100
Construction	20.7	9.5	1.5	3.4	17.3	3.9	31.2	6.4	6.2	100
Wholesale and retail trade	15.2	11.4	1.5	4.9	16.4	5.0	29.7	8.1	7.9	100
Transport	14.6	7.3	2.5	5.1	22.2	3.9	35.3	5.2	3.9	100
Finance	18.6	7.3	0.9	3.9	13.8	4.0	43.2	3.9	4.5	100
Community services	10.7	10.0	2.0	5.6	15.4	5.6	37.7	5.3	7.7	100

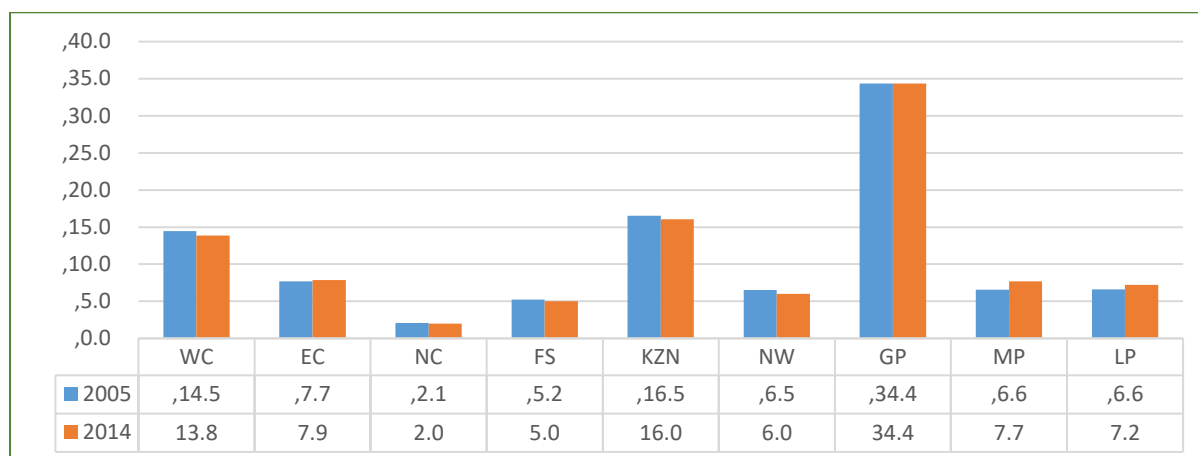
Source: Statistics South Africa; Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

Comparison amongst provincial economies' contribution to the South African economy reveals that Free State is the 2nd smallest provincial economy and its contribution to the South African economy has declined from 5.2 per cent in 2005 to 5.0 per cent in 2014. One of the components which determine the size of the nationally distributed equitable share amongst provinces is economic output; therefore the ailing size of Free State's GDP in relation to other provinces undermines the size of equitable share allocated to the province. Other provincial economies whose contributions declined are KwaZulu-Natal (from 16.5 per cent in 2005 to 16.0 per cent in 2014), Western Cape (from 14.5 per cent in 2005 to 13.8 per cent in 2014), North West (from 6.5 per cent in 2005 to 6.0 per cent in 2014) and Northern Cape (from 2.1 per cent to 2.0 per cent over the same reference period). The contribution of Gauteng, which contributes the lion share, has remained the same at 34.4 per cent in 2005 and 2014 (see figure 2.1 below).

It is the smaller economies whose contributions to the national economy have increased. The Eastern Cape's share of national output has increased by 0.2 of a percentage point, Mpumalanga by 1.1 percentage points and Limpopo by 0.6 of a percentage point during the review period.

The province of Gauteng remains the largest provincial economy in South Africa with a share 34.4 per cent in 2014, followed by KwaZulu-Natal (16.0 per cent) and Western Cape (13.8 per cent). On the other end of the scale, the smallest provincial economies were Northern Cape (2.0 per cent), Free State (5.0 per cent) and North West (6.0 per cent).

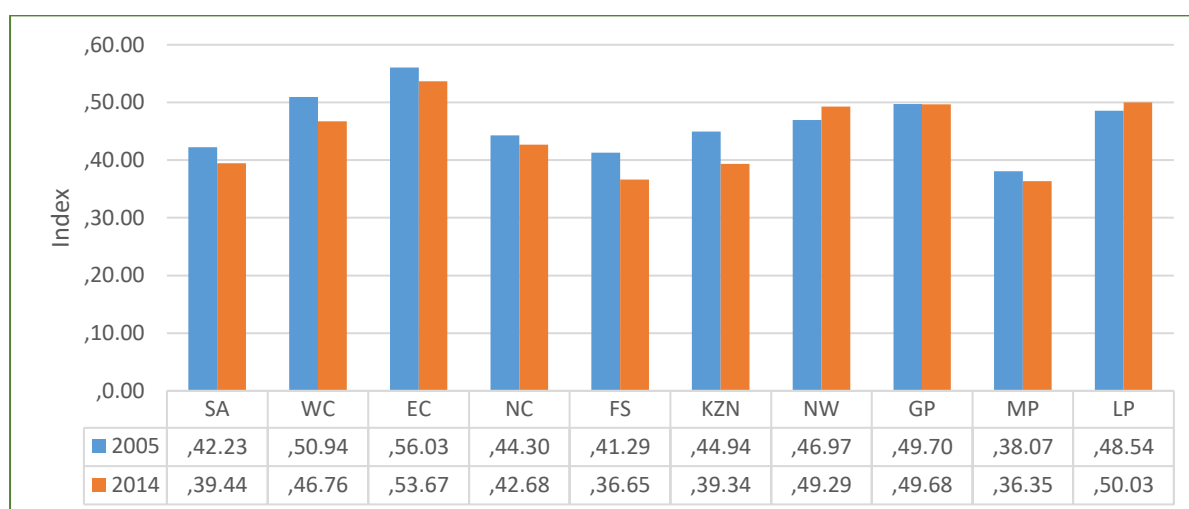
Figure 2.1: Provincial contribution to South African economy: 2005 and 2014



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

The Tress Index, depicted in figure 2.2 below, is utilized to determine the level of concentration or diversification of an economy and in terms of interpretation, an index of zero indicates a totally diversified economy whilst an index of 100 indicates a totally concentrated economy. A diversified economy is not heavily dependent on a particular sector and becomes advantageous to minimize the impact of negative external (or internal) economic shock in a particular industry on the entire economy. Based on recent global events of plunging commodity prices, countries which are mainly concentrated on a particular sector such as oil have felt the hush blow of a negative economic shock in the industry. Countries such as Nigeria have had to adjust their revenue and budget allocations for 2015.

Figure 2.2: Tress Index, 2005 and 2014

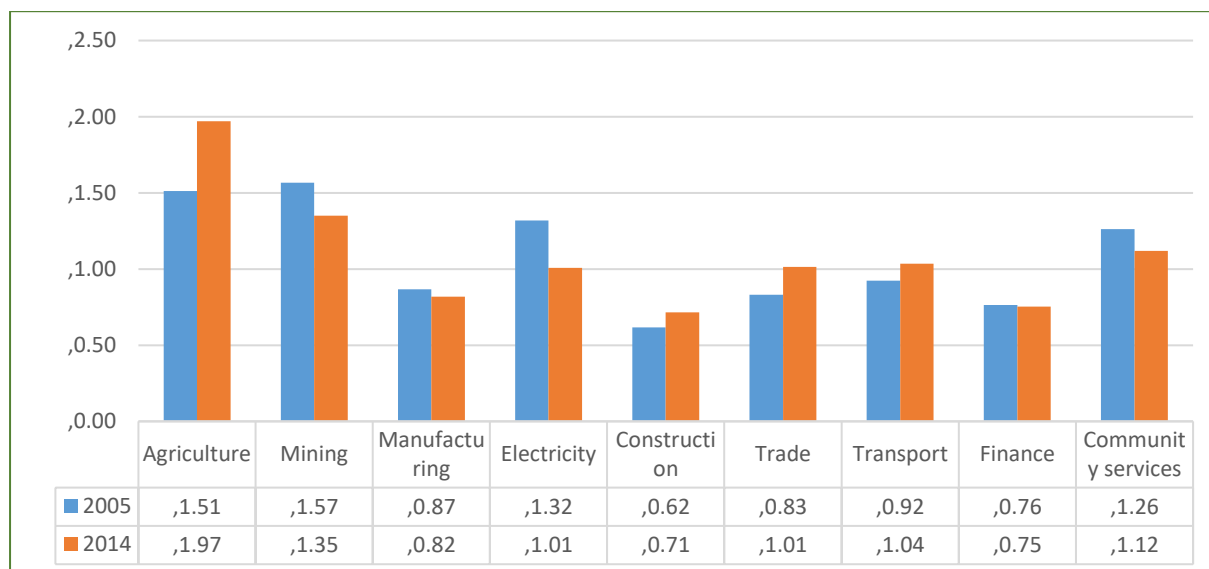


Source: IHS Global Insight, Regional eXplorer, 2015

In 2005, the tress index for Free State was 41.29, but has subsequently improved to 36.65 in 2014, reflecting a diversifying provincial economy. In comparison with the country, Free State's tress index indicated more diversity as South Africa's tress index was 42.23 in 2005 and subsequently improved to 39.44 in 2014. Comparison between provinces indicates that in 2014, Free State had the 2nd most diversified economy after Mpumalanga, which had the most diversified economy with an index of 36.35. KwaZulu-Natal had the 3rd most diversified economy with an index of 39.34 in 2014. The least diversified provincial economy was Eastern Cape with an index of 53.67 in 2014, followed by Limpopo (50.03), Gauteng (49.68) and North West (49.29).

The location quotient measures an industry's concentration in a particular region (e.g. Free State) in relation to the rest of the entire reference area (e.g. South Africa) and therefore determines a region's key industries, in terms of their employment contribution relative to the contribution of the industry to the country's employment. Figure 2.3 below depicts Free State location quotient in terms of its main industries, which would indicate that the province has comparative advantage (disadvantage) in a particular industry if the index is greater (less) than 1.

Figure 2.3: Location quotient



Source: HIS Global Insight, Regional eXplorer, 2015

The Free State economy had the greatest comparative advantage in mining with an index of 1.57 in 2005, followed by agriculture (1.51), electricity (1.32) and community services (1.26).

In 2014, two additional industries added to the province's comparative advantage, which are transport with an index of 1.04 and trade (1.01). However, the provincial economy's greatest comparative advantage still lies in agriculture (1.97), mining (1.35) and community services (1.12). Having comparative advantage in agriculture in the province enables the formulation of economic programmes and activities in the industry (e.g. agro-processing, beneficiation and development of special economic zones and Agro-parks) which are labour intensive and can absorb the high numbers of unemployed and lowly skilled workers in the province. As indicated in previous sections, Free State has a variety of minerals to extract, but in the case of gold mining, new technologies need to be developed to extract deeper lying minerals and to maximize the province's comparative advantage. Going forward, with the need for South Africa to import grain due to drought and the need for that grain to be distributed mainly by road (and rail), one can expect Free State comparative advantage in transport to increase given its centrality in the country.

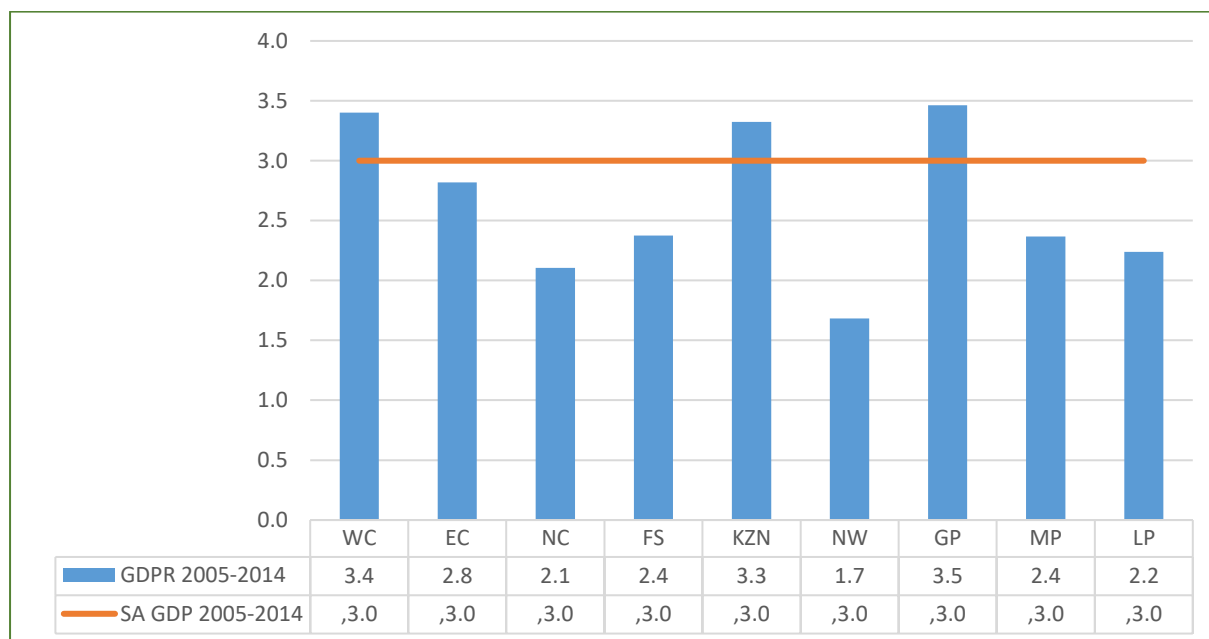
2.3. Free State Economic Performance

As contained in the FS PERO (2014), real Gross Domestic Product, which is the total value of goods and services that are produced in an economy over a specific period, is used to measure economic performance at a national and provincial sphere.

Free State's average annual real GDP growth between 2005 and 2014 is equivalent to 2.4 per cent, below the national average of 3.0 per cent over the reference period. As explained in preceding sections above, Free State has faced various challenges in some of its industries, which undermine growth. Such challenges include 2009 recession which undermined global and national growth and demand, drought in agriculture, deep-rooted gold reserves which require new technologies and skills to extract the mineral, etc. Tertiary industries have taken dominance over the economy, which could be viewed as a good sign of a maturing economy. However, even across some secondary and tertiary industries, there is heavy reliance on government or government-related participation, e.g. construction, community services and transport. Since fiscal consolidation has been introduced in 2014 provincially, this does not fare well for Free State economic growth. Free State is also not immune to a disastrous impact of high unemployment rate, which undermines the income base of the province and creates a higher dependence burden, and undercuts the performance of industries such as retail trade. At the moment, South Africa (and Free State) is a consumption-led economy.

As illustrated in figure 2.4 below, only three provinces have higher average annual real growth rates than South Africa, which are Gauteng (3.5 per cent), Western Cape (3.4 per cent) and KwaZulu-Natal (3.3 per cent). Provinces with the lowest average annual real economic growth rate are North West (1.7 per cent), Northern Cape (2.1 per cent) and Limpopo (2.2 per cent). The Free State is ranked fourth lowest at 2.4 per cent together with Mpumalanga.

Figure 2.4: Average real annual economic growth rate by region: 2005-2014

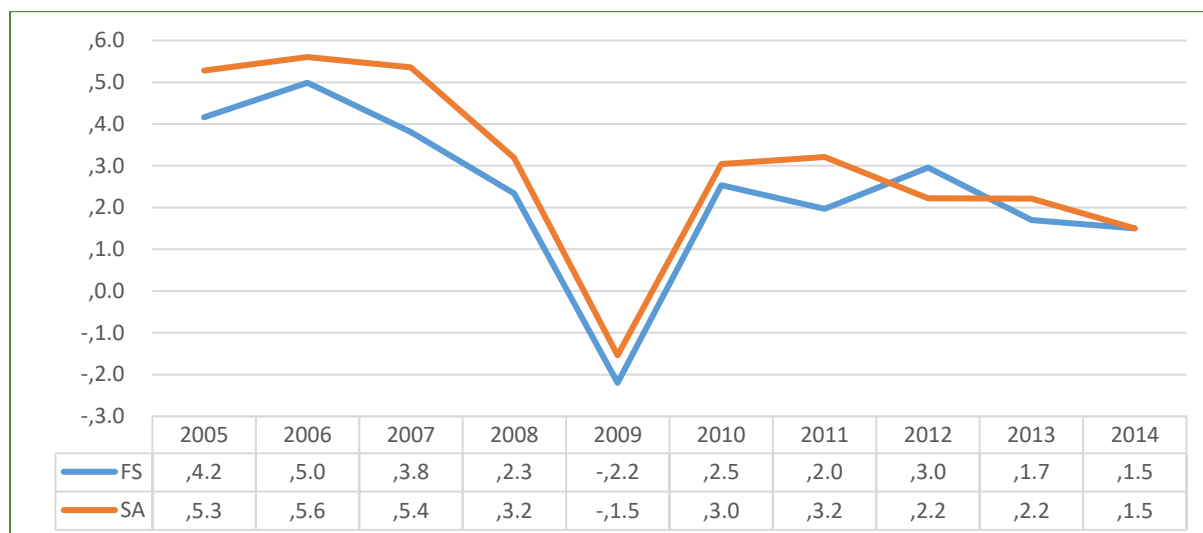


Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

Further explanation of the average annual growth rate for South Africa and Free State is illustrated in figure 2.5 below, which depicts real GDP growth of the two economies per year. South Africa's annual growth rates have been above the Free State growth rates for all the years except in 2012, when the Free State economy grew by 3.0 per cent in comparison with the 2.2 per cent of the national economy. According to SARB (2013), the year 2012 was characterized by halving of global economic activity from above 5 per cent in the first half of 2010 to 2.5 per cent in the final quarter of 2012. More specifically, South Africa experienced labour unrest in the platinum and gold mines, with significant number of jobs lost in the mining industry that year. Although Free State has the largest gold-mining complex nationally, according to FDC (2015), the province only accounts for 21.3 per cent of mining production in South Africa. This, as well as non-production of platinum in the provinces, may explain why Free State's economic performance fared better than the national economy. Post the 2009 recession, both

economies' performance have been fluctuating, however by 2014 both economies grew by 1.5 per cent. This again indicates the huge impact platinum mining has on the South African economy, since the platinum mining also experienced labour unrest in 2014.

Figure 2.5: South Africa and Free State and GDP annual growth rates



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

Pre-recession, the provincial economy's growth was already on a downward trajectory, and the rate of growth declined further from 4.2 per cent in 2005 to 2.3 per cent in 2008. Post the recession, growth accelerated and peaked at 3.0 per cent in 2012, before decelerating to 1.6 per cent in 2014.

The primary industries declined by 0.1 per cent on average between 2005 and 2014, mainly due to mining and quarrying, which declined by 0.5 per cent over the review period on account of poor performance between 2006 and 2009. Agriculture grew by 1.4 per cent over the review period. The secondary industries grew collectively by 1.8 per cent between 2005 and 2014, mainly supported by growth of construction, which grew by 4.6 per cent on average over the 10-year review period with high growth rates of 16.1 per cent and 11.2 per cent in 2007 and 2009 respectively. Manufacturing grew by 1.6 per cent and electricity, water and gas grew by 0.7 per cent over the review period. Tertiary industries grew collectively by 3.0 per cent between 2005 and 2014, mainly due to the finance industry growing by 3.2 per cent over the period under review. Wholesale and retail trade grew by 2.9 per cent, whilst transport grew by 2.4 per cent. The community services grew by 3.2 per cent on average (see table 2.3 below).

Table 2.3: GVA growth rates by sector (constant 2010 prices)

Industry	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Agriculture	4.1%	-9.2%	1.5%	21.9%	-3.5%	0.3%	-9.2%	0.6%	1.8%	5.4%
Mining	5.6%	-6.0%	-1.9%	-6.6%	-4.6%	4.9%	-1.4%	1.1%	3.3%	1.1%
Manufacturing	3.9%	6.9%	4.5%	1.9%	-7.9%	5.7%	1.1%	0.5%	0.2%	-0.8%
Electricity	4.4%	3.0%	3.3%	-4.0%	-4.2%	3.6%	1.5%	0.4%	0.1%	-0.3%
Construction	5.6%	6.3%	16.1%	7.0%	11.2%	-5.7%	0.6%	2.2%	2.0%	0.9%
Trade	3.3%	6.1%	4.5%	1.2%	-3.1%	3.5%	2.7%	7.4%	1.6%	1.8%
Transport	3.4%	5.0%	6.0%	3.5%	-1.7%	1.0%	2.1%	1.8%	0.7%	1.7%
Finance	5.1%	9.7%	5.1%	4.3%	0.1%	0.4%	2.7%	3.0%	0.5%	1.4%
Community services	3.1%	4.1%	4.7%	4.6%	1.2%	1.7%	3.7%	3.1%	3.3%	2.6%
Total Industries	4.1%	3.1%	3.8%	2.3%	-2.0%	2.4%	1.4%	2.9%	1.8%	1.6%

Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

2.4. Sector Analysis of the Provincial Economy

2.4.1. Primary Industries

Free State is still largely known for its primary industries, which have been the bedrock of the provincial economy in recent history. According to FDC (2015), about 14.5 per cent of South Africa's commercial farming takes place in the Free State, from which major crops such as maize, wheat, sunflower, sorghum, potatoes and cherries are produced. The agricultural industry bears both economic and social benefits for the province, through provision of food security, employment and social events such as the annual Cherry Festival held in Ficksburg. In terms of mining, Free State houses the largest gold mining complex in the country and also specializes in the mining of minerals such as diamonds, salts.

2.4.1.1. Agriculture, forestry and fishing

The NDP Vision 2030 calls for rural economies to be supported by agriculture, and if possible, by mining, tourism, agro-processing as well as fisheries. The document estimates that agriculture has the potential to create 1 million jobs nationally by 2030. In the Free State, agriculture continues to thrive. Various programmes have been implemented by the provincial Department of Agriculture and Rural Development which target food security, employment creation as well as economic growth and development. As contained in the 2015/16 Annual Performance Plan by Free State Agriculture and Rural Development, Free State has been declared a Poultry Hub of South Africa.

Amongst other factors, two prominent factors will play a key role in the economic performance of the Free State agriculture in 2015 and 2016, which are namely 1) the recent El Nino episode in Southern Africa which has resulted in drought for the region, as well as 2) unresolved issues between USA and South Africa surrounding the AGOA agreement. As explained in the previous chapter, the IMF (October, 2015) believes, based on historical experience, that the El Nino episode will have no effect on food prices globally, but the impact will remain localized at affected areas.

However, the Food and Agriculture Organization indices showed evidence that the El Nino episode experienced in India, Ukraine and Thailand, as well as heavy rains in the growing regions of Brazil, pushed food prices up in October 2015. Closer to home, drought has resulted in delays in preparation of land for next year's harvest, and pushed the price of yellow maize up (which is mainly utilized for animal feeding). What this means nationally and for the Free State is local drought will push local prices of food up. Also, food will have to be imported, which, given a depreciating South African currency, will further push local food prices up. In November 2015, the Department of Agriculture requested farmers to sell off their animal herds due to the drought and the land's grazing capacity, which may reduce meat prices in the short term, but increase them in the medium and long term. Table 2.4 displays contribution of agriculture by each province in South Africa over a ten year period spanning from 2005 to 2014.

Table 2.4: Contribution by province to agriculture, forestry and fishing (%)

Province	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Western Cape	23.7	23.0	23.9	22.0	21.9	22.1	22.5	22.2	22.3	22.2
Eastern Cape	5.4	5.5	5.4	5.1	5.1	4.8	5.3	5.7	5.5	5.3
Northern Cape	6.0	6.0	6.3	6.4	6.4	6.5	6.4	6.6	6.4	6.0
Free State	7.9	9.4	9.2	11.1	11.0	10.2	9.8	9.6	9.9	9.1
KwaZulu-Natal	27.0	25.8	25.6	26.2	26.8	27.0	26.5	26.1	26.2	29.4
North West	7.5	6.9	6.6	6.3	6.1	6.2	6.6	6.7	6.8	5.8
Gauteng	6.1	6.3	6.2	5.9	5.8	5.9	6.1	6.2	6.1	6.0
Mpumalanga	9.1	9.7	9.3	9.2	9.1	9.0	9.1	9.1	9.3	8.5
Limpopo	7.3	7.5	7.5	7.8	7.8	8.2	7.7	7.8	7.6	7.8

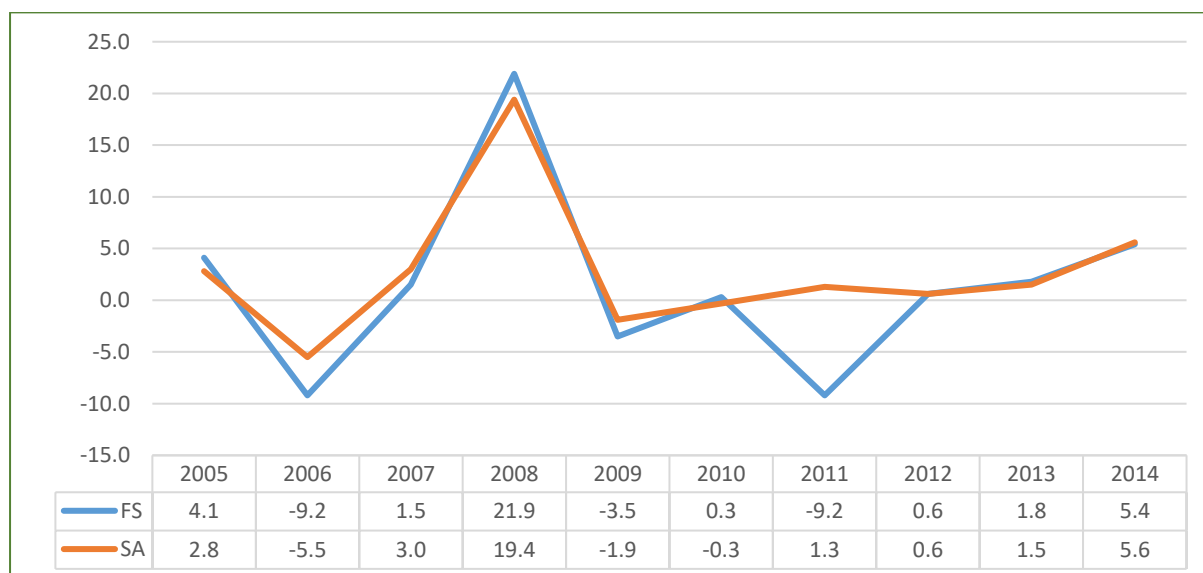
Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

The contribution of Free State's agriculture, forestry and fishing to the national sector has averaged 9.7 per cent between 2005 and 2014, third behind KwaZulu-Natal (26.7 per cent) and Western Cape (22.6 per cent). The average contributions of agriculture, forestry and fishing from Eastern Cape, Gauteng and Northern Cape have remained the lowest at 5.3 per cent, 6.1 per cent and 6.3 per cent respectively over the review period. Over the 10-year reference period, the contribution of Free State's agriculture, forestry and fishing reached its peak of 11.1 per cent in 2008, and has subsequently declined to 9.1 per cent in 2014.

In 2014, the biggest contributors to national agriculture, forestry and fishing were KwaZulu-Natal (29.4 per cent), followed by Western Cape (22.2 per cent) and Free State (9.1 per cent). The lowest contributors to the national sector were Eastern Cape (5.3 per cent), Gauteng (6.0 per cent) and Northern Cape (6.0 per cent).

The average growth rate for Free State agriculture, forestry and fishing between 2005 and 2014 is 1.4 per cent, below the national industry's average growth of 2.7 per cent. Climate change has an impact on agricultural production, as evidenced by a contraction of the provincial agriculture, forestry and fishing by 9.2 per cent in 2011. Since 2012, the national and provincial industries have followed a similar growth trajectory.

Figure 2.6: South Africa and Free State agriculture, forestry and fishing sector growth rates



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

2.4.1.2. Mining and quarrying

According to the FDC (2015), the discovery and subsequent mining of gold in South Africa led to the country's industrialization and advancement in Sub-Saharan Africa. The country is ranked 1st in terms of gold reserves, but is ranked 3rd in gold production, after China and Australia. The Free State Consolidated Goldfields, in particular, is the largest gold-mining complex with mining area of 330 square kilometers. However, the province's gold production is ranked 2nd after Gauteng. Other minerals extracted in the province include bituminous coal as well as diamonds in the Koppies area.

The performance of the mining industry for South Africa and Free State has, in recent years, been influenced by labour market disruptions (e.g. in the platinum industry in 2014 and in the coal and gold industries in 2015); rising input costs to mining; electricity crisis in South Africa; China's slow demand for commodities, which has resulted in lower commodities prices; and interest rate expectations in relation to investment (e.g. in gold as well as exchange rate fluctuations).

Table 2.5 below depicts the contributions by all provinces to the national mining and quarrying industry. The largest average contributors to the national mining and quarrying industry between 2005 and 2014 are North West (25.0 per cent), Limpopo (23.4 per cent) and Mpumalanga (20.9 per cent), whilst the lowest contributors are Eastern Cape (0.3 per cent), Western Cape (0.4 per cent) and KwaZulu-Natal (3.4 per cent). Free State ranks at 5th position with an average contribution of 8.1 per cent, mainly boosted by a contribution of 8.7 per cent in 2014.

Table 2.5 Contribution by province to mining and quarrying (%)

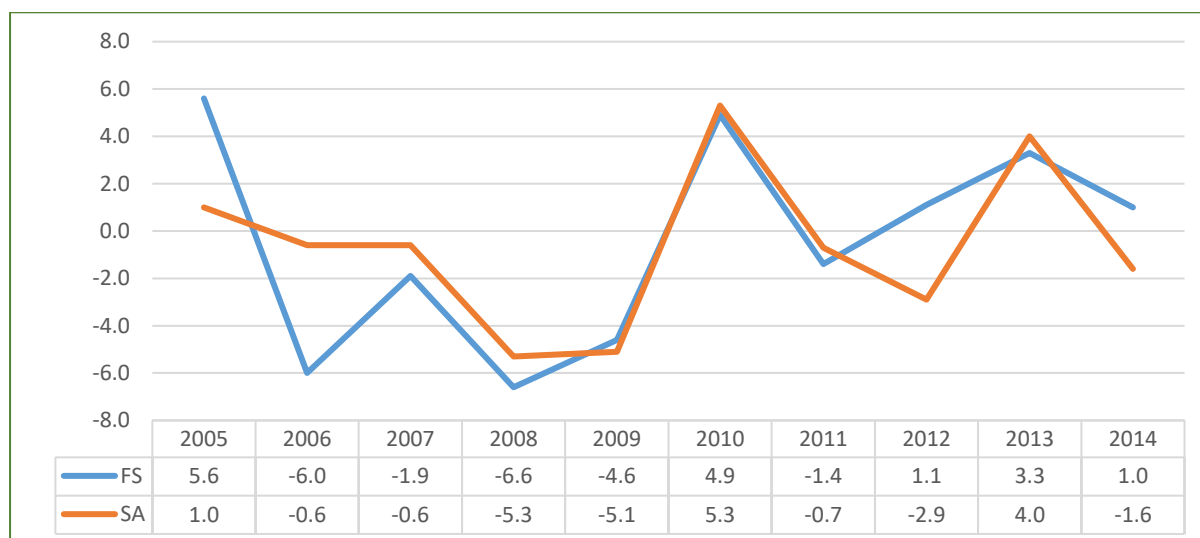
Province	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Western Cape	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Eastern Cape	0.2	0.3	0.3	0.3	0.4	0.3	0.3	0.3	0.2	0.3
Northern Cape	7.0	6.8	6.7	6.7	6.5	6.5	5.8	5.9	5.9	7.3
Free State	8.2	8.2	8.2	8.6	8.2	8.2	7.3	7.3	7.6	8.7
KwaZulu-Natal	3.4	3.5	3.5	3.6	3.4	3.5	3.1	3.3	3.3	3.7
North West	26.1	25.6	25.6	25.3	25.5	25.4	26.6	22.8	26.1	20.5
Gauteng	12.2	12.5	12.6	12.2	12.1	12.1	11.5	11.8	11.5	12.9
Mpumalanga	19.6	19.6	19.6	19.8	20.1	20.4	21.3	24.7	21.5	22.1
Limpopo	22.9	23.1	23.1	23.2	23.3	23.2	23.7	23.5	23.5	24.0

Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

Over the 10-year reference period, South Africa's mining and quarrying contracted at an average of 0.7 per cent, whilst the provincial sector contracted by 0.5 over the same period. The provincial sector was more resilient than the national sector in 2005, 2009, 2012 and 2014. During 2012, the Marikana Strike, which affected platinum mining, resulted in a contraction of national mining and quarrying by 2.9 per cent, whilst the Free State sector remained largely unaffected with a growth of 1.1 per cent. Again, the platinum strike in the first half of 2014 resulted in contraction of the national mining and quarrying sector by 1.6 per cent, but the Free State sector remained unaffected and grew by 1.0 per cent.

Free State's PERO (2014) indicates that large scale mining for the province includes gold, diamonds and coal, whilst small scale mining includes clay, salt, limestone, granite, gypsum and sand/stone aggregate. Therefore challenges around platinum mining have no direct impact on the province. Instead, in 2014 Free State had to worry about minute growth of 1.0 per cent and associated reasons such as decline in coal prices; slower growth globally and nationally, which affect disposable income and therefore the performance of diamonds; ever deepening gold mines and associated growing cost-base related to the industry; as well as on-going electricity crisis.

Figure 2.7: South Africa and Free State mining and quarrying sector growth rates



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

2.4.2. Secondary Industries

Secondary industries comprise of manufacturing, electricity and construction industries. In the Free State, manufacturing dominates the secondary sector. According to Global Insight (2015), the fuel, petroleum, chemical and rubber products sub-sector accounts for 70.5 per cent of gross value added in the manufacturing industry provincially, mainly due to the Petrochemicals Company Sasol, which is a world leader in the production of fuels, waxes, chemicals and low-cost feedstock from coal. The electricity and construction industries' contribution towards the provincial economy are minute but still play a critical role for the economy.

2.4.2.1. Manufacturing

The manufacturing industry in the Free State contributed 3.9 per cent in 2014 to the national sector output, which is relatively small in comparison with other provinces. However, the Minister of Finance in the 2015 Budget Speech identified (light) manufacturing as one of the key industries to boost short term growth prospects. Also, McKinsey Global Institute (2015) identifies advanced manufacturing as one of the South Africa's big five bold priorities for inclusive growth, acknowledging that the country does not globally have a competitive advantage in manufacturing from a wages perspective, but can gain competitive advantage in high value added goods which require skilled labour, technology and strong business

environment. The motor industry in South Africa is a perfect example of how such a success can be gained.

In the mist of economic turmoil globally and nationally in 2015, sound policies through the Department of Trade and Industry have ensured that this industry attracts and secures large foreign direct investment from companies such as Nissan and BMW. The World Bank (2015), in its June edition of Global Economic Prospects, highlighted that China's foreign direct investment is continually increasing in Africa, and that although it is mainly resource-driven, manufacturing's share is also increasing. This is partly due to growing business opportunities in Africa, but also due to Chinese efforts to develop global value chains as domestic labour costs rise relative to lower-cost Africa. South Africa and Free State should be positioned to take advantage of this global change in the manufacturing landscape, just as other African countries have done so e.g. Ethiopia, Mali and Uganda.

Table 2.6 below shows contribution towards manufacturing by each province. The largest average contributors to the national manufacturing sector between 2005 and 2014 were Gauteng (40.1 per cent), followed by KwaZulu-Natal (21.1 per cent) and Western Cape (15.3 per cent). The lowest contributors were Northern Cape (0.5 per cent), Limpopo (1.4 per cent) and North West (2.6 per cent). The average contribution of the Free State to the national manufacturing sector was 4.3 per cent, and ranked at 6th position nationally. The contribution of the manufacturing sector has been declining in the Free State, from 4.8 per cent in 2007 to 3.9 per cent in 2014; a fall of 0.9 of a percentage point.

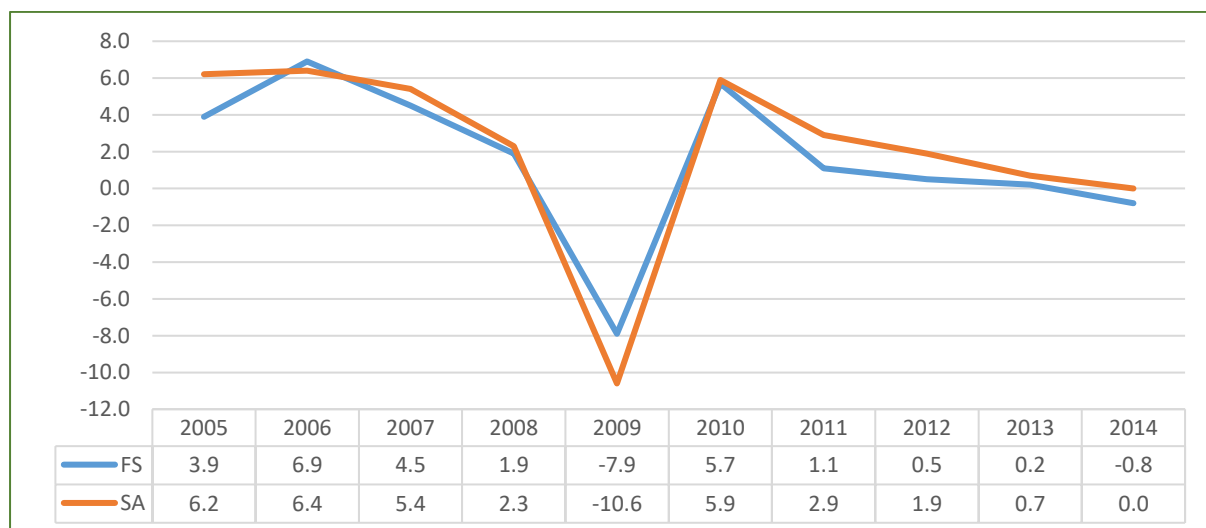
Table 2.6 Contribution by province to manufacturing sector (%)

Province	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Western Cape	14.8	14.9	15.0	15.3	15.2	15.4	15.5	15.8	15.9	15.4
Eastern Cape	7.8	8.0	7.7	7.4	7.5	7.6	7.5	7.2	7.2	7.6
Northern Cape	0.5	0.3	0.5	0.6	0.6	0.5	0.4	0.5	0.5	0.5
Free State	4.5	4.7	4.8	4.6	4.3	4.1	4.2	4.0	4.1	3.9
KwaZulu-Natal	21.2	20.9	20.8	21.0	21.2	20.9	21.0	21.3	21.4	21.0
North West	2.6	2.7	2.5	2.4	2.6	2.7	2.9	2.8	2.7	2.5
Gauteng	40.4	40.6	40.3	40.1	39.9	40.1	39.6	39.4	39.3	40.9
Mpumalanga	6.8	6.7	6.9	7.0	7.2	7.1	7.3	7.4	7.4	6.8
Limpopo	1.3	1.2	1.3	1.5	1.4	1.5	1.6	1.5	1.4	1.4

Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

The average growth of the manufacturing sector in South Africa between 2005 and 2014 is 2.1 per cent. The average growth of Free State's manufacturing sector is below the national average at 1.6 per cent over the same period. The national and provincial manufacturing sector have been on a downward trajectory since 2010, declining from growth of 5.9 per cent in 2010 to 0 per cent in 2014 for the national sector, whilst growth of Free State manufacturing has declined from 5.7 per cent in 2010 to a contraction of 0.8 per cent in 2014. According to SEDA (2012), some of the challenges faced by manufacturing on a national scale include higher labour and production costs and banks perceiving SMMEs as risky and therefore are reluctant to lend money to these companies. The McKinsey Global Institute (2015) also highlights challenges of high input costs including inland logistic as well as labour costs.

Figure 2.8 South Africa and Free State manufacturing sector growth rates



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

The following recommendations for manufacturing in South Africa (which is also applicable for Free State) are found in the McKinsey report:

- Focus on advanced manufacturing, which South Africa has competitive advantage on, as well as regional processing and resource intensive commodities (energy intensive only when supply crisis is over).
- There's potential for growth in adjacent manufacturing (components) items for multiplied growth.
- Manufacturing should be export-oriented.

- Strengthen SEZ in competitive export industries, cluster complementary businesses for greater economies of scale and reduction in transport costs, skills transfers, etc.
- Strengthen trade agreements and diplomatic marketing with other countries.
- Strengthen preferential procurement.
- Hands on in-company apprenticeships which are government funded should be provided to decrease unemployment and hone skills.
- Strengthen research and innovation funding in the manufacturing sector.

2.4.2.2. Electricity, gas and water

Most analysts both nationally and globally have sited electricity shortage as one of the impediments to economic growth in South Africa, with various stakeholders continuously revising growth forecasts of South Africa downwards in 2015. Electricity has a high impact on the performance of mining and manufacturing, which are both energy intensive and are not only important for the national economy, but also for the Free State. In 2015, much talk was about nuclear as future addition to the current energy mix, with several countries such as Russia and France interested in bidding to build new nuclear power plants in South Africa. South Africa has some experience in utilizing nuclear energy as an electricity source, through the Koeberg nuclear power plant in Western Cape, which contributes 4 per cent to the national electricity grid. Although the Department of Energy includes nuclear as part of its Integrated Energy Plan, various stakeholders in South Africa still debate the use of nuclear and its associated capital costs for the country.

In addition to existing electricity power stations established in the Free State, the Free State Development Corporation (2015), indicates that Free State's Sasol started producing electricity from natural gas in 2013 to supplement sourced energy from Eskom. Also, Free State has the potential to harvest solar energy, with Xhariep being the best area provincially based on its solar-radiation index.

In 2015, the water sub-sector nationally has been affected by the drought affecting the country, which will not only have an impact on energy production (e.g. electricity production through the Gariep Dam), but on agriculture, food and job security as well as households and businesses. Although certain parts of South Africa experienced rainfall late in November 2015,

this is likely to have an insignificant effect on dam levels across the country. According to the Department of Water Affairs, water levels at three of the biggest dams in Free State, as at 01 December 2015, were at 53 per cent for Gariep Dam, 92.7 per cent for Sterkfontein Dam and 53.8 per cent for Vaal Dam (Vaal Dam is shared by both Free State and Gauteng).

The highest contributors to the South African electricity, gas and water sectors, based on average contribution between 2005 and 2014 are Gauteng (30.6 per cent), KwaZulu-Natal (16.7 per cent) and Mpumalanga (15.0 per cent). The lowest contributors to the sector, on average, are Northern Cape (2.4 per cent), Eastern Cape (4.3 per cent) and North West (5.6 per cent). Free State ranks at 6th position, with an average contribution of 6.7 per cent over the reference period (see table 2.7 below).

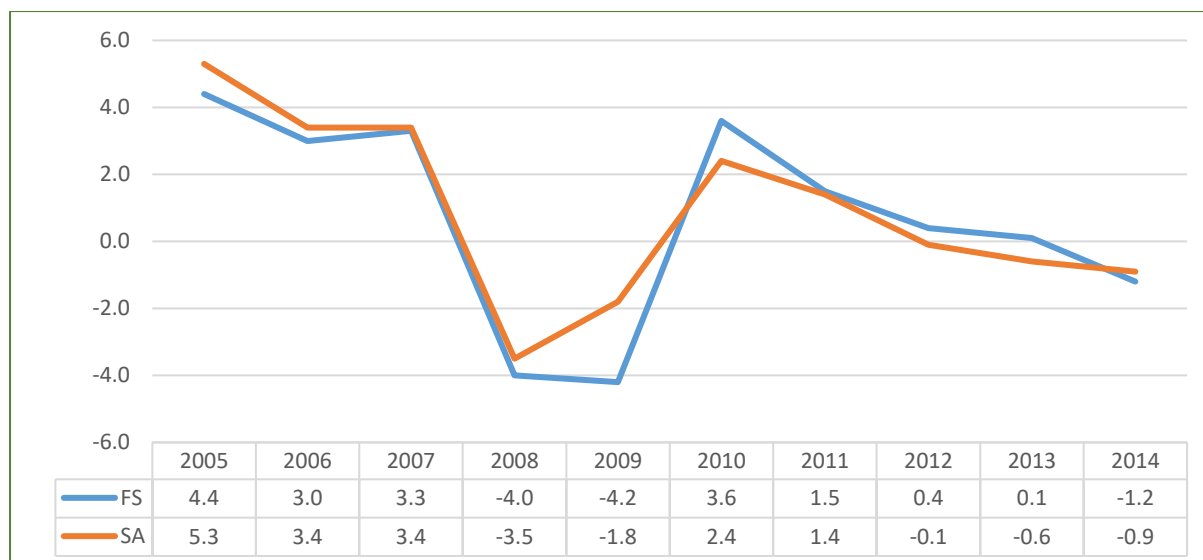
Table 2.7 Contribution by province to electricity, gas and water sector (%)

Province	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Western Cape	10.5	10.5	10.3	11.0	11.2	11.0	9.9	10.2	10.2	11.1
Eastern Cape	4.0	4.3	4.4	4.1	4.3	3.9	4.8	4.7	4.7	3.7
Northern Cape	2.0	2.2	2.1	2.5	2.7	2.7	2.5	2.3	2.2	2.7
Free State	6.9	7.0	7.1	6.7	6.8	6.6	5.7	5.5	5.1	6.7
KwaZulu-Natal	17.2	17.1	17.1	16.0	16.0	15.5	17.4	17.4	17.2	15.6
North West	5.8	5.7	5.6	5.4	5.6	5.7	5.9	5.1	6.2	5.1
Gauteng	31.1	30.2	30.5	30.9	30.1	31.2	30.2	30.6	30.2	31.3
Mpumalanga	14.1	14.9	14.5	15.1	15.1	15.1	15.2	15.3	15.3	15.4
Limpopo	8.4	8.2	8.4	8.3	8.1	8.4	8.5	8.8	8.9	8.4

Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

The average growth of the South African electricity, gas and water sector between 2005 and 2014 is 0.9 per cent, whilst the Free State's sector grew by 0.7 per cent over the same period. The low growth rates of 2009 and 2010, as illustrated in figure 2.9 below, may be indicative of the effects of reduced growth in mining and manufacturing during the recession. Overall, the growth of the electricity, gas and water sector both nationally and provincially is on a downward path and in 2014, contracted by 0.9 per cent and 1.2 per cent, respectively.

Figure 2.9 South Africa and Free State electricity, gas and water sector growth rates



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

Box 2.1: Gas Industry as another alternative source of energy for Free State Province

Whilst nuclear is being considered to add capacity to the national grid, Free State, through Sasol chemical complex, has the potential to explore gas industry and its contribution towards the country's (and provinces') economic growth. What is known so far about gas Industry?

- It is one of South Africa's big five bold priorities (McKinsey Global Institute, 2015)
- A shift towards the natural gas industry is estimated to add R16 billion to SA's GDP in 2020 and create 9 500 temporary jobs in construction and related industries. By 2030, the industry can add R251 billion to the country's GDP and create 44 000 to 102 000 permanent jobs, 226 000 in downstream industries and 82 000 temporary jobs.
- Based on future decommissioning of some coal plants in SA, the natural gas industry may be able to bridge the gap between energy capacity and demand between 2020 and 2030
- Lead time to plan, design and build a gas plant is estimated at 2 to 4 years, whilst lead time of coal power station is 8 years.
- Natural gas, as a base-load power supplier, has lower initial capital costs (R8600 per kW) in comparison with coal (R31 500 per kW) and nuclear (R70 900 per kW), although the overall levelised cost to produce natural gas is more expensive. (levelised is the total cost to produce power per unit of output)

- The relative high levelised costs of natural gas will decrease as coal becomes expensive and imposition of carbon tax favours natural gas more than coal.
- The carbon footprint of new combined-cycle gas turbines is less than half of carbon emissions from new coal plants, but worse than nuclear, although nuclear produces radioactive waste and has high disposal costs.
- Natural gas can substitute renewable energy quicker during fluctuations in energy provided by renewables due to the ability to switch its power on within one hour.
- Initial stages of natural gas industry will require imports either in LNG or gas, while domestic production will gain momentum thereafter.
- Sasol is already being supplied natural gas by Mozambique and Sasol plant already co-produces natural gas for existing gas market in South Africa together with PetroSA.

Source: McKinsey Global Institute, 2015

2.4.2.3. Construction

The construction industry remains one of the most vital industries to stimulate economic development, economic growth and job creation. The sector, like agriculture, has an ability to absorb and create livelihoods for relatively unskilled workers. For the Free State, which has a high unemployment rate of 31.5 per cent (2015:Q3) and 62.6 per cent of adults without a matric qualification in 2014 (Global Insight, 2015), construction as a labour intensive industry remains a vital sector. Post the 2009 economic recession, construction has been utilized in a counter cyclical manner to boost job creation and economic growth, through social and economic infrastructure envisioned by the NDP Vision 2030 and contained in the National Infrastructure Plan. The impact of government infrastructure is significant, as reflected by Price Waterhouse Coopers (2015), which in its 3rd edition of SA Construction, states that a good indication of the industry's performance is public expenditure on infrastructure; this idea is supported by visible slump of construction in the country since the 2010 Soccer World Cup. The Free State Province intends to spend just over R2 billion on building and fixed assets for provincial infrastructure in 2015/16, which is likely to stimulate other sectors such as manufacturing and trade. However, the waning planned expenditure over the 2015 MTEF is a reflection of tough fiscal and economic environment.

Table 2.8 below reflects contributions by each province towards South Africa's construction sector between 2005 and 2014. The largest average contributors were Gauteng (35.5 per cent), Western Cape (17.7 per cent) and KwaZulu-Natal (17.6 per cent). The lowest average contributors towards the national construction sector were Northern Cape (1.5 per cent), Free State (3.8 per cent) and North West (4.6 per cent). Free State's contribution to the national construction output increased by 0.7 of a percentage during the review period.

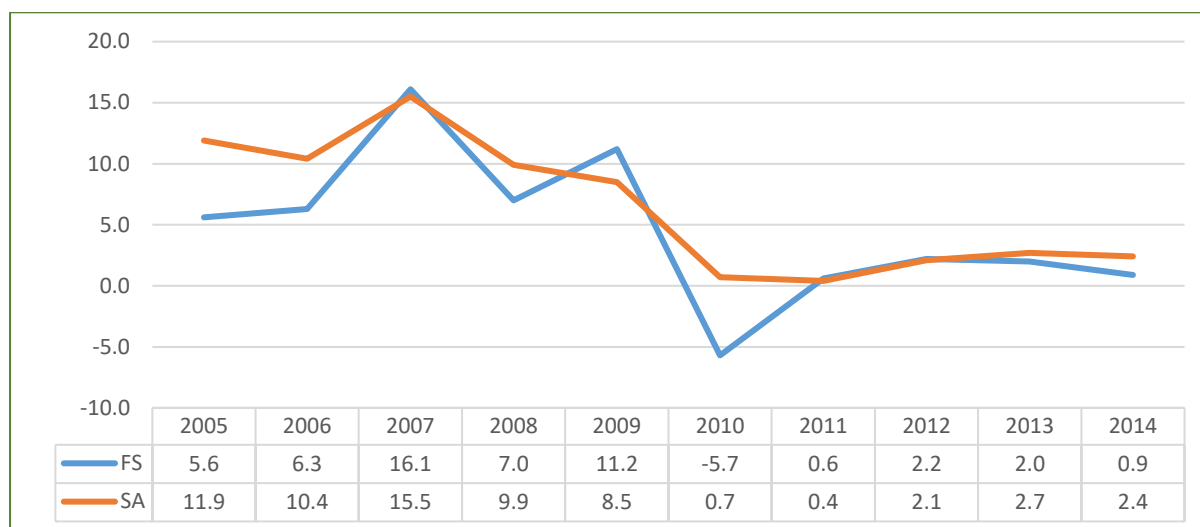
Table 2.8: Contribution by province to the construction sector (%)

Province	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Western Cape	19.9	18.2	17.6	16.8	16.3	15.3	18.2	18.9	20.2	15.6
Eastern Cape	6.2	7.8	7.6	7.1	7.4	7.9	7.2	7.7	9.1	7.9
Northern Cape	1.1	1.4	1.6	1.4	1.8	1.5	1.3	1.3	1.5	1.6
Free State	3.2	3.7	3.9	3.6	4.5	4.0	4.1	3.6	3.6	3.9
KwaZulu-Natal	14.8	15.9	15.2	16.6	18.6	19.1	20.6	18.1	18.3	19.0
North West	5.0	5.0	4.9	5.3	5.1	4.9	3.6	3.4	4.1	4.5
Gauteng	41.0	37.5	37.5	37.1	32.8	33.6	34.6	36.0	31.2	33.8
Mpumalanga	4.4	5.8	6.6	6.3	6.7	6.4	5.4	5.7	6.2	6.4
Limpopo	4.4	4.8	5.1	5.7	6.8	7.3	5.1	5.3	6.0	7.4

Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

The average growth rate of the South African construction sector between 2005 and 2009 was 11.2 per cent, whilst the average growth rate for Free State was 9.2 per cent, which reflected heavy public infrastructure expenditure leading towards the 2010 Soccer World Cup. The average growth for national construction has since dwindled and reached 1.7 per cent between 2010 and 2014 whilst for the Free State, this average growth was 0 per cent. The most recent dip in national and provincial construction growth rates in 2014 to 2.4 per cent and 0.9 per cent respectively may reflect a tougher economic environment and the implementation of fiscal consolidation, as well as labour unrest in the metal industry.

Figure 2.10 South Africa and Free State construction sector growth rates



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

2.4.3. Tertiary Industries

Tertiary industries encompass trade, transport, finance and community services industries and contributes the largest to the GDP of the Free State. As alluded to in the previous sections above, Free State has acquired comparative advantage in the trade industry in recent years and according to Global Insight (2015), trade is estimated to account for 16 per cent of the provincial GDP, in comparison with the 14 per cent contribution of national trade to the South African GDP. Overall, the retail industry in South Africa remains resilient in spite of sluggish economic growth, with a new trend of developing mega malls giving the industry a boost. Through Africa's development and growth, trade in South Africa can be boosted by retail shops opening up in other African countries. The significance that trade plays in the Free State may be an overall reflection of the country's increased trade liberalization, such as conducive trade policies which attract foreign investment through more foreign stores opening in South Africa and the province playing "catch-up" in retail. Free State also continues to receive increasing number of foreign tourists, who are also lured by the country's weakening exchange rate.

The performance of the transport sector is influenced by factors such as freight transportation and capital formation and to this end, investment by both government and private sector play a huge roles. Due to the current drought conditions, South Africa is forced to be a net importer

of maize temporarily. The Free State's transport industry might gain from the centrality of the province and the current needs to transport imported grain across the country.

The current need for the South African government to apply fiscal consolidation across all spheres of government has resulted in attempts to do more with a constrained budget. The economic performance of the community services in the province will, therefore, be influenced by the need to reduce overall government debt and government wages, and the need to keep the investment grade of the country healthy, among other things. Overall, tertiary industries will continue to play a dominant role in the contribution of the provincial GDP.

2.4.3.1. Wholesale, retail and motor trade; catering and accommodation

The wholesale, retail and motor trade; catering and accommodation industry is highly affected by the state of the economy, both domestically and globally. In South Africa, a number of economic changes have influenced the performance of this sector. Since 2014, petrol prices have fallen, positively affecting consumers' disposable income. However, the increases in interest rates by 1.25 basis points between July 2014 and November 2015, as well as an increase in tax rates in 2015 have affected consumer confidence and consequently, the consumer's willingness to spend on retail and possibly also on tourism. Business confidence has also been knocked in 2015, partly due to weaker consumer spending, but also due to increasing costs of production e.g. through weaker exchange rates and consequent import of inflation.

On an international platform, although a weaker exchange rate would ideally favour exports, South Africa is also faced with reduced international demand for commodities or raw goods. However, South Africa and China entered into 26 new trade agreements valued at R94 billion in December 2015 as part of South Africa's focus on re-industrialization and to address some of the trade imbalances between the two countries. These agreements have potential to significantly improve trade for South Africa. Some of the projects this multi-billion rand trade agreements will focus on include Silk Road Economic Belt and 21st Century Maritime Silk Road; strengthening corporation in ocean economy; and loan agreement for Eskom. These trade agreement are not only focused on government projects, but also business.

Also, the Free State government, in its efforts to bolster trade, hosted Free State China Week in April 2015, to link Chinese government and investors with Free State economic

opportunities for mutual benefits of both parties. In addition, the Free State government launched the Free State Global Investors Trade Bridge in September 2015 and according to South Africa's government website (2015), this event is meant to strengthen international partnerships through investment and facilitate the effective implementation of MOUs signed between Free State province and the rest of the world for trade and investment opportunities.

In tourism, as can be seen in Box 2.2 below, Free State is gaining momentum both in the growth of international tourist and share of the country's tourists. However, new Visa Laws implemented in South Africa that states that 1) a person should apply for a Visa to SA in person and 2) an individual entering and exiting SA with a child must carry an unabridged birth certificate for that said child, brings downside risks to the number of international tourists in the country (and Free State). Although government has attempted to implement amendments to these laws, the impact on domestic tourism has yet to be seen. The net effect on tourism numbers will likely be the negative effect of new Visa laws verses the positive effect of a weaker exchange rate.

The average contribution towards South Africa's wholesale, retail and motor trade; catering and accommodation between 2005 and 2014 is largest from Gauteng (30.5 per cent), KwaZulu-Natal (17.8 per cent) and Western Cape (15.5 per cent). In contrast, the smallest average contributions to the national sector between 2005 and 2014 are from Northern Cape (1.8 per cent), North West (5.0 per cent) and Free State (5.4 per cent).

Table 2.9 Contribution by province to wholesale, retail and motor trade; catering and accommodation (%)

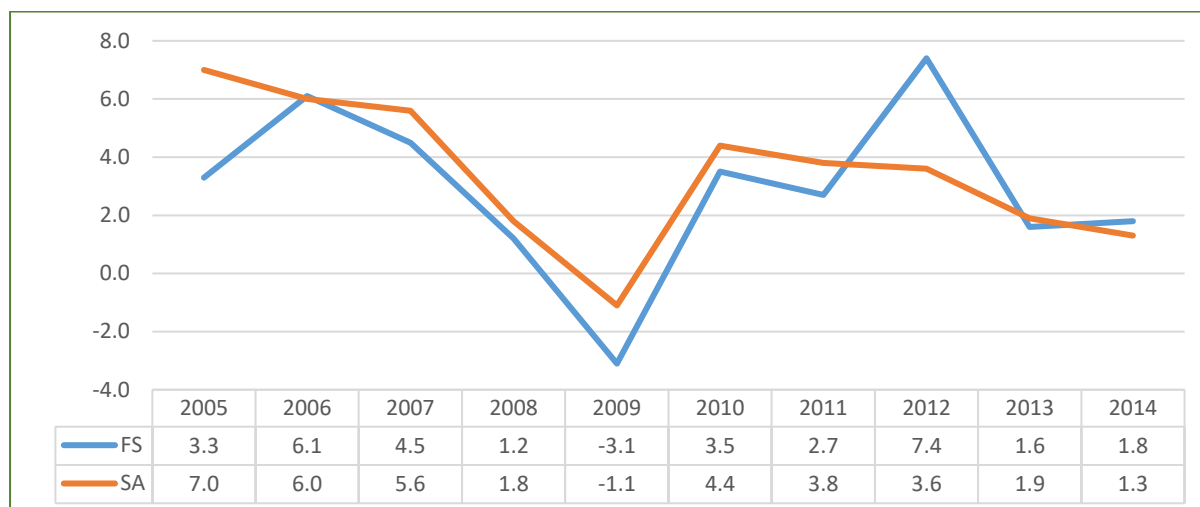
Province	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Western Cape	16.5	14.9	17.0	15.8	15.4	14.5	16.1	14.7	15.6	14.5
Eastern Cape	8.0	9.6	12.8	9.0	9.6	10.1	9.1	10.5	10.8	10.1
Northern Cape	1.8	2.2	2.2	2.0	1.7	1.8	1.8	1.6	1.5	1.7
Free State	4.3	5.3	4.8	5.4	5.7	6.1	5.7	5.3	5.1	6.3
KwaZulu-Natal	17.0	18.6	20.0	20.4	18.0	16.5	17.5	17.3	16.7	16.4
North West	5.4	4.7	4.7	5.1	5.0	5.1	4.9	5.1	5.3	4.6
Gauteng	35.8	32.2	25.1	29.5	29.1	31.0	31.0	30.3	29.7	31.7
Mpumalanga	5.2	5.9	7.1	6.7	7.3	7.4	7.1	7.5	7.9	7.2
Limpopo	6.0	6.7	6.3	6.1	8.1	7.6	6.9	7.7	7.6	7.4

Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

Figure 2.11 below shows that growth in the wholesale, retail and motor trade; catering and accommodation sector declined from 7.0 per cent in 2005 to 1.8 per cent in 2008 for the national sector, whilst the provincial sector's growth declined from 3.3 per cent in 2005 to 1.2 per cent in 2008. This reference period marked high economic growth rates for the country and the Free State, which would ideally be associated with positive income shocks and increased trade. The 2010 Soccer World Cup hysteria assisted in the growth of the sector, which rose to 4.4 per cent for South Africa and 3.5 per cent for Free State in 2010. Whilst growth for the national sector steadily declined from 4.4 per cent in 2010 to 1.3 per cent in 2014, growth movements for the Free State sector were less predictable. The year 2012 marked growth rate of 7.4 per cent for Free State, higher than South Africa's growth of 3.6 per cent.

According to Global Insight (2015), the sub-sectors of wholesale, retail and motor trade; catering and accommodation grew higher for the Free State than South Africa in 2014. Wholesale and commission grew by 7.4 per cent provincially and by 4.2 per cent nationally; Retail trade and repairs of goods grew by 7.1 per cent provincially and by 3.0 per cent nationally; Sale and repairs of motor vehicles & sale of fuel grew by 8.8 per cent provincially and 4.8 per cent nationally; lastly, hotels and restaurants grew by 5.9 per cent provincially and 1.8 per cent nationally. Also, there was remarkable growth in the number of tourists provincially (reflected in Box 2.2 below) of 9.2 per cent in 2012 and 9.1 per cent in 2013, in comparison with national growth rate of tourists of 2.6 per cent in 2012 and 0 per cent in 2013., The average growth rate in the number of tourists hosted by Free State has been higher than the national growth rate since 2011.

Figure 2.11 South Africa and Free State wholesale, retail and motor trade; catering and accommodation sector growth rates



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

2.4.3.2. Transport, storage and communication

Amongst different infrastructure needs which must be met in South Africa, transport is probably one of the most prominent. Transport plays a crucial role through the transporting of mineral resources across the country and regionally through rail way system and links business, goods and people between social and economic spaces. The Minister of Finance in the People's Guide on 2015 Budget highlighted the importance of transport to move people between social and economic spaces. As such, the rapid transport system has been extended towards other cities through the My-Citi in Cape Town and A Re Yeng in Pretoria. In air transport, a new airline called Skywise joined other existing airlines in South Africa in 2015 to provide affordable and competitive transport between major cities. Also, SAA intends to procure cost effective Airbus planes in the foreseeable future. The Minister announced that continued support for a more efficient transport system will be financed through public transport subsidies, which will grow at an annual rate of 4.3 per cent.

Free State is well endowed with transport infrastructure (e.g. rail, road, etc.) and remains important as a central province through which freight passes by between coastal harbours and some inland provinces. Overall, the Free State government, through the provincial Department of Police, Roads and Transport, has allocated R1.510 billion in 2015 towards transport

infrastructure to address key transport infrastructure needs in the province (Free State Adjusted Estimates of Provincial Revenue and Expenditure, 2015). The ability of the province to build quality road infrastructure through allocated funds was emphasized in the 2016 State of the Province Address, which acknowledged that the province won Best Construction Project for the revitalization of the Thaba Nchu Bus Route. In the 2016 National Budget Speech, the Minister of Finance announced the construction of multi-purpose Airport Development Node in Free State, which will cost R2.6 billion.

The communication sector experienced some changes in 2015. Telkom as well as MTN resized their staff establishment to reflect other industry players' size whilst MTN was fined billions of dollars in Nigeria for having unregistered customers on its network.

Table 2.10 below depicts that the provinces with the largest average contributions between 2005 and 2014 to the South African transport, storage and communication sector were Gauteng (36.0 per cent), KwaZulu-Natal (21.1 per cent) and Western Cape (15.0 per cent). The smallest contributors were Northern Cape (2.3 per cent), Limpopo (4.0 per cent) and North West (4.3 per cent). Free State ranked at 5th position, with an average contribution of 5.1 per cent over the reference period.

Table 2.10 Contribution by province to the transport, storage and communication sector (%)

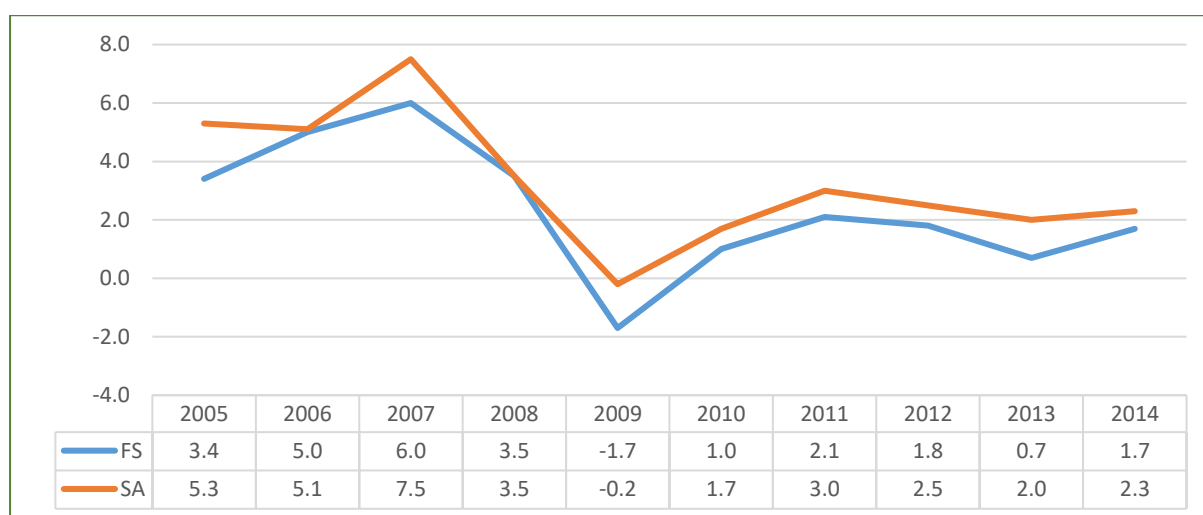
Province	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Western Cape	14.5	15.0	14.9	15.2	15.3	15.3	15.0	14.9	14.7	15.2
Eastern Cape	7.2	7.1	7.1	7.1	7.2	7.2	7.2	7.3	7.3	7.0
Northern Cape	2.3	2.3	2.3	2.4	2.3	2.3	2.4	2.4	2.4	2.3
Free State	4.8	5.3	5.3	5.3	5.2	5.0	5.1	5.1	5.1	4.9
KwaZulu-Natal	22.2	20.3	20.6	20.8	20.6	21.0	21.2	21.6	21.9	21.1
North West	5.8	4.1	4.1	4.2	4.1	4.1	4.2	4.2	4.2	3.7
Gauteng	31.0	37.7	37.2	36.5	36.9	36.5	36.2	35.6	35.3	37.5
Mpumalanga	5.9	4.5	4.7	4.7	4.7	4.8	4.9	5.0	5.2	4.7
Limpopo	6.2	3.7	3.8	3.8	3.8	3.7	3.8	3.8	3.9	3.5

Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

The South African average growth rate for transport, storage and communication between 2005 and 2014 was 3.3 per cent in comparison with Free State's average growth of 2.4 per cent. These average growth rates are supported by high pre-recession growth rates since the national

sector's growth post the recession was 1.7 per cent in 2010, and increased only to 2.3 per cent in 2014. The growth rate of Free State sector was 1.0 per cent and rose to 1.7 per cent, well below average growth between 2005 and 2014. The improvement in growth, particularly in 2014, is due to increased activity in land transport and communications, with the latter benefiting from successful data promotions and improved network quality (SARB, 2015). This growth was not overshadowed by the Post Office Strike which occurred in the latter half of 2014.

Figure 2.12: South Africa and Free State transport, storage and communication sector growth rates



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

2.4.3.3. Finance, real estate and business services

As alluded to in the FS PERO (2014), South Africa has a sophisticated financial sector. The Banking Association of South Africa even makes favorable comparison between the national sector and other industrialized economies. According to the 2015/16 World Economic Forum Global Competitiveness Survey, South Africa was ranked in 8th position out of 140 countries in terms of Financial Sector Development. The country's progress has been further evidenced by a Brookings Financial and Digital Inclusion Project (FDIP) report, released in the second half of 2015, which scored South Africa 2nd highest in terms of financial inclusion in emerging countries, after Kenya. The study analysed 21 countries in terms of the number of people who make use of formal banking and financial products and found that approximately 75 per cent

of adults in SA partook in formal banking activities in 2014 by means of a bank account. Financial inclusion is very important, as it brings about formal means of credit, which individuals can utilize to start and improve their SMMEs.

The performance of the real estate is sensitive to overall economic climate of the country, including the performance of economic indicators such as consumer spending, manufacturing and service provision. According to SA Commercial Prop (2015), South Africa's listed property industry and real estate housing sector is under pressure due to weaker economic growth rate and diminishing reputation. Xenophobic attacks, labour unrest, lower consumer confidence, etc. place pressure on the country's economy and investment into the country. Consumer confidence is related to disposable income (changes in taxes, household debt, income growth, etc.), whilst an expected economic growth rate of 1.4 per cent in 2015 will have an impact on job creation as well as property demand and supply.

Table 2.11 below depicts that the highest average contribution to South Africa's finance, real estate and business services sector between 2005 and 2014 was Gauteng (41.2 per cent), followed by Western Cape (19.3 per cent) and KwaZulu-Natal (13.8 per cent). The lowest average contributors to the sector were Northern Cape (1.3 per cent), Free State (3.9 per cent) and Mpumalanga (4.0 per cent).

Table 2.11 Contribution by province to finance, real estate and business services sector (%)

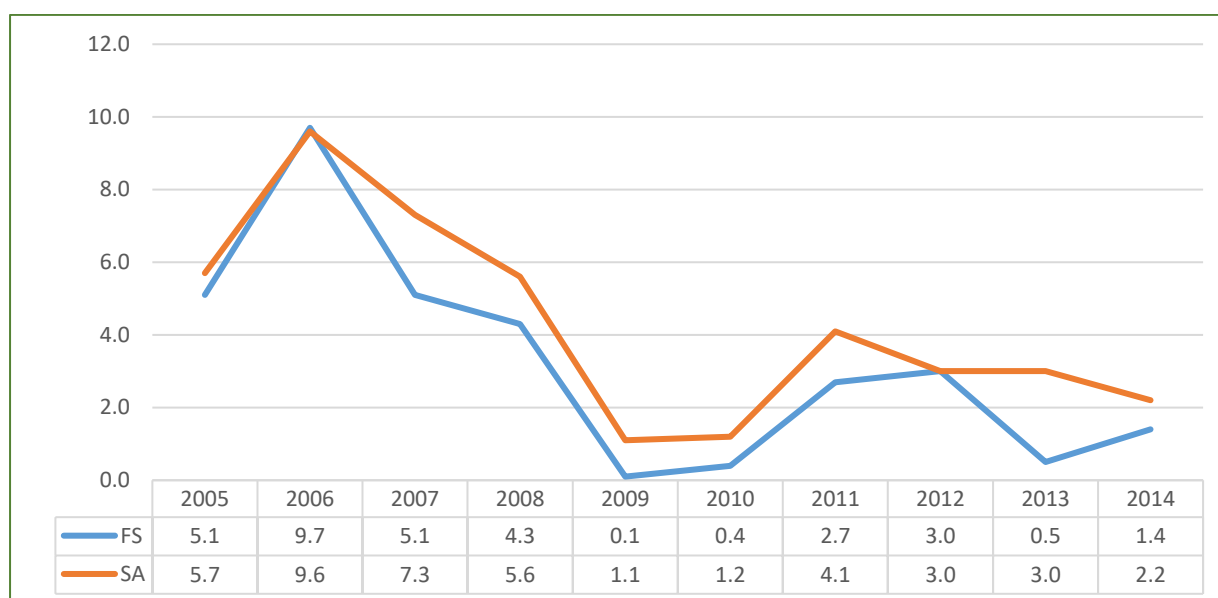
Province	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Western Cape	20.7	20.3	20.4	19.3	18.2	18.9	18.2	19.0	18.5	19.1
Eastern Cape	8.0	7.3	7.3	7.2	7.6	7.2	7.0	7.4	7.2	7.1
Northern Cape	1.3	1.4	1.6	1.4	1.2	1.4	1.3	1.4	1.0	1.3
Free State	4.0	4.2	4.1	4.2	4.0	3.9	3.8	3.7	3.8	3.7
KwaZulu-Natal	14.2	14.0	13.7	14.1	14.4	13.5	13.4	13.9	13.7	13.4
North West	4.3	4.0	3.8	3.9	4.2	4.1	4.0	4.2	4.3	3.7
Gauteng	38.8	39.5	40.2	40.8	41.0	41.7	42.8	41.3	43.0	42.5
Mpumalanga	3.6	3.9	3.9	4.0	4.1	4.2	4.1	4.3	3.9	4.1
Limpopo	5.1	5.2	5.0	5.1	5.3	5.2	5.2	4.8	4.7	5.0

Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

Between 2005 and 2014, the finance, real estate and business services sector grew, on average, by 4.3 per cent in South Africa and 3.2 per cent in Free State. This relatively high average was

mostly boosted by high growth rate of 9.6 per cent nationally and 9.7 per cent in Free State in 2006. These growth rates have since declined, and reached 2.2 per cent in 2014 for the national sector, whilst the provincial sector grew by 1.4 per cent in 2014. Nationally, the finance, real estate and business services sector grew stronger in the third and fourth quarter of 2014 due to an increase in trade activity in the domestic security markets and banking sector. However, the dip in growth, from 3.0 per cent in 2013 to 2.2 per cent in 2014, was mainly caused by a reduction in trade activity on the JSE Limited in the second quarter. The increase in the provincial sector's growth from 0.5 per cent in 2013 to 1.4 per cent in 2015 could be mainly supported by real estate development currently taking place in Free State, such as the Raceway Park, Pine Haven, extension of Grasslands and other residential development in Bloemfontein

Figure 2.13: South Africa and Free State finance, real estate and business services sector growth rates



Source: Statistics South Africa, Gross Domestic Product, Third Quarter 2014; IHS Global Insight, Regional eXplorer, 2015

2.4.3.4. Community Services

The community services sector is comprised of personal services industry as well as general government services industry. Personal services can simply be explained as commercial services that are supplied for the personal needs of the consumer, without huge capital outlay. As explained in FS PERO (2014), personal services operate across various fields such as law, medicine, engineering, design, finance, accounting, but may also be found in catering and

cleaning services. This sector is likely to be sensitive to demand, from consumer, business or organizations and therefore will be influenced by the performance of the economy, recent income shocks and consumer health (increase in taxes, inflation, exchange rate) as well as the performance of businesses and other organisations.

General government services sector represents all activity performed by government and ideally, also creates an enabling environment for private sector to thrive whilst supplying goods and services which private sector would not be inspired to provide, such as public goods e.g. public infrastructure such as provision and maintenance of roads. However, because all economies operate in an environment of market failure in one way or another e.g. 2009 global recession, government usually steps in through a countercyclical fashion.

In 2014, the South African government announced the implementation of fiscal consolidation (reduction in public expenditure and increases in tax revenue), with prudent public expenditure as an expectant result. The intention of the South Africa government is to reduce the budget deficit, worsened by the impact of 2009 recession, from 6.6 per cent in 2009/10 to 3.8 per cent in 2015, whilst stabilizing government debt as a proportion of national income over the long run. Fiscal consolidation is one of the main criteria stipulated by international lenders and credit raters to ensure borrowing for South Africa remains affordable through an investment-friendly credit rating. According to South African Reserve Bank (2014), essential services should not be compromised and the budget of key social programmes will remain protected. However, non-essential expenditure should be cut to identify savings whilst government improves on spending.

The Free State has followed the call of the Minister of Finance for fiscal consolidation, as evidenced also by the implementation of a moratorium on filling of posts to reduce compensation of employees' expenditure. The provincial government also continues to monitor expenditure on cost containment items and continues to reprioritize funding according to provincial needs.

Table 2.12 below depicts that Free State's average contribution towards community services sector between 2005 and 2014 was 5.9 per cent. The highest average contributors over the reference period towards South Africa community services sector are Gauteng (37.3 per cent), KwaZulu-Natal (15.3 per cent) and Western Cape (10.7 per cent); the lowest average

contributors to national sector are Northern Cape (2.1 per cent), Mpumalanga (5.2 per cent) and North West (5.7 per cent).

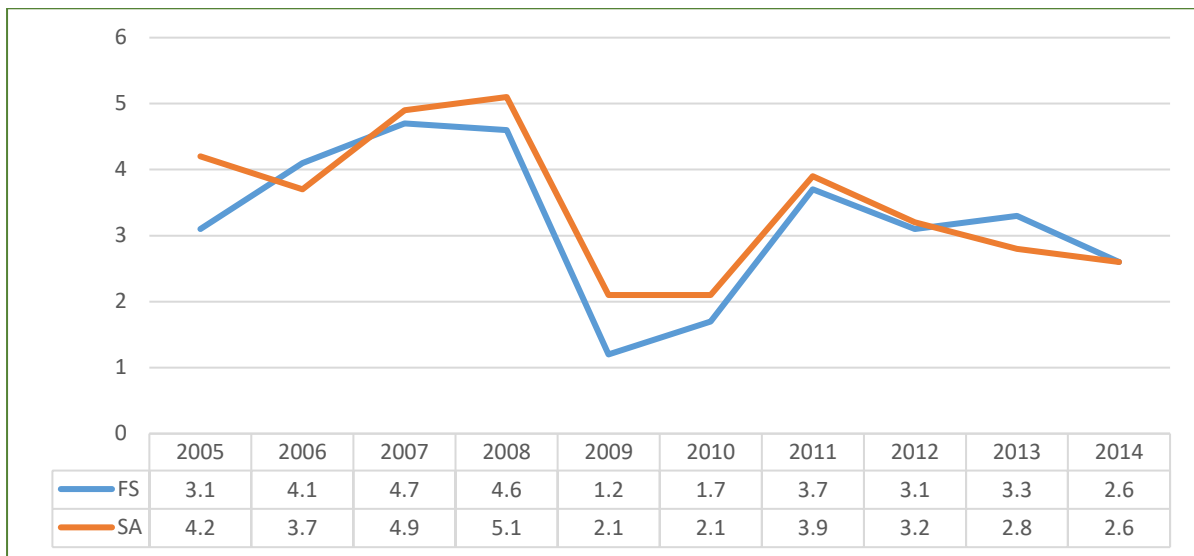
Table 2.12 Contribution by province to community services sector (%)

Provinces	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Western Cape	10.5	11.8	10.4	10.2	10.5	10.6	10.6	10.7	10.7	10.7
Eastern Cape	10.5	10.4	10.3	10.2	10.3	10.7	10.5	10.4	10.1	10.0
Northern Cape	2.2	2.2	2.1	2.3	2.1	1.9	2.0	2.0	2.0	2.0
Free State	6.6	6.4	6.2	5.9	5.7	5.5	5.6	5.5	5.6	5.6
KwaZulu-Natal	15.2	15.2	15.1	15.4	15.4	15.4	15.3	15.4	15.4	15.4
North-West	6.0	6.0	6.0	5.6	5.5	5.5	5.5	5.7	5.6	5.6
Gauteng	36.6	35.4	37.3	37.7	37.8	37.6	37.5	37.4	37.7	37.7
Mpumalanga	5.1	4.9	5.1	5.3	5.3	5.3	5.2	5.3	5.3	5.3
Limpopo	7.4	7.5	7.5	7.5	7.5	7.6	7.7	7.7	7.7	7.7

Source: HIS Global Insight, Regional eXplorer, 2015

The average growth for the community services sector between 2005 and 2014 for South Africa was 3.5 per cent, whilst that of Free State was 3.2 per cent. The upward trajectory of community services sector both nationally and provincially before 2009 reflects economic boom period in South Africa, which is normally associated with thriving business environment in the case of personal services and increased revenue in the case of general government services. The downward trajectory of growth for the national and provincial sector since 2011 is a reflection of impact of the 2009 recession as well as an overall ailing economy (reduced business and consumer confidence, dwindling government revenue prospects as well as reduced government allocations).

Figure 2.14: South Africa and Free State community services sector growth rates



Source: HIS Global Insight, Regional eXplorer, 2015

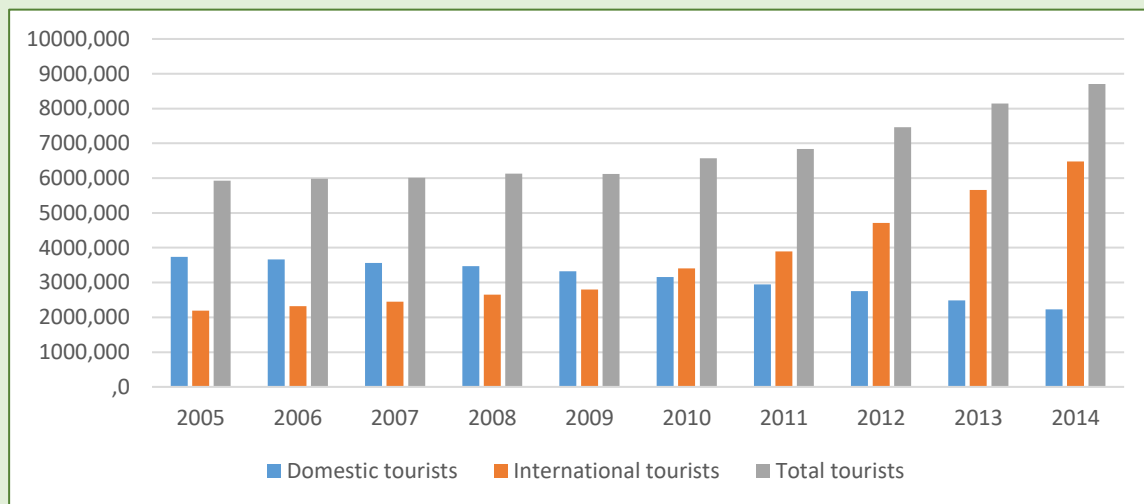
Box 2.2: Tourism in South Africa and Free State

Tourism in the Free State continues to grow and tourism spent as a percentage of GDP has increased from 4.7 per cent in 2005 to 4.9 per cent in 2014. In comparison, tourism spent as a percentage of GDP in South Africa declined from 6.3 per cent in 2005 to 6.2 per cent in 2014. According to South Africa.info (2015), South Africa's main foreign tourists come from Europe, given that 1.5 million foreigners visited the country in 2013. Tourists from Asia were equivalent to 435 076 tourists in 2013, while those from North America were equivalent to 417 582 in the same year. One can assume that the majority of visitors who come to provinces, and Free State to be specific, originate from these parts of the world. The Free State Tourism Authority listed the top 10 tourism attractions in Free State as Clarens, Macufe, Basotho Cultural Village, Gariep Dam, Naval Hill, Cherry Festival, Parys, Witsieshoek Resort, Mangaung Township and the Vrede Dome.

As one of the key tourist attractions of the province, Macufe receives massive investment from the Free State Government. Preliminary results from the Macufe Impact Assessment study reveal that the provincial government spends approximately R46 million per annum towards Macufe festivities. This investment produces R124 million in returns, from expenditure by visitors and locals within the province. Most of this income is generated from accommodation, restaurants, retailers and filling stations. A third of the 16 000 visitors originate from Gauteng. Macufe still provides an important socio-economic value in the province, like other attractions the province possesses.

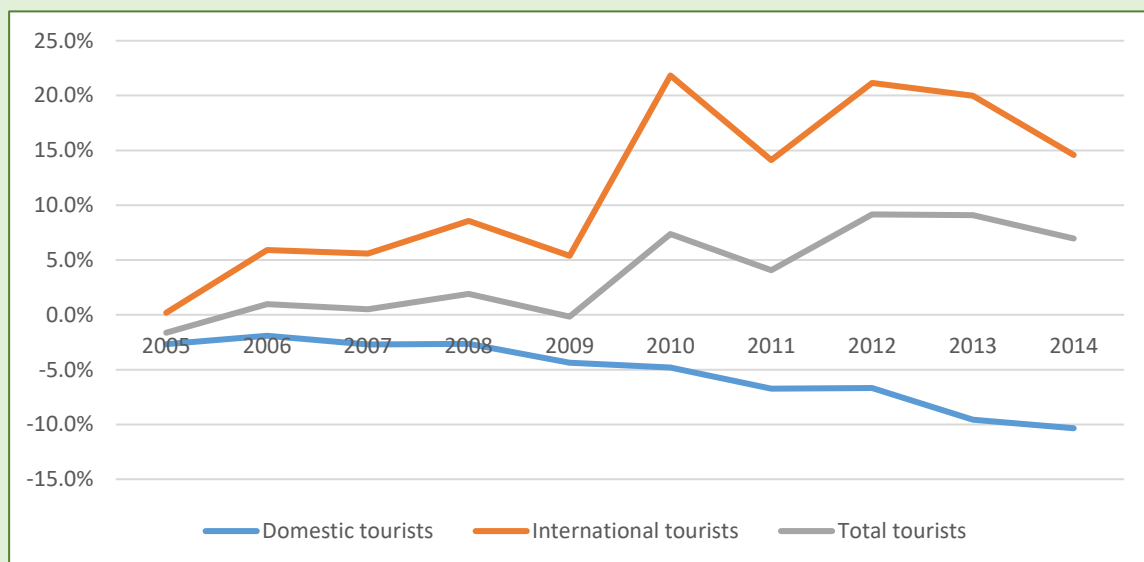
The number of tourists visiting Free State rose sharply from 6.1 million in 2009 to 6.6 million in 2010, with international tourists overtaking the number of domestic tourist in 2010. Domestic Tourists visiting attraction sites in the Free State have dropped from 3.7 million in 2005 to 2.2 million in 2014, which represents a decline of 40.5 per cent decline in local tourist numbers over the review period.

Number of tourists by Bed night in Free State



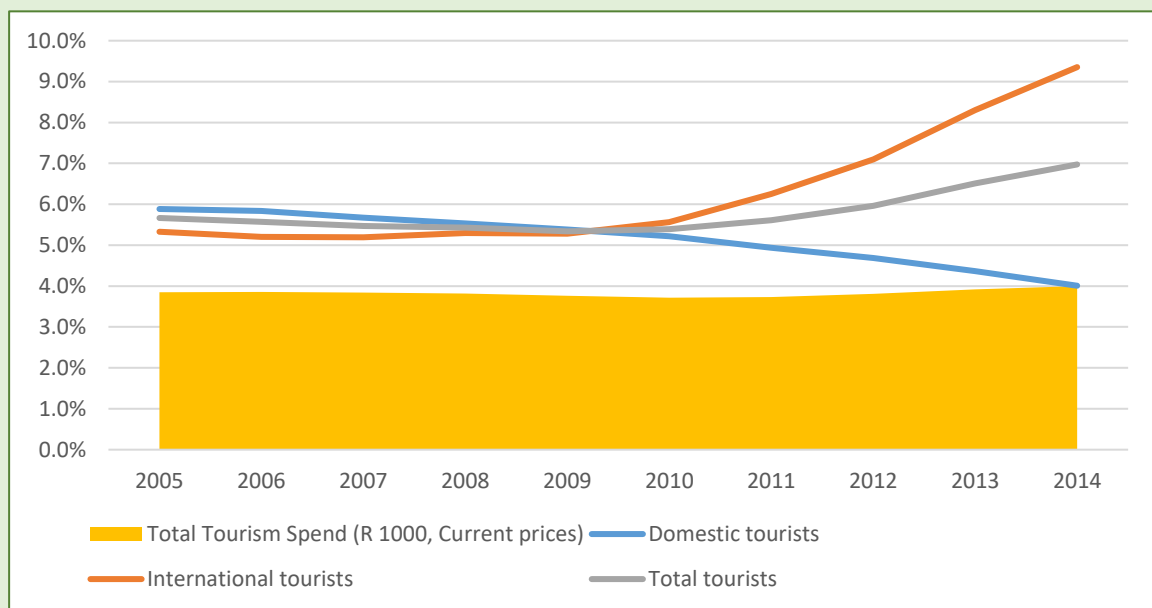
The growth of tourists by bed night in Free State has declined by 1.6 per cent in 2005, and thereafter improved and accelerated to 7.0 per cent in 2014. The trend of this growth was largely determined by growth in the number of foreign tourists by bed night, whose growth spiked from 5.4 per cent in 2009 to 21.8 per cent in 2010, positively boosted by the 2010 FIFA World Cup. The growth rate of the foreign tourists and therefore, total tourists post the 2010 World Cup exceed levels witnessed before the global event took place. The rate of decline of domestic tourists by bed night has worsening from -2.7 per cent in 2005 to -10.3 per cent in 2014.

Growth of tourists (by bed night) in Free State



The total share of Free State tourists to total South African tourists has increased from 5.9 per cent in 2005 to 7.0 per cent in 2014, mainly supported by international tourists, whose share has increased from 5.3 per cent in 2005 to 9.4 per cent in 2014. However, the provincial share of what is being spent nationally in tourism increased slightly from 3.9 per cent in 2005 to 4.0 per cent in 2014; perhaps an indication of Free State lower base in the number of tourists.

Share of Free State tourists to South Africa’s tourists; Free State’s share of total spent in South African tourism



Source: Global Insight, Rex eXplorer, 2015

2.5.Outlook of Free State Economy

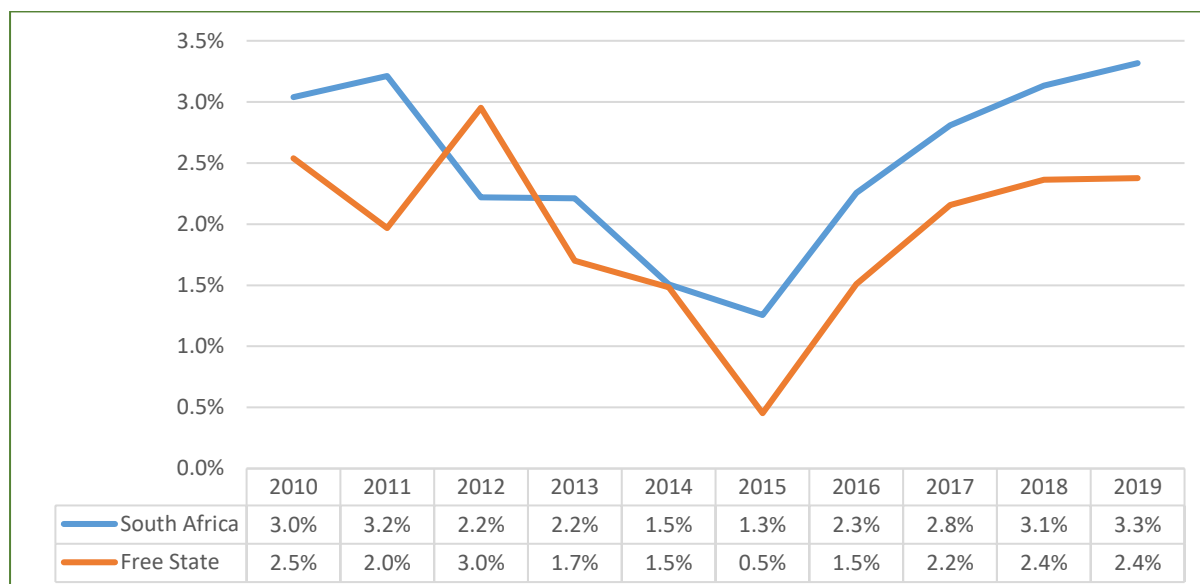
The South African and Free State economies have been on a downward trajectory post the 2009 economic recession, with the South African economic growth rate declining from 3.0 per cent in 2010 to 1.5 per cent in 2014, whilst the Free State economic growth rate declined from 2.5 per cent in 2010 to 1.5 per cent in 2015. Over the period, the provincial growth rate surpassed the national economic growth rate in 2012, when Free State's economy grew by 3.0 per cent in comparison with 2.2 per cent growth by national economy.

In terms of economic growth projections, both the national and provincial economies are expected to decelerate further in 2015, and reach 1.3 per cent and 0.5 per cent growth rates respectively. South Africa's growth prospects face downside risks such as structural bottlenecks, which include shortage of electricity supply, drought and water supply shortages, labour unrest in mining sectors such as the coal sector, increasing production costs associated with manufacturing as well as increased competition from China in the steel sector. The most pronounced changes in the economy are the reduction in the commodity demand from China and consequent reduction in commodity prices. Consumer confidence has been worsened by over-indebtedness with household debt ratio estimated at 78 per cent, personal income tax hikes as well as increase in food prices due to current drought, and imported inflation through a weaker exchange rate and necessary food import. Business confidence has also declined in 2015 as a reflection of a weakening domestic economy.

Economic growth for South Africa and Free State in 2016 is projected at 2.3 per cent and 1.5 per cent, respectively. However, the downside risk that exists for growth in 2016 remains the

labour unrest in the mineral industry. Overall, economic growth is forecast to accelerate over the immediate medium term, with South Africa's economic growth anticipated to reach 3.3 per cent in 2019, whilst the provincial economic growth is expected to reach 2.4 per cent in the same year. However, these targets fall far short of the NDP targets, that is to have economic growth rates of 5.4 per cent in order to half unemployment by 2030.

Figure 2.16: Free State and South Africa's GDP projections



Source: HIS Global Insight, Regional eXplorer, 2015

According to table 2.13 below, the Free State economy's output grew from R147 billion in 2010 to R159 billion in 2014, whilst economic growth rate declined from 2.5 per cent to 1.5 per cent over the same period. The size of the economy is expected to reach R160 billion in 2015, representing a 0.5 per cent economic growth rate. Over the medium term, the economy is anticipated to grow from R162 billion in 2016 to R174 billion in 2019, with growth rate picking up pace from 1.5 per cent to 2.4 per cent.

As a sector, agriculture is important for the Free State economy. Although its contribution towards the provincial economy has been declining, its socio-economic impact through food security, trade, job creation and poverty reduction remains relevant. As was the case in 2011,

the agricultural sector is expected to contract by 5.1 per cent in 2015, due to the drought delaying the commencement of production in 2015. The sector is expected to moderately recover over the medium term and grow by 1.6 per cent in 2016, followed by 2.0 per cent from 2017 to 2019. Mining and quarrying, influenced by the slowdown in commodity demand and prices, is projected to grow by 0.9 per cent in 2015, followed by higher growth rates of 3.3 per cent and 2.5 per cent in 2017 and 2018 respectively, before declining to 1.2 per cent in 2019. The downside risks faced in 2016 for mining and quarrying is a possible platinum strike.

Manufacturing is facing increasing production costs which undermine its competitiveness. Also facing cheaper steel imports from China and water shortages, the sector will contract by 0.6 per cent in 2015, before progressively recovering to 2.7 per cent in 2019. The electricity, gas and water sector is expected to decline by 2.3 per cent in 2015, with some of Free State's dams likely affected by the drought. Growth of the sector will remain restrained in the medium term, and only reach 1.6 per cent in 2019. The implementation of carbon tax from 2016 could also possibly influence the performance of Eskom and power producers, even in the Free State. Growth in the construction sector is expected to be muted in 2015, following government reduction in allocated funds towards infrastructure in the province due to a constraint fiscus. However, growth will resume by 0.7 per cent in 2016 and reach 1.6 per cent in 2019.

Although the wholesale, retail and motor trade; catering accommodation sector in the province grew by as high as 7.4 per cent in 2012, the sector is anticipated to decline by 0.4 per cent in 2015, partly influenced by constrained domestic consumers, but also partly due to barred commodities such as citrus from EU, one of South Africa's biggest trading partners. Over the medium term, growth will pick in the industry, reaching 2.6 per cent in 2019. The transport, storage and communication is expected to grow by 0.6 per cent in 2015 and reach a growth rate of 3.4 per cent in 2019, following the establishment of the Special Economic Zone near Harrismith and a supporting agro-processing park among others.

The finance, real estate and business services sector is expected to grow by 1.7 per cent in 2015, boosted by real estate developments in the province, which are more pronounced in Bloemfontein. Growth will continue to accelerate, and reach 2.9 per cent in 2019. Growth in the community services sector will decelerate from 2.6 per cent in 2014 to 1.2 per cent in 2015, in line with fiscal consolidation implemented by the provincial government. However, growth will pick up and reach 2.2 per cent in 2019.

Table 2.13: Economic growth projections of Free State economy

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
GDP-R (R'1000 constant prices)	147,189,067	150,085,872	154,516,711	157,142,254	159,470,832	160,192,971	162,609,316	166,117,545	170,045,069	174,084,264
Real GDP per cent growth	2.5%	2.0%	3.0%	1.7%	1.5%	0.5%	1.5%	2.2%	2.4%	2.4%
GDP-R by sector (real change)										
Agriculture	0.3%	-9.2%	0.6%	1.8%	5.4%	-5.1%	1.6%	2.0%	2.0%	2.0%
Mining	4.9%	-1.4%	1.1%	3.3%	1.0%	0.9%	1.7%	3.3%	2.5%	1.2%
Manufacturing	5.7%	1.1%	0.5%	0.2%	-0.8%	-0.6%	1.6%	2.1%	2.7%	2.7%
Electricity	3.6%	1.5%	0.4%	0.1%	-1.2%	-2.3%	-0.2%	0.1%	1.5%	1.6%
Construction	-5.7%	0.6%	2.2%	2.0%	0.9%	0.0%	0.7%	0.8%	1.3%	1.6%
Trade	3.5%	2.7%	7.4%	1.6%	1.8%	-0.4%	1.6%	1.7%	2.4%	2.6%
Transport	1.0%	2.1%	1.8%	0.7%	1.7%	0.6%	1.9%	2.8%	2.9%	3.4%
Finance	0.4%	2.7%	3.0%	0.5%	1.4%	1.7%	1.9%	2.4%	2.5%	2.9%
Community services	1.7%	3.7%	3.1%	3.3%	2.6%	1.2%	1.2%	1.8%	2.1%	2.2%
Total Industries	2.4%	1.4%	2.9%	1.8%	1.6%	0.3%	1.5%	2.1%	2.4%	2.4%

Source: HIS Global Insight, Regional eXplorer, 2015

2.6. Policy Interventions in Support of Free State Economic Outlook

Free State and South Africa are currently faced with ailing economies, based on different economic factors at play. Structural bottlenecks that are faced in the country include insufficient supply of electricity and skills mismatch between the structure of the economy and what the majority of the labour force can offer, to name a few. Temporary bottlenecks include the reduction in commodity demand and prices mainly due to China's attempts to move from an investment-led economy to a consumption-led economy. Also, the financial markets have experienced a lot of volatility in 2015, and emerging markets are faced with weaker exchange rates largely as a result of the increase in interest rates by the US. For South Africa, this occurs

on the backdrop of lower production levels of maize, a staple which will have to be imported. Consumers are also faced with increasing food and electricity prices, which has negative consequences on disposal income, even in the presence of reduced oil prices.

At the core of policy in the country and the Free State, lies the need to address the triple challenge of unemployment, inequality and poverty. The NDP Vision 2030 provides guidance in order to tackle this challenge. With social and economic infrastructure highlighted as a key economic activity to bolster economic growth and job creation, the country and province needs to address and discourage the challenge of waning gross fixed capital formation from the private sector, in the context of fiscal consolidation. Through the 2016 State of the Province Address, the Free State government commits to utilizing labour intensive methods in the creation and upgrading of road infrastructure such as transport routes in Parys, Hoopstad and Bothaville.

Rural development, included as part of priority in the NDP Vision 2030, is important for job creation and poverty reduction in rural economies. The farming community has been hard-hit by the El Nino episode and the resultant drought currently being experienced in the country. Lack of adequate rainfall has resulted in the delay of farm production in 2015. Therefore, the Department of Water Affairs has announced the development of an integrated Water Master Plan to plan ahead taking into account the current water shortage developments. The Minister of Water Affairs highlighted that the plan will support the NDP Vision 2030 and that it will include exploration of desalination, which is already being piloted in KwaZulu-Natal and Western Cape. The plan will identify areas to be prioritized for operation and maintenance, to capacitate the state.

The Agricultural Policy Action Plan (APAP) was formulated in 2014 to offer tangible steps and actions based on the Integrated Growth and Development Plan in relation to the agriculture, forestry and fisheries sector. With regards to agriculture, the document acknowledges challenges of job losses often associated with increasing farm size and capital intensity, whilst fisheries is facing depleted stocks of marine and coastal wild capture fisheries; forestry is undermined by water regulations and under investment in long-rotation saw log plantations. Key Actions Programmes are provided, which are sub-sector specific and aim to find solutions which range from addressing import tariffs to creating import substitutions; from protecting local industries from unfair labour practices to adoption of appropriate technologies during

natural disasters such as recent El Nino episode. As previously stated, Free State is the poultry hub of South Africa, therefore, policy levers directed at the Poultry/Soya beans/Maize integrated value chain will benefit the province. Examples of these policy levers related to this value chain are:

- Revise and improve current policy tariffs to protect the poultry industry (although this has been challenged by 2015 AGOA negotiations and re-negotiations).
- Introduce policy to address current barriers to export markets among most African states with limited or no export permits for SA poultry industry.
- Government Preferential Procurement Policy for public entities (institutions) to procure from smallholder producers.

The APAP also provides policy levers for the red meat value chain, the wheat value chain, fruit and vegetables, the bio-fuels value chain, aquaculture competitiveness improvement programme, etc.

Free State-specific interventions in agriculture include the release of the Emergency Drought Disaster Fund for the purchase of animal feed, medication for livestock and for water reticulation support for animals. The development of Agri-parks in Tshiame, Thaba Nchu, Wesselsbron, Parys and Springfontein will benefit rural economies through industrialization, by means of skilling and supporting small-holder farmers. According to the Department of Rural Development and Land Reform (2015), “an Agri-Park is a networked innovation system of agro-production, processing, logistics, marketing, training and extension services, located in a District Municipality.” The support provided to small-holder farmers will include capacity building, farm infrastructure and production inputs, amongst others.

Mining in South Africa has been hard hit by plummeting commodity prices in 2015, and although gold is priced in dollar-terms and the country is experiencing weaker exchange rate than ever before, South Africa’s terms of trade have not benefitted much as a country whose exports are mainly resource-oriented. Free State, being bountiful in gold, diamonds, etc. will not be exempted from the disappointing mining performance in 2015. Although not much can be done concerning external economic shocks, government, together with labour and the mining industry, has identified 10 areas to assist the sector and reduce the ailing sector’s impact on jobs. These interventions are:

- Delay the execution of retrenchments. This could allow consultations to be extended to continue during a section 189 of the Labour Relations Act notice period, to allow for the implementation of the interventions.
- Enhance productivity and managing cost pressures to improve efficiency.
- Accelerate concurrent rehabilitation activities to create alternative jobs for mineworkers.
- Sell distressed and other mining assets to possibly save and create jobs at alternative operators.
- Explore other options to avoid job losses. This will require the development of a framework for management, employees and the unions to seek solutions on a case by case basis, such as utilising the training layoff scheme or reskilling employees.
- Provide adequate support, such as counselling, training, and obtaining Unemployment Insurance Fund payments for mineworkers when job losses are unavoidable.
- Use the Multinational Companies' procurement levy to support employment opportunities for retrenched mineworkers. In terms of the Mining Charter, multinational suppliers of goods to the sector must contribute towards a development fund, which could help to create alternative employment for mineworkers.
- Streamline the processes for downscaling, updating the database and exploring fiscal instruments to enable comprehensive management of the circumstances facing mining.
- Investment in promotion and market development – this includes joint promotional activities to help increase the demand for South Africa's minerals.
- Communication and implementation plan – a milestone plan has been developed and progress regarding its implementation will be communicated from time to time.

Through Mining Operation Phakisa, announced by the President in the 2014 State of the Nation Address, key constraints to investment and growth of the mining industry will be identified, as well as develop a shared vision and growth strategy for the long term development and transformation of the sector.

The performance of the manufacturing industry and its attraction of future foreign direct investment are a reflection of the efforts and success of policy such as the Integrated Policy Action Plan. More specifically, the results of such efforts under tough economic conditions were visible in the motor industry, which played a key role in the rebound of the manufacturing industry in the third quarter of 2015. However, fourth quarter performance still shows lower

business confidence at the prospects of rising production costs and weak consumer demand, which discourages increase of output in the general manufacturing sector.

Going forward, South Africa has attracted investment in the motor industry from the likes of BMW, which will invest R6 billion to expand its Rosslyn manufacturing plant in Pretoria to produce BMW X3 in the near future. China is also estimated to invest R12 billion to build cars in South Africa whilst Japan's Hesto Harnesses will also open a manufacturing plant for dashboard instrument cluster for the new Toyota Hilux, to be introduced in 2016.

King Comfort, a bed manufacturing factory in Botshabelo, has created 55 direct jobs. DESTEA intends to assist the company with downstream supply of beds to townships in the province, which is expected to create 250 additional jobs. Free State has signed co-operation agreements with various countries such as China, India and Russia to bolster manufacturing in the province. As an example, the Harrismith Special Economic Zone has attracted an investment of R5 billion through such agreements. These are just examples of what can be expected in the manufacturing sector, with positive economic spillovers for Free State based on the province's centrality in South Africa.

In conjunction with interventions listed above for the water sub sector, government continues to address the shortage of energy as a priority in the country. In 2015, several countries such as Russia, China and France, are among bidders interested in building a multi-billion rand Nuclear Power Plant in South Africa. A nuclear co-operation accord, an agreement that provides a proper and solid platform for future extensive collaboration, has been signed with these countries, as well as Japan, South Korea and the USA. The intended nuclear power plant is an extension of the existing Koeberg facility operated by Eskom in the Western Cape. Challenges of high electricity debt is faced by Free State's (and other provinces') municipalities. The Free State's 2015 State of the Province Address stated that the Free State government will dispute arrears caused through municipalities exceeding their allocated load management volumes due to increasing access to electricity to Free State citizenry (these allocations have not been revised in years). Through partnership with NERSA, the Free State government intends to enhance municipal revenue through correct electricity tariffs for municipalities.

South Africa and China have signed 26 agreements in 2015, which will benefit several sectors, including trade. Addressing trade imbalance between the two countries is one of the important agreements established. The Free State government, through the Free State China Week and Free State Trade Bridge, both held in 2015, created a platform for foreign investors and existing economic opportunities in the province to be linked.

South Africa (including its provinces such as Free State), continues to benefit from the AGOA agreement between the country and USA, which allows duty free exports into the USA, in exchange for South Africa opening up its market for USA exports. Although some issues of poultry brought into South Africa still need to be ironed out, the recently renewed 10-year AGOA agreement will remain valid.

Lastly, the President announced a R100 million investment towards domestic tourism by SA Tourism, whilst the Free State government intends to create a tourism grant which will benefit historically disadvantaged individuals and boost economic growth.

All interventions implemented by the Free State (and the country at large) are intended to bolster economic growth and development, whilst attempting to address unemployment, inequality and poverty.

2.7. Conclusion

The Free State economy continues to be dominated by the tertiary industries, although the share of primary industries to the provincial economy (mining in particular) is also increasing, whilst the secondary industries' share is dwindling. The interventions mentioned in the previous section are imperative to ensure that labour-intensive industries are protected and are enabled to thrive for economic and social benefits of the province.

Between 2005 and 2014, the Free State province improved in terms of diversification and also has increased the number of industries which it has a comparative advantage in. What remains is to take advantage of these improvements by extensively identifying temporary as well as structural bottlenecks which the provincial economy faces and reduce them, with the aim to reduce the gap between South Africa's average growth of 3.0 per cent and Free State average growth of 2.4 per cent (between 2005 and 2014).

Of course, Free State's economy will not be exempted from the effects of an ailing South African economy and the challenges it faces. As the country battles with low growth prospects (1.4 per cent in 2015 and 0.8 per cent projected by National Treasury in 2016), rising interest rates which hurt consumer and business confidence, a weaker exchange rate, rising inflation rate and drought in the midst of high unemployment rate, Free State will have to find creative means to withstand their knock-on effects on the provincial economy whilst attempting to increase economic growth for the province. The interventions contained in both the 2016 National Budget Speech and 2016 State of the Province Address, stated in the section above, are developed to spur inclusive economic growth.

CHAPTER 3: LABOUR MARKET PERFORMANCE

Key findings

- The global employment gap caused by the 2008 global economic crisis continues to widen.
- The world unemployment rate increased from 5.5 per cent in 2007 to 5.9 per cent in 2014 and is projected to remain at the 5.9 per cent level over the next three years.
- Youth, especially young women, continue to be disproportionately affected by unemployment. The global youth unemployment rate is practically three times higher than is the case for their adult counterparts.
- In spite of employment levels increasing by 1.1 million since 2011 in South Africa, the national unemployment rate continues to rise, while the absorption rate has not yet recovered to pre-recessionary levels.
- In South Africa, the youth is estimated to have an unemployment rate of 36.9 per cent in 2015, compared to the adult rate of 17.0 per cent.
- In total, the unemployment rate of South Africa increased from 23.2 per cent in 2008 to 26.4 per cent in 2015.
- Black youth experience the highest incidence of unemployment in the country with an unemployment rate as high as 40.3 per cent.
- The black South Africans still command the highest unemployment rate in the country at 29.7 per cent, while Whites have the smallest incidence of unemployment at 7.2 per cent.
- The biggest employers in the Free State Province are the community and social services (27 per cent), followed by trade (21 per cent), private households (12 per cent) and finance (8 per cent).
- The tertiary industries together contributed the biggest portion to employment at 72 per cent, while the primary and secondary industries contributed the remaining 28 per cent.
- The unemployment rate in the province increased from around 28.5 per cent in 2005 to 30.9 per cent in 2014, an increase of 2.4 percentage points.

Key findings

- In 2014, the Free State had the highest unemployment rate in the country at 30.9 per cent
- Youth unemployment in the Free State increased substantially post the 2009 economic recession; increasing from 36.1 per cent in 2009 to 48.2 per cent in 2014 before decreasing to 39.4 per cent in 2015.
- The unemployment rate of the Free State youth in 2015 was higher than the national youth average.
- The percentage of unemployed youth work-seekers who are considered to be in long-term unemployment in the Free State rose from 54.0 per cent in 2008 to 67.5 per cent in 2015; an increase of 13.5 percentage points.
- In the Free State, the youth that were not in employment and not in education/training in 2014 were estimated at 30.7 per cent, which is the third lowest in the country behind Limpopo (28.6 per cent) and Gauteng (30.4 per cent).
- Unemployment in the Free State is highest among those with no Grade 12/Matric.

3.1. Introduction

The demand for readily available labour market information becomes increasingly important as globalisation, free trade and regional integration advance. Labour, but particularly income and employment indicators, are critical in analysing economic and social progress at both the macro and the micro levels. Labour market conditions are important for assessing the economic well-being of the people of a particular region. Without these, no meaningful assessment of development performance is complete. Therefore, it is critical for a country or region to have timely information on labour and income aspects of the development process available. This includes information on job losses and job creation, aggregate shifts in the allocation of labour between sectors and occupations, vacancies and job-seekers, the quality of new jobs, amongst others. It is also increasingly important to understand the world of work as economies and societies become more interdependent. Therefore, timely and focused information on the labour markets becomes essential for policy-makers. A systematic analysis of the labour market is essential to make good public policy choices.

The purpose of this chapter is to analyse trends in the global, national and in particular the provincial labour market with the purpose of informing the policy-making processes.

3.2. Global Labour Market Developments

The world economy continues to expand at rates well below the trends that preceded the onset of the global crisis in 2008 and is unable to close the significant employment and social gaps that have emerged. The challenge of bringing unemployment and underemployment back to pre-crisis levels now appears as daunting a task as ever, with considerable societal and economic risks associated with this situation.

According to the International Labour Organisation's (ILO) World Employment and Social Outlook (2015), the global employment outlook will weaken in the coming five years, i.e. 2015 to 2019. Over 201 million people were unemployed in 2014 around the world, which is over 31 million more than before the start of the global crisis in 2008. In addition, global unemployment is expected to increase by 3 million in 2015 and by a further 8 million in the following four years, with the global unemployment rate projected at 5.9 per cent over the next three years.

The global employment gap, which measures the number of jobs lost since the start of the crisis, is estimated at 61 million in 2015. If new labour market entrants over the next five years are taken into account, an additional 280 million jobs need to be created by 2019 to close the global employment gap caused by the crisis.

Youth, especially young women, continue to be disproportionately affected by unemployment. About 74 million young people (aged 15–24) were unemployed in 2014. The youth unemployment rate is practically three times higher than is the case for their adult counterparts. The heightened youth unemployment situation is common to all regions and is occurring despite the trend improvement in educational attainment, thereby fuelling social discontent (ILO, 2015).

Table 3.1: Unemployment rates by region, 2007 - 2017

Country/region	2007	2013	2014	2015*	2016*	2017*
World	5.5	6.0	5.9	5.9	5.9	5.9
G20 Economies	5.0	5.7	5.6	5.6	5.6	5.6
G20 Advanced Economies	5.7	8.4	7.7	7.4	7.2	7.0
G20 Emerging Economies	4.8	4.9	5.0	5.1	5.1	5.2
Developed Economies and the European Union	5.8	8.5	7.8	7.5	7.3	7.1
Australia	4.4	5.7	6.0	5.9	5.7	5.6
Canada	6.0	7.1	6.9	6.7	6.6	6.6
Japan	3.9	4.0	3.7	3.6	3.6	3.7
United States	4.7	7.4	6.2	5.9	5.5	5.2
European Union	7.2	10.9	10.2	9.9	9.7	9.5
France	8.0	10.4	9.9	10.0	10.0	9.9
Germany	8.6	5.3	5.0	4.7	4.9	5.0
Italy	6.1	12.2	12.5	12.6	12.5	12.3
United Kingdom	5.4	7.5	6.3	5.9	5.7	5.5
Central and South-Eastern Europe and CIS	8.2	7.8	7.7	7.8	7.8	7.8
Russian Federation	6.0	5.5	5.1	5.3	5.4	5.4
Turkey	10.3	9.7	9.2	9.2	8.9	9.0
Middle East	10.2	10.9	11.0	11.0	10.9	10.8
North Africa	11.4	12.4	12.5	12.5	12.5	12.5
Sub-Saharan Africa	7.8	7.7	7.7	7.7	7.7	7.7
South Africa	22.3	24.6	25.1	25.0	24.9	24.8
Latin America and the Caribbean	6.9	6.3	6.6	6.8	6.9	6.8
Brazil	8.1	6.5	6.8	7.1	7.3	7.3
Mexico	3.4	4.9	4.9	4.8	4.5	4.3
East Asia	3.8	4.5	4.6	4.8	4.9	4.9
Republic of Korea	3.2	3.1	3.5	3.5	3.5	3.5
South-East Asia and the Pacific	5.5	4.3	4.3	4.3	4.2	4.2
Indonesia	9.1	6.2	6.2	6.1	5.9	5.8

Source: International Labour Organisation, World Employment and Social Outlook, 2015

Table 3.1 above illustrates unemployment rates of different regions across the globe from 2007 until 2014 and forecasts between 2015 and 2017. The world unemployment rate increased from 5.5 per cent in 2007 to 5.9 per cent in 2014 and is projected to remain at the 5.9 per cent level over the following three years. East Asia had the lowest unemployment rates at 4.6 per cent in 2014, followed by the G20 economies at 5.6 per cent. The regions with the highest unemployment rates in 2014 were North Africa (12.5 per cent) and the Middle East (11.0 per cent). South Africa has one of the highest unemployment rates in the world estimated at 25.1 per cent in 2014.

Table 3.2: Labour market developments in Developed Economies and EU, 2009 - 2019

	2009	2012	2013	2014	2015*	2016*	2017*	2018*	2019*
Labour force participation rate	60.4	60	59.9	59.8	59.8	59.7	59.7	59.6	59.5
Unemployment rate (total)	8.4	8.6	8.5	7.8	7.5	7.3	7.1	6.9	6.8
Youth unemployment rate	17.4	18	17.7	16.7	16.3	15.8	15.5	15.2	15
Employment growth	-2.2	0.5	0.4	1.2	0.6	0.5	0.5	0.4	0.4
Youth employment growth	-7.5	-1.1	-0.2	0.9	0.1	0.1	0	-0.1	-0.1
Real wage growth	1	0.2	0.2	0.5	1.4	1.5	1.8	1.8	1.7
Productivity growth	-1.5	0.8	0.8	0.6	1.6	1.8	1.8	1.7	1.7

Source: International Labour Organisation, World Employment and Social Outlook, 2015

According to the ILO (2015), the rate on unemployment in the Developed Economies and EU has decreased from 8.4 per cent during the height of the recession in 2009 to 7.8 per cent in 2014 and is forecast to decline further to 6.8 per cent by 2019. Youth unemployment rate has also decreased and is projected to decline to 15.0 per cent in 2019 from a high of 17.4 per cent in 2009. Employment growth in the region has recovered somewhat from shrinking by 2.2 per cent in 2009 to growing by 1.2 per cent in 2014.

Table 3.3: Labour market trends in Sub-Saharan Africa, 2009 - 2019

	2009	2012	2013	2014	2015*	2016*	2017*	2018*	2019*
Labour force participation rate	70.4	70.6	70.8	70.9	71	71.1	71.2	71.2	71.3
Unemployment rate (total)	7.9	7.9	7.7	7.7	7.7	7.7	7.7	7.7	7.6
Youth unemployment rate	12.5	12.3	11.8	11.8	11.8	11.8	11.8	11.8	11.8
Employment growth	2.8	3.1	3.3	3.1	3.1	3.1	3.1	3	3
Youth employment growth	2.2	2.7	3.3	2.7	2.7	2.7	2.7	2.7	2.6
Real wage growth	3.2	2.5	0.4	0.3	0.7	1.1	1.4	1.4	1.4
Productivity growth	-1.5	0.8	0.4	1	1.3	1.7	1.6	1.5	1.5

Source: International Labour Organisation, World Employment and Social Outlook, 2015

Unemployment rates have also decreased in Sub-Saharan Africa although not at the same rate as was the case in the Developed Economies and EU. Total unemployment rate in Sub-Saharan Africa decreased from 7.9 per cent in 2009 to 7.7 per cent in 2014, representing a 0.2 of a percentage point fall. Forecasts by the ILO are that the unemployment rate in the region will decrease slightly to 7.6 per cent in 2019. The youth unemployment rate declined by 0.7 of percentage point between 2009 and 2014; from 12.5 per cent in 2009 to 11.8 per cent in 2014. Youth unemployment rate is projected to remain constant at 11.8 per cent over the next five years as youth employment growth remains unchanged at 2.7 per cent during the same period (see table 3.3).

3.3. South African Labour Market Review

The effects of the 2008/2009 global financial crisis on the South African economy continued to linger on unabated in 2014. This, combined with factors such as constrained electricity supply and labour unrest, has negatively impacted on the performance of the South African economy. Slowing growth rates over the period 2010 to 2013 (averaging a meagre 2.7 per cent), continued into 2014 owing to a protracted strike in the mining and quarrying sector in the first half of the year. While employment levels increased by 1.1 million since 2011, the unemployment rate continues to rise, while the absorption rate has not yet recovered to pre-recessionary levels (Stats SA, Labour Market Dynamics in South Africa, 2014). Addressing the problem of unemployment, without a doubt, remains a major challenge for South Africa.

Table 3.4: Labour market status of the working-age population, 2008–2015 (000)

	2008	2009	2010	2011	2012	2013	2014	2015	Change 2008– 2015
	Youth aged 15-34 years								
Working-age population	18 209	18 404	18 608	18 824	19 053	19 283	19 504	19 706	1 497
Labour force	9 596	9 489	9 005	8 923	9 146	9 171	9 390	9 885	289
Employed	6 460	6 296	5 789	5 704	5 874	5 850	6 000	6 239	-221
Unemployed	3 136	3 194	3 215	3 220	3 273	3 321	3 390	3 646	510
Not economically active	8 612	8 915	9 603	9 901	9 907	10 112	10 114	9 821	1 209
<i>Rates (%)</i>									
Unemployment rate	32.7	33.7	35.7	36.1	35.8	36.2	36.1	36.9	4.2
Employed/population ratio (Absorption)	35.5	34.2	31.1	30.3	30.8	30.3	30.8	31.7	-3.8
Labour force participation rate	52.7	51.6	48.4	47.4	48.0	47.6	48.1	50.2	-2.5
	Adults aged 35 - 64 years								
Working-age population	13 336	13 731	14 125	14 511	14 892	15 275	15 672	16 092	2 756
Labour force	9 212	9 493	9 405	9 577	9 907	10 249	10 732	11 109	1 897
Employed	7 977	8 320	8 008	8 200	8 410	8 708	9 054	9 220	1 243
Unemployed	1 235	1 173	1 397	1 378	1 496	1 541	1 677	1 889	654
Not economically active	4 124	4 238	4 720	4 933	4 985	5 026	4 941	4 983	859
<i>Rates (%)</i>									
Unemployment rate	13.4	12.4	14.9	14.4	15.1	15.0	15.6	17.0	3.6
Employed/population ratio (Absorption)	59.8	60.6	56.7	56.5	56.5	57.0	57.8	57.3	-2.5
Labour force participation rate	69.1	69.1	66.6	66.0	66.5	67.1	68.5	69.0	-0.1
	All ages 15–64 years								
Working-age population	31 545	32 135	32 733	33 335	33 945	34 558	35 176	35 798	4 253
Labour force	18 808	18 982	18 410	18 500	19 053	19 420	20 122	20 994	2 186

Employed	14 437	14 616	13 797	13 904	14 284	14 558	15 054	15 459	1 022
Unemployed	4 371	4 367	4 612	4 598	4 769	4 862	5 067	5 535	1 164
Not economically active	12 736	13 153	14 323	14 834	14 892	15 138	15 055	14 804	2 068
<i>Rates (%)</i>									
Unemployment rate	23.2	23.0	25.1	24.9	25.0	25.0	25.2	26.4	3.2
Employed/population ratio (Absorption)	45.8	45.5	42.2	41.7	42.1	42.1	42.8	43.2	-2.6
Labour force participation rate	59.6	59.1	56.2	55.5	56.1	56.2	57.2	58.6	-1.0

Source: Statistics South Africa, 2015

The working-age population comprises three groups: those who have jobs, those who are unemployed and actively looking for work, and those who are not economically active such as discouraged work-seekers, full-time students, homemakers and retired people. The national picture masks large and persistent differences in labour market outcomes when disaggregated among youth (aged 15 - 34 years) and adults (aged 35 - 64 years). Young people aged 15 - 34 years account for a larger share of the country's working-age population. Of the 31.5 million working-age people aged 15 - 64 years in 2008, 18.2 million (57.8 per cent) were the youth aged 15 - 34 years while 13.3 million (42.2 per cent) were adults aged 35 - 64 years. Population growth over the subsequent years, meant that by 2015 the working-age population stood at 35.8 million of which 19.7 million (55.0 per cent) were youth and 16.1 million (45.0 per cent) were adults (Department of Labour, 2015).

South Africa's working age population grew by 13.5 per cent between 2008 and 2015 and the labour force increased by 11.6 per cent, which translates into a 1.7 percentage point decline in the labour force participation rate. During the same period, the number of employed people increased by a mere 7.1 per cent, while the unemployed increased by a substantial 26.6 per cent, resulting in a 3.2 percentage point increase in the unemployment rate.

Whereas in 2015 as many as 3.6 million young people were unemployed and actively looking for work, a substantially lower number of adults (1.9 million) were in that situation. And only 6.2 million youth had jobs as against 9.2 million adults who were employed. Over the period 2008 to 2015, the increase in employment by 1.0 million was solely on account of job gains among adults (up by 1.2 million), while among youth job losses of 221 000 occurred (see table 3.4 above). Youth continue to be the most vulnerable group in South Africa. Even during tough economic times, the youth are more likely to be laid off or find it more difficult to find employment compared to their adult counterparts

Table 3.5: Unemployment rates among the youth and adults by population group

	2008	2009	2010	2011	2012	2013	2014	2015
	Youth 15-34 years							
Black African	36.3	37.5	39.9	39.5	39.4	39.6	39.4	40.3
Coloured	28.3	27.5	30.4	32.9	33.1	33.7	35.3	32.1
Indian/Asian	17.4	17.2	12.5	19.7	13.3	16.5	15.7	22.6
White	9.3	9.7	10.8	11.6	10.4	12.5	9.6	11.2
Total	32.7	33.7	35.7	36.1	35.8	36.2	36.1	36.9
	Adults 35-64 years							
Black African	16.8	15.3	18	17.3	17.7	17.4	18.1	19.5
Coloured	9.2	10.7	13.3	14.1	16	14.6	13.5	15.7
Indian/Asian	5.4	6.6	6	3.8	6	8.4	9.8	10.1
White	3.1	1.9	4	3.4	4	4.7	5.1	5.1
Total	13.4	12.4	14.9	14.4	15.1	15	15.6	17
	All ages 15-64 years							
Black African	27.3	27	29.3	28.7	28.7	28.3	28.5	29.7
Coloured	19.2	19.2	21.7	23	24.1	23.6	23.5	23.3
Indian/Asian	11.7	11.9	9.1	11.3	9.3	12.1	12.4	15.7
White	5.2	4.4	6.2	6	6.1	7.3	6.6	7.2
Total	23.2	23	25.1	24.8	25	25	25.2	26.4

Source: Statistics South Africa, 2015

According to table 3.5 above, the youth population (15 to 34 years of age) is estimated to have an unemployment rate of 36.9 per cent in 2015, compared to the adult (35 to 64 years) rate of 17.0 per cent. It is evident from the table that the youth bear the brunt of unemployment in South Africa more than adults do. For the period 2008 to 2015, the youth unemployment rate increased by 4.2 percentage points; from 32.7 per cent to 36.9 per cent. The adult unemployment rate also increased during the same period, although by a lesser amount of 3.6 percentage points. In total, the unemployment rate of South Africa increased by 3.2 percentage points, from 23.2 per cent in 2008 to 26.4 per cent in 2015.

Black youth experience the highest incidence of unemployment in the country with an unemployment rate as high as 40.3 per cent. Blacks also suffer the highest unemployment rate when it comes to adults at 19.5 per cent in 2015. During the review period, all races experienced an upward movement in the unemployment levels irrespective of age group. The black population still commands the highest unemployment rate in the country at 29.7 per cent, followed by Coloureds (23.3 per cent) and Indian/Asian (15.7 per cent). Whites have the smallest incidence of unemployment with a significantly lower rate of 7.2 per cent. These

statistics clearly indicate that the historical racial tendencies of Apartheid South African are still prevalent even today.

Box 3.1: South African Labour Market Regulations and Institutions

Following the transition to democracy, South Africa passed a series of labour laws, to extend to all workers the rights that historically governed the market for white labour in South Africa, but which also granted all workers additional rights and protections. In part, this was due to the significant role of the trade union movement, and specifically the Congress of South African Trade Unions (COSATU), in South Africa's transition to democracy, its subsequent alliance with the ruling ANC, and the entrenchment of organised labour in the legislative process. The key policies and institutions that govern the labour market are:

- The Labour Relations Act (1995) protects the right of workers to form unions and to strike. It also established a number of key labour market institutions such as:
 - The Commission for Conciliation, Mediation and Arbitration (CCMA), which resolves disputes between employers and individual employees who claim that their statutory employment rights have been infringed, especially their right not to be dismissed unfairly as defined in the law; and
 - A system of bargaining councils which entrench bargaining at a sectoral level, the agreements of which can, in certain circumstances, be extended to all participants in the sector even if they are not party to negotiations.
- The Basic Conditions of Employment Act (1997) sets out minimum standards for work, such as working hours, and overtime, as well as leave and health and safety standards across the economy.
- The Employment Equity Act (1998) seeks to compensate for historical inequality of opportunity by prohibiting discrimination and increasing opportunities for 'designated' groups, including women, black men, and disabled people.
- The Skills Development Act (1998) and the Skills Development Levies Act (1999) use a payroll levy distributed to Sector Education and Training Authorities (SETAs) to run skills development and training programmes within their sectors.

Source: CDE Roundtable, Rethinking South Africa's Labour Market, 2013

3.3. Free State Provincial Labour Market Analysis

This section of the publication explores trends in the Free State labour market and contains the latest official employment and unemployment estimates. The analysis is based Statistics South Africa data, supplemented by IHS Global Insight database.

3.3.1. Demographics

The demographics of the workforce play an important role in labour market trends. Demographic change consists of different trends, like total population decline, diminishing number of young people, shrinking labour force, ageing society, changing ethnic composition of population and changing household composition. These trends will have negative effects on the labour market and through these negative effects on the labour market have effects on society.

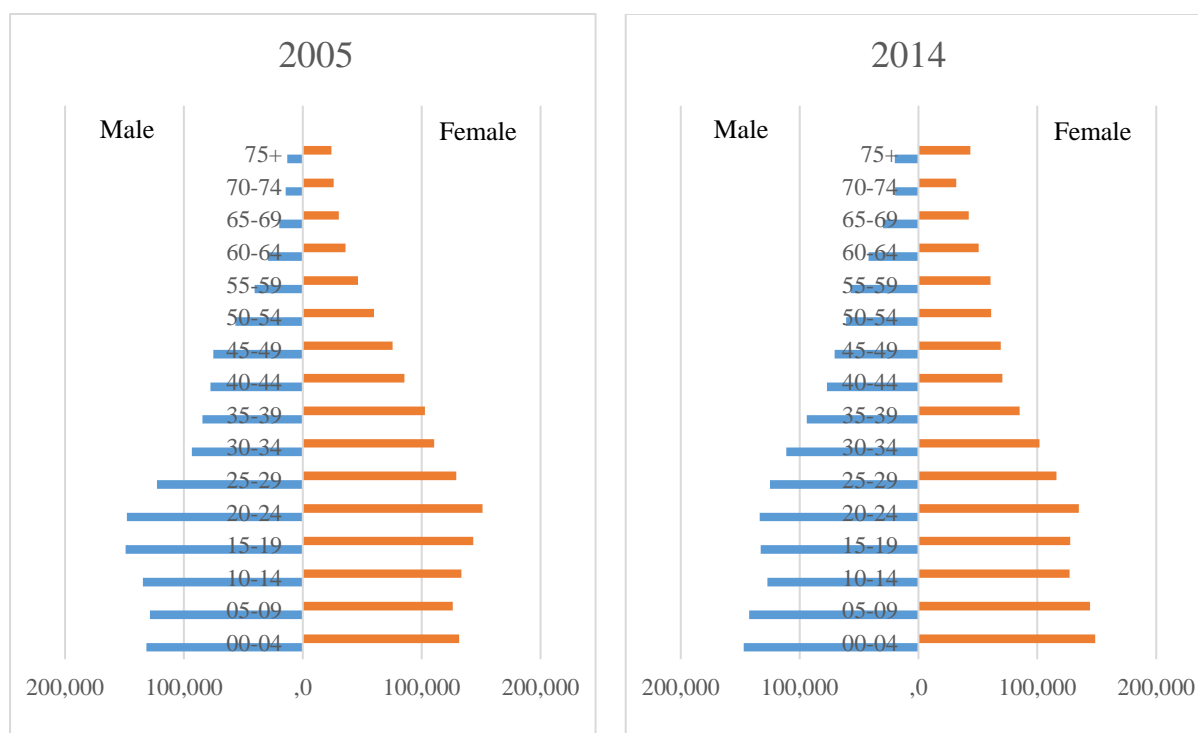
Demographic trends can have direct implications for labour markets through three primary channels: labour supply, labour productivity, and labour demand (because of shifts in the structure of aggregate demand). It is generally recognized that ageing societies will face economic and social challenges. What will inevitably happen in the labour market is that the labour force will shrink as large numbers of workers retire and the characteristics of the labour markets change. The workforce will be on average older and there will be less young people in the workforce. A shrinking labour population causes shortages on the labour market but may also affect the labour productivity and the innovative capacity (Coenen and Galjaard. n.d.).

A population structure is usually shown using a population pyramid, as depicted in figure 3.1 below. Population structure means the 'make up' or composition of a population. Looking at the population structure of a place shows how the population is divided up between males and females of different age groups. The left side of each pyramid shows the number of men in each age group, the right side shows the number of women in each age group. The age-sex structure of any population affects the labor force, demand for education facilities, retirement and medical systems amongst others. Therefore, the population pyramid provides crucial data that can be used by the government when planning. Cities need to begin with a regional growth forecast (RGF) based on GIS to determine level and location of population, the need and

location of schools, hospitals, fire and police protection, and sewage and water treatment plants, zoning for land uses, transportation plans, projected housing needs, projected energy demands, air quality, etc.

Figure 1 below shows the population pyramid of the Free State province for the years 2005 and 2014. Comparing the two years under review, it is evident that there is an increase in the 25 to 39 age groups. This pyramid shows that there are more females at age groups above 55 years, which indicates more women are living to older ages than males. A population pyramid that is very triangular, as is the case with the Free State, shows a population with a high number of young dependants and a low life expectancy, thus putting a lot of strain on the economically active population. The pyramid narrows toward the top because the death rate is higher among older people than among younger people. The structure of the Free State's population has not changed drastically over the review period, with the exception of the increasing 00 – 09 age group. By age composition, the country's population is rather young due to the high birth rate. The Free State's population pyramid depicts the characteristics of a developing nation which are: (i) low growth rates, (ii) high birth rate, and (iii) short life expectancy.

Figure 3.1: Age structure of the population



Source: Global Insight, Regional eXplorer, 2016

According to table 3.6 below, the Free State's labour force increased by an estimated 0.6 per cent over the past year, from 1 154 000 in Q3:2014 to 1 161 000 in Q3:2015. The working age population increased by 0.7 per cent over the same period. The number of people employed increased by a significant 5.3 per cent year on year, while the unemployed decreased by 8.2 per cent, resulting in a 3.1 percentage point decrease in the unemployment rate. The province has thus created 40 000 jobs during this period, whilst an estimated 33 000 were lost. The unemployment rate, therefore, decreased from 34.6 per cent in Q3:2014 to 31.5 per cent in Q3:2015. The number of discouraged work-seekers decreased by 8 per cent, indicative of the positive outlook of the unemployed people to find employment. The province's absorption rate¹ increased to 42.5 per cent in Q3:2015 from 40.6 per cent in Q3:2014, meaning the economy is absorbing more people into the labour market. The absorption rate is important as a separate indicator as it reflects two opportunities for increasing employment not captured by official unemployment statistics: the need to decrease the amount of discouraged work-seekers and the number of people too ill to work.

Table 3.6: Characteristics of Free State's labour market

	Jul-Sep 2014	Oct-Dec 2014	Jan-Mar 2015	Apr-Jun 2015	Jul-Sep 2015	Qrt to Qrt change	Year on year change	Qrt to Qrt change	Year on year change
	Thousand						Per cent		
Population 15-64 years	1 858	1 862	1 865	1 869	1 872	3	13	0.2	0.7
Labour Force	1 154	1 138	1 152	1 165	1 161	-4	7	-0.3	0.6
Employed	755	772	802	798	795	-4	40	-0.4	5.3
Formal sector (Non-agricultural)	499	507	518	520	496	-24	-3	-4.6	-0.5
Informal sector (Non-agricultural)	128	136	127	124	140	16	12	13.0	9.1
Agriculture	54	54	82	74	65	-9	11	-12.8	19.5
Private households	73	75	75	80	94	14	20	17.3	27.7
Unemployed	399	367	350	366	366	0	-33	-0.1	-8.2
Not economically active	705	723	713	704	711	7	6	1.0	0.9
Discouraged work-seekers	78	77	92	93	69	-24	-8	-25.6	-10.6
Other(not economically active)	627	647	621	610	642	31	14	5.1	2.3
Rates (%)									
Unemployment rate	34.6	32.2	30.4	31.4	31.5	0.1	-3.1		
Employed / population ratio (Absorption)	40.6	41.5	43.0	42.7	42.5	-0.2	1.9		
Labour force participation rate	62.1	61.1	61.8	62.3	62.0	-0.3	-0.1		

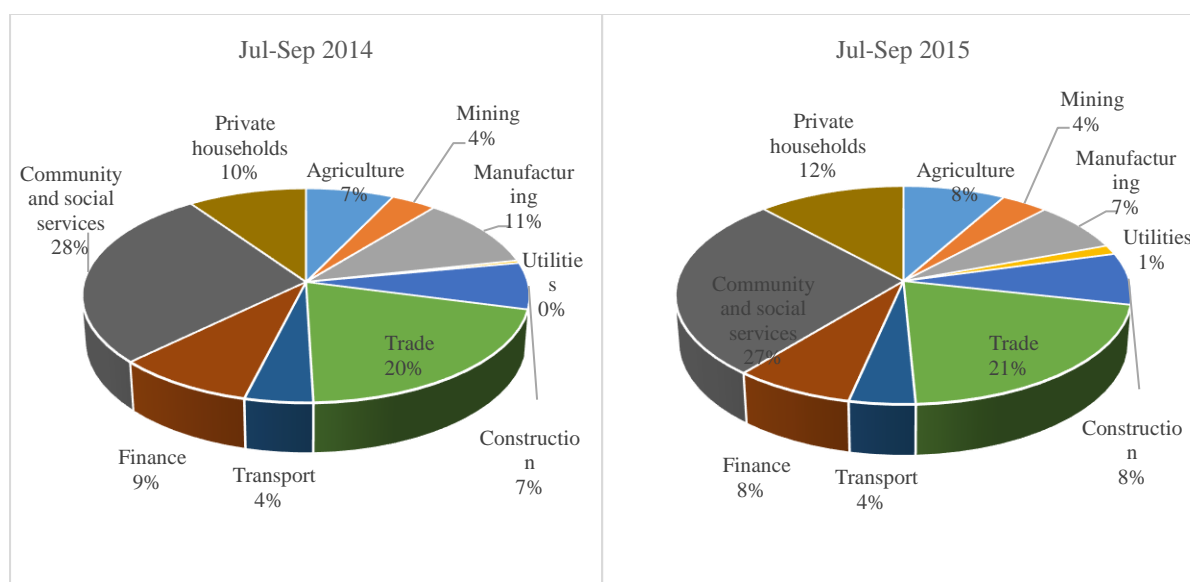
Source: Statistics South Africa, Quarterly Labour Force Survey, 3rd Quarter 2015

¹ The labour absorption rate is the percentage of the working-age population employed.

3.3.2. Employment Trends

Figure 3.2 below illustrate the share of employment by sector in the provincial economy between Q3:2014 and Q3:2015. The community and social services remain the biggest employer in the province with a share of 27 per cent in Q3:2015, down from 28 per cent share in Q3:2014. The second biggest employer in Q3:2015 was trade (21 per cent), followed by private households (12 per cent) and finance (8 per cent). The smallest employers were utilities (1 per cent), mining (4 per cent) and transport (4 per cent). The tertiary industries together contributed the biggest portion to employment at 72 per cent, while the primary and secondary industries contribute the remaining 28 per cent divided into 12 per cent and 16 per cent respectively. The share of the tertiary industries to employment continue to increase as the transformation of the provincial economy from primary industries to the services sectors continue to shape up. As the structure of the Free State economy has shifted, so have the kinds of skills required. The shift from the primary to the tertiary sectors normally result in growing demand for highly skilled professionals, technicians and managers to develop, implement, operate and maintain new technologies associated with the services economies.

Figure 3.2: Employment share by sector



Source: Statistics South Africa, Quarterly Labour Force Survey, 3rd Quarter 2015

Table 3.7 below shows trends in the share of employment by occupation. The tables shows that between Q3:2014 and Q3:2015 a considerable share of employees in the Free State were in elementary occupations, and it has increased significantly from 22.0 per cent in Q3:2014 to

28.3 per cent in Q3:2015. The other occupations with the highest share of employment in Q3:2015 were sales and services (15.4 per cent), craft and related trade (12.4 per cent) and clerks (9.8 per cent). On the other hand, the smallest employers were the skilled agriculture (0.5 per cent), professionals (3.6 per cent) and managers (4.4 per cent).

The semi-skilled occupations remain the largest employers although their share is on a decline; from 59.0 per cent in Q3:2014 to 54.8 per cent in Q3:2015, representing a fall of 4.2 percentage points. The share of skilled occupations also declined, from 11.0 per cent to 8.0 per cent during the review period, which is in contrast to the apparent transformation of the provincial economy from a resources based economy to a services driven economy which, in turn, require a highly skilled workforce. The share of low-skilled occupations increased by 7.1 percentage points from 30.1 per cent in Q3:2014 to 37.2 per cent in Q3:2015.

Table 3.7: Employment share by occupation

	Jul-Sep 2014	Oct-Dec 2014	Jan-Mar 2015	Apr-Jun 2015	Jul-Sep 2015	Qrt to Qrt change	Year on year change
Manager	6.4%	6.0%	6.3%	5.5%	4.4%	-1.1%	-2.0%
Professional	4.5%	4.8%	3.4%	3.4%	3.6%	0.2%	-0.9%
Skilled occupations	11.0%	10.7%	9.7%	8.9%	8.0%	-0.9%	-3.0%
Technician	9.8%	8.1%	6.9%	7.3%	7.8%	0.5%	-2.1%
Clerk	9.9%	10.2%	9.4%	8.4%	9.8%	1.4%	-0.1%
Sales and services	16.8%	17.4%	16.5%	16.4%	15.4%	-1.0%	-1.4%
Skilled agriculture	0.3%	0.4%	0.4%	0.5%	0.5%	0.0%	0.2%
Craft and related trade	11.9%	12.5%	11.4%	12.0%	12.4%	0.3%	0.5%
Plant and machine operator	10.2%	9.9%	9.2%	10.7%	8.9%	-1.8%	-1.3%
Semi-skilled occupations	59.0%	58.4%	53.8%	55.3%	54.8%	-0.5%	-4.2%
Elementary	22.0%	23.7%	30.4%	28.9%	28.3%	-0.6%	6.3%
Domestic worker	8.0%	7.1%	6.0%	6.8%	8.9%	2.0%	0.8%
Low-skilled occupations	30.1%	30.8%	36.5%	35.8%	37.2%	1.4%	7.1%

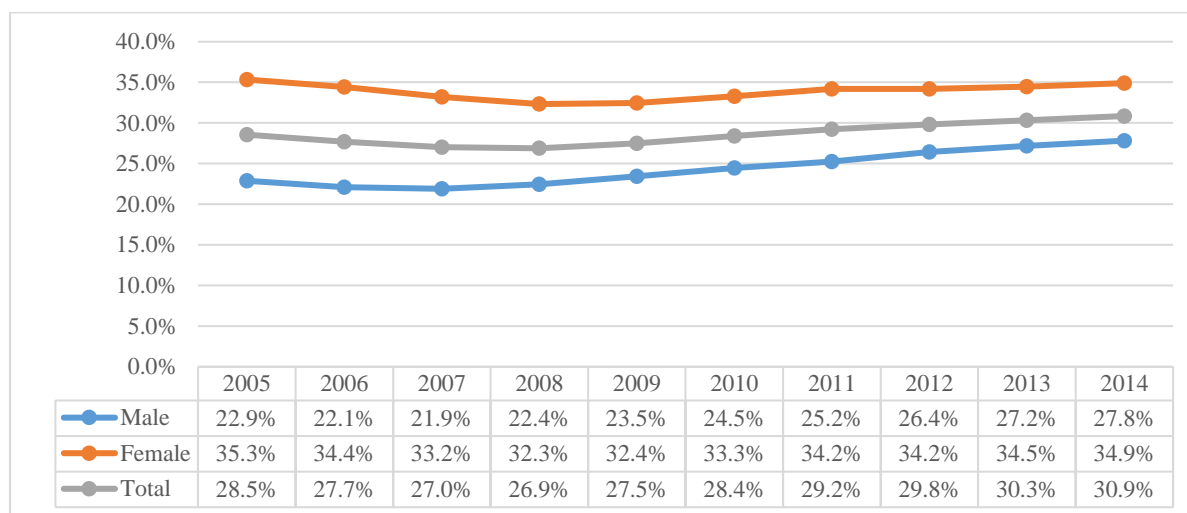
Source: Statistics South Africa, Quarterly Labour Force Survey, 3rd Quarter 2015

3.3.3. Unemployment

Work-seekers are still presenting the same challenges that are associated with low skills and limited experience which can still maintain skills mismatches in the labour market. These mismatches may have worsened during the economic crisis, with the large stock of current work-seekers facing few job opportunities and frequently accepting jobs that are not well matched to their skills (Department of Labour, 2014).

The continuing high unemployment rate in the province remains a major concern for the Free State. In this regard, the challenge of delivering a better life for all could be met by upgrading the skills of the work-seekers and by further education and training programmes for workers to learn skills that are in demand in line with the changing labour market situation.

Figure 3.3: Free State unemployment rate



Source: IHS Global Insight, Regional eXplorer, 2015

Figure 3.3 above illustrates trends in the unemployment rate of the Free State for the period 2005 to 2014. The unemployment rate in the province increased from around 28.5 per cent in 2005 to 30.9 per cent in 2014, an increase of 2.4 percentage points. In 2014, the Free State had the highest unemployment rate in the country at 30.9 per cent, followed by Northern Cape (30.4 per cent) and Eastern Cape (30.0 per cent). The provinces with the lowest unemployment rates were Limpopo (21.5 per cent), KwaZulu-Natal (22.0 per cent) and Western Cape (22.2 per cent).

Female unemployment rate in the Free State has remained stubbornly high at 34.9 per cent in 2014, and has registered a decline of only 0.4 of percentage point compared to 2005. In 2014, the unemployment rate for females was 7.1 percentage points higher than that of males. The gap between the male and female unemployment rate has declined by 5.3 percentage points, however, it is largely as a result of an increase in the male unemployment rate. During the period under review, the male unemployment rate increased by 4.9 percentage points, while for females it declined by 0.4 of a percentage point as already alluded to above. Therefore,

although the female unemployment rate is declining, it is still above that of males which recorded significant increases..

3.3.4. Youth Unemployment

Youth unemployment in the Free State increased substantially post the 2009 economic recession; increasing from 36.1 per cent in 2009 to 48.2 per cent in 2014 before decreasing to 39.4 per cent in 2015. The unemployment rate of the Free State youth in 2015 was higher than the national average by 2.5 percentage points, compared to a difference of 2.2 percentage points in 2008, indicative of the severity of the problem in the province. Between 2008 and 2015, youth unemployment in the Free State increased by 4.5 percentage points. The highest increases in the country were recorded in the Northern Cape (11.3 per cent), North West (8.8 per cent), and Gauteng (7.4 per cent). Only the province of Limpopo managed to decrease the incidence of youth unemployment from a weighty 43.5 per cent in 2008 to 30.4 per cent in 2015; representing a considerable decline of 13.1 percentage points (see table 3.8 below).

Early unemployment has a negative effect not only on the future employability of young people but also on their self-esteem, their role in the society and can represent a serious economic burden on state finances. Being young and unemployed can lead to increase in the risk of poverty, deskilling and social exclusion. Young people should be properly integrated in the labor market, so that the negative consequences of youth unemployment are reduced as much as possible. It is important to understand that having so many unemployed young people does not only bring personal struggles to them, but impacts the society as a whole and poses a threat to the economic welfare of the province.

Table 3.8: Youth unemployment rates by province

	2008	2009	2010	2011	2012	2013	2014	2015	change 2008 - 2015
Western Cape	25.9	27.4	27.6	32.1	31.6	33.2	31	29.9	4.0
Eastern Cape	37.6	39.2	40.3	37.0	38.1	39.8	40.7	41.0	3.4
Northern Cape	33.8	38.4	39.3	41.5	36.2	40.4	42.4	45.1	11.3
Free State	34.9	36.1	40.5	39.7	44.4	43.4	48.2	39.4	4.5
KwaZulu-Natal	30.5	32.1	27.1	29.7	29.8	30.5	30.5	33.4	2.9
North West	30.9	38.2	37.3	38.2	41.1	38	38.4	39.7	8.8
Gauteng	32.4	31.6	39.1	39.3	36.9	37.7	36.4	39.8	7.4
Mpumalanga	32.9	36	41.1	42.9	42.5	40.5	42.8	38.8	5.9

Limpopo	43.5	40.5	39.2	28.3	31.2	29.5	28.6	30.4	-13.1
South Africa	32.7	33.7	35.7	36.1	35.8	36.2	36.1	36.9	4.2

Source: Statistics South Africa, 2015

Figure 3.4 below illustrates the disparity in youth unemployment by gender for the period 2008 to 2015. Female youth are more prone to be unemployed than their male counterparts. In 2008, female youth unemployment rate was estimated at 41.8 per cent, which was 13.1 percentage points higher than the male youth unemployment rate. The latest estimates puts female youth unemployment rate at only 10.4 percentage points higher than male youth unemployment rate which is estimated to be at 45.5 per cent. However, the reduction in the gap between the two was not because of a decrease in the female youth unemployment rate, but rather due to an increase in the male youth unemployment rate from 28.7 per cent in 2008 to 35.1 per cent in 2015. Instead the female youth unemployment rate also increased by 3.7 percentage points to 45.5 per cent in 2015. Clearly, youth unemployment is a major problem for both genders but more so for females.

Figure 3.4: Youth unemployment rate by gender



Source: Statistics South Africa, 2015

Discouraged worker-seekers constitute one group of inactive work-seekers. These are persons who, while willing and able to engage in a job, are not seeking work or have ceased to seek work because they believe there are no suitable available jobs. Tables 3.9 below decipher the trends in the proportion of discouraged work-seekers between the ages of 15 to 34 for the period

2008 to 2015. The proportion of the working-age youth that is discouraged in the Free State has increased from 3.3 per cent in 2008 to 5.2 per cent in 2015. The Eastern Cape (12.4 per cent), Limpopo (12.0 per cent) and North West (12.0 per cent) have the lowest proportion the working-age youth that is discouraged, whilst the Western Cape (1.2 per cent), Gauteng (3.3 per cent) and Free State (5.2 per cent) have the least. In total, the country had about 7.8 per cent of the youth discouraged, up from 4.4 per cent in 2008.

Table 3.9: Proportion of working-age youth (15–34 years) that is discouraged by province

	2008	2009	2010	2011	2012	2013	2014	2015
Western Cape	1.8	0.7	1.9	0.7	1.1	1.2	0.8	1.2
Eastern Cape	7.1	7.5	10.3	10.4	11.6	12.2	12.2	12.4
Northern Cape	5.8	3.9	7.9	6.9	5.6	3.5	7.5	6.6
Free State	3.3	5.2	6.6	5.2	4.0	4.6	4.0	5.2
KwaZulu-Natal	3.3	5.1	9.5	10.4	10.0	9.7	10.6	10.2
North West	9.0	6.3	7.7	10.4	14.7	11.6	12.0	12.0
Gauteng	3.8	2.3	3.7	4.8	4.1	4.7	4.2	3.3
Mpumalanga	5.3	5.3	8.1	10.7	12.7	11.5	8.5	8.8
Limpopo	4.3	7.6	8.6	13.4	13.7	13.8	12.1	12.0
South Africa	4.4	4.6	6.9	8.1	8.4	8.3	7.9	7.8

Source: Statistics South Africa, 2015

Long-term unemployment, defined as being out of work for at least 27 weeks, has many costs over and above regular spells of unemployment. Research shows that an individual's earnings can suffer permanent damage after a long stretch of unemployment. Most alarming, long-term unemployment can be self-perpetuating, since workers who face extended periods of unemployment, in particular, may find new employment increasingly difficult to obtain. Lower wages and loss of employment opportunities could be the result of the loss of skills or the stigma employers attach to workers who have been unemployed for a long time (Bank of Canada Review, 2014).

As depicted in table 3.10 below, the percentage of unemployed youth work-seekers who are considered long-term unemployed in the Free State rose from 54.0 per cent in 2008 to 67.5 per cent in 2015; an increase of 13.5 percentage points. However, The rise in long-term unemployment has been even more striking in Mpumalanga (22.5 percentage points) and Eastern Cape (13.9 percentage points). At its peak in 2014, an estimated 69.4 per cent of those unemployed had been out of work for 27 weeks or more in the Free State, second only to

Mpumalanga with a high of 71.3 per cent. In contrast Limpopo and Northern Cape had a low of 50.3 per cent and 53.1 per cent respectively in 2014. The Northern Cape and Gauteng's incidence of long-term unemployment among the youth has decreased between 2008 and 2015. The decline in these two provinces may reflect improving labour market conditions, but may also be an indication of the long-term unemployed leaving the labour force at a different rate than the unemployed as a whole.

Table 3.10: Incidence of long-term unemployment among the youth by province

	2008	2009	2010	2011	2012	2013	2014	2015
Western Cape	44	52.2	54.5	58.3	60.6	64.4	66.1	55.4
Eastern Cape	49.3	59.7	60.1	58.1	64.3	67.4	60.0	63.2
Northern Cape	61.1	53.5	60.7	61.2	60.5	59.1	53.1	55.8
Free State	54.0	55.2	55.4	61.3	65.3	67.9	69.4	67.5
KwaZulu-Natal	49.0	54.4	60.7	66.4	62.6	60.6	62.8	58.3
North West	52.3	58.1	67.9	66.9	65.5	53.2	60.8	64.3
Gauteng	65.5	68.3	69.6	76.1	73.3	67.5	68.9	63.6
Mpumalanga	43.9	49.9	66.2	72.6	72.4	69.1	71.3	66.4
Limpopo	57.8	55.7	59.1	66.5	56.4	52.1	50.3	58.4
South Africa	54.7	58.7	63.4	68.0	66.8	64.4	65.0	61.9

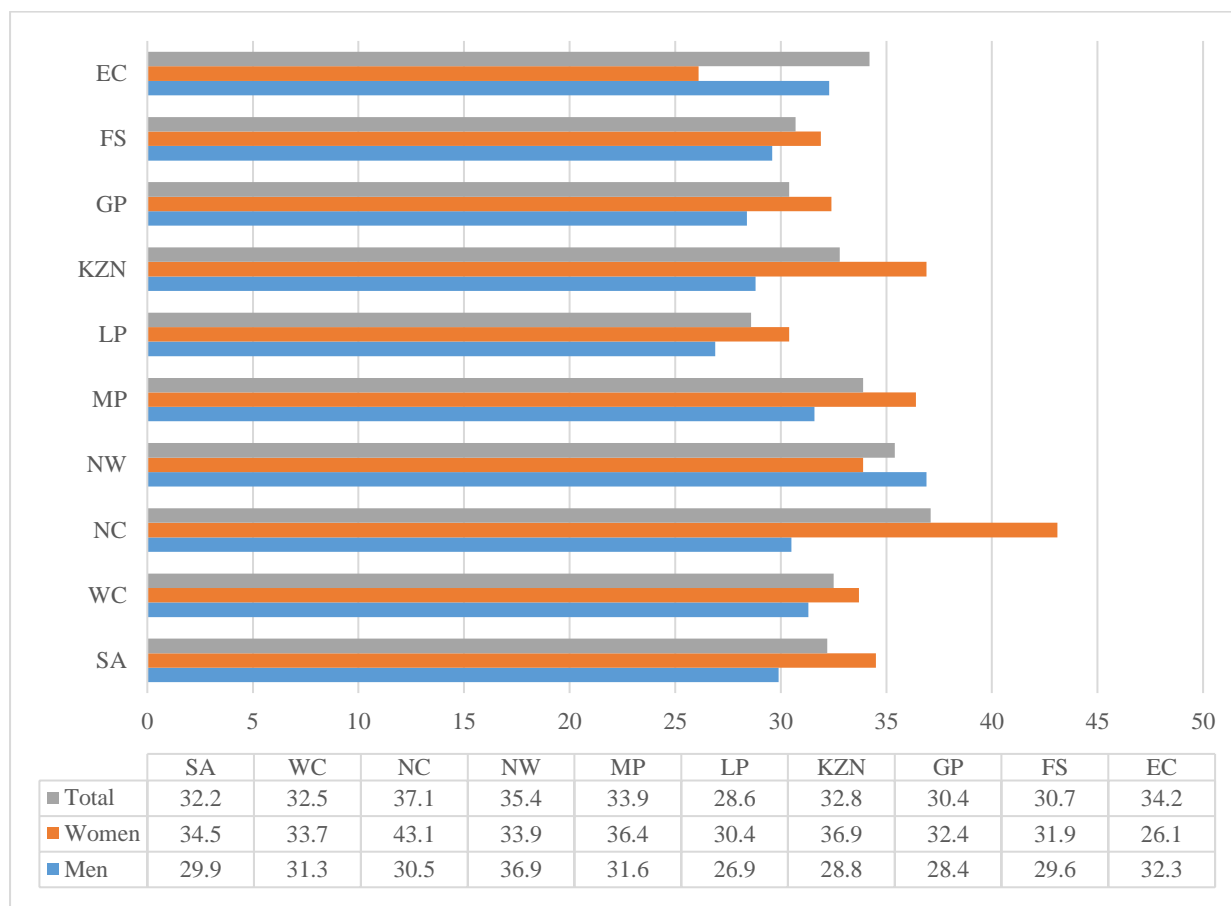
Source: Statistics South Africa, 2015

Since the global financial crisis of 2008, youth unemployment has become global, with rates of 57.7 per cent and 36.8 per cent for the under 25 years in Spain and Portugal respectively. In South Africa, some youth are more likely to find work than others but the trend remains unpredictable as the economy is also mired in long-term structural unemployment. This challenge has created another youth category to analyse, e.g., those who are not in employment, education or training (NEET). According to Statistics South Africa, one in every three young people aged 15-24 years (32.2 per cent) were not in employment and not in education/training (NEET) in South Africa. This proportion (the NEET rate) was higher among young women at 34.5 per cent than young men (29.9 per cent), as shown in figure 3.5 below. This trend was also observed across provinces where in every province the NEET rate among young women was also higher than that of young men.

In the Free State, youth that were not in employment and not in education/training in 2014 were estimated at 30.7 per cent, which is the third lowest in the country behind Limpopo (28.6 per cent and Gauteng (30.4 per cent). The incidence of NEET in the Free State was more prevalent

for women at 31.9 per cent than was the case for men (29.6 per cent). Young people who are NEET are at risk of becoming socially excluded, with income below the poverty-line and without the skills to improve their economic situation. Therefore, policies to address these changes need to be incorporated into overall strategies to strengthen growth.

Figure 3.5: Youth (15-24 years) who are not in employment, education or training (NEET) by gender (%), June 2014



Source: Department of Labour, Annual Labour Market Bulletin, 2014

3.3.5. Level of Educational Attainment

According to table 3.11 below, the supply of labour in the unskilled labour market is huge, while the demand for labour in that market is low. An estimated 90.7% of the labour force has matric or less, while only 9.3% has post-secondary school qualification. It is, therefore, clear that the supply of labour in the unskilled labour market in the Free State is huge, while the demand for labour in that market is low. Supply is renewed through simple population growth in the absence of good education and skills training. Demand decreases as technology provides

more efficient ways of performing the tasks. On the opposite end of the scale, the supply of labour in the highly skilled labour market is very limited and the demand very high. Only just over 2% of the Free State labour force has a degree or higher qualification. Emigration of educated and skilled population to other provinces and outside the country reduces supply and immigration of skills into the province is limited. Efficiency gains of high technology most help skilled workers to be more productive, increasing the profit from the products and services they offer, thus further increasing demand.

Table 3.11: Labour market indicators by highest level of education, 1st quarter 2015.

Highest education level	Share of Employed	Share of Unemployed	Unemployment rate	Discouraged job seeker share	Other not economically active share	Labour force share
Grade R/0	0.2%	0.0%	0.0%	0.7%	0.1%	0.1%
Grade 1/Sub A	0.9%	0.4%	16.7%	1.4%	1.5%	1.0%
Grade 2/Sub B	0.8%	0.4%	18.2%	1.4%	1.8%	1.1%
Grade 3/Standard 1	1.8%	0.9%	19.2%	2.8%	1.4%	1.5%
Grade 4/Standard 2	1.5%	0.7%	19.0%	2.1%	3.1%	1.9%
Grade 5/Standard 3	2.4%	0.9%	15.2%	2.1%	2.1%	2.0%
Grade 6/Standard 4	3.9%	3.2%	27.0%	4.9%	4.8%	4.1%
Grade 7/Standard 5	5.3%	5.2%	31.1%	5.6%	6.9%	5.9%
Grade 8/Standard 6/Form 1	6.4%	8.2%	37.0%	10.4%	10.6%	8.4%
Grade 9/Standard 7/Form 2	6.6%	9.7%	40.3%	6.9%	13.3%	9.5%
Grade 10/Standard 8/Form 3	12.0%	18.0%	40.8%	15.3%	14.3%	14.1%
Grade 11/Standard 9/Form 4	11.5%	17.1%	40.5%	14.6%	13.7%	13.5%
Grade 12/Standard 10/Form 5/Matric	29.7%	30.1%	31.8%	25.0%	16.4%	24.9%
NTC I/N1/NIC/(v) Level 2	0.1%	0.2%	50.0%	0.0%	0.3%	0.2%
NTC II/N2/NIC/(v) Level 3	0.1%	0.0%	0.0%	0.0%	0.4%	0.2%
NTC III/N3/NIC/(v) Level 4	0.1%	0.2%	50.0%	1.4%	0.1%	0.2%
N4/NTC 4	0.6%	0.0%	0.0%	0.7%	0.6%	0.5%
N5/NTC 5	0.3%	0.2%	25.0%	0.0%	0.1%	0.2%
N6/NTC 6	0.7%	0.7%	33.3%	0.7%	0.6%	0.7%
Certificate with less than Grade 12/Std 10	0.3%	0.0%	0.0%	0.0%	0.0%	0.1%
Diploma with less than Grade 12/Std 10	0.2%	0.0%	0.0%	0.0%	0.1%	0.1%
Certificate with Grade 12/Std 10	2.1%	0.7%	13.8%	0.0%	0.3%	1.1%
Diploma with Grade 12/Std 10	4.4%	1.1%	10.3%	1.4%	1.3%	2.6%
Higher Diploma	1.1%	0.2%	7.1%	0.0%	0.1%	0.5%
Post Higher Diploma (Masters; Doctoral Diploma)	0.5%	0.0%	0.0%	0.0%	0.3%	0.3%
Bachelor's Degree	2.8%	0.2%	2.9%	0.0%	0.6%	1.4%
Bachelor's Degree and Post Graduate Diploma	0.4%	0.0%	0.0%	0.0%	0.0%	0.2%
Honours Degree	0.7%	0.0%	0.0%	0.0%	0.0%	0.3%
Higher Degree (Masters/PhD)	0.7%	0.0%	0.0%	0.0%	0.1%	0.3%
Other	0.2%	0.0%	0.0%	0.0%	0.1%	0.1%
Do not know	0.5%	0.4%	25.0%	0.0%	0.1%	0.3%
No schooling	1.5%	1.3%	29.2%	2.8%	4.8%	2.7%
N=	100.0%	100.0%	31.5%	100.0%	100.0%	100.0%

Source: Statistics South Africa, SuperWeb, Quarterly Labour Force Survey, 1st Quarter 2015

Unemployment in the Free State is highest among those with no Grade 12/Matric as illustrated in table 8 above. For those with just Grade 12/Matric, the unemployment rate is estimated at around 31.8%. To make matters worse, those leaving school without Grade 12/Matric have the highest unemployment rate at around 40%.

What table 3.11 above is essentially saying is the following:

1. A matric/national certification without university exemption subjects and marks is poor preparation for employment. About 24.9% of the labour force has it and just over a third of them are unemployed. In the first quarter of 2015, this group represented around 30.1% of unemployed Free State residents.
2. Worse than completing a national certificate is leaving school without one. Nearly half (40.5%) of those with Standard 9 / Grade 11 and wanting to work are unemployed.
3. An overwhelming 95.8% of the discouraged job-seekers are those with only Grade 12 or less.
4. Unemployment is most prominent amongst the less skilled (i.e. those with Grade 12 or less). The evidence lends greater support to the hypothesis that education reduces the likelihood of unemployment.
5. A key feature of structural unemployment is that unemployment isn't universal. Pockets experience close to full employment while other groups have high unemployment. This table clearly indicates a problem of structural unemployment in the province.

Education is key to unemployment and growth. Unless it is recognised that education is the most important long-term solution to structural unemployment, and steps are taken the problem of unemployment will continue to persist in the province. Skilled labourers are by and large employed in the province, whereas unskilled labourers are unemployed at 30% to 40% levels.

3.4. Conclusion

This chapter demonstrated the importance of recent developments regarding global, national and provincial trends in labour markets. The global labour market situation remains uneven and fragile. Recent economic growth forecast for South Africa suggest that the national economy will continue to grow less than was the case before the global crisis. This complicates

the task of generating the number of jobs that are needed every year in order to meet the growing number of new entrants in the labour market. The Free State province is clearly faced with the challenge of creating jobs at quicker rates than before.

Stronger efforts are necessary to accelerate employment creation and to support the enterprises that create jobs. Active labour market policies and skills development initiatives, along with investments in public infrastructure and in strong social protection systems should be prioritized as appropriate, given national and provincial circumstances and specificities.

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