



PROVINCIAL ECONOMIC REVIEW & OUTLOOK

2018



100 Years of Nelson Mandela - The Year of Renewal, Unity and Jobs

MEC's Foreword



The pursuit of radical socio-economic transformation remains our key priority for the electoral period of 2019-2024. If we are to succeed in ensuring that radical socio-economic transformation translates to a practical change in the lived experience of our people, we must ensure that we remain focused on strengthening the three key levers to the implementation of the National Development Plan.

These are identified in the Budget Prioritisation Framework or Mandate Paper that guides the preparation of the 2018 Budget process, as follows:

- Growing the economy
- Enhancing the capabilities of South Africans and
- Building a capable state

Our Free State provincial population statistics indicate amongst others that (a) our provincial share of the national population has decreased from 5.8 % in 2002 to 5.1 % in 2017; (b) almost a third of our provincial population is concentrated in the Manguang Metro and also that (c) there were significant declines in the relative population shares of the Matjhabeng and Maluti-A-Phofung municipalities. These intra-provincial migration trends where population growth in non-urban municipalities is negative, are not accompanied by a concurrent reduction in the costs of service delivery. On the contrary, the costs of extending and expanding government services to non-urban and rural areas increases exponentially. The negative population growth trends are also reflected in the limitations faced by non-urban municipalities when it comes to development and economic growth potential and furthermore constrains revenue-raising abilities.

Furthermore, women constitute slightly more than 50 % of the provincial population but do not constitute more than 35 % of the province's labour force. Though the unemployment rate of women declined marginally, from 38.4 % in the fourth quarter of 2016 to 38.1% in the fourth quarter of 2017, it remains significantly high and requires a dedicated focus. These trends highlight the importance of local economic development and the need to capacitate and re-engineer our local municipalities.

The 2018 PERO is yet another important attempt to ensure that planning by all stakeholders within the province is sufficiently premised on the province's realities and that all interventions are in response to the needs on the grounds. In the spirit of "*Thuma mina*", I implore all to joins hands as we work for renewal, unity and jobs!

Ms. Elzabe Rockman
MEC for Finance

Executive Summary

Global and Regional Economies

Global economic activity continues to strengthen with global output estimated to have grown by 3.7 % in 2017, which is 0.5 percentage point higher than in 2016. The pickup in growth has been broad based, with notable upside surprises in Europe and Asia. Global growth forecasts for 2018 and 2019 have been revised upward by 0.2 percentage point to 3.9 per cent. The revision reflects increased global growth momentum and the expected impact of the recently approved U.S. tax policy changes. The cyclical upswing underway since mid-2016 has continued to strengthen. Some 120 economies, accounting for three quarters of world GDP, have seen a pickup in growth in year-on-year terms in 2017, the broadest synchronized global growth upsurge since 2010. We welcome the launch of the Inclusive Development Index by the World Economic Forum which provides an alternative metric of national economic performance. This index advocates for a global system that will, at its core, be greener, more equitable, and more respectful of diversity and particularly gender parity and must ensure the Fourth Industrial Revolution unfolds with humanity, not technology, at its centre.

The aggregate growth forecast for the emerging markets and developing economies for 2018 and 2019 remains unchanged, with marked differences in the outlook across regions. Emerging and developing Asia will grow at around 6.5 % over 2018–19, broadly the same pace as in 2017. The region continues to account for over half of world growth. Growth is expected to moderate gradually in China and to pick up in India. In Latin America, the recovery is expected to strengthen, with growth of 1.9 % in 2018 (as projected in the fall) and 2.6 % in 2019.

The growth pickup in Sub-Saharan Africa (from 2.7 % in 2017 to 3.3 % in 2018 and 3.5 % in 2019) is characterized by a modest upgrade to the growth forecast for Nigeria, but more subdued growth prospects in South Africa at an estimated 1.5 %. Positive indicators such as the stabilization of inflation, the strengthening of our currency and emerging positive indications of investor sentiment and business confidence have the inherent potential of supporting our economic recovery trajectory.

Free State Economy

The economy of the Free State province currently remains constrained in growth terms. The economy has experienced a recession in 2015, followed by a stagnation in 2016 and a projected reversion to a recession in 2017. One of the biggest factors which played a role in the dire performance of the provincial economy in 2015 and 2016 is the 2015/16 drought and the subdued commodity prices, which only started recovering late in 2016.

The size of the primary and secondary industries are declining, whilst the size of the tertiary industry is increasing. The Free State Provincial Economic Development Strategy indicates agriculture, mining, manufacturing, tourism and transport as instrumental industries to “attract, retain and grow investment, business and talent, create jobs, and reduce inequality and poverty, in an environmentally sustainable manner”. What is a challenge is that the sizes of four of these industries are currently declining in the province.

The share of primary industries has declined from 17.7 per cent in 2007 to 14.7 per cent in 2016, which represents a 3 percentage point decline. Over the period, the share of mining had also decreased by 2.8 percentage points, due to 1) the weak global demand for energy and non-energy commodities, 2) industrial action in the coal industry.e.g. in 2015, 3) milder winter weather inducing weaker internal demand for coal, 4) low confidence levels, 5) electricity-supply constraints, 6) rising input costs and 7) infrastructure constraints. The agricultural industry also faced challenges induced by the 2015/16 drought, and its share has declined by 0.2 percentage points between 2007 and 2016.

The secondary industries' share decreased from 19.1 per cent in 2007 to 18.7 per cent in 2016, which is equivalent to a 0.4 percentage point decrease. Amongst this group of industries, manufacturing has declined the most by 2.7 percentage points over the period. Manufacturing in the Free State is mainly reliant on the performance of Sasol, which could have been negatively affected by declining coal production and declining oil prices in 2014. The share of the construction industry declined by 0.1 percentage point between 2007 and 2016, possibly due to a lower business confidence as well as fiscal consolidation. Conversely, the share of the electricity industry has increased by 2.4 percentage points between 2007 and 2016.

The share of the tertiary industries increased from 63.1 per cent in 2007 to 66.6 per cent in 2016, largely due to the trade as well as the community services industries. The trade industry increased by 1.7 percentage points, whilst the community services industry increased by 2.0 percentage point over the period. The biggest increase in the share of the trade industry was detected in wholesale and commission sale sub-industry (1.1 percentage points) and the single biggest increase in the share of community services was detected in public administration & defence activities (6.9 percentage points). The finance industry increased by a minute 0.1 percentage point, whilst the transport industry is the only tertiary that declined (by 0.4 percentage points over the reference period).

The largest industries in the Free State in 2016 were community services (25.1 per cent), finance (17.0 per cent) and trade (13.9 per cent), whilst the smallest industries in the province were construction (2.4 per cent), electricity (4.7 per cent) and agriculture (4.8 per cent), respectively.

The Free State economy grew by an average of 1.5 per cent between 2007 and 2016, whilst the South African economy grew by an average of 2.1 per cent during the same period. In the two years preceding the economic recession in 2009, the Free State economy grew by 3.7 per cent and 2.6 per cent respectively. However, post the recession (2010-2016), the Free State only managed a meagre 1.6 per cent average growth rate. The provincial economy remained stagnant in 2016 due to the continuation of the drought and the subdued commodity prices.

The Free State economy is estimated to have contracted by 0.7 percent in 2016, after growing by 0.4 percent in 2015. The negative growth rate of the provincial economy is primarily informed by the following factors:

- The slowdown in the agriculture sector mainly as a result of drought;
- Declining output and low prices for commodities coming from our province;
- Stagnated manufacturing; as well as
- Marginal growth in the government and community services sector.

In 2018, the provincial economy is projected to recover and grow by 0.4 per cent. Finance, agriculture and transport are likely to grow the fastest in 2018, based on a recovering economy, although the base effect of the high growth in agriculture in 2017 will wither in 2018. The

provincial economy is projected to grow by 1.1 per cent on average over the next four years, reaching a high of 1.8 per cent in 2020.

The Free State Labour Market

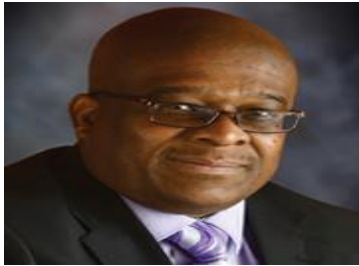
The current socio-economic situation in the Free State poses the challenge of providing opportunities for the integration of the marginalised and excluded population into productive activities and the general mainstream economy primarily through employment and general labour market participation. Eradicating unemployment is one of the major challenges faced by the Free State.

There has been some improvement in the provincial labour market in the past year. The Free State's unemployment rate decreased from 34.7 per cent in Q4: 2016 to 32.6 per cent in Q4: 2017. Over the reference period, the labour force increased by 35 000, due to the increase in the number of employed people (48 000), the decline in the number of unemployed people (13 000) as well as the decline in the number of not economically active individuals (29 000). The end of the 2015/16 drought resulted in the growth of agricultural industry by an estimated 12.8 per cent in 2017, which stimulated job creation in the agricultural industry (13 000). Other industries which contributed to job creation in Q4:2017 include finance (33 000) and construction (21 000).

Unemployment in the province exhibits certain demographic characteristics, in particular, unemployment is concentrated amongst black Africans, the less educated, the youth, women and those without prior work experience. The average unemployment rate of the African population (32.5 per cent) was higher than the provincial unemployment rate (29.6 per cent) between 2007 and 2016. All other populations in the province have average unemployment rates that is lower than the provincial average: White population (6.6 per cent), Asian population (11.5 per cent) and the Coloured population (28.1 per cent). The labour market, therefore, remains untransformed along racial lines with the African population bearing the brunt of unemployment. The Radical Economic Transformation strategy will continue to play a role to ensure inclusivity of those marginalised from participation in the mainstream economy.

Inclusive economic growth is vital for radical socio-economic transformation and development in the province. Anchored on education, training and skills development, entrepreneurship and

job-creation, local spaces are focal points for achievement of sustainable development goals (SDGs). There is thus a need to identify obstacles to growth at local municipality level and design customised interventions to unlock economic potential, including capacitation and resourcing of local municipalities. Sustainable economic growth and development should improve fiscal sustainability and service delivery through amongst others increased revenue at local government level.



Mr. Godfrey Mahlatsi
CEO: Free State Provincial Treasury

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CHAPTER 1: GLOBAL AND NATIONAL MACROECONOMIC PERFORMANCE

Key Findings

- The global economy is estimated to have grown by 3.7 per cent in 2017, up from the 3.2 per cent growth in 2016.
- It is projected to accelerate further from 3.7 per cent in 2017 to 3.9 per cent in 2018.
- Impediments to the acceleration of global growth in 2018 include trade protectionism, and the resultant trade war, which may occur in the two biggest economies (USA and China).
- Nevertheless, the acceleration of global economic growth in 2018 will be due to EMDEs, as the growth of this group is projected to increase from 4.7 per cent in 2017 to 4.8 per cent in 2018.
- In particular, China will maintain its growth above 6 per cent, growing by 6.6 per cent in 2018
- The growth of the Indian economy will accelerate from 6.7 per cent in 2017 to 7.4 per cent in 2018, post the 2016 demonetization shock and the implementation of Goods and Services Tax in 2017.
- Both Russia and Brazil will maintain a positive growth of 1.7 per cent and 1.9 per cent respectively post their 2016 recessions.
- The growth of the SSA region is projected to accelerate from 2.7 per cent in 2017 to 3.3 per cent in 2018, as commodity prices recover, the pass-through effects of the 2015/16 drought disappear and domestic demand within the region recovers.
- South Africa grew by a better-than-expected 1.3 per cent in 2017, and this growth is projected to accelerate to 1.5 per cent in 2018.
- The primary industry was mainly responsible for the growth of the country in 2017; agriculture grew by 17.7 per cent whilst mining grew by 4.6 per cent in the same year.
- In 2018, the domestic economy will likely benefit from 1) the removal of perceived political uncertainty, 2) greater policy certainty, 3) improved investor confidence, 4) inflation remaining within the target band, 5) increased trade opportunities within Africa under the African Continental Free Trade Agreement, amongst others.
- However, the implementation of additional fuel levy, the increase in RAF and the increase in VAT from 14 per cent to 15 per cent in the context of rising oil prices may dampen consumer confidence in South Africa and pose as a downside risk for growth in 2018

1.1 GLOBAL ECONOMIC PERFORMANCE

The global economy is estimated to have grown by 3.7 per cent in 2017, which represents a 0.5 percentage point increase from the 3.2 per cent growth in 2016 (IMF, 2018). Stronger growth is predicted for both advanced and emerging market and developing economies in 2017, with the fiscal policy stimulus to be implemented by the USA still on track, but assumed to be less expansionary than previously predicted. Growth is predicted to have also increased in the Euro Area as well as Japan, due to an upsurge in economic activity in both regions in 2017 which began in 2016. In emerging market and developing economies, growth is predicted to have been supported by strong growth in China, which is estimated to have been 6.8 per cent in 2017. The growth of the Indian economy may have weakened slightly in 2017, mainly reflecting the country's business adjustment to the introduction of the Goods and Services Tax introduced in July 2017 and the pass-through effects of a temporary consumption shock in the economy. Other large EMDE countries such as Brazil and Russia are expected to have exited their 2016 recessions and shown growth in 2017. The growth of the global economy appears to have been supported by an increase in commodity prices, an increase in investment and easier financial conditions, amongst other reasons. However the risks to the global economy remain skewed to the downside.

Such risks include 1) increase in interest rates in the USA, which could trigger a faster pace of tightening in global financial markets, 2) a possible future market correction following an unusual positive market valuations and low volatility in the context of high policy uncertainty, 3) inward-looking trade policies, 4) geo-political tensions and 5) terror attacks, amongst. China's strong credit growth is assumed to be unsustainable, and may trigger monetary policy tightening in the medium term, which may have an effect on global demand in the medium term.

Table 1.1 below shows that the growth of the global economy is projected to increase from 3.7 per cent in 2017 to 3.9 per cent in 2018, which represents a 0.2 percentage point increase in global growth. The IMF (2018) anticipates that the higher expectation of the global growth will be due to advanced economies, which are projected to collectively grow above 2 per cent in 2018. With the current favourable financial conditions and strong sentiment, demand will continue to accelerate, particularly in investment, with noticeable impact in economies with large exports. Also, the anticipated fiscal stimulus through tax reform in the USA is expected

to temporarily increase the country's growth, and have positive demand-side spill-overs for the country's trading partners.

Growth of EMDEs is also expected to increase from 4.7 per cent in 2017 to 4.9 per cent in 2018. China's growth is expected to moderate by 0.2 percentage points in 2018, but remain high above 6 per cent. India's growth is projected to rebound in 2018 when the effects of the temporary consumption shock have withered whilst Brazil and Russia will continue to display positive growth following from 2017. On the African continent, growth of the Sub Saharan Africa region is projected to accelerate by 0.6 percentage points, boosted by the continuous recovery in commodity prices as well as other idiosyncratic factors. The World Bank (2017) states that an increase in commodity prices, recovering industrial activity, stabilizing investment and improved confidence amongst commodity exporters may benefit global growth. Growth will also continue to be robust amongst commodity importers, even though the windfalls of previously low commodity prices are diminishing.

The IMF (2018) predicts that the collective global economic growth will remain unchanged from its 2018 level at 3.9 per cent in 2019. However, the reduction in growth of the advanced economies from 2.3 per cent in 2018 to 2.2 per cent in 2019 will be counteracted the continuous acceleration of the EMDEs' growth from 4.9 per cent to 5.0 per cent over the period. The World Bank (2018) also predicts an acceleration in growth of the EMDE group in 2019, based on assumptions of an improved global manufacturing activity and robust global trade, broadly favourable financing conditions, and firming commodity prices, amid an investment-led recovery in advanced economies. Risks to global trade and a possible trade war remain, as evident in the March 2018 announcement by the USA to increase steel tariffs for producers outside of North America by 25 per cent.

Table 1.1 Global economic performance

	Year-on-Year			
	Actual		Projections	
	2015	2016	2017	2018
World Output	3.4	3.2	3.7	3.9
Advanced Economies	2.1	1.7	2.3	2.3
United States	2.6	1.5	2.3	2.7
Euro Area	2.0	1.8	2.4	2.2
Germany	1.5	1.9	2.5	2.3
France	1.1	1.2	1.8	1.9
Italy	0.8	0.9	1.6	1.4
Spain	3.2	3.3	3.1	2.4
Japan	1.1	0.9	1.8	1.2
United Kingdom	2.2	1.9	1.7	1.5
Canada	0.9	1.4	3.0	2.3
Other Advanced Economies	2.0	2.3	2.7	2.6
Emerging Market and Developing Economies	4.3	4.4	4.7	4.9
Commonwealth of Independent States	-2.2	0.4	2.2	2.2
Russia	-2.8	-0.2	1.8	1.7
Excluding Russia	-0.5	1.9	3.1	3.4
Emerging and Developing Asia	6.8	6.4	6.5	6.5
China	6.9	6.7	6.8	6.6
India	8.0	7.1	6.7	7.4
ASEAN-5	4.9	4.9	5.3	5.3
Emerging and Developing Europe	4.7	3.2	5.2	4.0
Latin America and the Caribbean	0.1	-0.7	1.3	1.9
Brazil	-3.8	-3.5	1.1	1.9
Mexico	2.6	2.9	2.0	2.3
Middle East, North Africa, Afghanistan, and Pakistan	2.7	4.9	2.5	3.6
Saudi Arabia	4.1	1.7	-0.7	1.6
Sub-Saharan Africa	3.4	1.4	2.7	3.3
Nigeria	2.7	-1.6	0.8	2.1
South Africa*	1.3	0.6	1.3	1.5
Low-Income Developing Countries	4.6	3.6	4.7	5.2

Source: IMF, World Economic Outlook, January 2018, *Statistic South Africa; Gross Domestic Product, First Quarter 2018

1.1.1 Growth trends in Advanced economies

The aggregate growth of advanced economies is projected to have accelerated from 1.7 per cent in 2016 to 2.3 per cent in 2017. Notable increases in activity were evident in the 3rd quarter

of 2017 in Germany, Japan, Korea and the United States whilst an increase in investment, particularly from this group of countries, has benefited world trade in 2017 (IMF, 2018). The World Bank (2018) also attributes the rebound of advanced economies in 2017 to an increase in capital spending, a turnaround in inventories, and strengthening external demand, with the improvement in growth markedly stronger than expected in the Euro Area.

The growth of advanced economies in 2018 is projected to remain unchanged from the 2.3 per cent growth of 2017. This forecast may reflect the unwinding of a cyclical upturn in investment and further normalization of monetary policy, as advanced economy move closer to full output potential. Table 1.2 below focuses on some advanced economies who form part of the G7 countries and their economic performances.

Table 1.2 Advanced Economies Economic Data

	Real GDP growth			CPI (% changes)		
	Actual	Expected		Actual	Expected	
	2016	2017	2018	2016	2017	2018
Advanced Economies						
USA	1.5	2.3	2.7	1.3	2.1	2.1
Euro Area	1.8	2.4	2.2	0.2	1.5	1.4
United Kingdom	1.9	1.7	1.5	0.7	2.6	2.6
Japan	0.9	1.8	1.2	-0.1	0.4	0.5
	Current Account balances (% of GDP)			Official unemployment rates		
	Actual	Expected		Actual	Expected	
	2016	2017	2018	2016	2017	2018
USA	-2.4	-2.4	-2.6	4.9	4.4	4.1
Euro Area	3.5	3.1	3.0	10.0	9.2	8.7
United Kingdom	-4.4	-3.6	-3.3	4.9	4.4	4.4
Japan	3.8	3.6	3.8	3.1	2.9	2.9

Source: IMF, World Economic Outlook, October 2017 & January 2018

United States (USA)

The IMF (2018) anticipates that the growth of the USA economy may have increased from 1.5 per cent in 2016 to 2.3 per cent in 2017, which represents a 0.8 percentage point increase between the two years. Although economic activity in the USA was held back by inventory adjustment and weak investment in 2016, the higher growth expected in 2017 may have been mainly supported by a cyclical recovery in private investment and manufacturing, as well as an increase in confidence in the USA (IMF, 2017). A possible fiscal policy easing is expected

from 2018, which will increase the country's growth rate from 2.3 per cent in 2017 to 2.7 per cent in 2018. This fiscal stimulus may involve a decrease in personal and corporate taxes in the USA, which will be concentrated both in 2018 and 2019; however, reforms to infrastructure spending will still remain neutral in these years. The risk that might be created by this fiscal stimulus is an increase in the USA's budget deficit. Also, much uncertainty remains over the impact of the policy mix to be implemented by the USA, as the fiscal stimulus might cause demand to increase, which can fuel inflation, which will create an incentive to increase the pace of monetary policy tightening.

Inflation in the USA is projected to have risen from 1.3 per cent in 2016 to 2.1 per cent in 2017, which represents a 0.8 percentage point increase. USA prefers a minimum inflation rate of 2 per cent as an inflation rate that is too low causes deflationary pressures which may hamper economic growth due to an even-lower inflation expectation which leads to delayed current demand and consumption. The inflation rate in the USA in 2017 is benefitting from an increase in commodity prices, particularly energy prices, which have put upward pressure on its headline inflation as a net-commodity importer. The IMF (2017) indicates that the global producer price inflation has been increasing noticeably since August 2016, which indicates the significant role that commodity prices (as intermediate goods) have played to increase inflation globally since 2016.

In 2018, the inflation rate of the USA is projected to remain the same as the 2017, which is 2.1 per cent. The IMF (2018) assumes that the inflation rate of the country will remain unchanged in spite of the rise in domestic demand and rising oil prices, due to low sensitivity of core inflation to a reduction in slack in activity from recent years as well as the expected increase in interest rates in the USA.

The current account deficit of USA in 2017 is projected to have remained unchanged from the 2.6 per cent in 2016. However the indicator is projected to deteriorate from 2.6 per cent in 2017 to 2.8 per cent in 2018. The worsening of the current account deficit of the USA in 2018 may be due to a rise in commodity prices, as a net importer of those goods. The IMF (2017) explains that the widening of current account of the world's biggest debtor country is due to its increase in net external liabilities, particularly from 2018. The fiscal expansion to be implemented by the USA from 2018 will increase its domestic demand and lead to a wider current account deficit, through imports. It is almost predictable that the current account deficit of the country

will deteriorate further over a couple of years to come, as the implementation of infrastructure spending will require inputs to production that may need to be imported e.g. steel. It is worth noting that perhaps the implementation of the proposed import tariffs on steel by the USA in 2018 will partially counteract the predicted widening the current account deficit.

The unemployment rate in the USA has projected to have declined from 4.9 per cent in 2016 to 4.4 per cent in 2017, and to improve further to 4.1 per cent in 2018. As previously indicated in PERO 2017, the new administration of the USA is anticipated to apply fiscal stimulus to stimulate demand, growth and employment, whilst the cabinet is expected to seek trade policies for job creation in the USA. The expectation of improvements in economic growth and implementation of corporate tax reductions in 2018 may already be affecting hiring decisions in 2017, thereby assisting to decrease unemployment both in 2017 and 2018. Also, the reduction in personal tax in 2018 may increase domestic demand, which will stimulate the economy and hiring decisions as well.

Euro Area

The growth of the Euro Area is projected to have increased from 1.8 per cent in 2016 to 2.4 per cent in 2017, which represents a 0.6 percentage point increase over the period. Stronger activity in the first quarter of 2017 in the region has been recorded in the region. The IMF (2018) also indicates stronger growth was visible in 2017, especially for Germany, Italy, and the Netherlands, reflecting the stronger momentum in domestic demand and higher external demand. However, the Euro Area's growth is projected to slightly decline from 2.4 per cent in 2017 to 2.2 per cent in 2018, due to 1) slowdown of accommodative policies previously implemented by the ECB, 2) uncertainty w.r.t the direction of Brexit negotiations, 3) uncertainty w.r.t changes of the USA trade policies given that USA is the largest destination of Euro Area's exports and 4) the fragility of the EA's financial sector due to non-performing bank loans within some economies of the EA. The EA also faced terror attacks in 2017 e.g. Spain, which might continue to affect tourism in the future. Long term challenges in the Euro Area remain high public and private debt, aging population and low total factor productivity growth, as well as low investment.

The inflation rate of the Euro Area is projected to have drastically increased from 0.2 per cent in 2016 to 1.5 per cent in 2017, which represents a 1.3 percentage point increase between the two years. The inflation rate remains below the central bank's target of 2 per cent, but it was

likely boosted by an increase in internal demand, an increase in energy and food prices from a lower base, as well as a weaker euro, which likely fuelled imported inflation through increased external demand. Also, monetary policy in the region remains accommodative through low interest rates implemented by the European Central Bank. The inflation rate of the region is projected to slightly decline from 1.5 per cent in 2017 to 1.4 per cent in 2018, based on reduced growth in the Euro Area due to reasons listed in the previous paragraph.

The Euro Area has a positive current account balance, which is projected to have declined from 3.5 per cent in 2016 to 3.1 per cent in 2017, and is projected to decline further to 3.0 per cent in 2018. The declining current account surplus of the region between 2016 and 2018 is expected, given a rise in oil prices impact on commodity-importers such as the Euro Area. The region may also be negatively affected by inward-looking changes to trade policy to be implemented by the USA, since the USA is the single biggest destination of Euro Area exports.

The official unemployment rate of the Euro Area is projected to have improved, by declining from 10.0 per cent in 2016 to 9.2 per cent in 2017. The unemployment rate of the region is projected to further decline to 8.7 per cent in 2018. The region's unemployment rate could be improving due to low interest rates, which may stimulate economic activity and hiring decisions. Given that the pass-through effects of a movement in interest rates take almost 2 years to be fully felt, the impact of the current accommodative monetary policy of the ECB may remain in the medium term. As previously indicated.

United Kingdom

The growth of United Kingdom is projected to have decelerated from 1.9 per cent in 2016 to 1.7 per cent in 2017, and to decline further to 1.5 per cent in 2018. This is in line with the IMF's prediction that the fiscal stance of the UK would be contractionary in 2017 (IMF, 2017). The UK has been performing stronger than expected since 2016, with minimal and gradual effects of the aftermath of the decision by the country to leave the European Union. However, the economy faces downside risks over the medium term. The depreciation of the pound may reduce consumers' purchasing power. Also, it is assumed that there is high uncertainty w.r.t future private investment, and that the barriers to trade and migration will increase between the UK and EU. Lastly, financial services will be reduced in the UK with the reduction in cross border financial services between the UK and EU.

The inflation in the UK is projected to have increased from 0.7 per cent in 2016 to 2.6 per cent in 2017, and remain stable at 2.6 per cent in 2018. The Bank of England's target for inflation is 2 percent, and inflation in the country in 2017 may have been boosted by the depreciation of the Pound, as well as rise in energy prices globally. Also, the Bank of England has thus far implemented an expansionary monetary policy to stimulate internal demand and reduce the effects of the reduced investor sentiment following the Brexit decision.

The UK had a current account deficit of 4.4 per cent in 2016, which is projected to have improved to 3.6 per cent in 2017, and is projected to narrow down further to 3.3 per cent in 2018. There is a possibility of increased restrictions with regards to trade (and migration) between the UK and the EU, which will likely negatively affect the current account balance of the UK going forward. The size of the current account deficit remains uncertain going forward, given that the conditions for a Brexit still needs to be established and the UK will have to negotiate new trade agreements with other countries.

The official unemployment rate of the United Kingdom is projected to have declined from 4.9 per cent in 2016 to 4.4 per cent in 2017, and is projected to remain at 4.4 per cent in 2018. Although the economic growth rate of the UK has deteriorated in 2017, the improvement of the unemployment rate may indicate an increased number of inactive individuals in 2017. In the near future, the decision for Brexit will likely affect hiring decisions. The UK's desire to impose restrictions on migration has a potential to negatively affect future internal demand and hiring decisions as well. However, the impact of a possible reduction of the industries such as the financial services on the labour market in the UK remains uncertain.

Japan

The growth of the Japanese economy is projected to have increased from 0.9 per cent in 2016 to 1.8 per cent in 2017, as economic activity has been increasing since 2016 and has continued into 2017 in the country. Japan has experienced an increase in private consumption, investment and net exports in 2017, which supported growth. Although Japan may have benefited from increased external demand in 2017, with carryover effects into 2018, the growth of the country is projected to decline from 1.8 per cent in 2017 to 1.2 per cent in 2018. Global oil prices have been rising since the end of 2016 and have continued to strengthen into 2018. Also, although both fiscal and monetary policy have been accommodative in Japan in previous years, the IMF (2017) and the World Bank (2018) assume a fiscal support will be withdrawn in the country in

2018, which will negatively affect growth. The preparation of the 2020 Tokyo Olympics will have a positive impact on private investment, but the IMF (2017) assumes that increase in imports may outweigh this benefit.

The deflation of 0.1 per cent experienced in Japan in 2016, caused by lower energy prices and a stronger yen, is projected to have improved as the inflation rate may have increased to 0.4 per cent in 2017. The reversal of inflation to a positive territory of 0.4 per cent in 2017 may be due to a rise in energy prices, building wage-price pressures and a weakened Yen. Inflation in Japan will remain positive in 2018, and is projected to slightly increase from 0.4 per cent in 2017 to 0.5 per cent in 2018. Japan's inflation remains stubbornly low and below the central bank's aim of an inflation rate of 2 per cent, as price growth remains low in the country and core inflation remains low. The slight improvement of inflation in Japan in 2018 reflect rising oil prices as well as a weaker Yen.

Japan's current account surplus is projected to have declined from 3.8 per cent in 2016 to 3.6 per cent in 2017, possibly due to the impact of rising energy prices. The current account surplus of Japan is projected to improve and rise from 3.6 per cent in 2017 to 3.8 per cent in 2018. Even though the increase in energy prices will likely have a downward pressure on the positive current account balance, the current account surplus may increase due to a weakening Yen (IMF, 2018), and increased exports.

The Japanese unemployment rate is projected to have declined from 3.1 per cent in 2016 to 2.9 per cent in 2017; the economic indicator is projected to remain at 2.9 per cent in 2018. Japan has the lowest unemployment rate amongst OECD countries, tying with Iceland for the top position in 2016. This low unemployment rate, although desired by most countries, is reflecting structural challenges of an aging population and a shrinking labour force in Japan. It goes against expectation that the country's ratio of job offers to job seekers was at its highest in 2016 in 43 years, hitting 1.48 (148 job offers for 100 job seekers) when the economy is no longer in its booming years.

1.1.2 Growth trends in Emerging markets and developing economies

The World Bank (2017) predicts that growth of emerging market and developing economies strengthened in 2017 and will strengthen further in 2018. The IMF quantified the growth of these collective group of countries, that the group's growth may have increased from 4.4 per cent in 2016 to 4.7 per cent in 2017, boosted by a recovery in commodity prices, amongst other reasons. Commodity exporters have had to make structural adjustments to the economic growth rate tools since the commodity slump, whilst the recovery of commodity prices since 2016 has boosted their economic prospects in 2017 and likely in 2018 as well. Although the growth of commodity importers remains bust and they have gained windfalls from commodity prices that were decreasing during the commodity slump, their windfalls are diminishing. It is predicted that the growth of the seven largest EMDEs (China, India, Russia, Brazil, Mexico, Turkey and Indonesia) will increase over the medium term, and that these group of countries will collectively play an increasingly important role in the global economy (World Bank, 2017). Table 1.3 below facilitates the discussion on some of the most globally influential emerging markets and developing economies, including South Africa.

In 2018, emerging market and developing economies will collectively benefit from strong growth in China (6.6 per cent) and India (7.4 per cent), continued positive growth rates for both Russia (1.7 per cent) and Brazil (1.9 per cent), which were in recession in 2016, as well as stable high growth for the ASEAN-5 (5.3 per cent), better than expected performance of some countries in emerging and developing Europe as well as an increase in SSA's growth (3.3 per cent) based on rising commodity prices and gradually increasing domestic demand in the region.

Table 1.3. Emerging Economies Economic Data

	Real GDP growth			CPI (% changes)		
	Actual	Expected		Actual	Expected	
	2016	2017	2018	2016	2017	2018
Emerging Economies	6.7	6.8	6.6	2.0	1.8	2.4
China	6.7	6.8	6.6	2.0	1.8	2.4
India	7.1	6.7	7.4	4.5	3.8	4.9
Brazil	-3.5	1.1	1.9	8.7	3.7	4.0
Russia	-0.2	1.8	1.7	7.0	4.2	3.9
South Africa*	0.6	1.3	1.5	6.4	5.3	5.3
Nigeria	-1.6	0.8	2.1	15.7	16.3	14.8
	Current Account balances (% of GDP)			Official unemployment rate		
	Actual	Expected		Actual	Expected	
	2016	2017	2018	2016	2017	2018
China	1.7	1.4	1.2	4.0	4.0	4.0
India	-0.7	-1.4	-1.5	n/a	n/a	n/a
Brazil	-1.3	-1.4	-1.8	11.3	13.1	11.8
Russia	2.0	2.8	3.2	5.5	5.5	5.5
South Africa	-3.3	-2.9	-3.3	26.7	27.6	28.3
Nigeria	0.7	1.9	1.0	13.4	n/a	n/a

Source: IMF, World Economic Outlook, October 2017 & January 2018; Statistics South Africa, Gross Domestic Product, First Quarter 2018

China

China's economic growth is projected to have slightly increased from 6.7 per cent in 2016 to 6.8 per cent in 2017; however the country's growth may decelerate to 6.6 per cent in 2018. The anticipated stronger growth of China in 2017 reflects continued fiscal support and the effects of reforms, as well as a stronger-than expected recovery of exports and a slight positive contribution from net trade (World Bank, 2018). What has been sustaining high growth in China is continued policy support through affordable credit as well as public spending on infrastructure, which was offsetting the slower pace of private investment (World Bank, 2017). However the future reversal of easy credit presents financial sector vulnerabilities which might spill over to other EMDEs.

In 2018, the growth rate of China is projected to decelerate due to policies tightening, and that the economy faces downside risks such as financial sector vulnerabilities previously mentioned, increased trade protectionism from countries such as the USA e.g. with regards to increases in steel tariffs and rising geopolitical tensions. Long-term fundamental drivers of potential growth point to a further slowdown in China's growth over the next decade, as

population aging is expected to depress labour supply. However, China still seeks to reach its target of doubling its 2010 real GDP by 2020 (IMF, 2017).

Inflation in China is projected to have declined from 2.0 per cent in 2016 to 1.8 per cent in 2017, which represents a 0.2 percentage point reduction between the two years. Inflation in China could have eased in 2017 due to the reduction of price-support for agriculture which led to the fall of food prices from grain to pork. Even though China does not disclose the components of its CPI basket, it is assumed that food carries a great weight in the CPI index of the country. Therefore the reduction in food prices may have offset the increase in commodity prices in 2017. However, the projected upsurge of inflation from 1.8 per cent in 2017 to 2.4 per cent 2018 may reflect the pass-through effects of an increase in short term interest rates at the beginning of 2017, as well as the tightening of macro-prudential regulations (e.g. banks' capital requirements, lenders' extension of mortgage loans, etc.) to address financial stability risks. Also, the base effects of low food prices in 2017 may reflect in 2018.

China is a creditor nation, however its current account surplus is projected to have declined from 1.7 per cent in 2016 to 1.4 per cent in 2017, which represents a 0.3 percentage point decline between the two years. The decline may be linked to what is currently sustaining growth in China, which is credit growth and public infrastructure spending. The country has reduced production of some primary commodities such as iron ore and coal, which has led to stronger import demand for primary commodities in the context of affordable credit. The import of these commodities, together with the importing of oil whose prices are rising, may explain the decline in the current account surplus in 2017. China's current account surplus is projected to decline further from 1.4 per cent in 2017 to 1.2 per cent in 2018

The official unemployment rate of China is projected to remain the same at 4.0 per cent between 2016 and 2018, due to various offsetting effects that are currently taking place in the country which will affect the labour market. Whilst the economy's high growth is being fuelled by affordable credit and public investment, excess capacity in manufacturing and other industries is being sort as well.

India

Whilst India is possibly the highest growing EMDE at the moment, its growth is projected to have temporarily decreased from 7.1 per cent in 2016 to 6.7 per cent in 2017, which represents

a 0.4 percentage point decline between the two years. Growth below 7 per cent in 2017 by India was caused by the temporary consumption shock induced by the demonetization (or currency exchange) initiative to curb tax evasion in the country. Also, India implemented a Goods and Services Tax which the domestic business has had adjust to in 2017. However, the economic growth rate of India is projected to increase from 6.7 per cent in 2017 and 7.4 per cent in 2018, due to strong private consumption while services are expected to continue to support economic activity. Private investment is expected to revive as the corporate sector adjusts to the GST while infrastructure spending increases, partly to improve public services and internet connectivity. Private sector balance sheet weaknesses are projected to be mitigated with the help of the efforts of the government and the Reserve Bank of India (World Bank, 2018)

Inflation in India is projected to have slightly declined from 4.5 per cent in 2016 to 3.8 per cent in 2017. However, inflation in the country is projected to increase from 3.8 per cent in 2017 to 4.9 per cent in 2018. Inflation in India may have declined in 2017 as a continuous downward trend over the past few years, mainly due to a decline in food (pulses and vegetables) and beverage prices. Also, India has benefitted from a reduction in fuel prices after the commodity boom, which could have caused inflation the country to decline from 9.4 per cent in 2013 to 5.9 per cent in 2014, and declined further after the commodity bust (of oil) after 2014. The inflation rate in India is projected to increase from 3.8 per cent in 2017 to 4.9 per cent in 2018, which may be due to an increase in commodities prices, particularly fuel. Also, higher growth rate and closing output gaps, increasing rural wages in India and minimum support prices (the price at which government purchases crops from the farmers, whatever may be the price for the crops) may increase inflation in India in 2018.

The current account deficit of India is projected to have increased from 0.7 per cent in 2016 to 1.4 per cent in 2017; the deficit is projected to further widen to 1.5 per cent in 2018. As reported in the 2017 PERO, oil and gold's import account for approximately half of all imports by India. Therefore, the current account may have deteriorated in 2017 due to increasing oil prices. Also, given that inflation may be rising in 2018, the import of more gold as a hedge against inflation may attribute to the deterioration of the country's current account balance.

The historical and current official unemployment rates for India remain unavailable at present, however it is likely that unemployment will decrease in India in 2018 and over the medium

term, based on a better performing economy and all the reforms implemented in the country in support of growth.

Brazil

The economy of Brazil is projected to have exited its recession in 2017, from a decline of 3.5 per cent in 2016 to a growth of 1.1 per cent in 2017. This economy is projected to recover further and grow by 1.9 per cent in 2018. The growth of Brazil improved in 2017 due to increased retail and industrial trade, even though the construction sector continued to contract. In 2018, the acceleration of growth will be supported by improving labour market conditions and low inflation which will support private consumption. Also, the residual effects of the deep recession will fade, and policy conditions will become more supportive of investment. Overall, the growth of Brazil will be supported by a recovery in commodity prices as a commodity exporter, as well as easing monetary policy and reforms put in place to support the economy.

Inflation rate of Brazil is projected to have declined from 8.7 per cent in 2016 to 3.7 per cent in 2017. However, the economic indicator is projected to increase from 3.7 per cent in 2017 to 4.0 per cent in 2018. Inflation the country decreased in 2017 due food price deflation (World Bank, 2018). Even though inflation will slightly rise in 2018, the relatively low inflation will continue to support private consumption.

The dissipation of the effects of past currency depreciation will likely increase the current account deficit of Brazil. During a period when the currency was depreciating, this greatly benefitted exports, therefore when the currency performs better, it discourages export demand. Therefore, the current account deficit is projected to have worsened from 1.3 per cent in 2016 to 1.8 per cent in 2018. The current account balance of the country will also be determined by contradicting effects of increasing commodity prices as commodity exporters, as well as increasing fuel prices. Lastly, given that Brazil will recover from a recession in 2017, the current account deficit might increase and stabilize at 2 per cent in the medium term as demand in the country increases.

The official unemployment rate of Brazil is projected to have increased from 11.3 per cent in 2016 to 13.1 per cent in 2017. However, the unemployment rate will decline from 13.1 per cent in 2017 to 11.8 per cent in 2018. Given that labour market conditions lag the performance of

the economy, the unemployment rate is likely to have peaked in 2017 as the economy exits a recession, and thereafter recover only in 2018.

Russia

Similar to Brazil, Russia is projected to have exited a recession in 2017, as the economy is projected to have improved from a decline of 0.2 per cent in 2016 to a growth of 1.8 per cent in 2017. The growth of the economy is projected to slightly decrease from 1.8 per cent in 2017 to 1.7 per cent in 2018. As an oil producer, Russia's exit from a recession in 2017 was likely supported by rising oil prices globally, whilst easing financial conditions will bolster domestic demand and improve confidence. Russia still faces economic sanctions imposed due to the Ukraine crisis, which will likely keep its potential growth rate at approximately 1.5 per cent.

Russia is projected to exit its recession in 2017, however, inflation may lag this change in the country's economic performance and may have declined from 7.0 per cent in 2016 to 4.2 per cent in 2017. A lesser decline of the inflation rate is expected in 2018, as the economic indicator declines from 4.2 per cent in 2017 to 3.9 per cent in 2018. The IMF (2017) gives similar reasons for declining inflation in both Brazil and Russia, that negative output gaps, the declining effects of past currency depreciation, excess supply conditions will propel inflation in Russia to decline.

With firming oil prices and the dissipating effects of past currency depreciation, the current account surplus of Russia is projected to have climbed from 2.0 per cent in 2016 to 2.8 per cent in 2017. This current account surplus is projected to increase further to 3.2 per cent in 2018. The World Bank (2017) also affirms that Russia current account balance is driven by trade balance, and that increasing oil prices and an improving ruble will support stronger current account surplus in 2017 and going forward.

Russia's official unemployment rate is projected to remain the same at 5.5 per cent from 2016 to 2018. The World Bank (2017) explains that as unemployment remains low and inflation declines in Russia, real wage-growth is restarting. "The structure of unemployment remains the same, with the gaps between male/female and rural/urban unemployment remaining stable and most unemployment still being long-term (30 percent of the unemployed had been looking for a job for at least a year). Due to low labour mobility, unemployment by regions remained very unequal and followed the national trend."

South Africa

The growth of Africa's 2nd largest economy increased from 0.6 per cent in 2016 to 1.3 per cent in 2017 (Statistics South Africa, 2018), and it is projected to increase further to 1.5 per cent in 2018 (Budget Review, 2018). The South African economy grew better than anticipated in 2017 due to the end of the 2015/16 drought, the rebound in commodity prices since 2016 as well as extra electricity-generation capacity. Other factors which may have favoured SA's growth in 2017 include the decline of the inflation rate back into the target band, and the consequential monetary policy easing, which may have stimulated internal demand. South Africa still faces challenges of consumer confidence, which may decline further in the wake of the VAT increase from 14 per cent to 15 per cent in 2018, as well as rising fuel and RAF levy costs while global oil prices continue to rise. However, the economy may benefit from the removal of perceived political discord and policy uncertainty, which will boost business confidence.

Inflation rate in South Africa has declined from an average of 6.3 per cent in 2016 to 5.3 per cent in 2017 (Statistics South Africa, 2018). Albeit IMF (2017) projects inflation to be 5.3 per cent in 2018, inflation in the country will be influenced by various idiosyncratic factors such as 1) the increase of VAT from 14 per cent to 15 per cent in 2018, 2) the increase in transportation levies in 2018 3) rising oil prices, 4) the performance of the Rand, 5) the consumer confidence, amongst other factors.

The current account deficit of South Africa is projected to have narrowed from 3.3 per cent in 2016 to 2.9 per cent in 2017. However, the economic indicator is projected to worsen from 2.9 per cent in 2017 to 3.3 per cent in 2018. South Africa's growth prospects are strengthening in 2018, and together with a strengthened Rand. A stronger Rand normally discourages exports, as it makes South African products more expensive from a foreign country's point of view. Also, as a net-importer of oil, the increase in oil prices will likely disadvantage SA's current account balance in 2018.

South Africa's high unemployment rate is projected to have increased from 26.7 per cent in 2016 to 27.6 per cent in 2017. Rising unemployment rate in SA is a reflection of weak growth in the country, low consumer welfare which negatively affects business confidence and investment decisions. The unemployment rate is projected to further worsen from 27.6 per cent in 2017 to 28.3 per cent in 2018, however these forecasts exclude recent positive events which have increased economic prospects for South Africa in 2018.

Nigeria

Nigeria is projected to have emerged from the 2016 recession caused by low oil prices and the disruption of oil production. The growth of the economy is projected to have improved from a decline of 1.6 per cent in 2016 to a growth of 0.8 per cent in 2017, due to recovering oil prices, recovering oil production and ongoing strength in the agricultural sector. The economy depends heavily on oil exports for government revenue, export earnings, foreign currency and economic growth, therefore the rising oil prices since 2016 are benefitting the country's economic growth. Also, militant attacks on oil infrastructure have decreased in the country. Lastly, following the commodity slump that negatively affected oil prices in 2014, Nigeria has implemented reforms in the economy to diversify it, which include focusing on non-oil sectors such as agriculture, manufacturing and trade. Nigeria is projected to grow further, from 0.8 per cent in 2017 to 2.1 per cent in 2018. Although growth prospects are increasing in the country, it faces downside risks which include policy implementation, market segmentation in a foreign exchange market that remains dependent on central bank interventions (despite initial steps to liberalize the foreign exchange market), and banking-system fragilities are expected to weigh on activity in the medium term.

The inflation rate of Nigeria continues to climb, and is projected to have worsened from 15.7 per cent in 2016 to 16.3 per cent in 2017. The World Bank (2018) states that the decline of Nigeria's inflation rate between 2016 and 2017 reflects the effects of poor harvests in some parts of the country on food prices. However, inflation in Nigeria is projected to improve from 16.3 per cent in 2017 to 14.8 per cent in 2018.

The current account surplus of Nigeria is projected to have improved from 0.7 per cent in 2016 to 1.9 per cent in 2017, in line with rising oil prices given that oil accounts for 90 per cent of export earnings in the country. However, the current account surplus may decline from 1.9 per cent in 2017 to 1.0 per cent in 2018, due to a combination of factors. PWC (2017) explains that the business environment in Nigeria remains challenging due to the slow pace of reforms, and the lack of a market-driven exchange rate policy puts a lid on investment. As a result, capital inflows remain below pre-recession levels, and will likely narrow the current account surplus in 2018.

The official unemployment rate of Nigeria is projected at 13.4 per cent in 2016, notably high due to the recession the country was facing. Although forecasts of the indicator are unavailable for 2017 and 2018, an improvement can be predicted given that the economy will exit the recession in 2017 and improved economic growth prospects are expected in 2017 and 2018.

1.1.3 Global Inflation Outlook

From its peak in 2011, global inflation has trended downwards as global demand and growth eased. However, this inflation is projected to have increased 2017, bolstered by the recovery of oil prices as well as other commodity prices of metals.

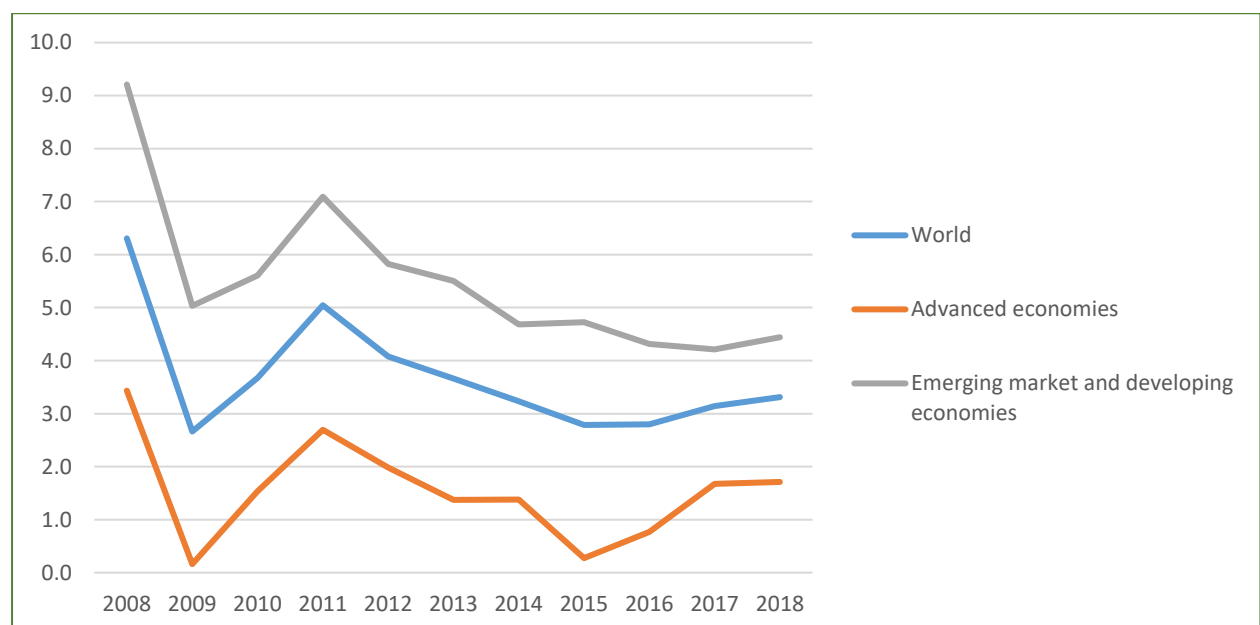
Post the recession, global inflation peaked at 5.0 per cent in 2011, and according to PERO 2017, this 2011 peaked was mainly supported by rising food and energy prices, which weighed heavily in the CPI basket. The rise in food and energy prices also put upward pressure on wages, and in the midst of accommodative monetary and fiscal policies, inflation rose. Inflation in emerging markets and developing economies reached 7.1 per cent in 2011 whilst inflation in advanced economies remained low at 2.7 per cent in 2011.

Thereafter, global inflation declined from 5.0 per cent in 2011 to 2.8 per cent in 2016, due to the onset of the commodity slump in 2012, which was further fuelled by sharp decline in oil prices in 2014. Also, the decline in global inflation coincided with slower global economic growth, with the latter declining from 4.2 per cent in 2011 to 3.2 per cent in 2016. Over the same reference period, global inflation was being propelled by inflation in emerging market and developing economies, which remained elevated although it was decline. The inflation rate amongst emerging market and developing economies declined from 7.1 per cent in 2011 to 4.3 per cent in 2016; it remained elevated due to idiosyncratic factors experienced by individual countries in this group, which included risk aversion by investors, capital outflow, currency depreciation, as well as the 2015/16 severe weather patterns. The collective inflation rate of advanced economies declined from 2.7 per cent in 2011 to 0.8 per cent in 2016, supported by low fuel- and other commodity prices.

Global inflation is projected to have picked up from 2.8 per cent in 2016 to 3.1 per cent in 2017, and the IMF (2017) states that higher commodity prices have helped elevate headline

inflation and reduced disinflationary pressures which were witnessed in advanced economies. The impact of rising commodity prices has been evident due to a marked increase in global producer price index, where commodity prices carry a higher weight. The increase in commodity prices has been bolstered by OPEC and some non- OPEC members’ extended agreement to decrease oil output in 2017, geo-political tensions in the Middle East which may have affected oil output, the temporary disruption in shale gas production in the USA following Hurricane Irma, China reduction in iron ore production and its subsequent external demand for iron ore and coal since late 2016, etc.

Figure 1.1: Global Inflation (% Change)



Source: IMF, World Economic Outlook, October 2017

Therefore, the IMF (2017) predicts that the inflation rate in advanced economies may have risen from 0.8 per cent in 2016 to 1.7 per cent in 2017, even though wage and core-price inflation remains weak. The inflation rate of EMDEs is projected to have slightly declined from 4.4 per cent in 2016 to 4.2 per cent in 2017, following a temporary decline in oil prices between March and July in 2017 (IMF, 2017), which weakened headline inflation. Core inflation amongst EMDEs may have also declined in 2017, owing mainly to the waning pass-through effects of past currency depreciations, as well as the appreciation of the dollar. Also, the drop in food-price inflation in India and excess capacity in Brazil could have also negatively affected core inflation amongst EMDEs in 2017. Global inflation, as well as inflation in

EMDEs is projected to slightly accelerate between 2017 and 2018, whilst inflation in advanced economies is projected to remain the same over the period.

The difference between an economy’s actual output and its potential output at full capacity is an output gap and is expressed as percentage of GDP. A negative output gap indicates the actual output of the economy is below its maximum potential output. Table 1.5 below shows that the negative output gap amongst advanced economies has declined from 1.4 per cent in 2014 to an estimated negative 0.2 per cent in 2017. It is projected to the output gap of these group of countries will switch from a negative 0.2 per cent in 2017 to a positive 0.1 per cent in 2018. The improving output gap may be a reflection that potential growth has declined due to e.g. crisis legacies, aging population in Japan and Euro Area, and that actual growth is growing above potential growth in some countries e.g. USA, and Euro Area.

An improving output gap shows that these advanced economies are operating closer towards their full capacity and efficiency. Therefore, a reduction in the unemployment rate in advanced economies is expected. The unemployment rate of advanced economies has collectively declined from 7.3 per cent in 2014 to an estimated 5.7 per cent in 2017. The unemployment rate is projected to decline further from 5.7 per cent in 2017 to 5.4 per cent in 2018, as the output gap turns positive. Even though the output gap for advanced economies is expected to be positive in 2018 and the unemployment rate is expected to fall in the same year, the inflation rate is projected to remain the same in 2017 and 2018, possibly reflecting that wage and core-price inflation remain weak (IMF, 2018).

Table 1.4: Output gaps and unemployment rates in advanced economies

Advanced economies	2014	2015	2016	2017	2018
Output gap	-1.4	-0.9	-0.8	-0.2	0.1
Unemployment Rate	7.3	6.7	6.2	5.7	5.4

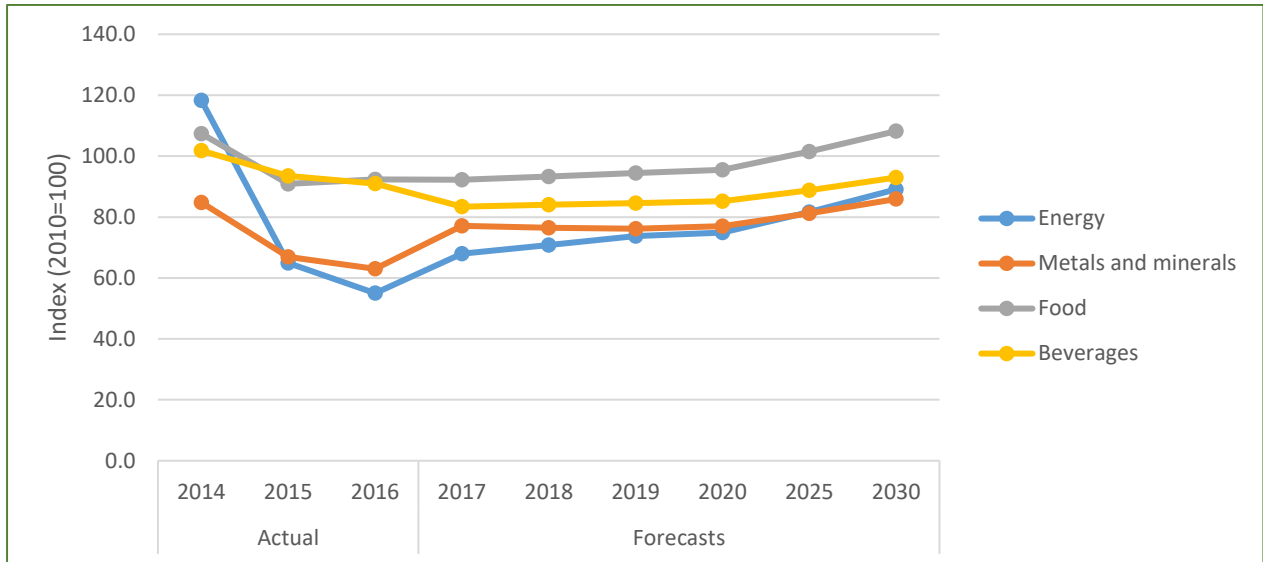
Source: IMF, World Economic Outlook, October 2017

1.1.4 Commodity Prices

Commodity prices fell from 2011-2012 in response to the commodity slump caused by structural changes in the economy of China. However, some commodities prices began

recovering towards the end of 2016 and are expected to continue to recover over the forecast period shown in Figure 1.2 below.

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



Source: World Bank, Commodity Markets Outlook, October 2017

Energy

Energy indices fell sharply by 63.3 points from 118.3 in 2014 to 55.0 in 2016, induced mainly by a fall in crude oil prices, which account for approximately 85 per cent of the entire energy index. The year 2014 signified the beginning of the slump in oil prices, which fell from \$96.3 per bbl in 2014 to \$42.8 per bbl in 2016, and was caused by increased oil output by OPEC members in order to protect their market share from competitors in the shale gas industry. However, this strategy proved to be counterproductive, in a sense that the decline in oil prices resulted in falling export- and government revenue for OPEC as well as non-OPEC oil exporters. Therefore, OPEC (Iran being exempted) as well as some non-OPEC members (Nigeria and Libya being exempted) took a decision to decrease oil output for the entire 2017 to rekindle oil prices for the benefit of their revenues. This decision, amongst others, may have caused the energy index to increase from 55.0 in 2016 to 68.0 in 2017. In particular, average crude oil prices increased from \$42.8 per bbl in 2016 to \$52.8 per bbl in 2017.

There are other upside and downside forces which determined the prices of oil in 2017. The downside pressures to oil prices included 1) the political rift between Qatar and other Arab countries, which may have temporarily decreased oil prices in the middle of 2017, 2) the

possibility of some countries may not have adhered to the restriction of oil supply in general and 3) Nigeria and Libya's increased production of oil. The upside pressures to oil prices included 1) adhering to the restriction of oil supply, which effectively eradicated the half of the oil inventory surplus by November 2017 and 2) the temporary supply disruption of shale gas production in the USA caused by Hurricane Irma and 3) strong global demand and the subsequent decline of inventories. The effect of political challenges faced internally and externally in Saudi Arabia in 2017 cannot be concluded at the moment. In general, the energy index is projected to increase from 68.0 in 2017 to 70.8 in 2018, and rise further to 89.1 in 2030. This coincides with an increase in average crude oil prices, from \$52.8 per bbl in 2017 to \$56.0 per bbl in 2018, which is predicted to increase further to \$70.0 per bbl in 2030.

Another commodity which affects the energy index is coal and according to the World Bank (2017), the Australian coal prices have decreased from \$70.1 per metric ton (mt) in 2014 to \$65.9 per mt in 2016. Although there was a decline in coal prices from 2014 to 2016, coal prices did increase between 2015 and 2016. The rise in coal prices, particularly in 2016, was caused by increased external demand for the commodity by China, as the country imposed production restrictions of the commodity in that year. China plays such an important role in the price of coal, given that it is the biggest producer and consumer of coal globally (Wikipedia, 2017). Its demand for coal will likely shape coal prices in the future, which may explain why coal price is projected to reach its peak of \$88.4 per mt in 2017 and thereafter dwindle to \$60 per mt in 2030. China is reducing its carbon footprint through the reducing the use of coal as a fuel (in favour of natural gas, nuclear energy and renewable resources), which is reducing its demand for- and therefore the price of coal. A potential upside pressure to the price of coal may come into existence through the mushrooming of coal-fired power stations in Africa, which may be funded through a partnership with China.

Metals

China previously reduced its external demand for metals and also flooded the market with cheap steel, which resulted in the metal index declining from 84.8 in 2014 to 63.0 in 2016. The World Bank (2016) indicated that the large drop in metal prices was also due to the surplus of copper in the market and weaker growth in EMDEs, which may have negatively affected demand for industrial commodities. However, China decided to reduce production of steel later in 2016 to reduce overcapacity in the steel sub-industry and to reduce pollution, which led to increased import of the commodity by the country and resulted in an increase in iron ore prices.

The upsurge in iron ore prices is evident between 2015 and 2016, when the price of the metal increased from \$55.9 per dry metric ton (dmt) in 2015 to \$58.4 per dmt in 2016.

The metals index increased from 63.0 in 2016 to 78.2 in 2017. Iron ore prices increased from \$58.4 per dmt in 2016 to \$71.8 per dmt in 2017 due to strong demand and restocking in China, which was evident in the 1st quarter of 2017. However, downside risks to the price of iron ore in 2017 included 1) expectations of weakening demand in China for the rest of 2017, 2) restarting of production in China's higher cost capacity, 3) new low cost capacity in Brazil and China's scrapping of steel products, increasing supply. The production of iron ore through low-cost capacity in Brazil may have two effects, namely that a) it will increase the supply of steel in the global market, which will reduce iron ore prices or b) it will create a disincentive for the restarting of high- cost capacity production in China, which will reduce supply and increase iron prices.

The metal index increased in 2017 as copper prices also increased from \$4868 per mt in 2016 to \$6170 per mt in 2017, mainly due to supply disruptions. Labour strikes have taken place in Chile and Peru, whilst contractual disagreements in Indonesia have reduced copper output. There is a strong demand for zinc to galvanize steel, therefore as the demand for steel increases, so will the demand for zinc. Also, there has been closure of large zinc mines in recent years, which will decrease output.

Although the metals index is projected to temporarily decline from 78.2 in 2017 to 76.5 in 2018, the index is projected to increase from 2018, rising to 85.9 in 2030. The increase in the index over the medium term may be supported by 1) infrastructure development for the Tokyo 2020 Olympics in Japan, and 2) USA's future investment in infrastructure under the current administration. The World Bank (2017) indicates that upside risks to metal price forecasts over the long term include stronger global demand, slower ramp up of new capacity, tighter environmental constraints and policy action that may limit trade and exports. Downside risks to the price of metals include lower demand for metals by China (e.g. as the property market slows down) and the possibly higher than expected production in China (which includes the restarting of idle capacity).

Food

The food index declined from 107.4 in 2014 to 90.1 in 2016, notably due to the decline in oil prices during these period. Oil not only affects food prices as an input cost to production, but it also contains by-products such as fertilizers (PERO, 2017). The food index remained overall steady, as it only increased from 90.1 in 2016 to 90.7 in 2017. The almost non-existent increase of the food index in 2017 could be due to projected good crop conditions in the 2017/18 crop season, which will result in large stock levels can potentially alleviate any potential production fall (World Bank, 2017). However, the food index is projected to increase from 90.7 in 2017 to 108.2 in 2030. One policy shift that is currently taking place that will affect the direction of the food index is increasing farm-gate prices (through production subsidies) and trade measures. The World Bank (2017) indicates that Egypt increased its wheat procurement price by 25 per cent in 2015, whilst for trade purposes in order to declare self-sufficiency, 1) India increased its import duty on wheat by 10 per cent, 2) Indonesia made the provision of subsidies to some inputs of maize and Philippines provided credit and seed subsidies in the rice sub-sector.

Beverages

The beverage index declined from 101.8 in 2014 to 91.0 in 2016, due to the surplus of the coffee market which exceeds consumption. The index declined further from 91.0 in 2016 to 82.8 in 2017, due to large cocoa supply from West Africa. Also, the Arabica market also remains well supplied due to bumper crop from Brazil as well as Colombia's ample supply. The beverage index is projected to increase from 82.8 in 2017 to 93.0 in 2030.

1.2 SUB-SAHARAN AFRICA'S ECONOMIC PERFORMANCE

The World Bank (2018) states that a modest recovery is underway in Sub Saharan Africa, supported mainly through the recovery of commodity prices which are benefiting resource-intensive countries. The growth of non-resource intensive countries is being propelled mainly by the infrastructure investments, which were made possible by previously high windfall gains which are now diminishing.

Based on the summary above, the growth of Sub Saharan Africa (SSA) is projected to have recovered and accelerated from 1.3 per cent in 2016 to 2.4 per cent in 2017. The World Bank (2018) attributes the projected improvement in growth in 2017 to a recovery in commodity

prices, global financing conditions remaining favourable, and slowing inflation lifting household demand. The rebound of the SSA region growth was slightly weaker than anticipated due to still-negative per capita income growth, low investment, and a decline in productivity growth. The three largest economies, namely Nigeria, South Africa and Angola, all rebound in growth in 2017. Nigeria and Angola depend mainly on oil exports for revenue and fiscal budget, and the recovery of oil prices may have assisted Nigeria to exit a recession (-1.6 per cent in 2016) to a growth of 1.0 per cent in 2017 whilst Angola may have improved from a muted growth in 2016 to 1.2 per cent in 2017. Additionally, Nigeria experienced a solid production of agricultural goods in 2017. The other large economy in SSA, South Africa, experienced a higher than expected recovery in growth from 0.6 per cent in 2016 to 1.3 per cent in 2017, due to the recovery of the agricultural industry after the 2015/16 drought, increased mining output due to a recovery in commodity prices as well as the rebound of manufacturing activity (World Bank, 2018). However, South Africa's growth continues to be weighed down structural and temporary bottlenecks, the temporary ones being low consumer welfare and a recovering business confidence, amongst others.

When the three largest economies in SSA are excluded, growth of the region was above 4 per cent in 2016, and improved from 4.1 per cent in 2016 to 4.5 per cent in 2017. The recovery in growth of SSA was bolstered by strengthening of commodity prices (including metal prices), strengthening external demand as the global economy recovers, the end of the 2015/16 drought and infrastructure investment. Some idiosyncratic risks faced by countries in SSA in 2017 include heavy debt burden (e.g. Mozambique), drop of some commodity prices (e.g. cocoa prices) and the humanitarian crisis post the 2015/16 drought (e.g. Kenya, Uganda, Somalia and South Sudan)

The growth of the SSA region is projected to advance further from 2.4 per cent in 2017 to 3.2 per cent in 2018, mainly due to a recovery in commodity prices, a strengthening domestic demand assisted by slowing inflation as well as reforms undertaken to solve macroeconomic imbalances (World Bank, 2018). As the largest economy in SSA, economic growth in Nigeria is projected to accelerate from 1.0 per cent in 2017 to 2.5 per cent in 2018 due to the continued recovery of oil production, reforms in the foreign exchange market as well as improved supply of electricity, which will help lift growth in the non-oil sector. South Africa is projected to increase its growth from 1.3 per cent in 2017 to 1.5 per cent in 2018 due to expected increase in private investment as a result of improved business (Budget Review, 2018). However,

consumer confidence may decline in 2018 due to the proposed increased of VAT from 14 per cent to 15 per cent, as well as rising transportation costs due to rising oil prices and fuel-related levies. Growth in Angola will strengthen from 1.2 per cent in 2017 to 1.6 per cent in 2018, due to recovery in commodity prices, as well as a successful political transition which signals the possibility of reforms that can ameliorate the investment climate in the country. When the three largest economies are excluded, growth of the SSA is projected to increase from 4.5 per cent in 2017 to 5.0 per cent in 2018. The acceleration of this growth in 2018 will be supported by recovering oil and metal prices, increased investments by metal exporters, easing inflation in metal exporters and the subsequent monetary policy easing and increased domestic demand, as well improved weather conditions which will support agricultural production and increased power generation.

Private consumption in the SSA region is projected to have advanced from 1.4 per cent in 2016 to 2.1 per cent 2017. Private consumption may be benefiting from the decline in inflation in some countries due stabilizing exchange rates (e.g. in metal exporters), as well as due to better weather conditions which are reducing food prices and benefiting consumer welfare. Where inflation is easing, central banks have cut interest rates in 2017, benefiting both consumers and businesses further (e.g. in SA and Ghana). Private consumption is projected to increase further, from 2.1 per cent in 2017 to 2.6 per cent in 2018.

Public expenditure in the SSA region is projected to have declined from 2.8 per cent in 2016 to 2.3 per cent in 2017. Some countries (including SA) have undertaken fiscal consolidation to reign in high budget deficit while the World Bank (2018) indicates that large public spending cuts were implemented in CEMAC deficit to reduce the overall budget deficit in CEMAC countries. Fiscal deficits declined in non-resource-intensive countries, but remained at high levels, partly reflecting infrastructure investment. Deficits also narrowed moderately in metals exporters as they continued to struggle to mobilize domestic revenue. However, oil exporters such as Angola and Nigeria loosened fiscal policy in 2017 in response to higher oil revenues. The growth of public expenditure is projected to increase from 2.3 per cent in 2017 to 2.5 per cent in 2018.

Fixed investment is projected to have immensely increased from 1.6 per cent in 2016 to 5.2 per cent in 2017, supported by non-resource intensive countries' investment in public infrastructure. As previously explained, non-resource intensive countries gained windfalls

since the commodity slump, which they have directed towards infrastructure spending. Although these windfalls are diminishing, these group of countries will still propel fixed investment, which is projected to accelerate from 5.2 per cent in 2017 to 6.8 per cent in 2018.

The growth of the aggregate exports of the SSA region is projected to have increased from 0.4 per cent in 2016 to 2.5 per cent in 2017, whilst growth of imports may have also increased from 0 per cent in 2016 to 2.3 per cent in 2017. The World Bank (2017) states that the current account deficits of oil and metal exporters have been narrowing in 2017, supported by a recovery in these commodities' prices. Therefore, mining companies across the SSA are restarting production and exports. The rise in commodity prices will obviously put negative pressure on current account balances of non-commodity exporters, who have also been importing capital goods to support public infrastructure projects through commodity-slump windfalls which are now decreasing. The growth of both exports and imports will increase further in 2018; exports' growth will increase from 2.5 per cent in 2017 to 3.2 per cent in 2018, whilst the growth of imports will rise from 2.3 per cent to 2.9 per cent over the reference period.

Table 1.5: Sub Saharan Africa forecast summary

Annual percentage changes (unless indicated otherwise)	2016	2017	2018	2019
	Actual	Forecast		
EMDE SSA, GDP	1.3	2.4	3.2	3.5
GDP per capita (U.S. dollars)	-1.4	-0.3	0.5	0.8
PPP GDP	1.6	2.7	3.5	3.7
Private consumption	1.4	2.1	2.6	2.7
Public consumption	2.8	2.3	2.5	2.7
Fixed investment	1.6	5.2	6.8	7.1
Exports, GNFS	0.4	2.5	3.2	3.4
Imports, GNFS	0.0	2.3	2.9	3.1
Net exports' contribution to growth	0.1	0.1	0.1	0.1
Memo items: GDP				
SSA excluding South Africa, Nigeria and Angola	4.1	4.5	5.0	5.1
Oil exporters	-0.4	1.5	2.8	2.8
CFA countries	2.8	3.2	4.3	4.6
South Africa*	0.6	1.3	1.5	1.8
Nigeria	-1.6	1.0	2.5	2.8
Angola	0.0	1.2	1.6	1.5

Source: World Bank, Global Economic Prospects, January 2018, *Statistic South Africa; Gross Domestic Product, First Quarter 2018; *Budget Review, 2018

The growth of the SSA region is projected to have declined from 7.0 per cent in 2010 to 2.6 per cent in 2017, which represents a 4.4 percentage point decline. Although the commodity

slump for various commodities began in 2012, the commodity slump for oil began in 2014 and had a huge impact on the growth of the region from 2015 onwards. Between 2010 and 2014, the average growth rate of the SSA region was 5.4 per cent. However, effects of the decline in global oil prices from 2014 became visible in the SSA the succeeding two years, when the growth rate declined from 5.1 per cent in 2014 to 1.4 per cent in 2016. Nigeria and Angola, two of the three biggest SSA countries, experienced recessions in 2016 with growth rates of negative 1.6 per cent and negative 0.7 per cent respectively. Other oil producers such as South Sudan, Equatorial Guinea and Chad experienced huge declines in growth of 13.8 per cent, 9.7 per cent and 6.4 per cent respectively in 2016. Thereafter, the SSA region started making a recovery in growth, as it accelerated from 1.4 per cent in 2016 to 2.6 per cent in 2017, assisted mainly by the decision taken by OPEC and non-OPEC oil producers to cut oil production in 2017 to boost global oil prices. The region also benefitted from the end of the 2015/16 drought. The growth of the region is projected to accelerate further from 2.6 per cent in 2017 to 3.4 per cent in 2018, in response to rising oil prices, rising metal pricing, easing inflation and the consequent strengthening of domestic demand.

Based on the previous paragraph, the growth of oil exporting countries declined from 9.2 per cent in 2010 to 2.5 per cent in 2014. These group of countries collectively experienced a recession of 1.5 per cent in 2016 based on the effects of declining global oil prices. However, the group is projected to have recovered from a decline of 1.5 per cent in 2016 to a growth of 0.8 per cent in 2017, due to the oil production cuts of 2017 and the subsequent rise in global oil prices. The oil exporters of SSA are projected to collectively recover further from 0.8 per cent in 2017 to 1.8 per cent 2018, as global oil prices continue to rise.

The growth of oil importers declined from 5.4 per cent in 2010 to 3.4 per cent in 2016. In comparison with oil exporters, the growth rate of oil importers remained higher over the period. Since the decline in oil prices began, oil importers benefitted from windfall gains due to declining oil prices. However, these gains were partial as oil exporters in the region actually increased their oil prices. The IMF (2017) explains that fuel prices in the region are mostly set by governments, either on a discretionary basis or by automatic adjustment formulas. Only about one-third of sub-Saharan African countries allow automatic adjustment of retail prices, while the rest set prices administratively. This pricing structure has historically translated into relatively low pass-through to changes in global oil prices. Oil importers also faced downside risks such as risk aversion from risky assets in 2015, currency depreciations and heightened

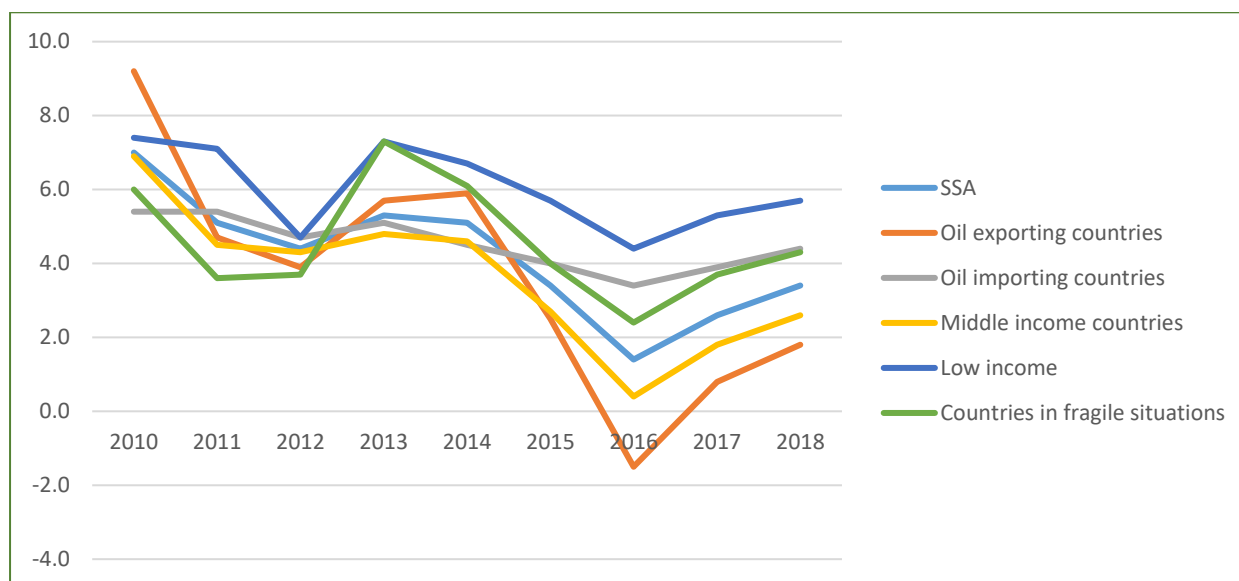
inflation, tighter monetary policy and reduced domestic demand. The growth of oil importers is projected to have accelerated from 3.4 per cent in 2017 to 3.9 per cent in 2017, as some commodity importers increased fixed investment from the windfall gains of lower commodity prices. Although this benefit is diminishing, the growth of oil importers is projected to strengthen from 3.9 per cent to 4.4 per cent as fixed investment continues to strengthen, weather patterns remain favourable and the domestic demand of SSA increases.

The growth of middle-income countries diminished from 6.9 per cent in 2010 to 0.4 per cent in 2016. However, the growth of these countries is projected to have recovered from 0.4 per cent in 2016 to 1.8 per cent in 2017, and will likely recover further to 2.6 per cent in 2018. The recovery in commodity prices will play a role in the recovery of middle income countries, as evident in countries such as Nigeria, South Africa, Angola, Chad, etc. The current forecasts by the IMF (2018) of growth for South Africa have not taken into account the better than expected growth which occurred in 2017 as well as the political and business climate changes which have occurred in the country since December 2017.

The growth of low income countries has also declined from 7.4 per cent in 2010 to 4.4 per cent in 2016. The number of low-income countries in debt distress or facing a high risk of debt distress increased from 7 in 2013 to 12 in 2016 (IMF, 2017). However, the region is expected to have recovered and grown by 5.3 per cent in 2017, and this growth is projected to accelerate to 5.7 per cent in 2018, as the SSA faces easing inflation and increasing domestic demand.

Lastly, the growth of countries with fragile economies has declined from 6.0 per cent in 2010 to 2.4 per cent in 2016. According to the IMF (2017), “the impact of lower commodity prices in sub-Saharan Africa has been more negative in countries in fragile situations than in other countries, often exacerbated by socio-political, governance, and security problems.” However, these group of countries are projected to have recovered from 2.4 per cent in 2016 to 3.7 per cent in 2017 and this growth is projected to accelerate further to 4.3 per cent in 2018. The recovery will be based on the recovery of commodity prices as well as the improvement of economic policy in some countries under this group.

Figure 1.3: Real GDP Growth in Sub Saharan Africa



Source: IMF, Regional Economic Outlook: Sub Saharan Africa, October 2017

The current account deficit of the SSA region was 0.8 per cent in 2010, and has deepened to 4.2 per cent in 2016. Over the period, the current account deficit of the region reached a peak of 6.1 per cent in 2015, possibly reflecting the huge impact of the global oil price drop which began in 2014, as well as the overall commodity slump which began in 2012. The recovery of various commodity prices towards the end of 2016 is reflected in the estimated narrowing of the current account deficit, from 4.2 per cent in 2016 to 3.4 per cent in 2017. Also, other factors which eased the current account deficit of the region in 2017 included tighter domestic policies (Mozambique and Uganda), increased foreign financing, including sovereign bond issuances (Nigeria), other forms of borrowing abroad (Ghana and Zambia) and a drop in imports (South Africa, Togo and Ethiopia). However, the current account deficit of SSA is projected to deteriorate from 3.4 per cent in 2017 to 3.6 per cent in 2018, possibly due to the rising domestic demand in the SSA region.

The current account surplus of 3.6 per cent in 2010 for oil exporters of SSA declined until it became current account deficit in 2014, which worsened to 5.3 per cent in 2015, due to the decline of oil prices. The current account deficit of oil exporters eased from 5.3 per cent in 2016 to 2.1 per cent in 2016, and is projected to ease further to 0.5 per cent in 2017 and 0.7 per cent in 2018 an oil prices continue to recover.

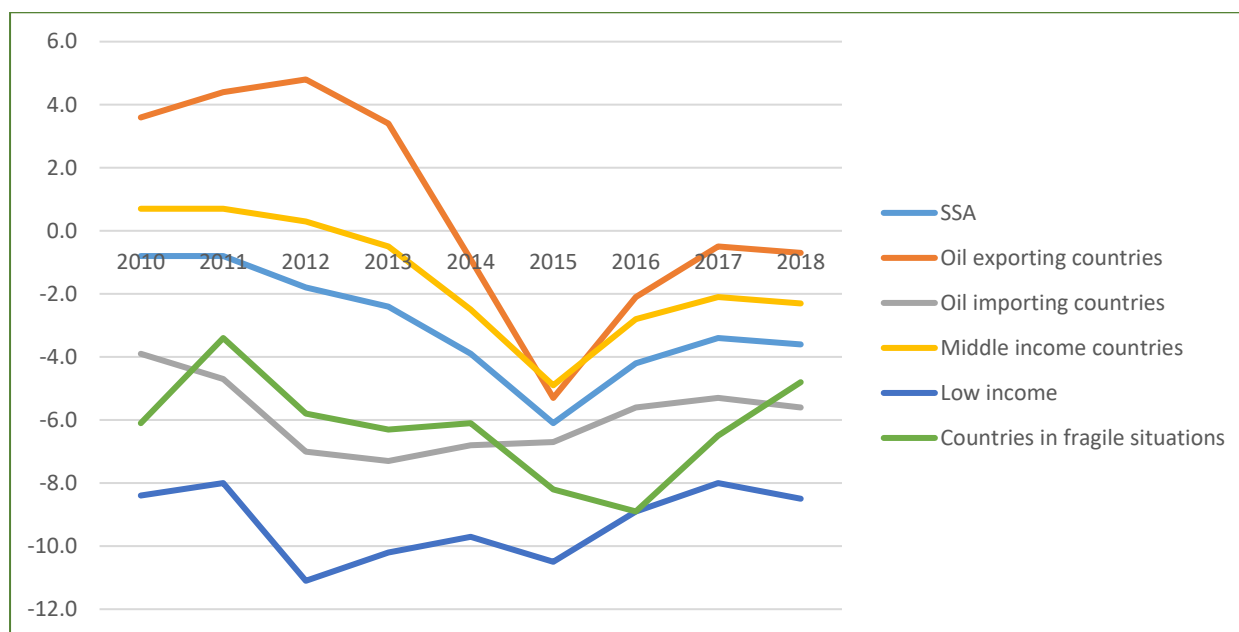
The current account deficit of oil importers has deteriorated from 3.9 per cent in 2010 to 5.6 per cent in 2016, due to a combination of factors. The windfall gains from the oil price drop were partial, whilst these countries also increased fixed investment from those windfalls, which could have increased imports. The current account deficit of oil importers is projected to have slightly eased from 5.6 per cent in 2016 to 5.3 per cent, due to a decline of imports in various countries based on their idiosyncratic factors such as: weak domestic demand in South Africa, financing constraints in Togo as well as a completion of major investment projects in Ethiopia.

The current account deficit of middle-income countries has deteriorated from 0.7 per cent in 2010 to 2.8 per cent in 2016; the indicator peaked at 4.9 per cent in 2015 but eased the following year. The deterioration of the current account deficits of Nigeria, Angola and South Africa also peaked in 2015, possibly in response to exchange rate pressure as well as the decline in oil prices applicable to Nigeria and Angola. The current account deficit of middle income countries is projected to have eased from 2.8 per cent in 2016 to 2.1 per cent in 2017 due to the recovery of oil prices as well as idiosyncratic factors such as weak domestic demand in South Africa. However, the current account deficit of middle-income countries is projected to deteriorate from 2.1 per cent in 2017 to 2.3 per cent in 2018.

The current account deficit of low-income countries is deeper in comparison to middle income countries. The indicator deteriorated from 8.4 per cent in 2010 to 11.1 per cent in 2012, and thereafter eased to 8.9 per cent in 2016. The current account of low-income countries is projected to have improved from 8.9 per cent in 2016 to 8.0 per cent in 2017. However, the indicator is projected to deteriorate from 8.0 per cent in 2017 to 8.5 per cent in 2018. Although countries such as Mozambique and Uganda have implemented tighter domestic policies, pressures on the current account deficit of low income countries remain elevated in relation to other group of countries.

Countries with fragile economies have experienced current account deficits which have deteriorated from 6.1 per cent in 2010 to 8.9 per cent in 2016. The rise of commodity prices may have assist to decrease the deficit from 8.9 per cent in 2016 to 6.5 per cent in 2017. The current account deficit of these group of countries is projected to decline further from 6.5 per cent in 2017 to 4.8 per cent in 2018.

Figure 1.4: Current account (% of GDP) in Sub Saharan Africa



Source: IMF, Regional Economic Outlook: Sub Saharan Africa, October 2017

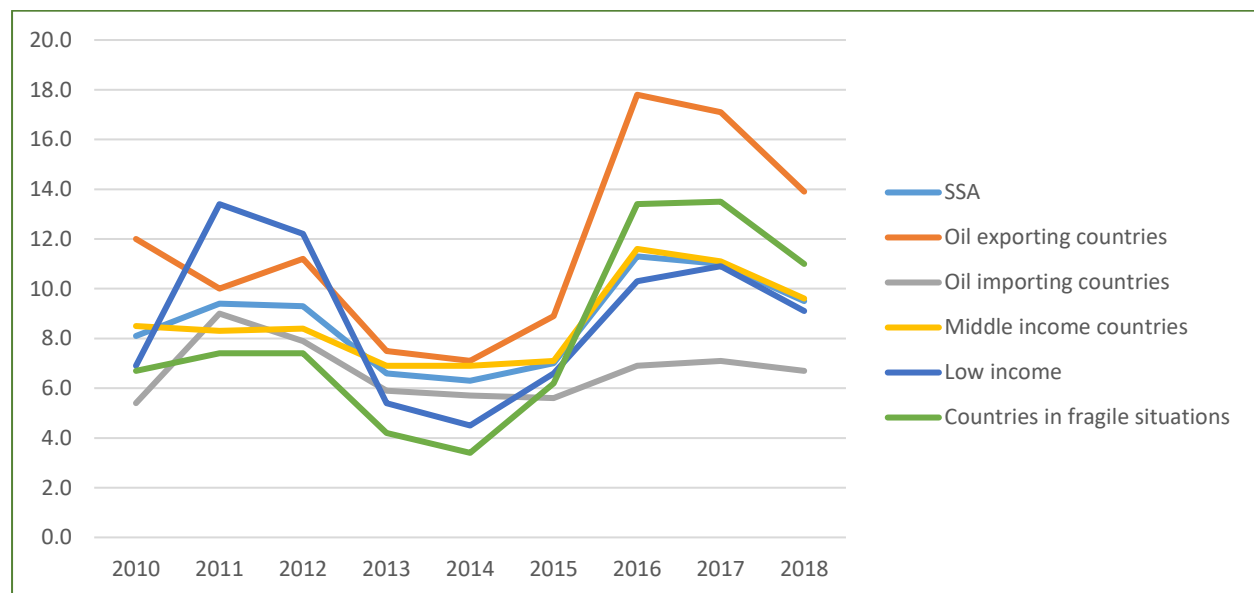
The inflation rate of the SSA region declined from 8.1 per cent in 2010 to 6.3 per cent in 2014. Thereafter, the indicator deteriorated from 6.3 per cent in 2014 to 11.3 per cent in 2016. Following the commodity price shock, inflation rose sharply during 2015–16, mainly reflecting the pass through of large currency depreciations in several resource-intensive countries, including Angola and Nigeria. The deterioration of the inflation rate between 2014 and 2016 was also due to negative investor sentiment towards assets of the emerging market and developing economies in 2015, which caused currency depreciation in the region and fuelled inflation through imports. The region also experienced unfavourable weather patterns in 2015/16, which could have fuelled inflation. The inflation rate of SSA is projected to have declined from 11.3 per cent in 2016 to 11.0 per cent in 2017 possible due to tighter monetary policy in response to the high inflation the region experienced. The indicator is projected to improve further from 11.0 per cent in 2017 to 9.5 per cent in 2018, as pressure on exchange rates of various countries in SSA ease and commodity prices continue to recover.

The impact of oil prices and exchange rate performances on the inflation rate of SSA is particularly evident in 2016-2017. Amongst oil-exporting countries, the inflation rate declined from 17.8 per cent in 2016 to 17.1 per cent in 2017 as oil prices started recovering whilst the inflation rate of oil –importing countries increased from 6.9 per cent to 7.1 per cent over the same period. The inflation rate of middle-income countries eased from 11.6 per cent in 2016

to 11.1 per cent in 2017, as rising oil prices benefitted approximately of oil exporters amongst this group, which are equivalent to a third of group. Given that most low-income countries and countries with fragile economies are oil importers, their inflation rate worsened as oil prices recovered in 2017. The inflation rate of low-income countries is projected to have increased from 10.3 per cent in 2016 to 10.9 per cent in 2017, whilst the indicator amongst countries with fragile economies also worsened from 13.4 per cent to 13.5 per cent over the same period.

The inflation rate is projected to ease across all group of countries in 2018, as exchange rate pressure eases, government maintains the relevant policy tools to pull-back inflation, the pass through effects of the 2015/16 drought die out and commodity prices recover.

Figure 1.5: Consumer prices in Sub Saharan Africa



Source: IMF, Regional Economic Outlook: Sub Saharan Africa, October 2017

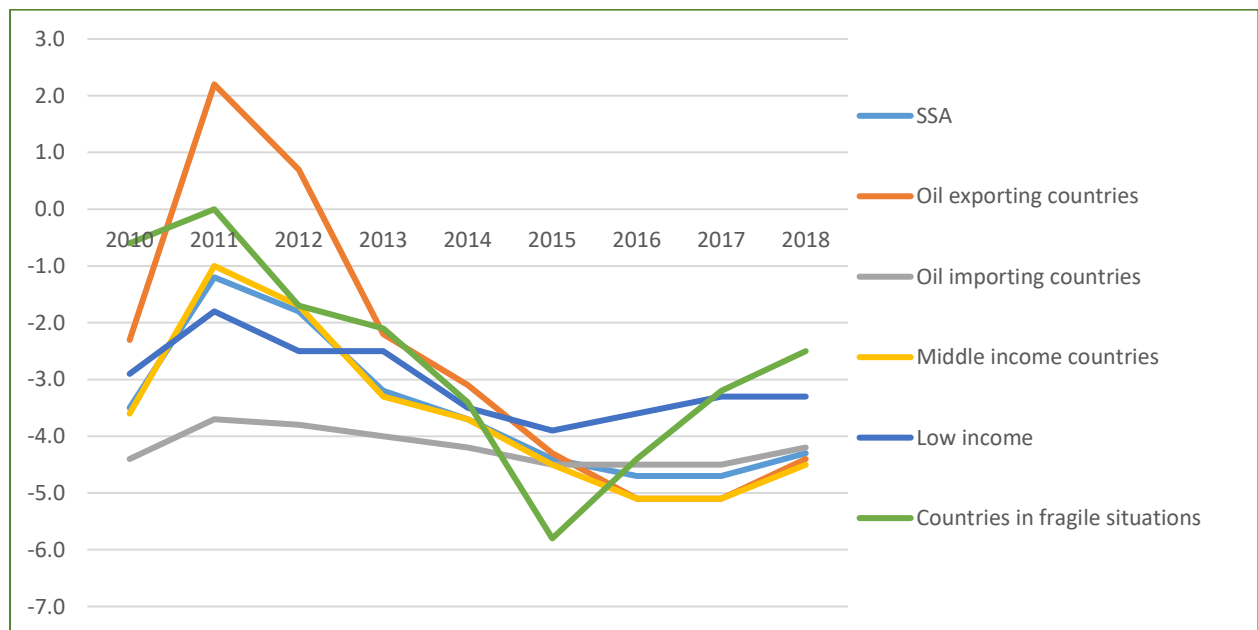
The SSA region has had a budget deficit from 2010 to 2016, and the budget deficit is projected to remain in the medium term. The budget deficit of the region has increased from 3.5 per cent in 2010 to 4.7 per cent in 2016, mainly due to the commodity slump, which has caused a decline in government revenue through exports. Although commodity prices started recovering towards the end of 2016, the budget deficit of the region is projected to have remained the same at 4.7 per cent in 2017, as non-resource intensive countries also continued to pursue infrastructure investment from the windfall gains of the commodity slump. The budget deficit of the region is projected to slightly ease from 4.7 per cent in 2017 to 4.3 per cent in 2018.

Due to the commodity slump in the oil industry, the budget deficit of oil-exporting countries deteriorated from 2.3 per cent in 2010 to 5.1 per cent in 2016. The negative fiscal balance of these group of countries is projected to have remained elevated at 5.1 per cent in 2017, however the indicator will improve to 4.4 per cent in 2018 as rising oil prices provide more government revenue for these countries.

The negative fiscal balance of oil-importing countries has remained elevated despite the commodity slump in the oil industry, from 4.4 per cent in 2010 to 4.5 per cent in 2016. Other factors at played a role in the elevated budget deficit of oil importers. Weakened exchange rates increased debt –service costs for those countries and the 2015/16 drought caused a decline in revenue through agriculture. The drought also heightened inflation and resulted in tighter monetary policy, which dampens internal demand, growth and reduces the tax base. The negative fiscal balance is projected to have stabilized at 4.5 per cent in 2017, however the indictor will ease to 4.2 per cent in 2018, as internal demand increases in SSA.

The negative fiscal balances of middle-income countries, low-income countries and countries with fragile economies deteriorated from 2010 to 2016, following the effect of the commodity slump on primary-commodity producers and infrastructure investment by non-resource intensive countries. However these fiscal balances are projected to ease in 2018.

Figure 1.6: Fiscal Balance including grants (% of GDP) in Sub Saharan Africa



Source: IMF, Regional Economic Outlook: Sub Saharan Africa, May 2017

1.3 THE SOUTH AFRICAN ECONOMY

The South African economy grew by a better-than-expected growth of 1.3 per cent in 2017, mainly due to the recovery of the agricultural industry post the 2015/16 drought and the recovery in mining due to rising commodity prices. The growth of the domestic economy is projected to accelerate from 1.3 per cent in 2017 to 1.5 per cent in 2018. However this growth remains far below the envisaged 5.4 per cent growth outlined in the NDP 2030 to significantly reduce the unemployment rate and address the triple challenges including poverty and inequality remain. Albeit, investor and consumer confidence are increasing in South Africa in 2018, and government will capitalize on the current upswing to propel the economy towards a higher growth trajectory.

1.3.1 GDP growth of SA

The growth of the South African economy recorded a better than expected growth of 1.3 per cent in 2017, mainly due to the performance of the primary industries. Agriculture recorded a growth of 17.7 per cent in 2017, as the industry also grew by 26.2 per cent, 36.8 per cent, 41.1 per cent and 37.5 per cent in the 1st, 2nd, 3rd and 4th quarters respectively in 2017. Agriculture experienced a firm growth in the field crop production of maize and soybeans following increased summer rainfall since the final quarter of 2016. With farmers rebuilding herd after the drought, livestock slaughtered decreased. The growth peak reached by agriculture in the 3rd quarter of 2017 reflected increased production of field crops which was supported by the 2017 bumper maize crop, while increased production of horticultural products was reflected in higher volumes of vegetable exports. Agriculture in South Africa continued to excel in 2017 against the backdrop of a drought in the Western Cape.

Statistics South Africa (2018) notes that mining grew by 4.6 per cent in 2017, recording growths of 12.6 per cent, 7.8 per cent and 6.2 per cent in the 1st, 2nd and 3rd quarters of 2017 respectively. However, a decline of 4.4 per cent was recorded in the mining industry in the 4th quarter of 2017. The overall positive performance of the mining industry in 2017 was underpinned by improved global economic activity, higher international commodity prices, the depreciation in the exchange value of the rand, and an increased demand for processed minerals from South Africa (SARB, 2017). The growth peak experienced in mining in the 1st quarter of

2017 was mainly due to an increased production of platinum in South Africa. Chrome and iron ore production also increased strongly, while gold production rose marginally. By contrast, production of coal and diamonds decreased. A combination of increased demand, higher international commodity prices and stable electricity supply supported domestic mining production in the first quarter of 2017 (SARB, 2017).

Industries which declined the most in 2017 were trade (0.6 per cent), construction (0.3 per cent) and manufacturing (0.2 per cent). Trade recorded the biggest decline in the 1st quarter of 2017, equivalent to 5.6 per cent. The industry was adversely affected by the low consumer and business climate, weak employment creation as well as a decline in real household disposable income. In terms of the sub-industries within trade, activity in the wholesale and retail trade as well as in the catering and accommodation subsectors contracted. Retail trade activity was weighed down by lower sales of textiles, clothing, leather and footwear products as well as hardware, paint and glass. Wholesale trade activity was impacted by lower sales of solid, liquid and gaseous fuels, machinery and equipment as well as agricultural raw materials and livestock.

Construction declined in all four quarters of 2017, with the biggest decline of 1.4 per cent recorded in the 4th quarter of the year. Construction has been adversely affected by insufficient demand for the construction of new buildings. Civil construction activity contracted over the period, consistent with the notable decrease in confidence among civil contractors who were adversely impacted by broader policy uncertainty, especially relating to the mining charter and key renewable energy programmes. Although manufacturing grew positively in the 2nd, 3rd and 4th quarters of 2017, it was the decline of 5.6 per cent in the 1st quarter of 2017 which caused the industry to decline in 2017. The undesirable performance of manufacturing in the 1st quarter of 2017 was caused by notable decreases in the production of clothing and footwear, petroleum and chemical products as well as electrical machinery.

Table 1.6: GDP growth in SA (including sectors)

	2016: Q1	2016: Q2	2016: Q3	2016: Q4	2017: Q1	2017: Q2	2017: Q3	2017: Q4
Primary industries								
Agriculture	-12.3	-11.4	-4.3	-4.1	26.2	36.8	41.1	37.5
Mining	-20.3	16.1	5.6	-9.9	12.6	7.8	6.2	-4.4
Secondary industries								
Manufacturing	1.2	8.2	-2.8	-2.5	-4.1	2.9	3.7	4.3
Electricity	-3.4	-1.1	-0.4	4.6	-5.6	8.1	-6.1	3.3
Construction	1.2	0.5	1.2	0.9	-1.2	-0.7	-1.2	-1.4
Tertiary industry								
Trade	2.2	1.9	-1.8	2.5	-5.6	0.9	-0.1	4.8
Transport	0.4	2.8	2.3	3.1	-1.3	2.6	0.8	2.8
Finance	2.7	3.5	2.4	2.6	-0.5	3.1	1.9	2.5
General government	1.6	1.5	2.2	1.2	-0.5	-1.9	1.1	1.4
Personal services	1.7	2.2	1.8	1.3	0.3	1.7	1.2	1.0
GDP at market prices	-0.8	3.6	1.0	0.4	-0.5	2.9	2.3	3.1

Source: Statistics South Africa, Fourth Quarter, 2017

1.3.2 Domestic expenditure

The Gross Domestic Expenditure of South Africa grew positively for the first three quarters of 2017, which is a contrast to the performance of the indicator in 2016; GDE grew by 1.3 per cent, 2.6 per cent and 0.7 per cent in the 1st, 2nd and 3rd quarters of 2017. The growth of GDE in the 1st quarter reflects a growth of 1.3 per cent in real gross fixed capital formation as well as an accumulation in real inventory holdings. Growth in real capital outlays by private business enterprises turned positive in the first quarter of 2017, and capital expenditure by general government expanded further, benefitting GFCF. Accumulation in inventories in the trade and transport industries also benefitted GDE in the 1st quarter of 2017, and the build-up of inventories in the telecommunication sub-industry of transport was boosted by the growing demand for telecommunication services over time.

However, real gross domestic final demand decreased by 1.7 per cent as real final consumption expenditure by households and general government contracted. The decline in real household spending in the 1st quarter of 2017 occurred within an environment of tight credit conditions, a contraction in the real disposable income of households and persistent low consumer confidence levels. The contraction of government expenditure reflected lower outlays on both

non-wage goods and services as well as compensation of employees, broadly in line with government's efforts to contain growth in the public-sector wage bill as a means of narrowing the primary budget deficit.

The GDE growth accelerated from 13 per cent in the 1st quarter of 2017 to 2.6 per cent in the 2nd quarter of 2017, due to a growth in domestic final demand of 2.7 per cent in the 2nd quarter, reflecting a 4.7 per cent growth of final household expenditure and a 1.4 per cent in the final government expenditure in the same quarter. Accumulation of inventories was also equivalent to R5.8 billion in the 2nd quarter of 2017. Growth of final household demand surged in the 2nd quarter despite a low consumer confidence, and an increase in real expenditure on durable, semi-durable and nondurable goods induced the turnaround in total household expenditure for the country. Among the three categories of goods consumed by households, the greatest growth occurred in semi-durable goods, due to an increased expenditure on clothing and footwear in the 2nd quarter of 2017. Growth of final government expenditure reflects a rise in spending on non-wage goods and services over the period while expenditure on the real compensation of employees declined at a slower pace. The subdued growth of the government expenditure reveals efforts by general government to restrain current expenditure given the negative impact of weak economic growth on government revenue, which poses a risk to the attainment of fiscal deficit targets. In contrast, gross fixed capital formation declined by 2.0 per cent in the same quarter. Fixed capital formation by the private sector was deterred by subdued domestic demand, ample capacity in some parts of the domestic economy, ongoing political uncertainty, and weak business confidence.

The growth of GDE decelerated from 2.6 per cent in the 2nd quarter of 2017 to 0.7 per cent in the 3rd quarter of the same year. The slower growth of GDE in the 3rd quarter of 2017 reflects a de-accumulation of inventories by R5.5 billion as well as a decline in growth by final government consumption of 0.5 per cent in the same quarter. Real inventory holdings decreased by R5.5 billion largely reflected a decrease in agricultural stocks-in-trade, impacted by an increase in the exports of agricultural products. In the manufacturing sector, the slower pace of increase occurred in the petroleum sub-sector as less crude oil was imported due to scheduled maintenance of some refineries over the period. In contrast, GFCF grew by 4.3 per cent while final household grew by 2.6 per cent in the 3rd quarter of 2017.

Table 1.7: Percentage change in real gross domestic expenditure

GDE Growth	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Final consumption expenditure							
Final household consumption	-1.5	1.2	2.2	2.2	-2.7	4.7	2.6
Final government consumption	1.5	2.8	1.9	0.3	-1.7	1.4	-0.5
Gross fixed capital formation	-10.4	-2.8	-3.5	1.7	1.3	-2.0	4.3
Domestic final demand	-2.8	0.7	1.0	1.7	-1.7	2.7	2.3
Change in inventories (R billions)	-2.2	-37.0	10.8	-16.4	6.8	5.8	-5.5
Gross domestic expenditure	-3.6	-4.2	7.5	-1.9	1.3	2.6	0.7

Source: SARB, Quarterly Bulletin, December 2017

The South African economy declined by 0.5 per cent in the 1st quarter of 2017, and net exports subtracted the most from the economic growth of the country. Net exports subtracted 1.9 percentage points from the total economic growth of the country, followed by households (1.7 percentage points) and general government (0.4 percentage points). However, changes in inventories contributed 3.0 percentage points towards the economic growth rate of South Africa, as well as GFCF (0.1 percentage points).

The economy of the country recovered and grew by 2.9 per cent in the 2nd quarter of 2017. Households contributed 2.8 percentage points towards the growth of the economy, together with general government (0.3 percentage points) and net exports (0.2 percentage points). In contrast, GFCF and changes in inventories subtracted 0.4 percentage points and 0.1 percentage points from the GDP growth of the country.

The economy of the country maintained a positive growth and grew by 2.3 per cent in the 3rd quarter of 2017. Households continue to contribute the most towards the economy of the country despite the presence of low consumer confidence. Households contributed 1.6 percentage points towards the growth of the country, followed by net exports (1.3 percentage points) and GFCF (0.8 percentage points). Conversely, de-accumulation of inventories subtracted 1.5 percentage points from the country, followed by general government (0.1 percentage points).

Table 1.8: Contribution of expenditure components to growth in real gross domestic product

GDE Share	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Final consumption expenditure							
Households	-0.9	0.7	1.3	1.3	-1.7	2.8	1.6
General government.	0.3	0.6	0.4	0.1	-0.4	0.3	-0.1
Gross fixed capital formation	-2.2	-0.6	-0.7	0.3	0.3	-0.4	0.8
Change in inventories	-1.1	-4.6	6.2	-3.5	3.0	-0.1	-1.5
Net exports	2.3	7.5	-6.8	1.7	-1.9	0.2	1.3
Residual	0.2	-0.5	0.0	-0.2	0.1	0.1	-0.2
Gross domestic expenditure	-1.5	3.1	0.4	-0.3	-0.6	2.8	2.0

Source: SARB, Quarterly Bulletin, December 2017

1.3.3 Inflation trends in South Africa

The average headline inflation rate of South Africa was 6.4 per cent in 2016, reflecting the effects of the 2015 currency depreciation as well as the effects of the 2015/16 drought. The inflation rate remained above 6 per cent in the first three months of 2017, as the year began with inflation rates of 6.6 per cent, 6.3 per cent and 6.1 per cent in January, February and March respectively. However, the inflation rate re-entered the upper target band as it declined from 6.1 per cent in March 2017 to 5.3 per cent in April 2017, and has remained within the target band for the remainder of 2017. The inflation rate of the country has declined from 5.3 per cent in April 2017 to 4.7 per cent in December 2017, as almost all the components of inflation that are reflected in Table 1.10 below (Education being exempted) declined over the period.

The three largest components of headline inflation in South Africa are housing and utilities, food and non-alcoholic beverages as well as miscellaneous goods and services; the weight of these components are 24.62, 17.24 and 15.05 respectively. The inflation rate of housing and utilities, which accounts for owner's equivalent rent, water and electricity, etc. has been within the target for the entire 2017, and has declined from 5.6 per cent in January to 4.4 per cent in December. The inflation rate of food and non-alcoholic beverages was in double digit territory in 2016 due to the 2015/16 drought. However, this inflation has declined from 11.4 per cent in January 2017 to 4.8 per cent in December 2017. The inflation rate of miscellaneous goods and services was above the upper target band throughout 2017, but has declined from 7.7 per cent in January to 7.1 per cent in December of the same year. Miscellaneous goods and services represents insurance, personal care and financial services, amongst other goods and services.

Transport inflation also carries a high weight of 14.28, and this inflation rate has declined erratically from 6.7 per cent in January 2017 to 6.4 per cent in December of the same year. Oil prices play a huge role in the performance of transport inflation, and the rising of global oil prices since 2016 may explain why this inflation has remained above the 6 per cent target band.

In general, inflation has an impact on consumer and business confidence. When the inflation rate is too high, it negatively affects the disposable income of consumer through high prices and rising interest rates, and dampens demand in the economy. If consumer confidence is low, business confidence is also negatively affected which provides a disincentive to invest in the economy. Banking sector activity through lending also declines when the interest rate rises. The impact of inflation rate spills over in various ways into the economy; therefore the decline of overall inflation from 6.6 per cent in January to 4.7 per cent in December is favourable for consumers, business and the rest of the economy.

Table 1.9: Headline inflation in South Africa (% change over 12 months)

	2017												
	Weights	January	February	March	April	May	June	July	August	September	October	November	December
All items	100	6.6	6.3	6.1	5.3	5.4	5.1	4.6	4.8	5.1	4.8	4.6	4.7
Food and non-alcoholic beverages	17.24	11.4	9.9	8.7	6.7	6.9	6.9	6.8	5.7	5.5	5.3	5.2	4.8
Alcoholic beverages and tobacco	5.82	3.5	2.8	3.2	2.9	3.1	3.3	3.3	4.3	4.7	5.1	5.0	4.9
Clothing and footwear	3.83	5.1	4.8	4.5	4.0	3.9	3.8	3.6	2.8	2.3	1.9	1.8	1.8
Housing and utilities	24.62	5.6	5.6	5.7	5.7	5.7	5.7	4.5	4.5	4.9	5.1	5.1	4.4
Household contents and services	4.35	4.2	3.4	3.2	2.8	2.8	2.4	2.3	2.0	2.1	1.8	1.9	1.7
Health	1.40	6.0	6.7	6.2	6.5	6.9	7.0	7.0	7.0	7.2	6.6	6.4	5.7
Transport	14.28	6.7	7.2	7.7	4.6	5.2	3.3	1.0	3.9	5.6	5.4	4.4	6.4
Communication	2.63	-0.4	-0.3	-0.9	-0.8	-0.9	-1.1	-1.2	-1.3	-1.4	-1.5	-1.6	-1.7
Recreation and culture	5.16	3.7	3.7	3.7	3.6	3.8	3.3	3.2	2.4	2.2	1.5	1.5	0.4
Education	2.53	4.6	4.6	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Restaurant and hotels	3.09	6.2	6.4	6.1	6.4	4.8	4.1	4.1	4.2	3.4	3.2	3.3	3.0
Miscellaneous goods and services	15.05	7.7	7.4	7.5	7.3	7.3	7.1	7.6	7.5	7.6	7.2	7.2	7.1

Source: Statistics South Africa, Consumer Price Index, December 2017

1.3.4 Interest rates in South Africa

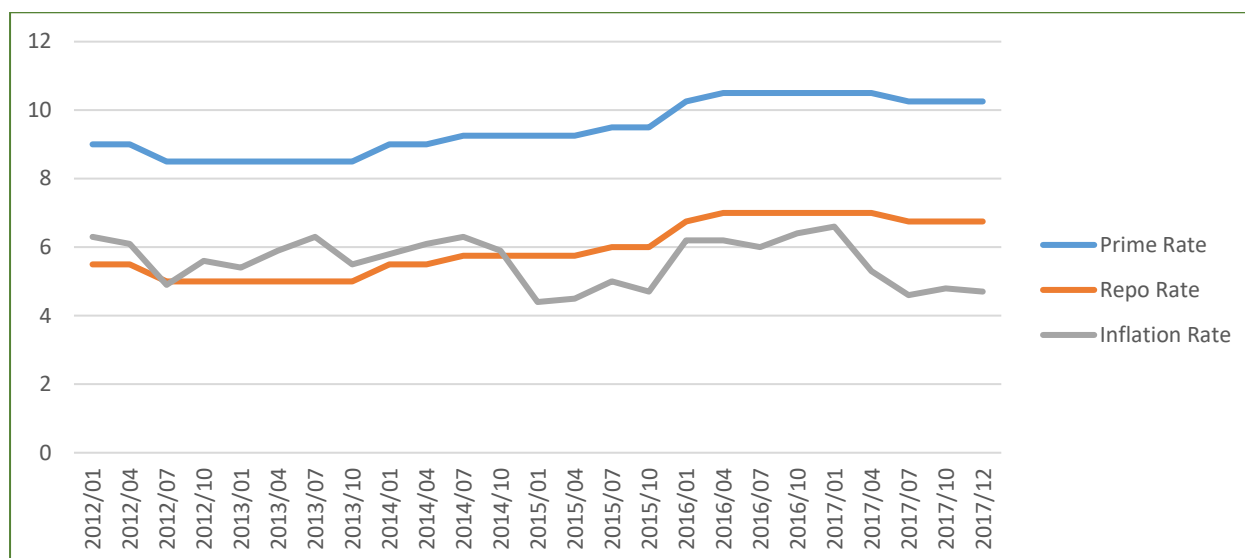
The performance of inflation and interest rates in South Africa have a direct impact on consumer and business confidence in the country. As explained in the previous paragraph, when inflation is high, the SARB increases interest rates in order to contain inflation as

inflation targeting is the core mandate of the institution. Between 2012 and 2017, upside risks to the inflation of the country included the 2015 currency depreciation, the 2015/16 drought and the recovery of oil prices since 2016. However, the end of the drought resulted in the easing of inflation in 2017.

Figure 1.8 below shows that the inflation rate of South Africa has declined from 6.3 per cent in January 2012 to 4.7 per cent in December 2017. However the indicator reached its peak of 7.0 per cent in February 2016. As explained in the 2017 PERO, the Rand depreciated against the dollar from approximately R14 per dollar in early December 2015 to over R16 per Dollar by January 2016, which posed an upside risk on inflation as it increased imported inflation for South Africa.

Therefore the repo rate was increased from 5.5 per cent in January 2012 to 6.75 per cent in February 2016. The pass-through effects of the 2015/16 drought resulted in average inflation remaining above the target band for eleven of the twelve months in 2016, therefore the repo rate increased from 6.75 per cent in February 2016 to 7 per cent in March 2017, and it remained at 7 per cent until June 2017. The inflation rate of the country re-entered the upper target band at 5.3 per cent in April 2017 and has remained within the target band for the remainder of 2017, which prompted the SARB to decrease the repo rate from 7 per cent in June 2017 to 6.75 per cent in July 2017. The inflation rate of South Africa has eased further going into 2018, reaching 4.0 per cent in February 2018, due to easing food and non-alcoholic beverage inflation, a stronger Rand and the elimination of perceived political and policy uncertainty. However, the expected rise in interest rates in the USA in 2018 may cause Rand depreciation, fuelling imported inflation.

Figure 1.7: South Africa's Repo, Prime and Inflation Rates



Source: SARB, Online Statistical Query, 2018; Statistics South Africa, Consumer Price Index, December 2017.

1.3.5 Current account and trade balance

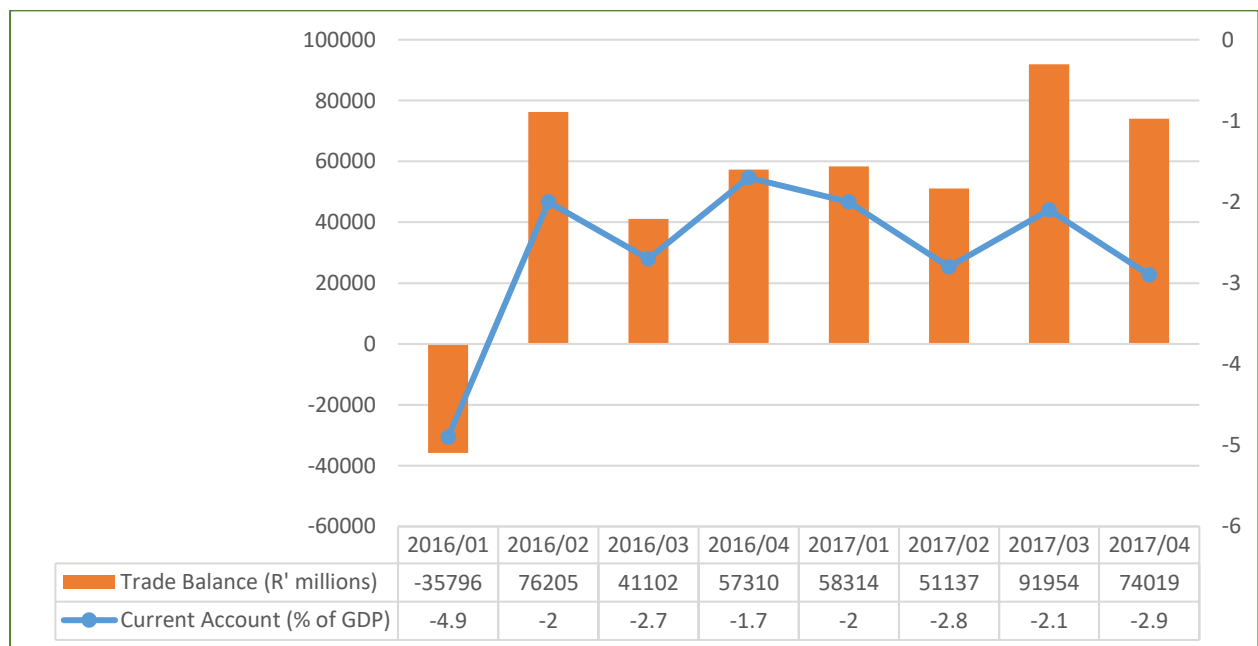
Figure 1.10 below displays the performance of the trade and current account of South Africa in 2016 and 2017. With the exemption of the 1st quarter in 2016, the trade and current account balances of South Africa were in positive territory in 2016 flowing into 2017. Whilst the trade surplus of the country increased from R57.3 billion in the 4th quarter of 2016 to R58.3 billion in the 1st quarter of 2017, the current account deficit slightly worsened from 1.7 per cent to 2.0 per cent over the same period. The higher trade surplus in the 1st quarter of 2017 resulted from a slight increase in the value of net gold and merchandise exports more than fully offsetting the marginal increase in the value of merchandise imports (SARB, 2017). However, the worsening of the current account deficit in the same period was due to widening of the shortfall on the other components of the current account, which are services, income and current transfer account, from R132 billion in the 4th quarter of 2016 to R149 billion in the 1st quarter of 2017.

The trade surplus thereafter declined from R58.3 billion in the 1st quarter of 2017 to R51.1 billion in the 2nd quarter of the same year. Concurrently, the current account deficit worsened from 2.0 per cent to 2.8 per cent over the same period. The shortfall on the services, income and current transfer account widened further in the 2nd quarter of 2017, negatively impacting the current account balance.

However, both the trade and current account balances improved in the 3rd quarter of 2017. The trade surplus of the country increased from R51.1 billion in the 2nd quarter to R92.0 billion in the 3rd quarter of 2017 whilst the current account deficit also improved from 2.8 per cent to 2.1 per cent over the period. The widening in the trade balance in the 3rd quarter of 2017 came about as the value of merchandise imports decreased more than that of net gold and merchandise exports. These declines in the value of both imported and exported goods were largely driven by lower volumes (SARB, 2017).

The trade and current account balances of South Africa deteriorated in the final quarter of 2017. The trade surplus declined from R92.0 billion in the 3rd quarter of 2017 to R74.0 billion in the 4th quarter of the same year, whilst the current account deficit widened from 2.1 per cent to 2.9 per cent over the same period. The decrease in the trade surplus came about as the value of merchandise imports increased more than that of net gold and merchandise exports. These increases were largely driven by higher volumes of both imported and exported goods. The smaller trade surplus together with a further widening of the shortfall on the services, income and current transfer account resulted in a significantly larger deficit on the current account of the balance of payments (SARB, 2018).

Figure 1.8: Trade Balance (R' million), Current account (% of GDP)



Source: SARB, Online Statistical Query, 2018

1.3.6 Key risks and opportunities for the South African economy

Global Risks

The global economy is recovering. However various factors are at play which pose downside risks on the global economy, which will indirectly impact on the growth of South Africa as a trade partner. The current trade protectionism being implemented by the USA through increasing aluminium and steel tariffs towards imports by trade partners will may result in a trade war and discourage global trade, investment and growth. The USA announced a 10 per cent levy on aluminium and a 25 per cent tariff on steel in March 2018, much to the disadvantage of its trade partners, including South Africa. However, these tariffs have been suspended until the 1st of May 2018 for the following countries for national security reasons: EU member states, Argentina, Australia, Brazil, Canada, Mexico and South Korea. The USA also announced a \$60 billion import tariff on China's goods in March 2018, while China has indicated that it will retaliate with a \$3 billion import tariff on goods created in the USA. Such decisions can be seen as the beginning of a trade war if they are implemented, and the decline of both countries' growth will detriment the growth rate of their trade partners, such as South Africa. Trade barriers decrease consumer satisfaction through anti-competitive behaviours, increase production costs, sour trade relations and reduce global growth.

The USA also hiked its interest rate to 1.5 per cent -1.75 per cent band in March 2018. Although the Rand surprisingly strengthened after the announcement, the increase in the interest rate of the USA is generally detrimental for the economy of SA in two ways. Investors seeking higher yield become discouraged by the narrowing gap between the interest rate of the USA and an emerging market and developing economy e.g. South Africa. This leads to capital flight and a currency depreciation for South Africa. Imported inflation rises, which leads to a rise in the interest rate of South Africa, and a consequent decline in consumer confidence, business confidence and growth. Gold, as a safe haven exported by countries such as SA, also becomes less appealing in favour of higher yield in the USA.

Rising oil prices may be beneficial for oil exporters in the SSA region, but increase production and transportation costs for South Africa. When production costs increase, domestic goods become expensive which may either dampen demand, or increase an appetite for cheaper foreign goods to the detriment of domestic businesses and job creation. The rise in

transportation costs may also dampen passenger transportation, and industries such as tourism, which is an important industry for job creation and overall growth.

Domestic Risks

The immediate domestic risks (as outlined in the 2018 Budget Review) facing the South African economy include the policy uncertainty and a deterioration in the finances of state-owned entities; these two factors play an important role in the foreign credit ratings provided by major rating agencies. The current drought being experienced in the Western Cape, Eastern Cape and Northern Cape poses significant risks to agriculture and tourism in those provinces and in the country, and may result in job losses rather than further job creation.

Opportunities

As previously indicated, the global economy is recovering, and its growth is projected to accelerate from 3.7 per cent in 2017 to 3.9 per cent in 2018. This recovery will likely be supported by the growth of EMDEs, which is projected to accelerate from 4.7 per cent to 4.9 per cent over the period, due to the recovery of commodity prices, amongst other reasons. Within Africa, the growth of SSA region is projected to accelerate from 2.7 per cent in 2017 to 3.3 per cent in 2018 and the signing of the African Continental Free Trade Area by 44 countries within Africa will benefit the SSA region and individual countries such as South Africa through trade and investment.

Although commodity exporters are encouraged to reduce their dependence on primary commodities, the recovery of commodities prices such as coal, iron ore and gold in South Africa will likely continue to benefit the trade balance and export revenue. The high growth of agriculture in 2017 flowing into 2018 provides opportunities to expedite agro-processing, thereby linking a well performing primary industry to manufacturing, which is seen as important for high future terms of trade for any country.

The elimination of perceived political uncertainty towards the end of 2017 will benefit the growth of South Africa. The growth of the country is projected to accelerate from 1.3 per cent in 2017 to 1.5 per cent in 2018 as business confidence recovers based on a desired policy certainty.

1.3.7 Policy implications to mitigate the key risks in the economy

Radical Economic Transformation is a strategy created by the South African government in 2017 to fundamentally change the structure, systems, institutions and patterns of ownership and control of the economy in favour of all South Africans, especially the poor, the majority of whom are Africans and female. This strategy seeks to place the economy on a qualitatively different path that ensures a 1) more rapid and sustainable growth, 2) higher investment, 3) increased employment, 4) reduced inequality and 5) deracialisation of the economy. The components of RET include job creation, accelerating shared and inclusive growth, transforming the structure of production, ownership of means of production as well as enabling the talents and productive potential of our people to flourish. Therefore government's actions to improve the economy of South Africa will take into consideration this strategy.

The short term intervention implemented by the South African government to complement the structural reform agenda set out in the NDP 2030 and the RET is the 14 Confidence-Boosting Measures, which was created in July 2017. The 14 Confidence-Boosting Measures have focused on the following: Fiscal policy, Financial sector and tax policy, Leverage public procurement, Recapitalisation of SOEs and government guarantees, Broader State Owned Entity (SOE) reforms, Private Sector Participation (PSP) Framework, Costing Developmental Mandates, Energy, South African Airways (SAA), Telecommunications, Postbank Licensing, Minerals and Petroleum Resources Development Act Amendment Bill, Broad-based Socio-Economic Empowerment Charter for the South African Mining and Minerals Industry as well as the Regulation of Land Holdings Bill. The National Treasury (2018) states that much improvement has been made in terms of these measures, even though much more needs to be done to fully realize the positive impact of these measures.

The cyclical upturn and improved investor confidence realized from measures and interventions implemented thus far in SA have provided a platform for faster economic growth in the country through finalizing outstanding policy and administrative reforms, in industries with high growth potential. These efforts will focus on:

- Mining industry policies that support investment and transformation
- Telecommunication reforms, including the release of additional broadband spectrum
- Lowering barriers to entry by addressing anti-competitive behaviour

- Supporting labour-intensive industries such as agriculture and tourism, and increasing skills levels across the country.

Government intends to capitalize on the renewed energy currently being experienced and realize tangible and sustainable economic benefits for all our people which include:

- Creating the right environment for investment,
- Partnering with the social partners to create sustainable employment,
- Dealing decisively with governance and financial failures at state owned companies; and
- Addressing the concentrated and inequitable structure of the economy.
- Achieving these objectives will require us to forge a new compact between the social partners.

The importance of partnership has been demonstrated by the CEO initiative, which has established a business-led fund committing approximately R1.4 billion to support high potential SMMEs. Over the medium term, small and medium enterprises will also benefit through a fund with an allocation of R2.1 billion developed between the Departments of Small Businesses, Science and Technology and the National Treasury. This fund will focus on the early start-up phase, which is an area that has historically had limited support because of the risks involved (Budget Speech, 2018).

The most immediate actions which will take in 2018 to catalyse inclusive growth and job creation include the convening of two summits, namely the investment and jobs summits. The Jobs Summit will align the efforts of every sector and every stakeholder behind the imperative of job creation. It will look at what needs to be done to ensure the economy grows and becomes more productive, that companies invest on a far greater scale, that workers are better equipped, and that the economic infrastructure is expanded. This summit is expected to produce practical solutions and initiatives that will be implemented immediately.

The Investment Summit will propel investment into the South African economy by targeting both domestic and international investors, to market the compelling investment opportunities to be found in the country. Focus will be placed on manufacturing capacity, which deeply affects employment and exports. Greater investment in key manufacturing sectors through the strategic use of incentives and other measures is seen as useful to propel re-industrialise on a

scale and at a pace that draws millions of job seekers into the economy. The localisation programme will stimulate local manufacturing through products such as textile, clothing, furniture, rail rolling stock and water meters which are designated for local procurement. Thus far, the South African government has spent more than R57 billion on locally-produced goods that may have been imported from other countries. The process of industrialization will support transformation, and instruments such as preferential procurement and the black industrialists programme will assist in developing a new generation of black and women producers that are able to build enterprises of significant scale and capability.

Within the manufacturing industry, Special Economic Zones remain important instruments which will be used to attract strategic foreign and domestic direct investment and build targeted industrial capabilities and establish new industrial hubs.

In agriculture, government intends to accelerate land redistribution and implement expropriation without land in a manner that increases agricultural production, improves food security and ensure that the land is returned to those from whom it was taken under colonialism and apartheid.

In tourism, government will enhance support for destination marketing in key tourism markets and take further measures to reduce regulatory barriers and develop emerging tourism businesses.

Lastly, the Mining Charter will be relooked and finalized in such a manner that it will ensure the sustainable transformation within the economy

1.4 CONCLUSION

The growth of the global economy is recovering, as the world growth is projected to increase from 3.7 per cent in 2016 to 3.9 per cent in 2018. This economic recovery might be propelled by EMDEs, as the growth of these countries might collectively increase from 4.7 per cent to 4.9 per cent over the same period. In contrast, the growth of Advanced Economies is projected to remain 2.3 per cent in 2018, similar to the group's 2017 growth. However, the tax policy changes in the USA is projected to benefit both the country and the global through increased domestic demand.

The SSA region is projected to recover further from a growth of 2.7 per cent in 2017 to a growth of 3.3 per cent in 2018, mainly due to the recovery of commodity prices, the better performance of agriculture post the 2015/16 weather crisis and recovering domestic demand

South African economy is recovering, and its growth is projected to accelerate from 1.3 per cent in 2017 to 1.5 per cent in 2018. Agriculture continues to perform well post the 2015/16 drought, although Western Cape, Eastern Cape and the Northern Cape are facing water crisis. Mining in SA is benefiting from a recovery in commodity prices. Inflation in 2018 is projected to remain within the target band, providing the incentive for an interest rate cut in the near term. Lastly, consumer and investor confidence is recovering in the country.

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

Key findings

- The structure of the Free State economy is dominated by the tertiary industry's whose size is collectively increasing
- On the contrary, the size of primary and secondary industries have decreased.
- Although agriculture has faced challenges of drought in 2015/16, its size rose from 4.6 per cent in 2015 to 5.2 per cent in 2016.
- Free State is the 3rd most diversified provincial economy, after Mpumalanga and Northern Cape.
- The province has comparative advantage in agriculture (1.97), electricity (1.27), mining (1.26), community services (1.08) and transport (1.05).
- The provincial economy has been on a downward growth trend post the recession, similar to the country's growth trend.
- The province also entered a recession when it declined by 0.1 per cent in 2015, and the recession is projected to have worsened to 0.2 per cent in 2017.
- The performance of the provincial economy in 2015 has been disadvantaged by the drought in the agricultural and water sub-industries, as well as a declining commodity prices in mining.
- The province remained in recession in 2016 due to the drought, although commodity prices only started recovering towards the end of year.
- The provincial recession might have worsened in 2017 due to the industrial strike in the coal sector, which could have negatively affected both mining and manufacturing. Although, a stronger rand in the country is desirable, it could have also negatively affected manufacturing in the Free State.
- The Free State economy is projected to recover and grow by 0.4 per cent in 2018, boosted by interest rates cuts in the finance industry and rainfall in agriculture and water –sub-industry.
- Over the medium term, the recovery of growth of the Free State province will be supported by positive growth rates in finance, agriculture and transport.

2.1. INTRODUCTION

The global economy is recovering, together with the SSA region and South Africa. In the same light, the Free State economy is projected to recover in 2018 from the recession it has been experiencing over the past three years.

The most prominent factor which will contribute towards the Provincial economy in 2018 is the continuous positive performance of the agricultural industry, in the presence of adequate rainfall and the dissipated effects of the 2015/16 drought. The economy of Free State will also likely benefit from improved consumer confidence as the Rand strengthens and inflation in the overall country is kept within the target band of 3 per cent-6 per cent. The strengthening of the Rand and lower inflation plays such a critical role in the performance of Free State (and South Africa) due to the possible reduction in interest rates, which will benefit industries such as finance through increased banking sector activities. The strengthening of the Rand also counteracts the rising of global oil prices and benefits the transport industry through passenger transportation.

As part of the South Africa, Free State will also benefit from Moody's decision to keep the foreign credit rating of SA above investment grade and uplift the rating from "negative" to "stable", as perceived political discord ends and policy certainty strengthens.

However, the provincial economy is also facing downside risks in the commodity markets. Rising oil prices, *ceteris paribus*, decrease the disposable income of consumers and dampens demand in the economy for transport and possibly domestic tourism. Also, the prices of commodities such as gold, coal and silver, which the Free State province mines, are projected to decline in 2018 (World Bank, 2017). In effect mining in the Free State is projected to decline the most in 2018.

2.2. STRUCTURAL COMPOSITION OF FREE STATE ECONOMY

The dominance of tertiary industries in the Free State economy continuous to increase, while the share of the primary and secondary industries has declined between 2007 and 2016. Although the dominance of tertiary industries reflects a maturing economy, the Free State province still needs to capitalize on its strength in agriculture, and the potential fruitful link

between agriculture and manufacturing through agro-processing, in order to address the current high unemployment rate, poverty as well as inequality.

Table 2.1 below shows that the share of the primary industries has collectively declined from 17.7 per cent in 2007 to 15.7 per cent in 2016, which represents a 2.0 percentage point deterioration. The size of the primary industries has declined due to the decline of the mining industry size, from 12.7 per cent in 2007 to 10.5 per cent in 2016. The sizable decline of mining's contribution towards the provincial economy (from 12.3 per cent in 2014 to 10.5 per cent in 2016) reflects various mining challenges that unfolded over that period. In 2014, the production of gold, diamonds and coal declined. In 2015, the weak global demand for energy and non-energy commodities became evident, whilst coal production declined due to industrial action as well as weaker internal demand based on milder winter weather. In general, the mining industry has been experiencing in South Africa and presumably in the Free State was negatively affected by declining commodity prices, low confidence levels, electricity-supply constraints, rising input costs and infrastructure constraints (SARB, 2014). Although some commodity prices began to increase late 2016, mining production in almost all mineral groups declined on an annual basis in 2016. South Africa, and consequently Free State, faced added challenges of low confidence levels, policy uncertainty in mining as well as steep increases in the price of electricity and steel. Overall, the data shows that mining has had the most impact in terms of the primary industries decline between 2007 and 2016.

Conversely, the size of agricultural industry has enlarged from 5.0 per cent in 2007 to 5.2 per cent in 2016. However, the lower contributions of 4.6 per cent by agriculture towards the provincial economy in 2012, 2013 and 2015 reflect the mid-season dry conditions which affected field crop production (maize) in 2012 and 2013, as well the overall 2015/16 drought. The upturn of agriculture in size from 4.6 per cent in 2015 to 5.2 per cent may reflect that the effects of the 2015/16 drought may have started diminishing in 2016.

The share of the secondary industries has collectively declined from 19.1 per cent in 2007 to 18.7 per cent in 2016, which represents a 0.4 percentage point decline over the reference period. The decline amongst secondary industries occurred due to the decline of manufacturing in size, which declined from 14.3 per cent in 2007 to 11.6 per cent in 2016. Manufacturing in the Free State is mainly reliant on the performance of Sasol, which could have been negatively affected by declining coal production and declining oil prices in 2014. However, the increase of

manufacturing size from 10.0 per cent in 2014 to 11.4 per cent in 2015 may be due to currency depreciation, given that the oil produced in Sasol is priced in dollars. Whilst the share of manufacturing declined between 2007 and 2016, electricity industry in the Free State increased its contribution towards the provincial economy from 2.3 per cent in 2007 to 4.6 per cent in 2016, whilst the share of construction also slightly increased from 2.5 per cent in 2007 to 2.6 per cent in 2016. Although the role of business confidence cannot be ignored, the share of the provincial construction industry reflects the bigger role the provincial government plays in the construction industry, notable through the industry's higher share during 2010 FIFA World Cup and subsequent years, and the decline of the construction industry during the process of fiscal consolidation.

The tertiary industries have collectively increased from 63.1 per cent in 2007 to 65.5 per cent in 2016. The increase of this group of industries is mainly attributed to the trade as well as the general government services industries. The share of the trade industry increased from 12.2 per cent in 2007 to 14.1 per cent in 2016, which represents a 1.9 percentage incline, whilst the general government services industry increased its size from 13.4 per cent to 17.3 per cent over the reference period, which represents a 3.9 percentage point incline over the same period. The biggest increase in the share of the trade industry was detected in wholesale and commission sale (0.7 percentage points) and the single biggest increase in share of general government services was detected in public administration & defence activities (1.9 percentage points).

The size of other tertiary industries declined over the reference period. The size of the transport industry declined from 10.9 per cent in 2007 to 10.4 per cent in 2016, which represents a 0.5 percentage point decline. The finance industry declined from 16.9 per cent to 15.7 per cent over the reference period, which represents a 1.2 percentage point decline. Lastly, the size of the personal services industry declined from 9.7 per cent to 8.0 per cent over the same period, which represents a 1.7 percentage point decline.

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

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Primary Industries	17.7	20.7	19.4	19.1	18.5	18.0	17.6	17.1	14.6	15.7
Agriculture, forestry and fishing	5.0	6.4	6.1	5.0	4.8	4.6	4.6	4.8	4.6	5.2
Mining and quarrying	12.7	14.4	13.3	14.2	13.7	13.4	13.0	12.3	10.1	10.5
Secondary Industries	19.1	18.4	18.4	17.1	17.2	16.9	17.0	16.9	18.6	18.7
Manufacturing	14.3	13.3	12.0	10.9	10.7	10.2	10.3	10.0	11.4	11.6
Electricity, gas and water	2.3	2.2	2.9	3.4	3.5	3.9	3.7	4.1	4.6	4.6
Construction	2.5	2.9	3.5	2.8	3.0	2.8	3.0	2.7	2.6	2.6
Tertiary industries	63.1	60.9	62.2	63.8	64.4	65.1	65.4	66.1	66.7	65.5
Trade, catering and accommodation	12.2	13.5	14.6	16.9	15.7	15.4	14.9	14.4	14.4	14.1
Transport, storage and communication	10.9	10.0	9.4	8.7	9.3	9.9	10.1	10.6	10.6	10.4
Finance, real estate and business services	16.9	15.8	15.5	15.3	15.3	15.0	15.3	15.9	16.6	15.7
Personal services	9.7	8.1	8.1	7.5	8.0	8.1	8.1	7.8	8.1	8.0
General government services	13.4	13.5	14.6	15.4	16.1	16.7	17.1	17.3	17.0	17.3
All industries at basic prices	100	100	100	100	100	100	100	100	100	100

Source: Statistic South Africa; Gross Domestic Product, First Quarter 2018

Table 2.2 below shows each province's contribution towards a particular South African industry in 2016. The Free State province only ranks amongst the top three provinces in agriculture, as KwaZulu-Natal, Western Cape and Free State continue to contribute the most towards South Africa's agricultural industry, contributing 25.2 per cent, 22.0 per cent and 10.6 per cent respectively in 2016. In comparison to the previous year, Free State's contribution towards the national agricultural industry increased by 0.6 percentage points. In mining, North West, Limpopo and Mpumalanga dominate in South Africa's industry, and have contributed 26.9 per cent, 25.1 per cent and 21.1 per cent respectively in 2016. In contrast, Free State only contributes 6.7 per cent towards the national mining industry, which represents a 0.2 percentage point increase from the 2015 contribution and ranks the province as the 5th highest contributor towards the national industry.

In the secondary and tertiary industries, Gauteng still dominates in terms of each share towards all the national industries, with KwaZulu-Natal and Western Cape interchanging their rankings between 2nd and 3rd place amongst various industries in 2016. The Free State contributed 4.3 per cent towards SA's manufacturing, which has remained unchanged from its 2015 contribution; the province ranks at 6th position. Free State's contribution towards the national electricity industry has decreased from 6.2 per cent in 2015 to 6.1 per cent in 2016 and ranks at 6th position nationally. Similarly to manufacturing, the province's contribution towards the

national construction industry in 2016 has remained unchanged from 3.2 per cent in 2015 and ranks at 2nd least amongst provinces.

Within the tertiary industries, the contribution of Free State towards the trade industry has slightly declined from 4.9 per cent in 2015 to 4.7 per cent in 2016 and ranks at 2nd least nationally. In addition, the province's contribution towards the national transport industry in 2016 has remained unchanged from 5.3 per cent in 2015 and ranks at 5th position. Free State has also decreased its contribution towards South Africa's finance industry, from 4.2 per cent in 2015 to 3.9 per cent in 2016, and ranks at 2nd least. The province's contribution has remained 7.0 per cent in 2015 and 2016, and ranks at 6th position. Lastly, Free State's contribution towards general government services has decreased from 5.0 per cent in 2015 to 4.9 per cent in 2016 and ranks at 6th position nationally, sharing the same rank as North West.

Overall, the increase of Free State's contribution towards national industries occurred in two of the nine industries (22 per cent of all industries), namely in agriculture and mining. It is with noting that the province strives towards industrialization, and therefore the strengthening of the link between agriculture and agro-processing can play a supportive role towards the strengthening of manufacturing in the province. Gold, diamonds and coal continue to play a critical role in the Free State mining industry and even though the global demand for gold and coal may have dwindled, Anglo American decision to concentrate on diamonds (together with copper and platinum which Free State doesn't mine) will continue to benefit the Free State economy.

Table 2.2: Provincial distribution of economic activity, 2016 (current prices, %)

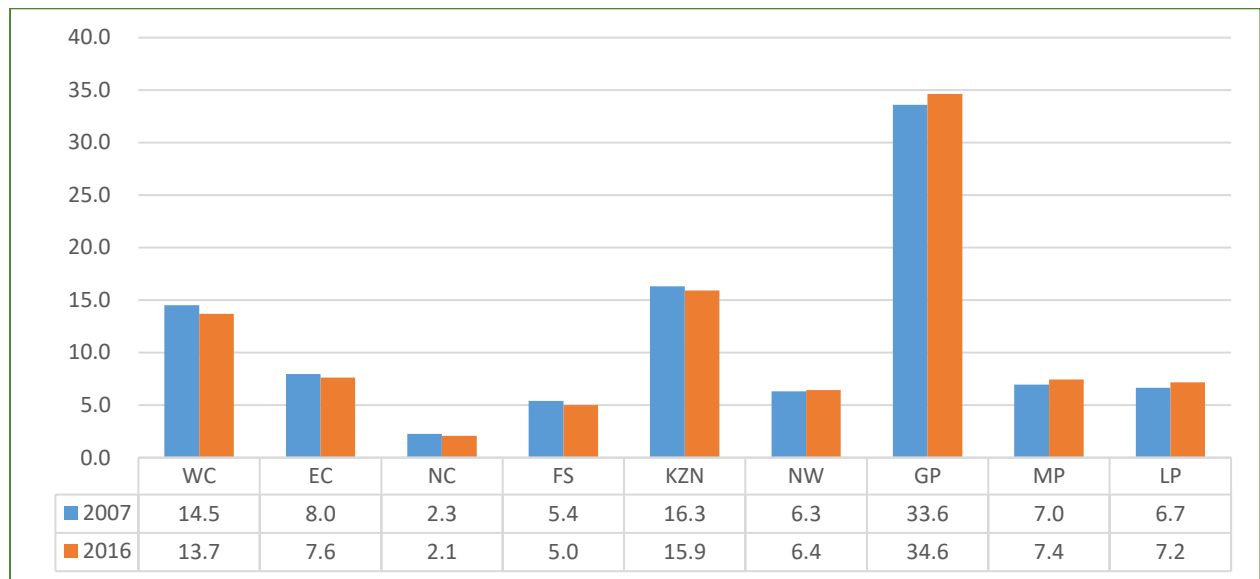
	WC	EC	NC	FS	KZN	NW	GP	MP	LP	SA
Agriculture	22.0	6.0	6.3	10.6	25.2	7.0	6.7	8.7	7.4	100
Mining and quarrying	0.4	0.1	5.6	6.7	3.0	26.9	11.0	21.1	25.1	100
Manufacturing	15.6	7.2	0.6	4.3	21.5	2.6	39.0	7.8	1.6	100
Electricity and water	10.6	4.9	2.3	6.1	16.4	5.9	29.9	15.4	8.4	100
Construction	19.1	8.1	1.9	3.2	17.4	4.0	34.5	5.9	5.9	100
Wholesale and retail trade	15.8	10.4	1.7	4.7	16.4	5.1	31.3	7.3	7.3	100
Transport	15.0	7.2	2.6	5.3	21.7	4.2	35.5	5.0	3.6	100
Finance	17.6	6.8	1.4	3.9	13.2	4.2	43.4	4.3	5.2	100
Personal services	16.0	9.8	2.0	7.0	16.7	8.5	29.7	5.1	5.3	100
General government services	9.0	10.0	2.0	4.9	15.1	4.9	40.7	5.3	8.0	100

Source: Statistic South Africa; Gross Domestic Product, First Quarter 2018

Figure 2.1 below depicts each province's contribution towards the South African economy in 2007 and in 2016. Amongst the three biggest provincial economies in South Africa, only Gauteng increased its contribution towards the national economy, from 33.6 per cent in 2007 to 34.6 per cent in 2016. The contributions of KwaZulu-Natal and Western Cape towards SA's economy declined from 16.3 per cent to 15.9 per cent and from 14.5 per cent to 13.7 per cent respectively over the reference period. The only other two provincial economies which succeeded to increase their contributions towards the national economy are Mpumalanga (from 7.0 per cent in 2007 to 7.4 per cent in 2016) and Limpopo (from 6.7 per cent in 2007 to 7.2 per cent in 2016).

Free State remains the second smallest provincial economy after Northern Cape, and the province's share has declined from 5.4 per cent in 2007 to 5.0 per cent in 2016. The decline of the Free State's share of the national economy over the reference period may reflect the decline of mining, manufacturing, transport, finance and personal services industries in the province (see table 2.1 above). Free State faces an ailing mining industry together with reduced commodity prices, the province's main manufacturing activity depends on the price of oil and the performance of the dollar, whilst low consumer and business confidence, fiscal consolidation and subdued domestic economy have negatively impacted on the performance of the Free State economy in 2016.

Figure 2.1: Provincial contribution to South African economy: 2007 and 2016



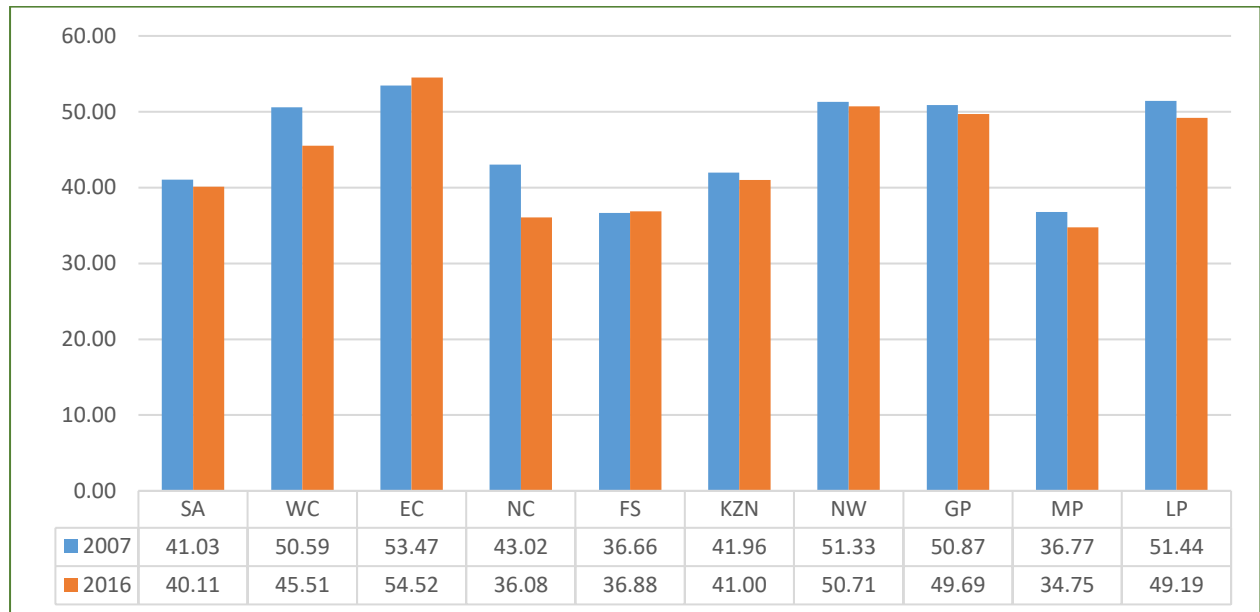
Source: Statistic South Africa; Gross Domestic Product, First Quarter 2018

Figure 2.2 below shows tress indices of all provinces within South Africa. The DBSA (2001) set guidelines to regional socio-economic analysis and one of the indicators included in those guidelines is the tress index. The institution defines the tress index as a “sectoral composition of economic activity in a region which indicates the level of diversification or concentration of a region’s economy”. A tress index closer to zero indicates more diversified economy and a tress index. Therefore, an increase in the tress index that the economy is increasing its dependence on a single or a few industries, which is undesirable. An increased concentration of a region’s economy makes it vulnerable to both internal and external shocks e.g. a decline in commodity prices if that economy depends heavily on mining or drought if it heavily depends on agriculture.

Figure 2.2 below shows that the South African tress index was 41.03 in 2007, but has improved and declined to 40.11 in 2016. A comparison amongst provinces reveals that in 2007, Free State had the most diversified economy with a tress index of 36.66, followed by Mpumalanga (36.77) and KwaZulu-Natal (41.96). On the contrary, Eastern Cape (53.47), Limpopo (51.44) and North West (51.33) had the least diversified economies. In 2016, Mpumalanga had the most diversified economy with a tress index of 34.75, followed by Northern Cape (36.08) and Free State (36.88). Provinces which had the least diversified economies in 2016 are Eastern Cape (54.52), North West (50.83) and Gauteng (49.69). The tress index of the Free State, which was 36.66 in 2007, has slightly worsened to 36.88 in 2016. In comparison with other provinces,

the tress index of the province has changed the least by 0.22 over the reference period, but its rank declined from the province with the most diversified economy in 2007 to the 3rd most diversified provincial economy in South Africa in 2016. It is with noting that in comparison with the country, the tress index of the province has remained below that of the country in 2007 and in 2016.

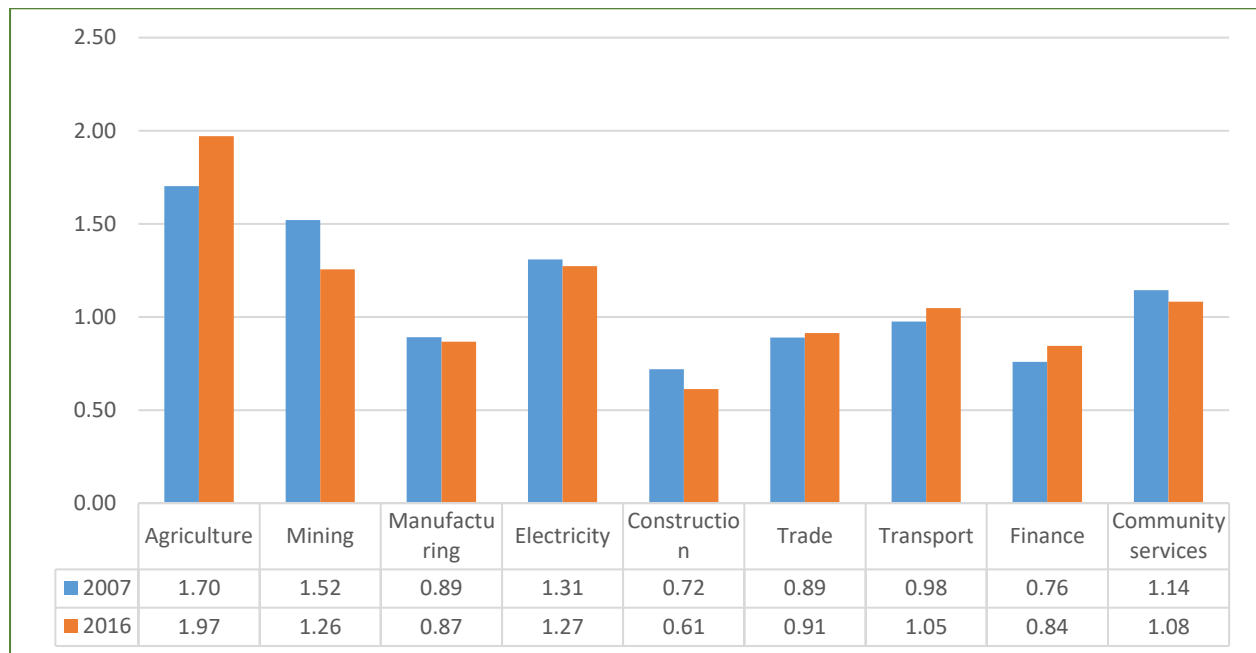
Figure 2.2: Tress Index, 2007 and 2016



Source: IHS Markit ReX, 4th Quarter, 2017

Figure 2.3 below indicates the location quotient of all industries within the Free State economy. A location quotient measures an industry’s concentration in a particular region (e.g. Free State) in relation to the entire reference area (e.g. South Africa). The economic indicator measures the province’s key industries in terms of their employment contribution, relative to the employment contribution of the entire country. Therefore, a location quotient measures a province’s comparative advantage in a particular industry, and a province is deemed to have comparative advantage (disadvantage) in a particular industry if its index is greater (less) than 1.

Figure 2.3: Location quotient



Source: IHS Markit ReX, 4th Quarter, 2017

In 2007, the Free State province had the greatest comparative advantage in agriculture with a location quotient index of 1.70, which was followed by mining (1.52), electricity (1.31) and community services (1.14). In 2016, the province’s comparative advantage in agriculture strengthened, from 1.70 in 2007 to 1.97 in 2016. Although the Free State province still has comparative advantage in mining, electricity and community services, its comparative advantage in these industries has declined between 2007 and 2016. Therefore, the province had comparative advantage in mining, electricity and community services of 1.26, 1.27 and 1.08 respectively in 2016. A notable change for the province is in transport. In 2007, the province didn’t have a comparative advantage in transport (0.98), however the province has since gained comparative advantage in the industry (1.05) in 2016.

The province seeks to bolster industrialization, and subsequently, attain comparative advantage in manufacturing in the future. The Prebisch-Singer hypothesis argues that the long term terms-of-trade for primary commodities decline relative to the terms-of-trade of manufactured goods. Therefore, industrialization plays an important role in increasing the export value of a country (or region) over the long term. In the Free State province, this industrialization can be realized through agro-processing, amongst other industries. Therefore, it is advantageous that the

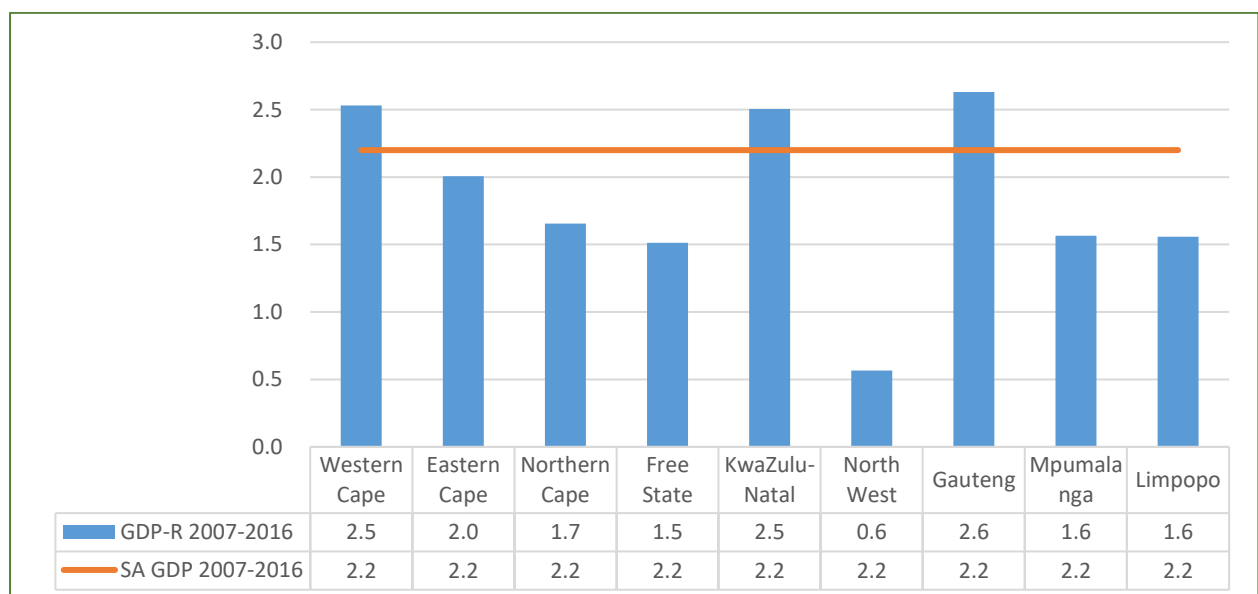
province has a strengthening comparative advantage in agriculture, as an input to agro-processing.

Also, the Free State province has developed an Agriculture Master Plan, which can assist investors or farmers to know which part of the province has suitable soil for which plant.

2.3. FREE STATE ECONOMIC PERFORMANCE

The Free State province has been in recession from 2015 to 2017. The two most notable economic occurrences which have undermined the performance of the provincial economy recently have been the 2015/16 drought and declining commodity prices. However, the historically higher growth rates of the province such as the 2010 FIFA World Cup have ensured that the average growth rate of the economy between 2007 and 2016 remains positive. Figure 2.4 below shows the average performance of the Free State province over a 10-year period, in comparison with the South African economy and other provinces. The average growth rate of the Free State between 2007 and 2016 is 1.5 per cent, which is 0.7 percentage points below the national average growth of 2.2 per cent over the review period. The Free State’s average growth rate is the 2nd lowest in the country over the reference period, and the only provinces which have grown above the national growth rate on average are Gauteng (2.6 per cent), KwaZulu-Natal (2.5 per cent) and Western Cape (2.5 per cent).

Figure 2.4: Average real annual economic growth rate by region: 2007-2016



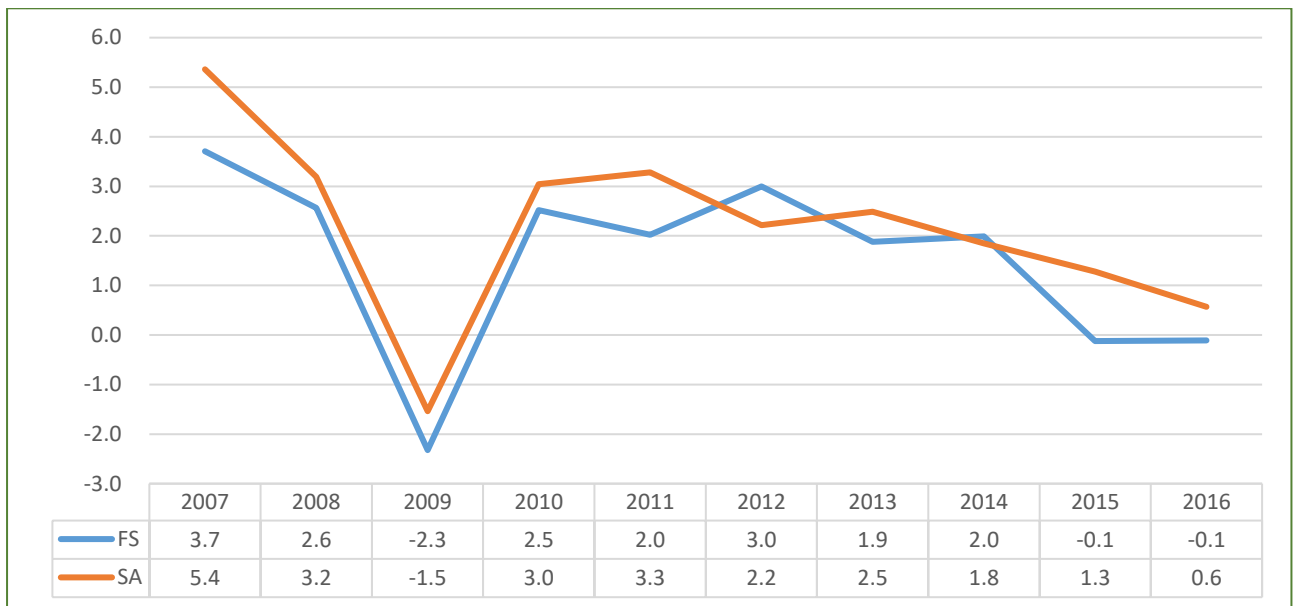
Source: Statistic South Africa, Gross Domestic Product, First Quarter 2018

Figure 2.5 below depicts the South African and Free State real annual GDP growth rates between 2007 and 2016. Throughout the reference period, the Free State economy grew above the South African economy only in 2012 and 2014. In 2012, the provincial economy grew by 3.0 per cent, which is 0.8 percentage points higher than the 2.2 per cent growth of the national economy. Two years later, the Free State economy grew by 2.0 per cent in 2014, which is equivalent to 0.2 percentage points above South Africa's economic growth rate on 1.8 per cent in the same year. The country experienced industrial strikes in the platinum mining industry, which occurred both in 2012 and 2014. These two strikes had no impact on Free State, given that the commodity is not mined in the province. Also, the trade industry of the Free State also performed better than its national counterpart in 2012 whilst the provincial manufacturing industry performed better than the national manufacturing industry in 2014.

Statistics South Africa (2018) depicts that the latest recession being experienced by the Free State economy started in 2015, when the provincial economy declined by 0.1 per cent, which is 1.4 percentage point below the country's growth rate of 1.3 per cent in the same year. The provincial economy was negatively affected by the 2015 drought, as well as reduction in commodity prices which commenced in 2012.

The provincial recession continued in 2016, as the economy declined by 0.1 per cent, in comparison with South Africa's growth rate of 0.6 per cent in the same year. The 2015 drought filtered into 2016, causing the provincial agricultural industry to decline by 19.8 per cent. Although the price of some mining commodities such as iron ore and oil prices started rising in late 2016, these were not beneficial for the province as the region's mining industry declined by 2.1 per cent in 2016. Another provincial industries which contributed towards the recession in the Free State in 2016 was electricity (-2.1 per cent). The performance of the electricity industry could have also been affected by the 2015/16 drought, through the water sub-industry.

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



Source: Statistic South Africa; Gross Domestic Product, First Quarter 2018

Table 2.3 below displays sector performance of the Free State between 2007 and 2016. Within the primary industries, agriculture declined by an average of 1.4 per cent between 2007 and 2016, which was exacerbated by the 2015/16 drought. Severe drought affected field crop, horticulture as well as animal production in 2015 and in 2016, which caused the industry to decline by 25.0 per cent and 19.8 per cent respectively in the Free State. The mining industry of the province declined by an average of 0.8 per cent over the reference period. Post the recession, the mining industry declined the most in 2016. Although commodity prices started increasing towards the end of 2016, low levels of confidence and policy uncertainty with regard to the Mining Charter contributed towards the decline of the industry in 2016. The mining industry also faced lower production in almost all mineral groups, including gold and coal. In the case of coal, mines which are depleted were closed and maintenance was done on others (SARB, 2017).

Within the secondary industries, manufacturing in the Free State grew by an average of 1.1 per cent between 2007 and 2016, with high growth rates of the industry visible in 2010 and 2014. However, the impact of production of petroleum and its by-products was most evident in the 2nd quarter of 2016, when petroleum and its by-products played a significant role in avoiding the country's recession in the first half of 2016. The electricity industry declined by an average of 0.4 per cent between 2007 and 2016. The negative growth rates of the industry pre-recession

may have been due to electricity shortages the overall country was experiencing and post the recession, whilst post the recession, the industry declined the most by 2.1 per cent in 2016. Although electricity supply may have been favourable in 2016, the poor performance of the electricity industry is a reflection of mild winter weather, the implementation of high electricity tariffs, the use of alternative sources of energy, poor performance of energy-intensive mining industry and the impact of drought on the water sub-industry. The construction industry grew by an average of 4.0 per cent over the reference period, supported mainly by the 2010 FIFA World Cup. Of late, the industry's performance has been lacklustre, growing only by 0.6 per cent in 2016. Low business confidence and fiscal consolidation continue to weigh down on the industry.

Within the tertiary industries, the trade industry has increased by an average of 2.1 per cent between 2007 and 2016. Although the industry grew by 7.9 per cent in 2012, this growth rate has dwindled to 0.8 per cent in 2016, and may reflect the recession the province experienced in 2016 and its impact on retail, wholesale and domestic tourism. The average growth rate of the transport industry was 1.9 per cent between 2007 and 2016, and the industry was mainly supported by higher growth rates pre-recession. Post the recession, the transport industry of the province has grown below 2 per cent for the majority of the time, and even grew by a minute 0.4 per cent in 2016. The lacklustre growth of the transport industry in 2016 may be attributed to the 3rd quarter industrial strike in the petroleum industry, which temporarily hampered the delivery of fuel to petrol stations and impacted all transport related activities including logistics. The low growth of the industry is also a reflection the mining industry's impact on freight transportation, as well as passenger transport being negatively affected by higher transport tariffs, rising oil prices towards the end of 2016 and the 2016 provincial recession.

The provincial finance industry grew by an average of 2.2 per cent between 2007 and 2016. Post the recession, the industry had the highest growth rate of 3.2 per cent in 2012. SARB (2013) attributes the high growth rate of 2012 to increased activity in the equity, bond & other financial markets, improvement in the lending activities of banks as well as a recovery in the confidence in the life insurance industry. The personal services industry grew by an average of 1.8 per cent whilst general government services grew by an average of 3.2 per cent between 2007 and 2016. The high average growth rate of general government services reflects high growth rates of the industries before the implementation of fiscal consolidation. Given that fiscal consolidation continues to be implemented, the industry grew by 1.5 per cent in 2016,

reflecting the deceleration in general government employment and the subsequent reduction in compensation of employees, as well as the subdued national and provincial economies' impact of revenue and expenditure.

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

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Agriculture	2.3	26.4	-3.5	1.0	-8.6	1.8	4.3	6.9	-25.0	-19.8
Mining	-2.5	-5.9	-5.8	4.7	-1.4	1.1	2.1	2.5	-0.8	-2.1
Manufacturing	4.5	1.9	-7.9	5.7	1.3	0.9	0.9	2.6	0.2	0.7
Electricity	2.6	-4.2	-2.9	2.5	1.6	0.2	0.2	-0.8	-0.7	-2.1
Construction	16.1	7.0	11.2	-5.7	0.6	2.7	4.0	2.2	1.6	0.6
Trade	4.5	1.2	-3.1	3.5	2.8	7.9	1.6	1.1	1.1	0.8
Transport	6.0	3.5	-1.7	1.0	2.4	1.6	1.4	2.3	1.7	0.4
Finance	5.1	4.3	0.1	0.4	2.8	3.2	0.1	2.0	1.7	2.1
Personal services	5.0	3.4	-1.6	0.2	2.4	1.7	2.2	1.2	1.3	1.9
General government services	4.6	5.3	2.6	2.4	4.7	3.2	4.1	2.2	1.7	1.5

Source: Statistic South Africa; Gross Domestic Product, First Quarter 2018

2.4. SECTOR ANALYSIS OF THE PROVINCIAL ECONOMY

2.4.1. Primary Industries

As shown in figure 2.1, the primary industries collectively account for 15.7 per cent of the provincial economy. Agriculture accounts for 5.2 per cent of the economy, whilst mining account for 10.5 per cent of the economy (Statistics South Africa, 2018). The Crop Estimates Committee (2018) indicates that Free State produced the highest quantity of maize in 2017, equivalent to 7.3 million tons or 43.8 per cent the maize produced in South Africa. Free State is projected to remain the largest producer of maize in 2018, and is projected to produce 5.3 million tons or 43.6 per cent of the country's maize. Agriculture in the Free State also plays a critical role for the country in other produce, as the province was also the largest producer of sunflower seeds (54.7 per cent), the 2nd largest producer of soybeans (38.8 per cent), groundnuts (37.0 per cent), wheat (16.1 per cent) and the 3rd largest producer of sorghum (16.2 per cent) in 2017. One of the support programmes provided by government in order to boost the agricultural industry of the Free State (and the country) is the extension of the Black

Industrialist Programme towards black commercial farmers. A total of 50 commercial farmers from each province, including Free State, will benefit from the BIP.

Mining continues to influence the performance of the South African and Free State economies, as evident during the commodity slump. Amongst other commodities that the Free State mines is gold, coal and diamonds. Due to the commodity slump, the demand for gold and coal has dropped, negatively affecting the prices of these commodities. Besides the commodity slump, mining in the Free State has also been recently influenced by two significant events, which is the unbundling of Gold Fields and the decision by Anglo American to concentrate on three minerals – copper, platinum and diamonds. This has meant that while the mining of gold and coal has been negatively affected by recent global and domestic events, the production of diamonds has increased, benefiting the province. By-products of gold operations (uranium, silver, platinum-group metals and sulphuric acid) and bentonite are also found in the Free State. The most promising event which may benefit mining in the Free State is the revision of the Mining Charter which will take place in 2018, which will boost investor confidence in the country and province.

2.4.1.1. Agriculture, forestry and fishing

The 2015/16 El Nino episode and the consequent drought which was experienced by South Africa and the Free State displayed the importance and impact of the agricultural industry. Nationally, agriculture contributes 2.4 per cent towards the economy whilst in the province, the industry accounts for approximately 4.8 per cent of the economy. The sizes of the national and provincial agricultural industries might seem minute, however they contributed towards a tremendous rise in food inflation in the country, which resulted in the average of the inflation of food and non-alcoholic beverages to be 10.5 per cent in 2016. Whilst this inflation rate reverted back into the upper target band in August 2017, its average between January 2017 and September 2017 is 7.6 per cent. High food inflation negatively affects consumer welfare through declining disposable income in real terms as well as rising interest rates, and leaves many South Africans vulnerable to food insecurity.

Also, the after effect of the El Nino episode was the outbreak of army worms in the early months of 2017 in South Africa as well as some parts of Sub-Saharan Africa. However, the

damage caused by these worms was limited in South Africa due to genetically-modified crops (GMO), cold weather and the rainfall (which limits their ability to fly).

Instead, the end of the 2015/16 drought through rainfalls brought some relief for the farming sector as well as consumers. The Crop Estimates Committee predicts that South Africa will plant 16.7 million tons of maize in 2017, which is more than twice the maize of 7.7 million tons produced in 2016. The impact of increased supply of maize is the reduction in its prices to the final consumer, as well as increased exports of the commodity by South Africa and the Free State.

Flowing from 2016, the existence of some poultry farms was threatened due to oversupply of the “cheap” brown portion of chickens, mainly from the European Union (EU) and Brazil. The affected companies were Astral Chickens, Country Bird Chickens and Rainbow Chickens, with Rainbow Chicken foreseeing closure of 15 of its farms, resulting in the loss of employment to the tune of 20 000. Some stakeholders believe that the challenge of foreign competition on the local poultry industry may have been exuberated by the regulation to cap the brine injected in chicken at 15 per cent, which is believed to have kept the price of chicken produced locally elevated. The Department of Trade and Industry (DTI) to this challenge by imposing a 13.9 per cent safeguard duty on imports of bone-in chicken from the UK as well as the EU. The department is also seeking new markets for South African chicken such as the Middle East. Another challenge which exists w.r.t to imported poultry is the lack of traceability of different chicken portions within one bag of chicken meat. A single bag of frozen chicken can consist of pieces from as many as five different countries, which is not only confusing for consumers but can have serious health implications.

A challenge which also occurred in the poultry industry of South Africa was the outbreak of Avian influenza (Bird Flu) in June 2017; in 2015 alone, the virus cost South Africa approximately R40 billion. Where the virus was detected, such as the first outbreak in Mpumalanga, those farms were under quarantine and the chickens have been culled. The outbreak of Bird Flu temporarily affected trade, as it resulted in countries such as Botswana, Zimbabwe, Mozambique and Namibia banning chicken import from South Africa following the outbreak. The Avian Flu has since been contained in South Africa.

However, the biggest scandal which has affected the poultry industry is the outbreak of Listeriosis in South Africa in 2017/18, with a Rainbow Chicken factory in Wolwehoek in the Free State initially implicated, but cleared in March 2018 of any connection to the ST6 strain.

Although agriculture faced so many challenges in 2017/18, there exist some opportunities for the agricultural industry in South Africa and the Free State. A memorandum of understanding was signed between South Africa and China in February 2017, to allow South Africa to export beef to China. This presents opportunities, not only for South Africa but for the Free State. The Free State Department of Agriculture and Rural Development has set aside R40 million for the construction of an abattoir and for the development of Thabo Mofutsanyana Beef Development zone. This allocation will also be utilized to establish feedlots and support beef farmers with good quality beef animals (FS Department of Agriculture and Rural Development Vote speech, 2017/18). Also, the Department of Agriculture and Rural Development and the House of Traditional Leaders visited Rwanda in November 2017 in a quest to enhance food security and learn best practices from other countries. Through Marena Hlasela Tlala program, the department seeks help people living in rural villages to grow their own food.

Lastly, South Africa as a whole can benefit from innovation in agriculture, such as the Mobile Fly Farm created by Bandile Dlabuntu. The Mobile Fly Farms use black soldier fly larvae to convert organic waste into animal feed; it aims to assist emerging farmers to organically improve their yields. This kind of innovation is imperative by reducing the input cost associated with animal production given that animal feed is expensive.

Table 2.4 depicts the contribution of each province to the agricultural industry of the country. The contribution of the Free State's agriculture, forestry and fishing to the national industry has averaged at 10.1 per cent between 2007 and 2016, behind KwaZulu-Natal (26.1 per cent) and Western Cape (22.3 per cent). The average contribution to the national agriculture, forestry and fishing industry is lowest in Eastern Cape (5.5 per cent), Gauteng (6.2 per cent) as well as Northern Cape and North West (6.5 per cent each). Following the 2015/16 drought, the Crop Estimates Committee projects Free State to be the biggest producer of white and yellow maize, which is equivalent to 7.3 million tons or 43.8 per cent of total maize production in South Africa in 2017. Free State is projected to also be the biggest producer of sunflower seeds in the country in 2017 (478 500 or 54.7 per cent), and also the 2nd largest producer of soybeans after Mpumalanga at 504 000 tons or 38.3 per cent of South Africa's production.

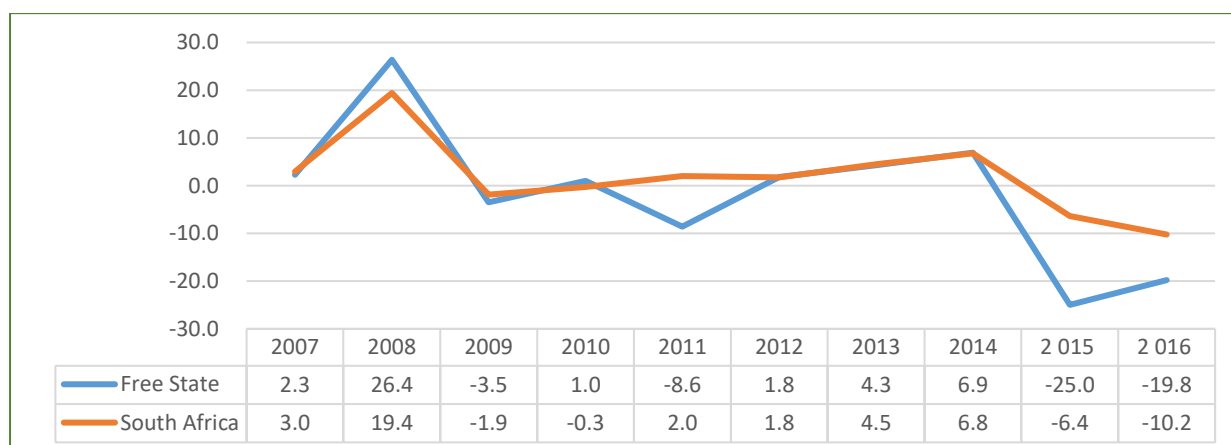
Table 2.4: Contribution by province to agriculture, forestry and fishing (%)

Province	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	23.9	22.0	21.9	22.1	22.6	22.3	22.3	22.0	21.9	22.0
Eastern Cape	5.4	5.1	5.1	4.8	5.3	5.7	5.5	5.9	6.1	6.0
Northern Cape	6.3	6.4	6.4	6.5	6.4	6.6	6.3	6.8	6.9	6.3
Free State	9.2	11.1	11.0	10.2	9.8	9.6	9.7	9.9	10.0	10.6
KwaZulu-Natal	25.6	26.2	26.8	27.0	26.6	26.1	26.4	25.5	25.6	25.2
North West	6.6	6.3	6.1	6.2	6.6	6.8	6.7	7.2	6.8	7.0
Gauteng	6.2	5.9	5.8	5.9	6.1	6.2	6.2	6.6	6.6	6.7
Mpumalanga	9.3	9.2	9.1	9.0	9.0	9.1	9.3	9.2	9.0	8.7
Limpopo	7.5	7.8	7.8	8.2	7.7	7.8	7.5	7.1	7.3	7.4

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

The average growth rate of the provincial agriculture, forestry and fishing declined by 1.4 per cent between 2007 and 2016, and is below the average growth rate of South Africa of 1.9 per cent over the reference period. Post the recession, the provincial agricultural industry declined in 2011, 2015 and 2016, when the industry declined by 8.6 per cent, 25.0 per cent and 19.8 per cent respectively. Production in 2011 was adversely affected by unfavourable weather conditions which resulted in the lower production of maize (prolonged dry spells, followed by rainy periods), and yield losses were also aggravated by harvesting difficulties experienced during this period. The decline of the provincial industry in 2015 and 2016 was caused by El Nino episode, which caused drought. Although some rainfall relief occurred towards the end of 2016, dry underground soil conditions impacted negatively on the production of field crops and horticulture.

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



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

2.4.1.2. Mining and quarrying

Part of the efforts made by the South African government to ensure inclusive growth and radical economic transformation in 2017 is in the area of mining. The third Mining Charter, which was realized in June 2017, seeks that the mandatory black ownership of mining assets be raised from 26 per cent to 30 per cent. The 30 per cent black ownership will be made up of shares held by black investors, employees and community groups, as it relates to black ownership in mining companies, employment equity targets, procurement of mining goods, and a community-development tax equal to one percent of revenue. At present, the new Mining Charter is being challenged by both the Chamber of Mines as well as community organisations. The former is challenging it from a stand point that the Minister of Mineral Resources is not empowered by the Mineral Resource Act to effect those changes in the new Mining Charter, whilst community organisations are challenging it based on the lack of consultation. The government of South Africa will undertake a review of the Mining Charter in 2018, which has boosted investor confidence and has eased the concerns brought forward by major rating agencies.

South Africa has also faced other challenges in the mining industry in 2017, which include the expected closure of three gold mines by Anglo Gold and Sibanye Gold. In August 2017, Sibanye Gold cited illegal mining, poor productivity and the strong rand as the factors behind its plans to shed approximately 10 000 jobs. Gold production for Anglo Gold Ashanti may have been negatively affected by high costs, declining productivity, volatile commodity prices as well as stagnant, weak prices (e.g. in the case of platinum). The closure of two gold mines by Anglo Gold might equate to a decline of approximately 85 000 jobs in the industry.

In September 2017, South Africa also discovered that it has considerable less shale gas in the Karoo, almost 40 times less than the previous estimate of 390 trillion cubic feet (Tcf). The technically recoverable shale gas reserves are estimated at closer to 13 Tcf. However, it is believed that the Karoo deposits may still serve purpose and be of commercial interest to large gas-fracking companies such as Shell.

The mining industry of the country is facing several challenges; however, government continues to bolster growth in several sub-industries of mining. Although average platinum prices have declined from \$987 per toz in 2016 to \$921 per toz in October 2017, South Africa

has been bolstering in efforts to boost the industry through attending the 2nd Conference on Platinum Group Metals in Moscow in October 2017. South Africa and Russia entered into a MOU in 2013 in areas of corporation between the two countries for skills development, R&D and investment opportunities, particularly in the platinum industry; these two countries are the two largest producers of platinum.

Table 2.5 below depicts the average contributions by provinces towards the South African mining and quarrying industry. The provinces with the largest average contributions between 2007 and 2016 are North West (25.8 per cent), Limpopo (23.7 per cent) and Mpumalanga (21.2 per cent). The provinces which contribute the least towards the national mining industry in average terms over the reference period are Eastern Cape (0.3 per cent), Western Cape (0.4 per cent) and KwaZulu-Natal (3.3 per cent). Free State has contributed 7.6 per cent between 2007 and 2016, and ranks at 5th position in terms of its contribution towards the national mining and quarrying industry.

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

Province	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.4
Eastern Cape	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.2	0.1
Northern Cape	6.7	6.7	6.5	6.5	5.8	6.0	6.1	6.1	5.5	5.6
Free State	8.2	8.6	8.2	8.2	7.4	7.4	7.2	7.3	6.5	6.7
KwaZulu-Natal	3.5	3.6	3.4	3.5	3.1	3.4	3.3	3.5	2.9	3.0
North West	25.6	25.3	25.5	25.4	26.4	22.7	26.6	26.1	27.7	26.9
Gauteng	12.6	12.2	12.1	12.1	11.5	12.0	11.0	10.9	10.3	11.0
Mpumalanga	19.6	19.8	20.1	20.4	21.5	24.1	21.6	21.8	21.8	21.1
Limpopo	23.1	23.2	23.3	23.2	23.6	23.7	23.6	23.8	24.6	25.1

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

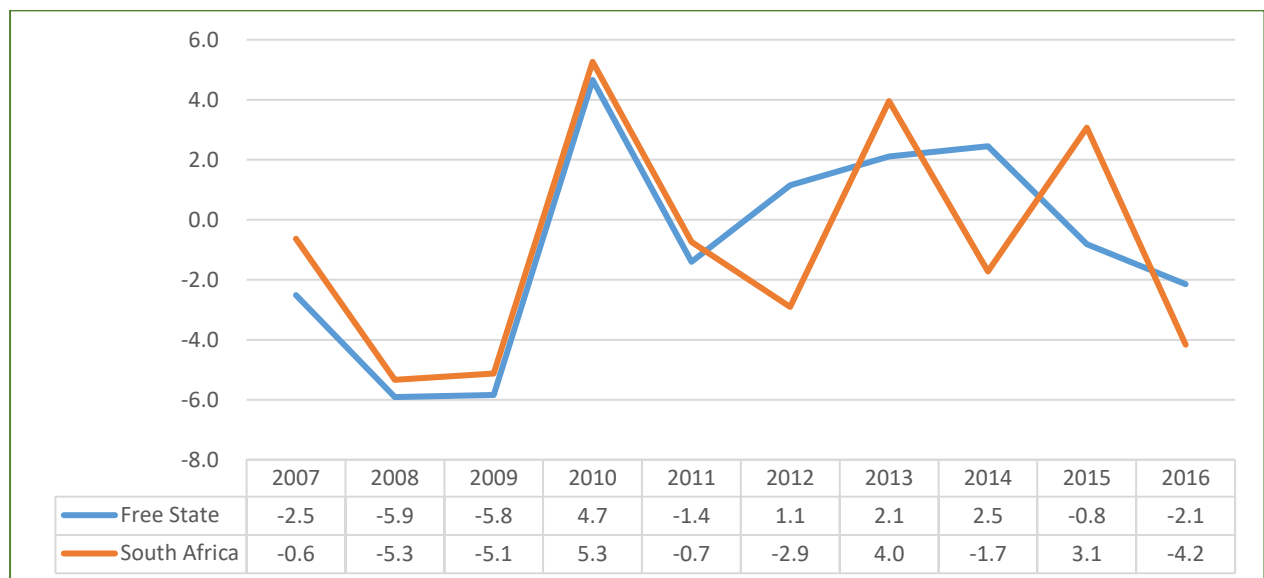
As depicted in figure 2.7 below, the Free State mining and quarrying industry declined by an average of 0.8 per cent between 2007 and 2016, similarly to the decline by the national industry over the reference period. Post the recession, the biggest decline in the growth of the national and provincial mining industries occurred in 2016, when these industries declined by 4.2 per cent and 2.1 per cent respectively. Nationally, the biggest declines of the mining industry occurred in the 1st and 4th quarters of 2016. The decline of South Africa's mining industry growth in the 1st quarter was due to the decline in the production of iron ore as well as the

necessary safety stoppage at a platinum refinery due to a fire. In the 4th quarter of 2016, the growth of the national mining industry also declined due to the lower production in all major mineral groups, in particular gold, platinum, coal and iron ore. Platinum production continued to trend downwards, while coal production decreased in the fourth quarter of 2016, partly due to depleted mines being shut down and maintenance done at some other mines.

SARB (2017) notes that on an annual basis, real output of the mining sector contracted in 2016 as production in all mineral groups declined over the period, with the exception of building materials. Although the industry experienced an increase in commodity prices (although still relatively low), the decrease in mining output could in part be attributed to low levels of confidence and legislative uncertainty in the mining sector as well as steep increases in the cost of electricity and steel, and the cost of ensuring the safety of mine workers.

Aside from 2016, the growth of the Free State mining industry post the recession was higher in 2014, when the provincial mining industry grew by 2.5 per cent, contrary to the decline of the national mining industry 1.7 per cent in the same year. Mining in South Africa declined in 2014 due to the effects of labour strikes in the platinum industry, which the province does not produce.

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



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

2.4.2. Secondary industries

The secondary industries collectively account for 18.7 per cent of the Free State economy, with manufacturing taking the lion's share of the secondary industries (Statistics South Africa, 2018). Within the secondary industries, manufacturing contributed 11.6 per cent towards the provincial economy, followed by electricity (4.6 per cent) and construction (2.6 per cent) in 2016. In South Africa as a whole, manufacturing still facing a downside risk due to the over-supply of the commodity globally, which puts downward pressure on steel prices. The USA's decision to impose a 10 per cent import tariff on steel in March 2018 is also unfavourable for manufacturers in South Africa. However Free State doesn't produce steel, but mainly depends on petroleum and petroleum products as the main component of manufacturing in the province. Therefore, the performance of manufacturing in the Free State depends on the exchange rate between the Rand and the Dollar, and directly depends on the price of oil.

Electricity is one of the main factors that are driving economic growth in the country and electricity supply has been reliable in South Africa in recent years. However, the cost of electricity is increasing, and citizenry are finding and utilizing alternative sources of energy (SARB, 2017). The approval by NERSA for a 5.23 per cent hike in electricity tariffs in 2018 will be beneficial for both citizenry and businesses in the wake of other rising costs e.g. VAT.

Investor and business confidence play a key role in the performance of the construction industry given that the private sector plays a significant role in this industry. The Nedbank Group (2018) composed a Capital Expenditure Project Listing shows that planned capital formation remained weak in 2017 and that the value of projects announced decreased from R90.6 billion in 2016 to R63.0 billion in 2017, while the number of projects fell from 67 to 48 after 67 over the same period. The private sector announced the most projects, although the number of projects recorded declined in 2017. The number of projects by general government and public corporations also dropped. However, Nedbank Group (2018) believes that growth in gross fixed capital formation is likely to improve in 2018, supported by better global growth prospects, firmer international commodity prices and rising investor confidence based on political certainty, which encourage fixed investment plans by the private sector.

2.4.2.1. Manufacturing

The Free State Growth and Development Strategy as well as the Provincial Economic Development Strategy identify manufacturing as one of the important industries needed to propel inclusive growth of the province over the long term. Through the Special Economic Zone Programme by the Department of Trade and Industry, the Free State government launched the Maluti-a-Phofung SEZ in April 2017 as part of its efforts to boost industrialization, regional development and job creation in the Free State. A SEZ is defined as a geographically designated area of a country set aside for specifically targeted economic activities, which are supported through special arrangements and support systems to promote industrial development. The SEZ will also serve an important role in attracting foreign direct investment into the country and province. Value –addition of natural and mineral resources, focused on priority sub-industries such as automotive, agro-processing, logistics, ICT, pharmaceuticals and general processing. The SEZ is projected to create approximately 22 000 job opportunities.

The Free State government is also giving support for a fully functioning industrial park in Botshabelo. An amount of R24 million was spent to revitalize the Botshabelo Industrial Park, which was launched by the Department of Trade and Industry in June 2016. This industrial park focuses on manufacturing activities such as corrugated iron, paraffin stoves, clothing, etc. It forms part of a group of well-established industrial infrastructure in the Free State, such as those in Phuthaditjhaba, Tshiame and Thaba Nchu.

Although manufacturing is attracting investment both nationally and in the province, it has faced a couple of headwinds in 2017. In April, the USA declared a dumping probe on countries it perceives to be dumping or illegally subsidizing imports of steel, chemicals and other products. The implied dumping in this case means manufacturers are exporting products to another country at a price below the price charged in their home market, or below its production costs, with the sole purpose of to drive out competition and increase its market share. The countries implicated in this probe include South Africa, Belarus, Italy, South Korea, Russia, Spain, Turkey, Ukraine, United Arab Emirates and Britain.

Also, a cartel which plotted, fixed prices and divided markets in the milling industry had been identified by the Competition Commission and fined R4.4 million. This cartel included a

collusion with other maize milling firms to fix the price of milled white maize and the dates when the new pricing would be implemented. Cartels such as the one identified in the food sector are undesirable as higher prices are passed on to the most vulnerable of consumers, who spend a large portion of their income on food. Cartels also negatively impact agriculture as well as value- addition by keeping emerging farmers and agents out of the market.

Table 2.6 below shows the contribution of each province’s manufacturing towards South Africa’s manufacturing industry. The three biggest provincial economies (Gauteng, KwaZulu-Natal and Western Cape) also have the highest average contributions towards South Africa’s manufacturing industry between 2007 and 2016, which are 39.8 per cent, 21.1 per cent and 15.5 per cent respectively. Conversely, Northern Cape, Limpopo and North West contribute the least towards the national manufacturing industry, as these provinces contributed an average of 0.5 per cent, 1.5 per cent and 2.7 per cent respectively over the reference period. The manufacturing industry of the Free State has contributed an average of 4.2 per cent between 2007 and 2016 towards national manufacturing industry, and ranks at 4th least contributor amongst provinces.

Table 2.6 Contribution by province to manufacturing sector (%)

Province	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	15.0	15.3	15.2	15.4	15.5	15.9	15.9	15.2	15.6	15.6
Eastern Cape	7.7	7.4	7.5	7.6	7.5	7.3	7.3	6.7	7.1	7.2
Northern Cape	0.5	0.6	0.6	0.5	0.4	0.5	0.6	0.5	0.5	0.6
Free State	4.8	4.6	4.3	4.1	4.2	4.0	4.0	3.7	4.3	4.3
KwaZulu-Natal	20.8	21.0	21.2	20.9	21.0	21.0	21.0	21.4	21.5	21.5
North West	2.5	2.4	2.6	2.7	2.9	2.8	2.7	2.7	2.6	2.6
Gauteng	40.3	40.1	39.9	40.1	39.6	39.8	39.8	40.3	38.8	39.0
Mpumalanga	6.9	7.0	7.2	7.1	7.2	7.2	7.2	7.7	7.8	7.8
Limpopo	1.3	1.5	1.4	1.5	1.6	1.5	1.5	1.7	1.7	1.6

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

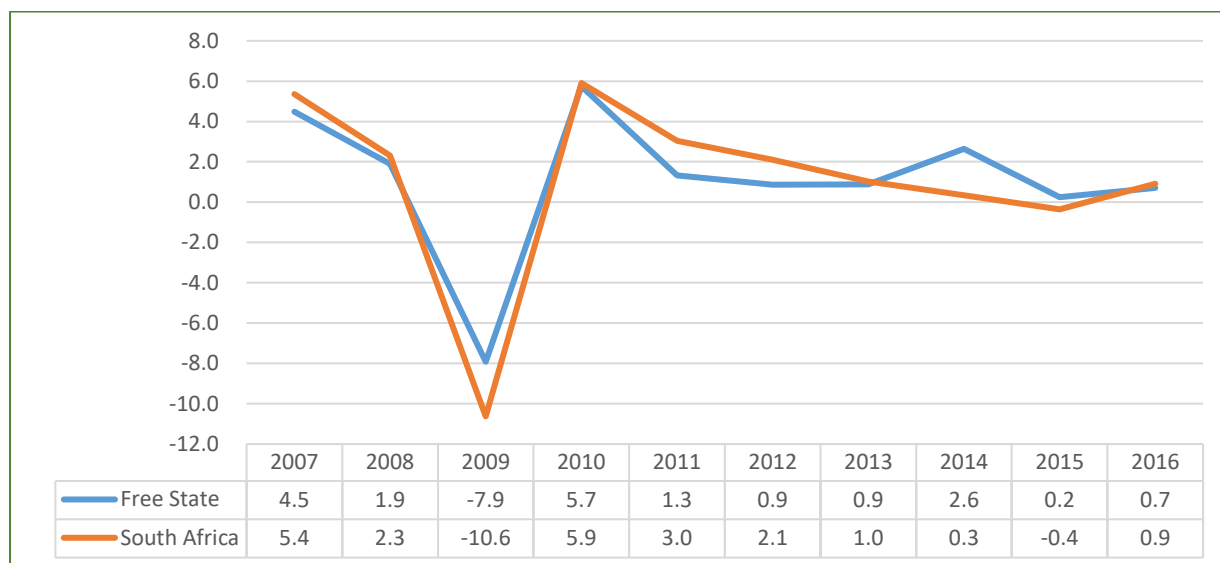
Post the 2009 recession, manufacturing in South Africa and the Free State has followed a downward trajectory in terms of growth. From a pick of 5.9 per cent in 2010, the growth rate of manufacturing in South Africa has declined by 5.0 percentage points to 0.9 per cent in 2016. In the Free State’s case, the growth rate of manufacturing has also declined from 5.7 per cent in 2010 to 0.7 per cent in 2016, which represents a 5.0 percentage point decline over the period.

What is interesting to note is that the growth rate of the manufacturing industry in the Free State exceeded the growth of the national manufacturing industry in 2014, when the provincial industry recorded a growth of 2.6 per cent, which is 2.3 percentage points above the national industry. The growth of the provincial manufacturing industry has remained above the national industry also in 2015, however, the growth of the national manufacturing industry was greater than the provincial industry in 2016.

As alluded in the 2017 FS PERO, South Africa's weaker performance in manufacturing in 2014 is attributed to industrial strikes in the steel and engineering sector, industrial strikes in the platinum sector, the unsteady electricity supply (manufacturing is energy-intensive), the increase in input costs such as electricity and declining commodities prices of commodities such as steel. The consequences of the commodity slump and increased competition from China has negatively affected manufacturing in South Africa through a decline in iron ore prices, which had no impact on manufacturing in the Free State. SARB (2015) notes that in 2014, production increased in manufacturing subsectors such as petroleum, chemical products, rubber and plastic products, which may mainly explain the growth of 2.5 per cent for the provincial manufacturing in that year.

In 2016, manufacturing in the Free State grew by 0.7 per cent, which is 0.2 percentage points below the national industry's growth rate of 0.9 per cent. These growth rates are low and SARB (2017) notes that production activity in the manufacturing sector of South Africa continued to be restrained by factors such as the protracted decline in agricultural output, the contraction in mining output, higher electricity prices feeding into production costs, persistent low business confidence, local infrastructure constraints, and sluggish domestic demand.

Figure 2.8 South Africa and Free State manufacturing sector growth rates



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

2.4.2.2. Electricity, gas and water

South Africa and the Free State must take into account, not only local factors that will determine the production, supply and demand of electricity, but international occurrences as well. Based on the 2009 Copenhagen Accord, China is moving away from its reliance on fossil fuels for energy generations towards the utilization of solar and wind power. It is estimated that China’s wind and solar power will attract an investment of R10.9 trillion between 2016 and 2030 in the country’s pursuit of its renewable energy targets. China desires to increase its non-fossil fuel energy to at least 20 per cent of its total consumption by 2030 in order to tackle air pollution and bring carbon dioxide emissions to a peak by the same year. The implications of China’s changes in its energy creation will likely have a negative impact on both South Africa and Free State as producers of coal. It can almost be expected that the demand for the commodity from both regions will decline, together with commodities prices, and provision for this impact needs to be made. Both South Africa and Free State also need to take cognizance that locally, winter weather is getting milder, hence a reduction in electricity demand may also occur.

Africa is making strides in the creation of clean energy. One of the continent’s biggest solar energy producer, Azuri Technologies, is assisting rural communities to have access to

electricity and boost their economic prospects. This home solar system provides eight hours of hours of lighting and has also enabled people to acquire electronic goods such as cellphones, radios, TVs and have regular access to media and the internet. The system also costs less than utilizing diesel or kerosene, allowing consumers to divert some of their disposal income for other uses. It is estimated that approximately 600 million (or two-thirds) people in Sub Saharan Africa are living without access to the main electricity grid, therefore such renewable energy initiatives will indeed benefit the region through improved quality of life and economic opportunities.

The listing of African Energy Partners (AEP) as a special purpose acquisition company on the JSE in June 2017 is another achievement that has been done in the energy sector. AEP is the first black-empowered energy group on the JSE to expose investors to a full spectrum of clean energy beyond renewable energy, to include Liquefied Natural Gas (LNG) as its fuel of choice. The company will generate income from products it produces such as electricity as well as by-products such as heating and cooling.

Although Eskom is faced a number of challenges such as liquidity in 2017, the state utility has been able to sign a loan agreement with China to the value of R 19.78 billion in the current year. By July 2017, Eskom secured approximately 77 per cent of its funding requirements. The state-owned utility may have produced a surplus of electricity in 2017, which may have benefited the economy of South Africa to meet local demand as well as export sales.

In the Free State, the University of the Free State has collaborated with FCE Consulting Engineers on a ground-breaking initiative by launching its first (out of nine) solar energy charging station which will provide approximately 600 watts of electricity on the Bloemfontein campus. The energy will be utilised by students to charge gadgets such as phones and tablets. The other eight units are expected to be rolled out in the first quarter of 2018 across all three UFS campuses (4 more at the main campus, 2 at the South Campus and 2 more at the QwaQwa campus). This project is beneficial for planet as a clean energy, as well as financial sustainability and to meet the needs of students on those campuses.

Following the 2015/16 drought, the water sub-industry shows that the fullness of Free State Dams was 69.1 per cent as at 27 November 2017, which higher than 2016's average of 51.0 per cent. What is good to note is that the water levels of the 2nd and 3rd largest dams in the Free

State were above the November 2017 average, as Vanderkloof Dam was 70.5 per cent full and Sterkfontein Dam was 94.4 per cent full. The biggest dam in the Free State, the Gariep Dam, was 57.7 per cent full in November 2017.

Table 2.7 below depicts shows the contribution of provinces towards the electricity, gas and water industry of South Africa from 2007 to 2016. Gauteng, Kwazulu-Natal and Mpumalanga contributed the highest towards the national electricity industry with average contributions of 30.4 per cent, 16.6 per cent and 15.2 per cent respectively between 2007 and 2016. In contrast, Northern Cape, Eastern Cape and North West contribute the least towards the electricity industry with average contributions of 2.4 per cent, 4.5 per cent and 5.6 per cent respectively over the same period. The average contribution of Free State towards the electricity industry is 6.1 per cent between 2007 and 2016, and the province ranks at 6th position in terms of its contribution towards the electricity industry of the country.

Table 2.7: Contribution by province to electricity sector (%)

Province	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	10.3	11.0	11.2	11.0	9.9	10.2	10.2	10.4	10.5	10.6
Eastern Cape	4.4	4.1	4.3	3.9	4.8	4.7	4.7	4.4	4.6	4.9
Northern Cape	2.1	2.5	2.7	2.7	2.5	2.3	2.2	2.5	2.4	2.3
Free State	7.1	6.7	6.8	6.6	5.7	5.5	5.1	5.6	6.2	6.1
KwaZulu-Natal	17.1	16.0	16.0	15.5	17.4	17.5	17.2	16.7	16.6	16.4
North West	5.6	5.4	5.6	5.7	5.9	5.1	6.2	5.4	5.6	5.9
Gauteng	30.5	30.9	30.1	31.2	30.2	30.6	30.0	30.4	29.8	29.9
Mpumalanga	14.5	15.1	15.1	15.1	15.2	15.3	15.3	15.7	15.8	15.4
Limpopo	8.4	8.3	8.1	8.4	8.4	8.8	9.0	9.0	8.6	8.4

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

Figure 2.4 below shows that the electricity, gas and water industries of the Free State and South Africa declined by an average of 0.4 per cent between 2007 and 2016. The biggest declines of both industries occurred in 2008, when the country was experiencing electricity supply shortages and the consequent blackouts. Post the recession, the provincial industry grew by 2.5 per cent in 2010, which subsequently declined to a negative 0.8 per cent in 2014, and has worsened to a decline of 2.1 per cent in 2016. The growth of the national electricity industry was 2.4 per cent in 2010, however the growth turned into a negative 0.4 per cent 2012, and has since worsened to a decline of 2.3 per cent in 2016.

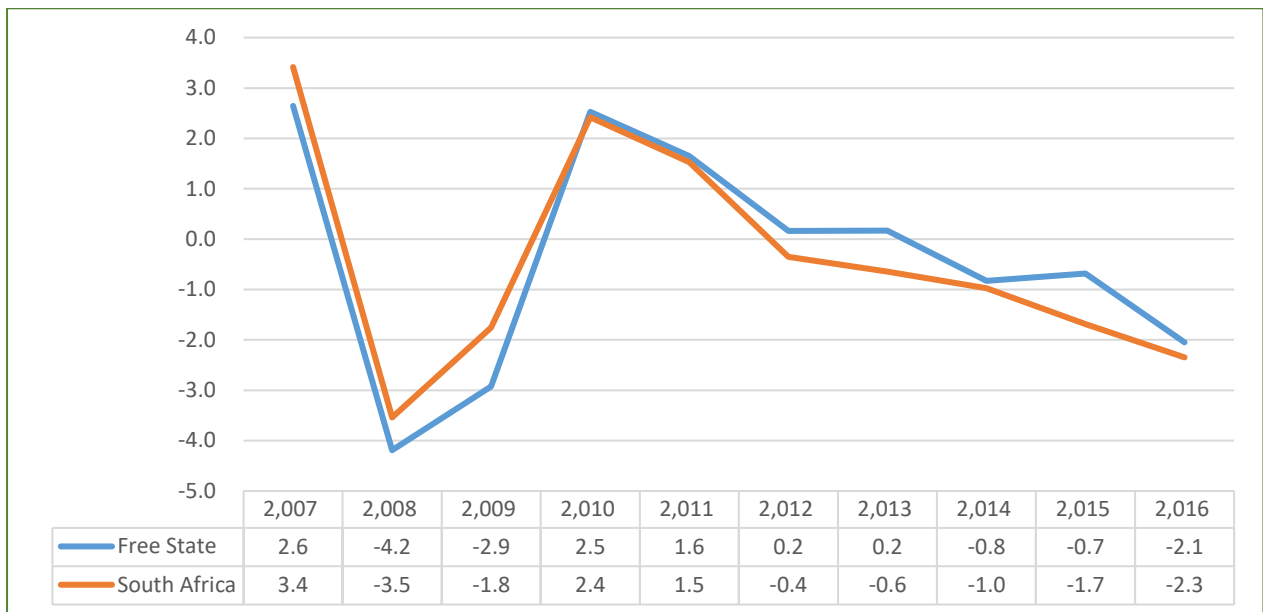
Albeit warmer winter weather and higher electricity tariffs caused a decline of the electricity industry in the country in the 2nd and 3rd quarters of 2010, the high annual growth rate of the industry for both South Africa and the Free State is attributed to stronger demand from the manufacturing and mining industries as well as higher export volumes of electricity to neighbouring countries in the 1st and 4th quarters of 2010 (SARB, 2011).

Whilst the national electricity industry declined by 0.4 per cent in 2012, the industry in the Free State grew by 0.2 per cent in the same year. SARB (2012) attributes the decline of the national industry to lower demand from manufacturing and mining industries (which are energy-intensive), lower consumption due to milder winter weather, a shutdown of some power stations due to maintenance work as well as power buy-back arrangements between Eskom ferrochrome producers. Some of these factors may have contributed towards the provincial industry's lacklustre performance, however what may have resulted in the decline of the national electricity's growth in 2012 could be explained by the power buy-backs. South Africa has the 2nd largest deposit of chrome ore after China, and the mineral is mainly found in the Bushveld Igneous Complex on the north-eastern part of the country. Neither of the two minerals (chromium and iron) which make up ferrochrome are mined or produced in Free State, which may explain why the electricity industry had less challenges in the province. Also, the decline of iron prices during the commodity slump may explain the dire performance of the national electricity industry in comparison with the province.

In 2014, the growth rate of electricity industries of South Africa and Free State simultaneously declined, by 1.0 per cent and 0.8 per cent respectively. SARB (2014) notes that the electricity industry was negatively affected by reduced demand due to moderate winter weather and higher electricity prices, as well the scheduled maintenance, a fire and explosion at two different power stations and a closure of a large aluminium smelter.

In conjunction to some of the common challenges experienced in previous years, the deterioration of the performances of the electricity industries in 2016 may also be attributed to the 2015/16 drought, which negatively affected the water sub-industry.

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



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

2.4.2.3. Construction

In 2015, countries globally adopted the 17 new sustainable development goals as a set of goals to end poverty, protect the planet and ensure prosperity for all over a 15-year period. Among those goals, Goal 9 – Industry, Innovation and Infrastructure as well as Goal 11- Sustainable Cities and Communities, relate directly to the role that construction and infrastructure plays in development.

The United Nations (2017) states that quality infrastructure is positively related to the achievement of social, economic and political goals. Inadequate infrastructure leads to a lack of access to markets, jobs, information and training, creating a major barrier to doing business. Also, undeveloped infrastructures limit access to health care and education. Therefore, infrastructure development has an indirect impact on the attainment of other sustainable development goals such as Goal 1 - No Poverty, Goal 2 - Zero Hunger, Goal 3 – Good Health and Wellbeing and Goal 4 – Quality Education. In relation to Goal 11, construction and infrastructure will play a critical goal in addressing current and potential future challenges cities may face. Some of these challenges include congestion, lack of funds to provide basic services, a shortage of adequate housing and declining infrastructure.

Some of the targets set for 2030 to achieve Goal 9 and 11 include:

- Develop quality, reliable, sustainable and resilient infrastructure, including regional and trans-border infrastructure, to support economic development and human well-being, with a focus on affordable and equitable access for all;
- By 2030, upgrade infrastructure and retrofit industries to make them sustainable, with increased resource-use efficiency and greater adoption of clean and environmentally sound technologies and industrial processes, with all countries taking action in accordance with their respective capabilities;
- Facilitate sustainable and resilient infrastructure development in developing countries through enhanced financial, technological and technical support to African countries, least developed countries, landlocked developing countries and small island developing states;
- access for all to adequate, safe and affordable housing and basic services and upgrade slums;
- support positive economic, social and environmental links between urban, peri-urban and rural areas by strengthening national and regional development planning

Therefore, to achieve the goals related to construction and infrastructure development, Regional Roundtables on Infrastructure Governance have been formed. The first roundtable - Building the Right Infrastructure for Tomorrow- took place in November 2017 in South Africa and focused on infrastructure development through good governance. The roundtable sort to:

- bring together high-level decision-makers to set the direction for how Africa can boost its infrastructure pipeline through better governance;
- ensure that senior African officials, reputable business partners and sector experts meet and share knowledge about concrete cases and what works;
- make ready-to-use tools available—unfold available standards and tools and develop specific demand-driven knowledge products that build on what is needed going forward.

Even so, South Africa and the Free State still faced low business confidence, reduced investment and fiscal consolidation in 2017 which reduced the performance of construction in these two regions. However, the elimination of political uncertainty has resulted in rising investor and business confidence in 2018, which might benefit the construction industry.

Table 2.8 below displays the contribution of all provinces towards the construction industry between 2007 and 2016. Gauteng, KwaZulu-Natal and Western Cape contribute the most towards national construction industry, with average contributions of 34.4 per cent, 18.1 per cent and 18.1 per cent respectively over the reference period. Contrariwise, Northern Cape, Free State and North West contributed the least towards the industry, with average contributions of 1.5 per cent, 3.7 per cent and 4.4 per cent respectively between 2007 and 2016. Therefore, Free State's contribution towards the national construction industry ranks at 2nd least amongst provinces.

Table 2.8 Contribution by province to construction sector (%)

Province	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	17.6	16.8	16.3	15.3	18.2	18.9	20.1	19.0	19.3	19.1
Eastern Cape	7.6	7.1	7.4	7.9	7.2	7.7	9.1	8.4	8.2	8.1
Northern Cape	1.6	1.4	1.8	1.5	1.3	1.3	1.5	1.4	1.5	1.9
Free State	3.9	3.6	4.5	4.0	4.1	3.6	3.6	3.3	3.2	3.2
KwaZulu-Natal	15.2	16.6	18.6	19.1	20.6	18.1	18.3	18.5	18.7	17.4
North West	4.9	5.3	5.1	4.9	3.6	3.4	4.0	4.3	4.1	4.0
Gauteng	37.5	37.1	32.8	33.6	34.6	36.0	31.3	33.1	33.2	34.5
Mpumalanga	6.6	6.3	6.7	6.4	5.4	5.7	6.2	6.4	5.9	5.9
Limpopo	5.1	5.7	6.8	7.3	5.1	5.3	5.9	5.7	5.8	5.9

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

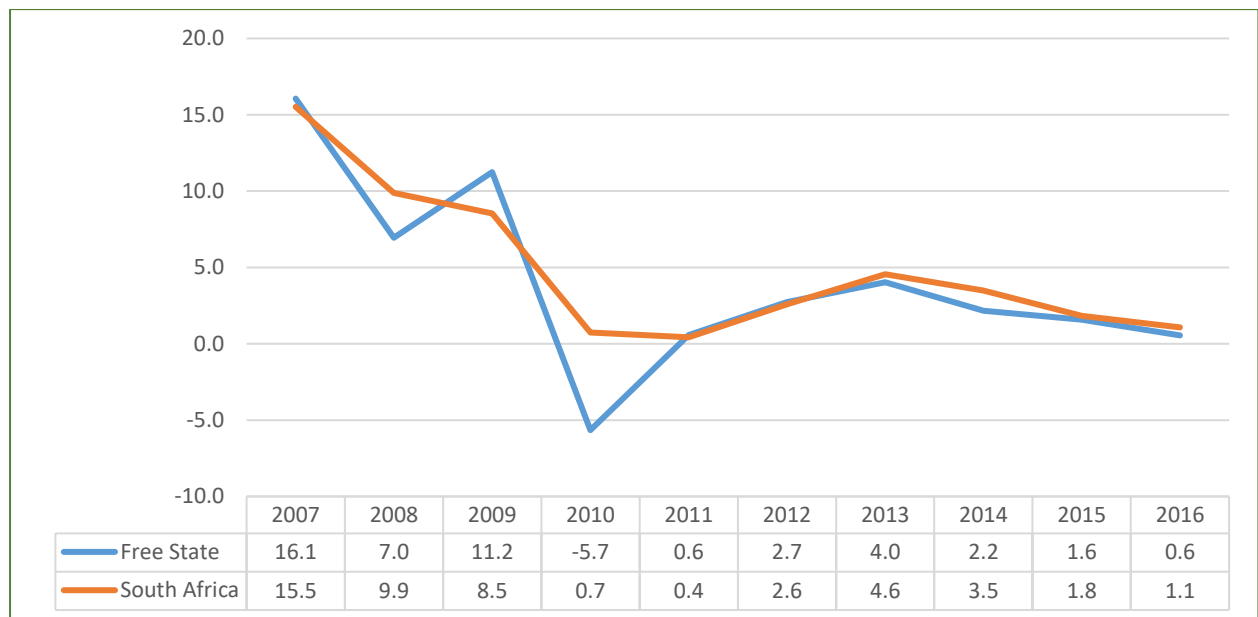
Figure 2.10 below shows that the growth of the construction industries of South Africa and Free State have followed a downward trajectory between 2007 and 2010. The particular sharp decrease in the growth of the construction industry of the Free State from 11.2 per cent in 2009 to a negative 5.7 per cent in 2010 is due to the completion of the 2010 FIFA World Cup infrastructure, therefore the dismal performance of the construction industry in the province in 2010 can mainly be attributed to the base effect between the two years. A similar explanation is applicable in South Africa's case, since the growth of the national construction industry also declined enormously from 8.5 per cent in 2009 to 0.7 per cent in 2010.

Thereafter, the growth of national and provincial industries recovered and advanced, from a decline of 5.7 per cent in 2010 to a growth 4.0 per cent in 2013 in the case of the Free State, and from a minute growth of 0.7 per cent to 4.6 per cent over the same period in South Africa's instance. SARB (2014) attributes the peak of both industries in 2013 to civil construction

activity, wherein government spent on the construction and upgrading of public goods such as roads, schools and hospitals. Since then, the growth of the construction industry of the Free State has declined from 4.0 per cent in 2013 to 0.6 per cent in 2016. Similarly, the growth of the national industry has declined from 4.6 per cent to 1.1 per cent over the same period. The lower pace of growth for the industries in 2016 are attributed to a decline in civil construction (fiscal consolidation) as well as rising production costs in the industry (SARB, 2016).

Given that private sector construction accounts for a large portion of the entire construction industry, the subdued economy, as well as lower business confidence may have played a larger role in the waning performance of the industry between 2013 and 2016. Factors such as labour strikes and the consequent delays in construction activity have also played a role in the declining performance of the industry in recent years.

Figure 2.10: South Africa and Free State construction sector growth rates



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

2.4.3. Tertiary Industries

The tertiary industries consist of trade, transport, finance, personal services and general government services and these industries have collectively increased from 63.1 per cent in 2007 to 65.5 per cent in 2016, which represents a 2.4 percentage point increase over the period. The trade industry.

Within the trade industry, trade protectionism globally is rising, and will likely have a negative impact on growth in South Africa and the Free State. In 2018, the USA decided to impose a 25 per cent import tariff on steel and 10 per cent import tariff on aluminium, with a few countries being exempted. The USA has also imposed a \$60 billion tariff on goods from China. These trade barriers have an impact on South Africa and the Free State in two ways. China may retaliate with a \$3 billion import tariff on goods from the USA and a possible trade war may ensue. A trade war will likely reduce trade between the two largest economies in the world and reduce their growth and global growth. A reduction in global growth might dampen demand for goods from other countries such as South Africa and reduce their growth, including provinces. Even though Free State doesn't produce steel or aluminium, South Africa does produce these commodities and the import tariffs that the USA is implementing will negatively affect the trade industry of South Africa and reduce its growth. The outbreak of Listeriosis in the South Africa from 2017 flowing into 2018 will also negatively affect trade for the country. In 2018, countries such as Zimbabwe, Botswana, Zambia, Mozambique and Kenya have banned import of cold meats from South Africa, effectively reducing trade in this category of goods from South Africa.

At the 2018 International Travel Trade Show in Germany held in March 2018, South African Tourism CEO Sisa Ntshona was quoted as stating that tourism is vitally important to the South African economy, and that the sector should be nurtured for sustained and inclusive growth. Although tourism only accounts for 2.9 per cent of the GDP in the country, it has outperformed other industries in terms of job creation, and therefore plays a critical role in addressing the triple challenges of unemployment, poverty and inequality. Statistic South Africa (2018) notes that the tourism industry in South Africa has added over 40 000 net new jobs to the economy between 2012 and 2016, which is higher than the number of jobs gained in industries such as trade and utilities. Tourism also gained more jobs than manufacturing over this period, which experienced a net loss of 125 000 jobs over the same period.

The performance of commodity prices continue to play a role in the performance of the transport industry. When the prices of commodities produced in South Africa and the Free State recover, the incentive to increase mining production increases, and transportation for freight increases. The average commodity prices for gold and coal have increased in 2016 and 2017, benefitting the province and country. However, the World Bank (2017) predicts that

these prices will decline in 2018, which may negatively affect freight transportation. The increase of global oil prices, together with the increase in fuel levy and RAF may also decrease passenger transportation, and this effect may also spill over into other sub-industries such as domestic tourism

The finance industry is influenced by the performance of interest rates, amongst other factors. Interest rates influence banking activities through lending, and therefore the reduction of repo rate in March 2018 from 6.75 per cent to 6.5 per cent may boost borrowing from consumers in 2018. When interest rates are affordable, they also increase consumer confidence may have positive spill-overs into other industries through increased domestic demand.

General government services will continue to apply tighter fiscal policy in 2018. The most eye-catching changes government has made in 2018 is the implementation of VAT increase from 14 per cent to 15 per cent. What is worth noting is that some companies in South Africa have decided to partially absorb the impact of the VAT increase, to ease the pressure on consumers' disposable income.

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

The World Trade Organisation (2017) noted an improved outlook in global trade in September 2017, that trade growth was becoming more synchronised across regions than it had been for many years, which could make the current trend self-reinforcing. However, organisation noted that downside risks remain for global trade growth including 1) trade protectionism, 2) geopolitical tensions, 3) natural disasters and the resultant direct and indirect disruption of trade, 4) an expectant tightening of monetary policy in the USA and the Eurozone. One downside risk which is currently unfolding in 2018 is the trade protectionism by the USA through import tariffs, and a possible trade war which could take place if China decides to retaliate. As already mentioned, trade wars are undesirable as they reduce trade, economic growth and may dampen global demand.

Nonetheless, good developments have taken place within the trade industry in 2017. Through ICT, a new online trade-boosting tool that makes it easier for businesses in developing countries to identify and target market opportunities was unveiled by the International Trade Centre (ITC) in Paris in October 2017. The Export Potential Map is a user-friendly, free tool

that takes much of the guesswork and second-hand intelligence out of trading decision-making. The map makes it faster and easier for traders in emerging economies to connect to one another and the world. The map ensures that companies, even the smallest and most remote, can target new markets with knowledge of trade costs and expected demand. "This allows policy makers and trade support institutions to optimize the policy environment and support programmes for existing and would-be exporters. It will also assist to overcome one of the top three challenges regarding trade, which is identifying potential market for exports. The map "is the world's largest database on exports and imports and its market access map is the largest database on tariffs and other requirements. A sister method that will explore the export potential of services is being developed, given that data on trade in services is scarcer than for trade in goods

Africa remains a lucrative market for trade and the tourism sub-industry in South Africa and also likely, the Free State province. During the Export Week which took place in October 2017, the KZN MEC of Economic Development, Tourism and Environmental affairs was quoted saying that Africa's future hinged on intra-African trade and investment, which has expanded by 42 per cent since 2007, led primarily by Kenya, Nigeria and SA. However, in order for there to be more intra-African trade, a few prerequisites have to be met. These include the elimination of the non-tariff barriers among African countries, reduction in transport costs, minimal delays at border control posts and the reduction of red tape that heightens the cost of doing business in Africa. Thus, the development of the African Continental Free Trade Area by the African Union is seen as one of the tools to overcome barriers facing African Trade. The main objectives of the ACFTA are to 1) create a single continental market for goods and services, with free movement of business persons and investments, and thus pave the way for accelerating the establishment of the Continental Customs Union and the African customs union, 2) expand intra African trade through better harmonization and coordination of trade liberalization and facilitation regimes and instruments across RECs and across Africa in general, 3) resolve the challenges of multiple and overlapping memberships and expedite the regional and continental integration processes, and 4) enhance competitiveness at the industry and enterprise level through exploiting opportunities for scale production, continental market access and better reallocation of resources.

Within the tourism sub-industry, the Department of Tourism has developed a government-financed tourism development fund in collaboration with development finance institutions to support small-and medium-sized enterprises, including community-based projects, taking in to

consideration radical economic transformation. Further details of the fund will be unveiled in May 2018, however the Department of Tourism wants to boost tourism by focusing on land, government procurement, investment in tourism through the One-Stop-Shop, the Black Industrialist Programme and tourism in the marine and coastal sphere.

Table 2.9 below displays the contribution by all provinces in South Africa towards the national trade industry between 2007 and 2016. Gauteng, KwaZulu-Natal and Western Cape have contributed the most over the reference period, as their average contributions amounted to 29.9 per cent, 17.5 per cent and 15.6 per cent respectively. Contrariwise, Northern Cape, North West and Free State have contributed the least towards the national trade industry, with average contributions of 1.8 per cent, 5.1 per cent and 5.2 per cent respectively between 2006 and 2017.

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

Province	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	17.0	15.8	15.4	14.5	16.2	14.7	15.7	15.6	15.6	15.8
Eastern Cape	12.8	9.0	9.6	10.1	9.2	10.7	10.7	10.6	10.6	10.4
Northern Cape	2.2	2.0	1.7	1.8	1.7	1.5	1.6	1.8	1.8	1.7
Free State	4.8	5.4	5.7	6.1	5.5	5.2	5.0	4.9	4.9	4.7
KwaZulu-Natal	20.0	20.4	18.0	16.5	17.3	17.3	16.6	16.2	16.2	16.4
North West	4.7	5.1	5.0	5.1	5.0	5.0	5.4	5.2	5.2	5.1
Gauteng	25.1	29.5	29.1	31.0	31.2	30.4	29.8	31.1	31.0	31.3
Mpumalanga	7.1	6.7	7.3	7.4	7.2	7.5	7.8	7.2	7.3	7.3
Limpopo	6.3	6.1	8.1	7.6	6.8	7.7	7.5	7.4	7.4	7.3

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

Figure 2.11 below depicts the growth rate of the trade industry in South Africa as well as the Free State between 2007 and 2016. Post the 2009 recession, the average growth rate of the trade industry in the province is 2.7 per cent, which is 0.1 percentage points lower than the average growth rate of trade in South Africa, which was equivalent to 2.8 per cent between 2010 and 2016.

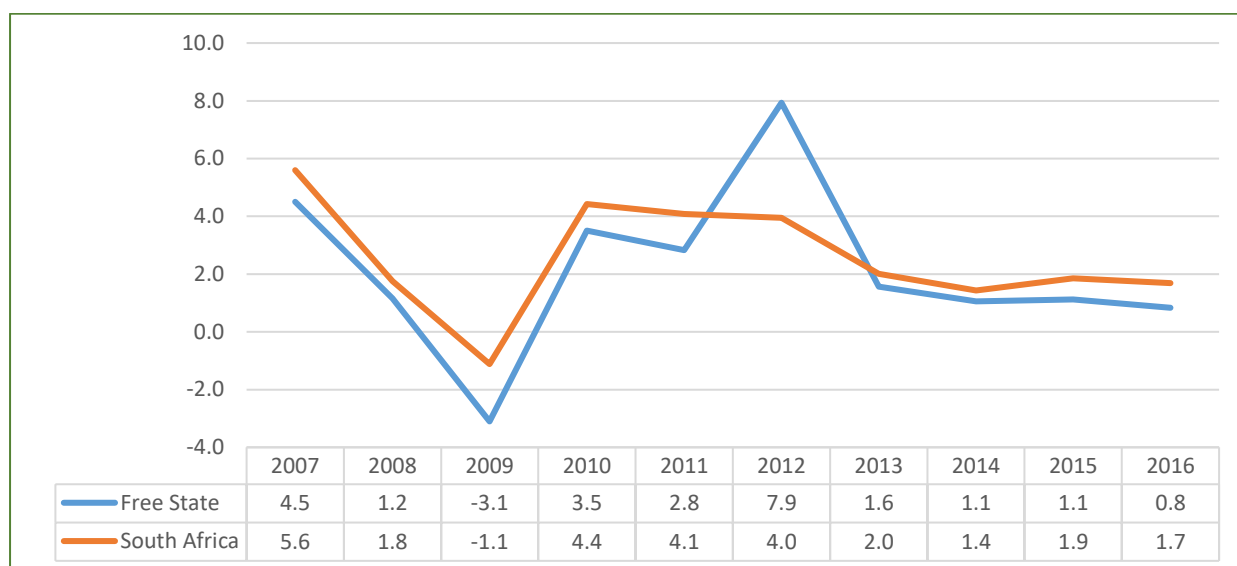
A clear outlier between the country and the province's growth rate is in 2012, when the provincial trade industry grew by 7.9 per cent in comparison with the national trade industry's growth rate of 4.0 per cent. As explained in PERO 2017, the growth in the number of tourists

visiting the province (9.2 per cent) was higher than the national growth rate of tourists (2.6 per cent). The province likely benefitted from the exposure of the 2010 FIFA World Cup, as well as the ANC Centenary which took place in 2012. However, the lower growth rate of the national trade industry in 2012 was attributed to a subdued economic growth, higher inflation as well as industrial strike of the road freight transport industry, which negatively affected the real output in the wholesale sub-industry (SARB, 2012).

Since 2012, the growth of both industries have been on a downward trajectory. The growth of the trade industry in Free State declined sharply from 7.9 per cent in 2012 to 1.6 per cent in 2013, which represents a 6.3 percentage point decline between the two years. Similarly, the growth of the trade industry declined nationally from 4.0 per cent in 2012 to 2.0 per cent in 2013. SARB (2014) notes that real value added by all subsectors slowed between the two years. Growth of the trade industry was particularly lower in the 3rd quarter of 2013, due to an industrial strike at vehicle assemblers and the vehicle component industry negatively affected the motor sub-industry. SARB (2013) also notes that subdued demand in the economy also hampered the performance of the trade industry. The performance of the provincial trade industry in 2013 could have been affected by subdued demand as well as base effect from 2012 tourism inducing events.

Thereafter, the growth of the provincial trade industry declined from 1.6 per cent in 2013 to 0.8 per cent in 2016. Likewise, the trade industry in South Africa declined from 2.0 per cent to 1.7 per cent over the same reference period. SARB (2016) attributes the lower growth of the trade industry in the country to lower consumer and business confidence, slower growth in the disposable income of households, subdued credit extension and weak employment growth. The same reasons are likely applicable to the Free State.

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, First Quarter 2017; IHS Markit ReX, 4th Quarter, 2017

2.4.3.2. Transport, storage and communication sector

The performance of global oil prices has an impact on passenger transportation. Global oil prices are expected to increase from an average of \$52.8 per barrel in 2017 to \$56.0 per barrel in 2018. This will likely increase the cost of transportation, *ceteris paribus*, and discourage domestic passenger transportation. Another negative consequence for South Africa (and Free State) regarding an increase in oil prices is the resultant increase in headline inflation in countries such as USA and the Eurozone, which will result in a tighter monetary policy from those regions and decrease the interest rate differentials between those regions and South Africa. The decline in interest rate differentials between South Africa and those regions may result in capital flight, a weaker Rand, and rising imported inflation.

Although commodity prices of gold and coal have risen in 2016 and 2017, the World Bank (2017) predicts that they will decline in 2018. Although the size and direction of the impact cannot be quantified at this stage, the general result of a decline in commodity prices of commodities produced by South Africa and the Free State is a reduction in freight transportation.

Nonetheless, government recognizes the transport industry as vital for growth. At the African Round Table on Infrastructure Governance in 2017, the National Department of Treasury stated that rail and electricity capacity are key sectors the government has earmarked for infrastructure development. In South Africa, the Department of Trade and Industry showed the importance of rail infrastructure by launching the Musina cross-border terminal in the same year. Not only will the terminal reduce transportation costs as some cargo switches from road to rail, it will support interregional trade and support the manufacturing industry through the Musina-Makhado SEZ.

The communication sub-industry continues to play a crucial for the transport industry, as the active mobile network subscribers have continued to increase in South Africa. Technological innovations and attractive data promotions also create positive gains for the sub-industry.

The contributions of each province towards the South African transport industry are displayed in table 2.10 below. The three largest economies, Gauteng, KwaZulu-Natal and Western Cape, also contribute the most towards this industry. They have contributed average contributions of 36.1 per cent, 21.3 per cent and 15.0 per cent respectively between 2007 and 2016 towards the national transport industry. Conversely, the average contributions of Northern Cape, Limpopo and North West towards the national transport industry, equivalent to 2.4 per cent, 3.8 per cent and 4.1 per cent respectively, are the least over the reference period. The Free State has contributed an average of 5.2 per cent towards the country's transport industry between 2007 and 2016, and ranks at 5th highest in comparison to other provinces.

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

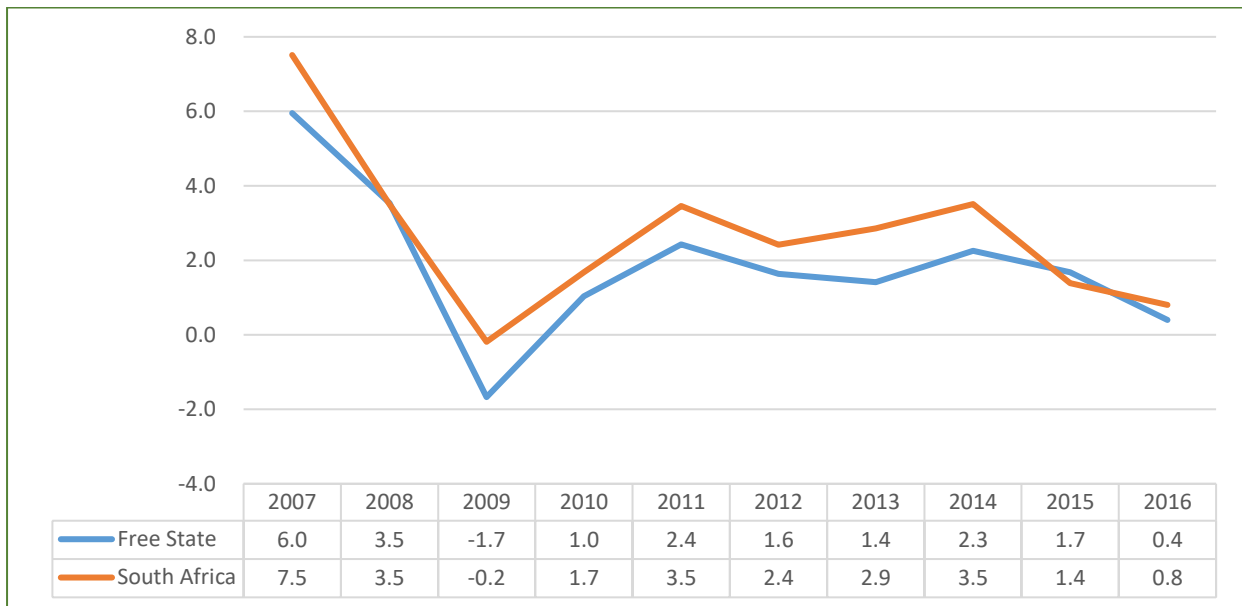
Province	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	14.9	15.2	15.3	15.3	15.0	15.0	14.7	15.0	15.1	15.0
Eastern Cape	7.1	7.1	7.2	7.2	7.2	7.3	7.3	7.1	7.0	7.2
Northern Cape	2.3	2.4	2.3	2.3	2.4	2.4	2.4	2.6	2.7	2.6
Free State	5.3	5.3	5.2	5.0	5.1	5.1	4.9	5.2	5.3	5.3
KwaZulu-Natal	20.6	20.8	20.6	21.0	21.2	21.6	21.8	21.9	21.8	21.7
North West	4.1	4.2	4.1	4.1	4.1	4.1	4.2	3.9	4.1	4.2
Gauteng	37.2	36.5	36.9	36.5	36.2	35.6	35.8	35.5	35.2	35.5
Mpumalanga	4.7	4.7	4.7	4.8	4.9	5.0	5.1	5.0	5.1	5.0
Limpopo	3.8	3.8	3.8	3.7	3.8	3.8	3.8	3.8	3.7	3.6

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

The growth of the transport industry in the Free State has been volatile between 2010 and 2015. However, the growth of this industry has deteriorated from its peak of 2.4 per cent in 2011 to negative growth of 0.4 per cent in 2016. Similarly, the growth of the transport industry of South Africa has also declined from its peak of 3.5 per cent in 2011 to a minor growth of 0.8 per cent in 2016. The transport industry benefitted from improved performance of land transport (both freight and passenger transportation), along with a steady growing communication sub-industry (SARB, 2011). Also, public corporations continued to invest in areas such as transport to remove existing bottlenecks. Lastly, heightened volumes of import and export merchandise was visible in the 2nd quarter of 2011, which may have indirectly benefitted the transport industry in of the country and province through freight.

Since then, the growth of transport industries of the country and province have been declining, although erratically. The dismal performance of the transport industry in 2016 was due to weaker activity in the both the transportation of freight and passengers in the 1st quarter of 2016. The performance of the industry may have been hampered by slower increases in real value added by the trade and general government industries (SARB, 2016). Industrial strikes also have an indirect impact on the performance of the transport industry, which may partially explain the decline in growth of the industry in 2012 and 2014.

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



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

2.4.2.3.3. Finance, real estate and business services

The performance of interest rates plays a crucial role for the finance sub-industry within finance, real estate and business services. The SARB sets the repo rate for the country based on the current and future level of the inflation rate. The inflation rate of South Africa has declined from an average of 6.4 per cent in 2016 to 5.3 per cent in April 2017. The inflation rate has remained within the target band since, and has declined further to reach 4.0 per cent in February 2018. The low inflation rate has given the SARB room to decrease the repo rate from 6.75 per cent to 6.5 per cent in March 2018. The decline of the interest rate will ease pressures on disposable income and also increase lending activity in the banking industry as debt becomes more affordable.

Consumers might also benefit from increased competition in the banking industry. The Register of Banks granted Discovery a banking license in 2017, putting the health and life insurance group a little closer to its goal of establishing a retail bank by 2018. Competition is the critical driver of performance and innovation. It benefits everyone by enabling us to choose from an array of excellent products at affordable prices. Competition also encourages the adoption of innovation as companies evolve and new ideas flourish in the marketplace

Competition for businesses in SA has also been bolstered through proposed amendments to SA’s competition legislation that aim to open up markets to new small businesses, particularly black-owned businesses, rather than relying on transformation through the transfer of stakes in existing businesses to black owners. The amendments will empower the Competition Commission to launch market enquiries into sectors which are dominated by just a handful of large firms and to impose remedies, if necessary, to open these sectors to new competitors. Competition authorities to take market structure into account when mergers are being scrutinized, or when alleged cartel activity is investigated.

Table 2.11 below displays each province’s contribution towards the finance industry of South Africa. Gauteng, Western Cape and KwaZulu-Natal continue to dominate this industry, as the provinces had average contributions of 41.9 per cent, 18.5 per cent and 13.7 per cent respectively between 2007 and 2016. Oppositely, Northern Cape, Free State and North West and contributed 1.4 per cent, 3.9 per cent and 4.1 per cent respectively over the same period, making their contributions the least amongst provinces.

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

Community Services

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	20.4	19.3	18.2	18.9	18.2	19.0	18.4	17.7	17.2	17.6
Eastern Cape	7.3	7.2	7.6	7.2	7.0	7.4	7.1	7.6	7.7	6.8
Northern Cape	1.6	1.4	1.2	1.4	1.3	1.4	1.0	1.4	1.5	1.4
Free State	4.1	4.2	4.0	3.9	3.8	3.7	3.8	4.0	4.2	3.9
KwaZulu-Natal	13.7	14.1	14.4	13.5	13.4	13.9	13.7	13.6	13.5	13.2
North West	3.8	3.9	4.2	4.1	4.0	4.2	4.3	3.8	4.3	4.2
Gauteng	40.2	40.8	41.0	41.7	42.9	41.4	43.1	42.5	42.2	43.4
Mpumalanga	3.9	4.0	4.1	4.2	4.1	4.3	3.9	4.5	4.4	4.3
Limpopo	5.0	5.1	5.3	5.2	5.2	4.8	4.7	4.9	5.1	5.2

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

The overall growth trend of the finance industries of South Africa has been downward since 2011 whilst the growth trend of the Free State province has been volatile post the recession. According to figure 2.13 below, the finance industry of the province increased from 0.4 per cent in 2010 to 3.2 per cent in 2012, and thereafter declined to 2.1 per cent in 2016. In the

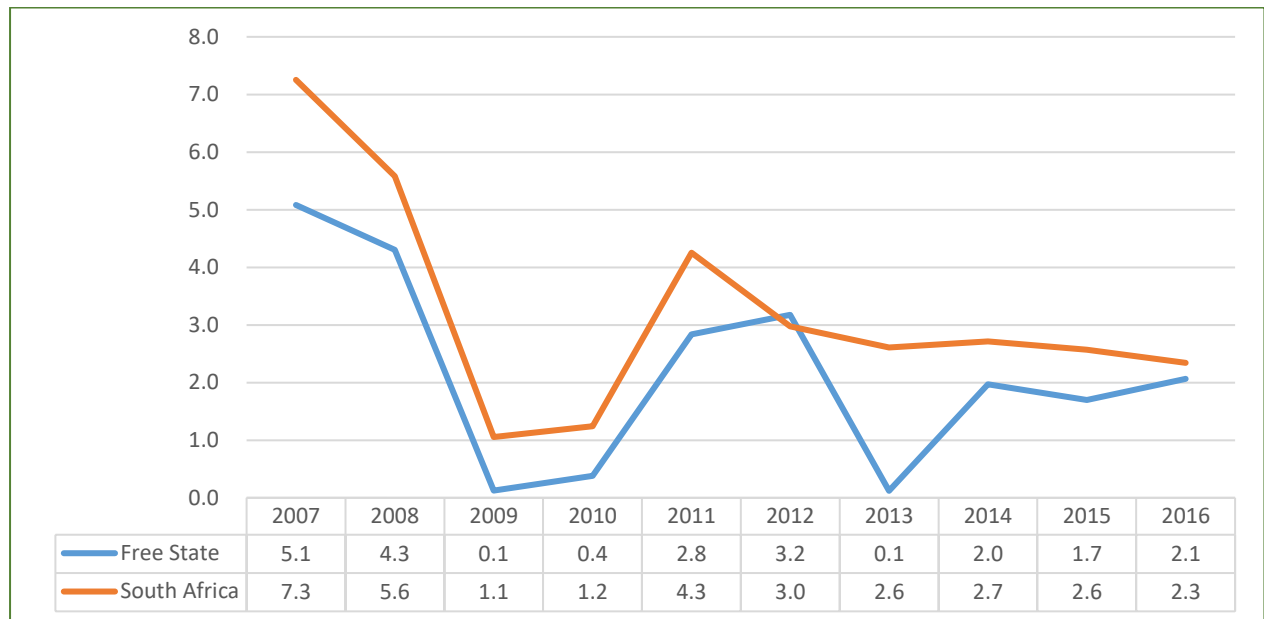
country's instance, the finance industry increased from 1.2 per cent in 2010 to 4.3 per cent in 2011, and thereafter declined to 2.3 per cent in 2016.

The growth peaks of the finance industries of South Africa and the Free State for the period 2011-2012 can be explained in the following manner. In 2011, growth of the finance industry in the country was mainly supported by improved growth in deposits with, and credit extension by commercial banks (SARB, 2012). However, increased activity in the equity, bond and other financial services played a role in the high growth of the industry in 2011, particularly in the 1st and 3rd quarters of the year. In 2012, increased activity in the equity, bond and other financial markets were noticeable in the 1st quarter of the year, compounded by increased lending activity in the banking sector. SARB (2013) also notes that increased level of confidence in the life insurance industry in the final quarter of 2012 may have benefitted the industry, even provincially.

The sharp decline in the growth of the provincial finance industry from 3.2 per cent in 2012 to 0.1 per cent in 2013 may be credited to the decline of real output in the banking sector in the 1st quarter of the year. Reduced trading activity on the JSE Limited may have affected brokers and/ or investors in the same quarter.

The subdued growth of the finance industries of the country and province (2.1 per cent for the Free State industry and 2.3 per cent for the country's industry) reflects the overall subdued economy in 2016. The country experienced slower growth in real-estate and business services sub-industries in the 3rd quarter of 2016 whilst, as well as reduced activity in the equity, bond and other financial services in the same quarter.

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



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

2.4.2.3.4. Personal Services

Personal Services is defined as an industry that accounts for “any business enterprise with the primary purpose of providing personal services. Personal-service activities encompass a wide range of professions, including law, medicine, engineering, design, finance, accounting and even performing arts.” In South Africa, educational activities, hospital activities, other recreational activities as well as medical and dental practice activities take the lion’s share of the industry, as these activities accounted for approximately 67 per cent of all income within the industry in 2010 (FS PERO, 2017).

There are three major obstacles faced within the personal services industry. Firstly, services are intangible, making it difficult for potential customers to understand what they will receive and what value it will hold for them: Some consultants and providers of e.g. investment services offer no guarantees of the value for price paid. Secondly, since the quality of most services depends largely on the quality of the individuals providing the services, "people costs" are usually a high fraction of service costs in comparison to a provision of goods e.g. a manufacturer may use technology, simplification, and other techniques to lower the cost of goods sold, whilst the service provider often faces an unrelenting pattern of increasing costs.

Lastly, product differentiation is often difficult, e.g. how does one choose one investment adviser over another, since they are often seen to provide identical services? Charging a premium for services is usually an option only for the most established firms, who charge extra based upon brand recognition (Wikipedia, 2018).

Table 2.12 below displays the contributions of all provinces towards the South African personal services industry. Gauteng, KwaZulu-Natal and Western Cape contribute the most towards the industry, with average contributions of 29.7 per cent, 16.7 per cent and 15.5 per cent respectively between 2007 and 2016. Provinces which contributed the least towards the industry over the reference period were Northern Cape, Mpumalanga and Limpopo, with average contributions of 2.1 per cent, 5.1 per cent and 5.3 per cent respectively. The Free State province, which has contributed an average of 7.2 per cent between 2007 and 2016 towards the country's personal services industry, ranks at 6th position amongst provinces.

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

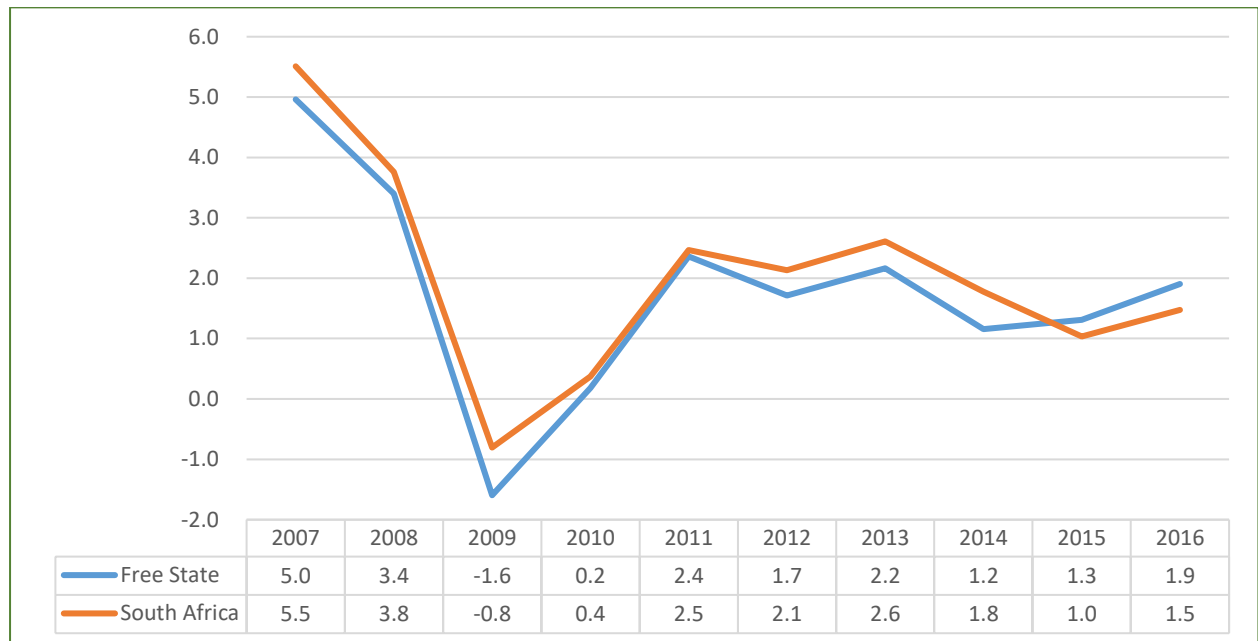
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	14.2	14.8	15.3	15.7	15.8	16.0	15.8	16.0	15.9	16.0
Eastern Cape	9.9	9.6	9.4	9.7	9.6	9.8	9.7	9.5	9.7	9.8
Northern Cape	2.8	2.6	2.3	1.8	2.0	1.9	1.8	2.1	2.0	2.0
Free State	8.6	7.7	7.3	6.7	6.9	6.8	6.9	6.8	7.0	7.0
KwaZulu-Natal	16.5	16.6	16.7	16.5	16.6	16.8	16.9	17.0	16.8	16.7
North West	8.8	8.6	8.7	8.7	8.9	9.1	8.9	8.7	8.5	8.5
Gauteng	28.5	29.4	30.0	30.9	30.0	29.6	29.6	29.6	29.6	29.7
Mpumalanga	5.7	5.5	5.2	4.8	4.9	4.9	5.1	5.0	5.1	5.1
Limpopo	5.2	5.3	5.2	5.1	5.3	5.2	5.3	5.4	5.4	5.3

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

The growth of the personal services industry in South Africa and in the Free State has been declining unsteadily since 2011, as shown in figure 2.14 below. The growth of the provincial industry has declined from 2.4 per cent in 2011 to 1.9 per cent in 2016, which represents a 0.5 percentage point decline between the two years. Similarly, the growth of the industry at a national level has also declined from 2.5 per cent in 2011 to 1.5 per cent in 2016, which represents a 1.0 percentage point decrease over the period. As indicated in the 2017 PERO, the subdued economy and consequent decline in consumer and business confidence in recent years, may have negatively affected the growth of the industry. The correlation between economic

growth and personal services is particularly notable at national level, as evident through the temporary recovery of South Africa’s growth from 2.2 per cent in 2012 to 2.5 per cent in 2013, which correlated with the recovery of the provincial industry’s growth from 2.1 per cent to 2.6 per cent over the same period.

Figure 2.14 South Africa and Free State personal services sector growth rates



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

2.4.2.3.5 General Government Services

In South Africa, fiscal consolidation continues to be implemented, and this is evident in the slow growth of general government services, from 1.4 per cent in 2016 to 0.3 per cent in 2017, which represents a 1.1 percentage point decline between the two years. In 2018, the Minister of Finance has announced a fiscal policy tightening through the 2018 Budget Speech in order to address a fiscal shortfall of R50.8 billion announced in the 2017 MTBPS. Fiscal policy tightening can happen by increasing tax, by decreasing expenditure ceilings or a combination of both. In the Budget Speech (2018), a combination of tax increases and decline in expenditure ceilings are expected to take place in the 2018/19 fiscal year.

The most eye-catching implementation of fiscal policy tightening is the increase of VAT from 14 per cent to 15 per cent in 2018. National Treasury will also implement below-inflation adjustments to personal income tax brackets and rebates. Other tax increases include: an

increase in the ad-valorem excise duty rate on luxury goods from 7 per cent to 9 per cent, a higher estate duty tax rate of 25 per cent for estates greater than R30 million, a 22 cents per litre for the general fuel levy and a 30 cents per litre increase in the Road Accident Fund Levy as well as an increases in the alcohol and tobacco excise duties of between 6 and 10 per cent.

The expenditure ceiling of the country has been declined by R85 billion over the medium term. However, the need to address skills shortage and skills mismatch in South Africa remains imperative. To this end, R57 billion has been allocated over the medium term to address fee-free higher education and training in the country. Free education will be implemented in the following way: all new first-year students with a family income below R350 000 per annum at universities and TVET colleges in the 2018 academic year will be funded for the full cost of study. This will be rolled out in subsequent years until all years of study are covered. Returning NSFAS students at university will have their loans for 2018 onwards converted to a bursary.

Table 2.13 below displays each province’s contribution towards South Africa’s general government services industry. Gauteng, KwaZulu-Natal and Eastern Cape contribute the most towards this industry, with average contributions of 40.1 per cent, 14.9 per cent and 10.5 per cent respectively between 2007 and 2016. On the contrary, Northern Cape, North West and Free State contributed the least towards the national industry, with average contributions of 2.0 per cent, 5.0 per cent and 5.1 per cent respectively over the same period.

Table 2.13: Contribution by province to general government services sector (%)

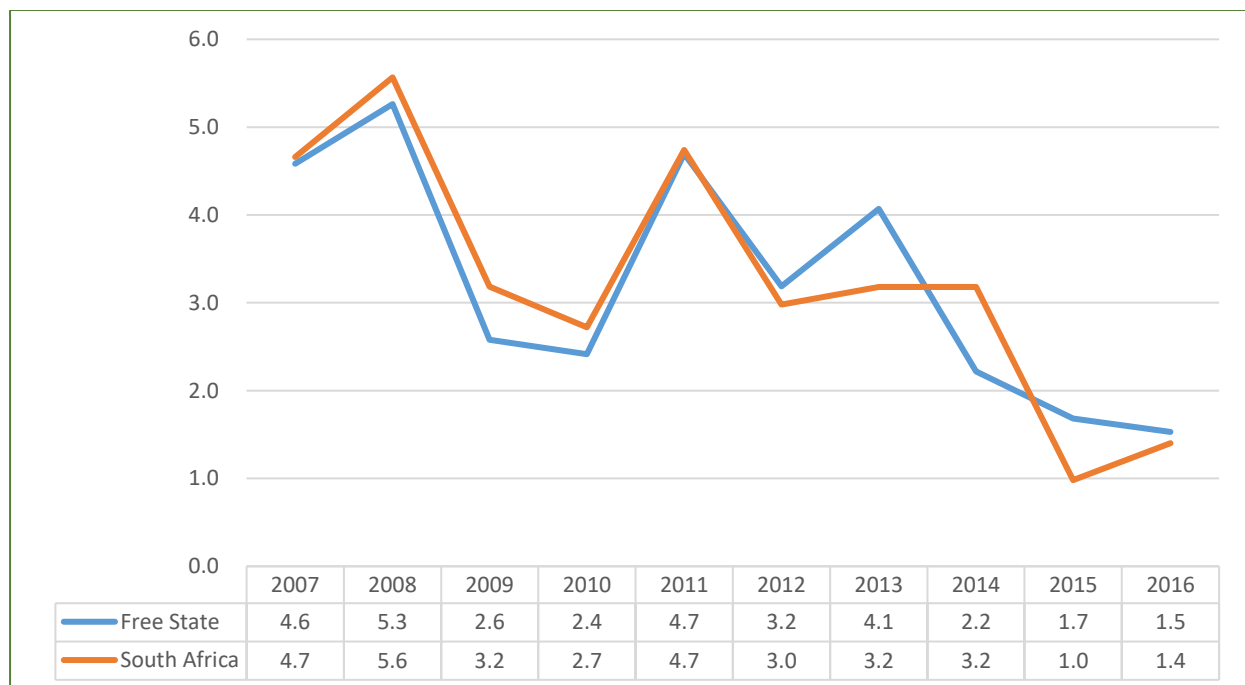
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Western Cape	8.8	8.4	8.7	8.6	8.7	8.8	8.8	8.9	8.9	9.0
Eastern Cape	10.5	10.4	10.7	11.1	10.9	10.6	10.5	10.3	10.3	10.0
Northern Cape	1.9	2.2	2.0	2.0	2.0	2.0	2.0	2.2	2.1	2.0
Free State	5.2	5.1	5.1	5.1	5.1	5.1	5.1	5.0	5.0	4.9
KwaZulu-Natal	14.4	15.0	14.9	14.9	14.8	14.9	14.9	14.9	15.1	15.1
North West	5.6	5.0	4.9	4.9	4.9	4.9	4.9	4.9	5.0	4.9
Gauteng	40.4	40.3	40.1	39.4	39.5	39.8	40.0	40.1	40.3	40.7
Mpumalanga	4.8	5.2	5.3	5.4	5.4	5.4	5.3	5.2	5.2	5.3
Limpopo	8.5	8.4	8.4	8.5	8.7	8.6	8.5	8.3	8.1	8.0

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

According to figure 2.15 below, the growth of the general government services industries of South Africa and the Free State have declined from 2011 onwards. The growth of the provincial industry has declined from 4.7 per cent in 2011 to 1.5 per cent in 2016, which represents a 3.2 percentage point decline. Likewise, the growth of the national industry has declined from 4.7 per cent in 2011 to 1.4 per cent in 2016, which denotes a 3.3 percentage point decline. SARB (2012) attributes the high growth rate of the industry in 2011 to a steady rise in employment levels in the industry nationally. Even though the industry incurred some expenditure by hiring additional workers to assist with the 2016 local elections (SARB, 2016), the growth of the industry is lower in 2016 in comparison to 2011 due to the positive results of fiscal consolidation, with its main focus being to cap and reduce the high expenditure on compensation of employees.

The momentary recovery in the growth of general government services for both the province and the country in 2013 may be attributed to departments increasing their capital expenditure on housing and construction works in the 1st quarter of the year. Also, there was a rise in employment levels in government in the 3rd quarter of 2013.

Figure 2.15 South Africa and Free State general government services sector growth rates



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018

2.5. OUTLOOK OF FREE STATE ECONOMY

A number of factors had led to the decline in the growth of the Free State and the South African economies between 2012 and 2016. Figure 2.16 below shows that the growth rate of the Free State province declined from 3.0 per cent in 2012 to negative 0.1 per cent in 2016. Likewise, the growth of the South African economy declined from 2.2 per cent in 2012 to 0.6 per cent in 2016. In 2012, both the province and the country were facing a commodity slump in mining which commenced the previous year, effectively reducing gains to be made in mining through a reduction in the prices of commodities. In nominal terms, South African coal prices have declined from \$116.30 per mt in 2011 to \$64.12 per mt in 2016, whilst gold prices have also declined from \$1569.21 per toz to \$1248.99 per toz over the same period. Silver prices have also declined from \$35.22 per toz in 2011 to \$17.15 per toz in 2016.

Other mining commodities which are not produced in the Free State but are important for the country's economy have also declined in average prices. The price of iron ore has declined from \$167.75 per dmt in 2011 to \$58.42 in 2016 whilst the price of platinum has also decreased from \$1719.48 per toz to \$987.09 per toz over the same period.

South Africa is a water-scarce country. In certain instances, the country, including the Free State province, experiences dry weather spells and in other cases, a drought. The 2015/16 drought played a major role in the performance of industry such as agriculture, and the water sub-industry of electricity. Consequently, this drought partially also explains why the growth of the country and province declined between 2012 and 2016. Other factors which caused a deterioration of both region's performances between 2012 and 2016 include reduced consumer confidence, reduced business confidence, perceived political and policy uncertainty, trade protectionism as well as threats of credit downgrades by major rating agencies.

In spite of some credit downgrades materializing in 2017, the growth of the South African economy enlarged from 0.6 per cent in 2016 to 1.3 per cent in 2017. The World Bank (2018) also attributes the improved growth of the country between 2016 and 2017 to improved rainfalls in the agricultural industry, the expansion of mining activity as well as the rebound in manufacturing activity. However, the decline of the provincial economy is projected to have worsened from 0.1 per cent in 2016 to 0.2 per cent in 2017. Even though the end of the 2015/16 drought as well as the rise of several commodity prices may have benefitted the province in

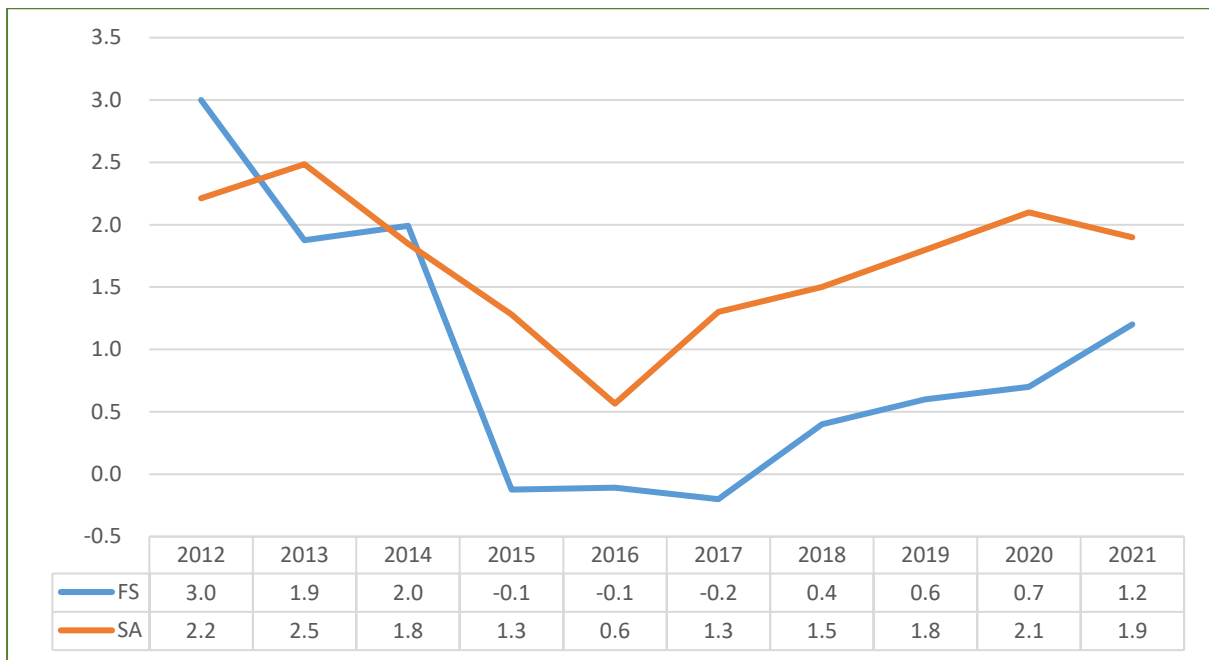
2017, an industrial strike in coal which could have negatively affected mining and manufacturing, the latter industry being affected due to coal being an feedstock for the Secunda (Sasol Synfuels) and Sasolburg (Sasolburg Operations) complexes in South Africa. The coal supplied to Sasol Synfuels is mainly used as gasification feedstock, while some is used to generate electricity. The coal supplied to the Sasolburg Operations is used to generate electricity and steam. Some coal is also exported from the Twistdraai Export Plant to international power generation customers.

The current year estimates show that growth of the South African economy is projected to improve from 1.3 per cent in 2017 to 1.5 per cent in 2018, whilst the provincial economy is projected to exit the recession, from a 0.2 per cent decline in 2017 to a growth of 0.4 per cent in 2018. Although earlier estimates of the World Bank (2017) indicate a decline in the commodity prices of gold, coal and iron ore, the organization in 2018 expects South Africa to benefit from the strengthening of some commodity prices as well as rising domestic demand. This internal demand is benefitting from a reduction in inflation, and the interest rate cut which took place in March 2018. Inflation has remained within the target band since April 2017 due to subdued internal demand, rainfall, as well the election of a new ANC leadership towards the end of 2017, which is viewed as market friendly and brings about more policy certainty.

The improvement of the provincial growth rate in 2018 improved performance of the finance industry (possibly due to a cut in the repo rate in March 2018) as well as the positive growth rate of agriculture post the 2015/16 drought, as evident in table 2.14 below.

The MTEF estimates in figure 2.16 below projects that national growth rate will increase from 1.5 per cent in 2018 to 1.9 per cent in 2021, whilst the provincial growth rate will accelerate from 0.4 per cent in 2018 to 1.2 per cent in 2021. Table 2.14 below shows that higher positive growth rates are expected in finance, agriculture and transport over the medium term.

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



Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018; National Treasury Budget Review, 2018; IHS Markit ReX, 4th Quarter, 2017

Table 2.14 below shows that the Free State economy might have declined from R160.3 billion in 2016 to R159.7 billion in 2017. In 2017, the economy had the largest declines in the trade (-2.6 per cent), mining (-2.3 per cent), manufacturing (-2.0 per cent) and construction (-1.1 per cent). The decline of mining in the Free State in 2017 could have been due to an industrial strike in the coal mining, and the link between coal mining and manufacturing has been explained in the section above. Also, manufacturing industry could have declined in 2017 due to the Rand strengthening in 2017, the fuels produced by SASOL are priced in dollars. Trade could have declined in 2017 due to low consumer confidence whilst construction could have declined due to low business confidence as well as fiscal consolidation by the public sector.

The provincial economy is estimated to increase from R159.7 billion in 2017 to R160.4 billion in 2018, which represents a 0.4 per cent growth. The performance of the finance and agriculture will support the economic recovery of the province in 2018. As already explained, interest rate cuts may improve lending activities in the finance industry whilst agriculture will continue to grow positively in 2018 post the 2015/16 drought. On the contrary, mining is projected to decline by 5.6 per cent while community services is projected to decline by 0.4 per cent in 2018. Mining may decline based on earlier forecasts by the World Bank (2017), which indicate

that the prices of gold and coal may decline in 2018. Given that the Minister of Finance has announced a fiscal policy tightening for the country in the 2018 Budget Speech, community services might also decline in 2018.

This growth is slower in comparison with the previous year mainly due to a slower growth of the agricultural industry (3.4 per cent), a decline of the mining industry (-4.6 per cent). Lower growth rates are also projected in electricity (0.4 per cent) and construction (1.0 per cent), whilst trade is projected to stagnate and community services is also projected to decline (-0.4 per cent) in 2018. The slower pace of agricultural growth as well as the continuous decline of the mining and community services industries will result in the lower growth of the provincial economy over the MTEF.

The Free State economy is projected to increase in size from R160.4 billion in 2018 to R164.5 billion in 2021. The province might record the highest average growth rates in finance (2.9 per cent), agriculture (2.6 per cent) and transport (2.6 per cent) between 2019 and 2021.

Table 2.14: Economic growth projections of Free State economy by industry

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
GDP-R (Constant 2010 prices - Rmillion)	154 670	157 573	160 710	160 512	160 337	159 726	160 418	161 449	162 538	164 459
Real GDP-R per cent growth	3.0	1.9	2.0	-0.1	-0.1	-0.2	0.4	0.6	0.7	1.2
GDP-R by industry (real growth)										
Agriculture	1.8	4.3	6.9	-25.0	-19.8	12.8	3.0	2.9	2.4	2.6
Mining	1.1	2.1	2.5	-0.8	-2.1	-2.3	-5.6	-5.1	-5.4	-5.1
Manufacturing	0.9	0.9	2.6	0.2	0.7	-2.0	1.3	1.3	1.5	1.7
Electricity	0.2	0.2	-0.8	-0.7	-2.1	0.0	0.4	1.0	1.1	1.7
Construction	2.7	4.0	2.2	1.6	0.6	-1.1	0.6	-0.2	1.3	2.5
Trade	7.9	1.6	1.1	1.1	0.8	-2.6	0.3	0.5	0.9	1.6
Transport	1.6	1.4	2.3	1.7	0.4	0.9	2.2	2.3	2.5	2.9
Finance	3.2	0.1	2.0	1.7	2.1	0.7	3.1	3.0	2.7	3.1
Community services	2.7	3.5	1.9	1.6	1.6	0.3	-0.4	-0.1	-0.1	0.4
Total industries	3.0	1.9	2.1	-0.3	-0.1	-0.4	0.2	0.4	0.5	1.0

Source: Statistics South Africa, Gross Domestic Product, First Quarter 2018; IHS Markit ReX, 4th Quarter, 2017

2.6. POLICY IMPLICATIONS IN SUPPORT OF THE FREE STATE ECONOMIC OUTLOOK

The Radical Economic Transformation is a strategy that has been developed in South Africa in 2017 to accelerate efforts to reach the NDP Vision 2030 in an inclusive manner. The strategy is about placing the economy on a qualitatively different path that ensures: 1) a more rapid and sustainable growth, 2) higher investment, 3) increased employment, 4) reduced inequality and 5) deracialisation of the economy. The strategy refers to a fundamental change in the structure, systems, institutions and patterns of ownership and control of the economy in favour of all South Africans, especially the poor, the majority of whom are Africans and female. The main components of RET are:

- Job creation
- Accelerating shared and inclusive growth
- Transforming the structure of production
- Ownership of means of production
- Enabling the talents and productive potential of our people to flourish

The five sectors identified to assist the South African economy in changing patterns of ownership are agriculture, mining, manufacturing, transport and tourism. These five priority sectors are embedded in the Free State Growth and Development Strategy as well as the Provincial Economic Development Strategy Framework.

The PEDS was developed in 2016 taking into account the subdued global, national and provincial economy, and the challenges the provincial economy will face in addressing the triple challenge of unemployment, poverty and inequality. The Free State government a need for an economic development strategy for the Free State Province that will give guidance in the kind of interventions to implement given the comparative advantage of the province, in order to put the economy on a path that will help address the triple challenge confronting the province. Hence the Free State Government took a decision to develop an economic development strategy.

The PEDS is informed by the FSGDS, and seeks to leverage on the competitive and comparative advantages of the Free State Province. The Free State contains strengths in the following manner:

- South Africa's most centrally situated province: in particular Johannesburg and Durban are within easy driving distance
- Boasts some of the country's largest man-made dams: Gariep Dam, Sterkfontein Dam (a reliable water resource for Gauteng and the northern Free State's industrial hubs) and the Sandveld Dam
- The Golden Gate Highlands National Park which is a key tourist attraction
- Home to world-famous Vredefort Dome.
- Five of South Africa's major roads, the N1 to Cape Town, the N3 to KwaZulu-Natal, the N5 which connects the N1 at Windburg with the N3 at Harrismith via Senekal, Paul Roux and Bethlehem, the N6 to East London and the N8 connecting Kimberley, Bloemfontein and Maseru in Lesotho, traverse the province, making the Free State ideally situated as a transport and logistics hub.
- Home to the South African petrochemicals giant Sasol
- Considered to be the breadbasket of the country, with 3.2 million hectares of cultivated land. Owing to its counter-seasonality to Europe, the primary SA export market is itself a competitive advantage.

The five priority sectors, namely agriculture, mining, manufacturing, transport and tourism, are reviewed in terms of their strengths in each district of the Free State, and opportunities are identified in specific local municipalities under each district, so that the growth targets for each of the priority industries are set for 2014, 2019, 2024 and 2030.

The specific interventions to be applied by the Free State government in 2018 are contained in the 2018 State of the Nation Address, the 2018 State of the Province and the 2018 Free State Provincial Budget Speech. Some interventions which take into account the priority sectors are:

In agriculture

Nationally, the land redistribution programme will be accelerated to redress a grave historical injustice, but also to bring more producers into the agricultural sector and to make more land available for cultivation. The expropriation of land without compensation is a mechanism that

will be implemented in a way that increases agricultural production, improves food security and ensure that the land is returned to those from whom it was taken under colonialism and apartheid

The Free State province has allocated R2.5 billion towards the Department of Agriculture and Rural Development over the medium term and makes provision for land care programme, support and training of farmers, veterinary services, infrastructure investments and implementation of agricultural projects.

Also, the Comprehensive Agriculture Support Programme (CASP) Grant is currently undergoing a review in order to improve the performance of the grant and to increase the number of black commercial farmers.

In mining

The most prominent intervention by the South African government will be to review the Mining Charter in 2018 in order to ensure that it becomes an effective instrument to sustainably transform the face of mining in South Africa.

In manufacturing

The South African government seeks to re-industrialise the economy on a scale and at a pace that draws millions of job seekers into the economy. Incentives will be offered in order to draw more investments into the manufacturing industry, whilst the localization programme will be propelled in areas such as textile, clothing, furniture, rail rolling stock and water meters, which will be procured in South Africa.

Free State Development Corporation is allocated R132.7 million over the medium term which includes transfers to the Maluti-A-Phofung Special Economic Zone but excludes transfer payments for the implementation of provincial projects on behalf of other Departments. Substantial economic benefits are expected from this project as set out in the State of the Province address and provision is also made for the implementation of radical socio-economic transformation programmes by FDC.

In tourism

The South African government will enhance support for destination marketing in key tourism markets in 2018 and take further measures to reduce regulatory barriers and develop emerging tourism businesses.

In the Free State, the tourism industry will be further supported by the establishment of the Karoo Regional Development Initiative announced by the hon. Premier during the State of the Province Address

In transport

The Free State Department of Police, Roads and Transport is allocated R8.5 billion over the medium term to fund activities such as

- The construction and maintenance of the provincial road network
- The continuation of existing and implementation of new EPWP programmes
- Transport regulation and operations and our Fleet Management Trading Entity
- Learner Transport Programme, and
- Oversight over policing and promotion of community policing

These are some interventions focused on the priority industries in order to accelerate the economic growth of the country and the Free State in an inclusive and sustainable manner.

2.7. CONCLUSION

The Free State economy was in recession in 2016 and 2017, as the provincial economy declined by 0.1 per cent and 0.2 per cent respectively in those two years. The 2015/16 drought had resulted in agriculture declining by 19.8 per cent in 2016, together with the decline of the electricity (2.1 per cent) possibly due to the water sub-industry. Commodity prices only started recovering towards the end of 2016, therefore mining also declined by 2.1 per cent in 2016. The recession in the Free State might have worsened in 2017 due to the industrial strike in the coal sector, which could have negatively affected both mining and manufacturing. Although, a stronger rand in the country is desirable, it could have also negatively affected manufacturing in the Free State. However, the growth of the agricultural industry in 2017, which is projected to have been 12.8 per cent, could have eased the weight of the recession in 2017. The provincial

economy is projected to recover from 2018 onwards, boosted by positive growth rates in finance, agriculture and transport.

CHAPTER 3: LABOUR MARKET REVIEW

Key findings:

- Global unemployment levels and rates are expected to remain high in the short term, as the global labour force continues to grow.
- The global unemployment rate is expected to rise modestly in 2017 to 5.8 per cent from 5.7 per cent in 2016 and hold relatively steady in 2018,
- An additional 2.7 million unemployed people are expected in 2018 globally as the pace of labour force growth will outstrip job creation.
- The South African labour force has faced significant difficulties to retain or find employment, particularly at lower skill levels, due to poor economic performance.
- South Africa's official unemployment rate increased from 21.5 per cent in Q4:2008 to 26.7 per cent in Q4:2017, whilst for the expanded definition it increased from 28.7 per cent to 36.3 per cent
- The high unemployment rate and the lack of job opportunities has led to very long unemployment spells. In 2016, around 57.0 per cent of the unemployed in South Africa had been out of a job for a year or more, compared with the OECD average of 33.8 per cent.
- The Free State's weak economic growth over the past ten years has had a major impact on the province's labour force.
- The structure of the Free State's working age population remains unchanged. Around 90.8 per cent of the working age population were African in Q4:2017. Whites constituted about 6.0 percent, followed by Coloureds (2.6 per cent) and then Indians/Asians (0.7 per cent).
- The African population constitute of about 86.8 percent of the province's EAP, followed by Whites (9.1 per cent), Coloureds (3.7 per cent) and Asians (0.4 per cent) respectively.
- In spite of the recent surge in employment, the level of employment in the province is still below the pre-recession level. In fact, compared to 2008, the number of employed people was 2 924 lower in 2016.

Key findings:

- The majority of the employed in the Free State are found in Mangaung (34.6 per cent) followed by Lejweleputswa (22.2 per cent), Thabo Mofutsanyana (21.3 per cent), Fezile Dabi (17.4 per cent) and then Xhariep (4.6 per cent).
- The majority of the jobs in the Free State are in the tertiary industries, whilst the share of the primary industry continues to dwindle largely due to the diminishing mining sector.
- The community services is the biggest employer in the province, followed by trade, private households and agriculture. On the other end of the spectrum the smallest employers in the province are utilities and mining.
- An estimated 47.0 per cent of the Free State's workers are employed in the semi-skilled occupations, 36.0 per cent in the low-skilled occupations and only 17.0 per cent in the skilled occupations.
- The Free State's workforce remains largely unskilled which contributes to the problem of structural unemployment.
- During the economic boom between 2002 and 2008, the number of unemployed people decreased significantly resulting in a drop in the unemployment rate from 28.4 per cent to 25.4 per cent. However, as a result of the economic recession, the number of unemployed people has been on an increase since.
- By the year 2016 the provincial annual unemployment rate had reached a high of 33.0 per cent; 7.7 percentage point higher than it was in 2008.
- There were 117 139 more unemployed people in 2016 than there were in 2008. The persistently poor economic performance post the 2009 recession can be largely blamed for the huge and increasing unemployment levels in the province.
- In Q4:2017, an overwhelming majority (82.1 per cent) of the employed had no tertiary qualification. Only 17.7 per cent of the employed had completed a tertiary qualification. These statistics indicate the poor education level of the Free State's workforce.
- Unemployment in the province exhibits certain demographic characteristics, in particular, unemployment is concentrated amongst black Africans, the less educated, the youth, women and those without prior work experience.

3.1. INTRODUCTION

Building technical and institutional capacity to collect and analyse information on the labour market, establishing a labour market profile, and using the labour market diagnosis to design appropriate policies and evaluate such policies, is critical to accelerating progress towards full and productive employment and decent work for all. It is, therefore, important to establish or maintain sound labour market information and analysis systems in order to produce accurate and comparable data on decent work and labour market conditions, and use them to develop evidence-based policy-making.

The purpose of this chapter is, therefore, to contribute to the maintenance of this sound labour market information and analysis systems. And also to contribute to informed policy-making in the province.

3.2. GLOBAL AND NATIONAL OVERVIEW

3.2.1. International Labour Market Trends

Global unemployment levels and rates are expected to remain high in the short term, as the global labour force continues to grow. In particular, the global unemployment rate is expected to rise modestly in 2017, to 5.8 per cent (from 5.7 per cent in 2016); representing 3.4 million more unemployed people globally (bringing total unemployment to just over 201 million in 2017). And while the global unemployment rate is expected to hold relatively steady in 2018, the pace of labour force growth (i.e. those in search of employment) will outstrip job creation, resulting in an additional 2.7 million unemployed people globally (see table 3.1).

The increase in unemployment levels and rates in 2017 will be driven by deteriorating labour market conditions in emerging countries (as the impacts of several deep recessions in 2016 continue to affect labour markets in 2017). In fact, the number of unemployed people in emerging countries is expected to increase by approximately 3.6 million between 2016 and 2017 (during which time the unemployment rate in emerging countries is expected to climb to 5.7 per cent, compared with 5.6 percent in 2016). Of notable concern are developments in Latin America and the Caribbean, where the unemployment rate is expected to rise by

0.3 percentage points in 2017, to reach 8.4 per cent, largely driven by rising unemployment in Brazil.

In contrast, unemployment is expected to fall in 2017 in developed countries (by 670,000), bringing the rate down to 6.2 per cent (from 6.3 per cent in 2016). In Europe, notably Northern, Southern and Western Europe, unemployment levels and rates are both projected to continue to drop, but the pace of improvement will slow, and there are signs that structural unemployment is deteriorating. The same applies to Canada and the United States. For example, in both Europe and Northern America, long-term unemployment remains high in comparison to pre-crisis levels and, in the case of Europe, it increased recently, despite the reductions in the unemployment rate. In fact, in the EU-28, the share of unemployed people who had been looking for a job for 12 months or longer reached 47.8 percent in the second quarter of 2016, up from 44.5 per cent for the same quarter of 2012. Furthermore, in the second quarter of 2016, more than two-thirds of this group, a total of 6 million people, had been unemployed for over two years.

Table 3.1: World unemployment, vulnerable unemployment and working poverty

	Unemployment rate			Unemployment (millions)		
	2016	2017*	2018*	2016	2017*	2018*
World	5.7	5.8	5.8	197.7	201.1	203.8
Developed countries	6.3	6.2	6.2	38.6	37.9	38
Emerging countries	5.6	5.7	5.7	143.4	147	149.2
Developing countries	5.6	5.5	5.5	15.7	16.1	16.6
	Vulnerable employment rate			Vulnerable employment (millions)		
	2016	2017*	2018*	2016	2017*	2018*
World	42.9	42.8	42.7	1396.3	1407.9	1419.2
Developed countries	10.1	10.1	10	58.1	58.2	58.1
Emerging countries	46.8	46.5	46.2	1128.4	1133.6	1138.8
Developing countries	78.9	78.7	78.5	209.9	216.1	222.3
	Extreme and moderate working poverty rate			Extreme and moderate working poverty (millions)		
	2016	2017*	2018*	2016	2017*	2018*
Total emerging and developing countries	29.4	28.7	28.1	783	776.2	769.4
Emerging countries	25	24.3	23.7	589.9	589.9	580.3
Developing countries	69	67.9	66.7	186.3	186.3	189

Source: ILO, World Employment and Social Outlook – Trends, 2017

Unemployment levels in developing countries are also expected to increase in 2017 (by 450,000), with unemployment rates hovering at around 5.5 percent in 2017 and 2018. For many developing and emerging countries, however, chronic poor-quality employment, as represented by high shares of own-account workers and contributing family workers (collectively classified as workers in vulnerable forms of employment) and working poverty, takes centre stage

3.2.2. Performance of the South African Labour Market

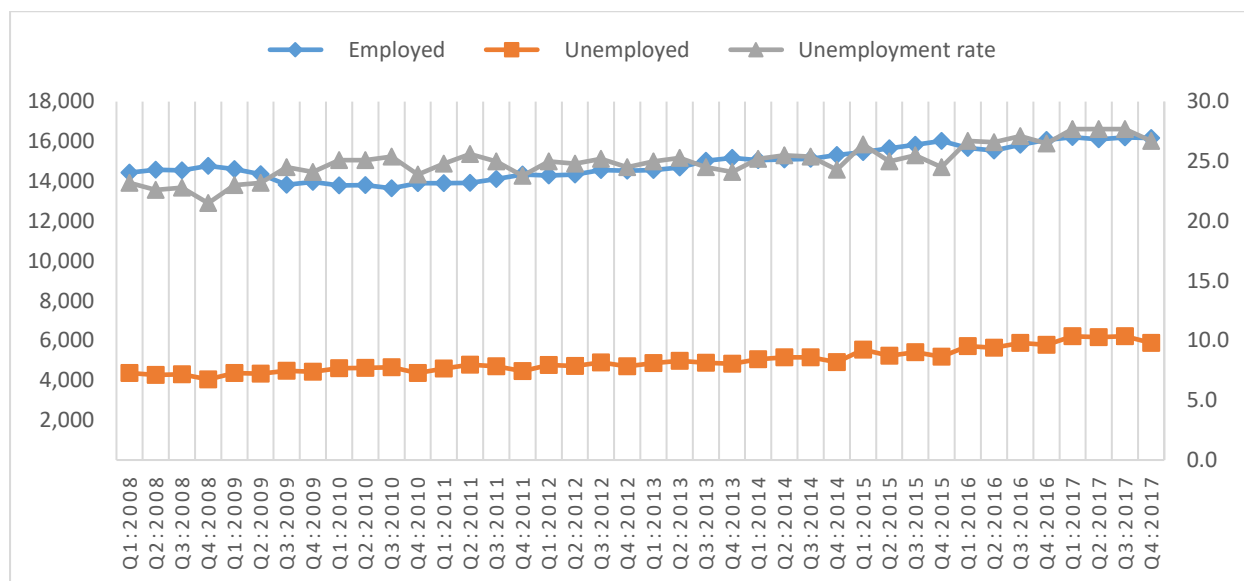
Subsequent to the devastating global financial crisis, which triggered the collapse of world markets and a recession locally, South Africa struggled to return to sustained economic growth. In this weak economic environment, the labour force has faced significant difficulties to retain or find employment, particularly at lower skill levels. As adequately illustrate in Chapter 2 above, growth in the South African economy remains subdued, nonetheless is projected to pick up modestly in 2017. This is expected to lead to some improvement in both the employment and unemployment figures. Despite this, labour market conditions in South Africa remain very challenging. In Q1:2008, the employment rate (total employment as a share of the population aged 15-64) was around 45.8 per cent. In Q4:2017 this employment rate decreased to 43.1 per cent. Since Q1:2008, the employment rate, therefore, decreased by 2.7 percentage points. In Q1:2008, unemployment affected 23.2 per cent of the labour force, increasing to 26.7 per cent in Q4:2017; representing an increase of 3.5 percentage points over the ten year period.

South African employment and unemployment trends are illustrated in figure 3.1 below, using data from Statistics South Africa's Quarterly Labour Force Surveys (QLFS) from Q1:2008 to Q4:2017. The South African economy saw a decline in employment of 944 000 or 6.4 per cent from 2008 to 2009 sparked by the local effects of the global financial crisis. Thereafter, employment increased steadily, peaking at 16.0 million jobs in Q4:2015, although it subsequently fell below that level before increasing again and reaching a high of 16.2 million in Q1:2017. On the other hand, the number of unemployment people increased from 4.4 million in Q1:2008 to 5.8 million in Q4:2017. Prior to the economic recession of 2009, the number of unemployed people in South Africa were on a decline, reaching a low of 4.0 million. However, since Q1:2009, the number of unemployed has been on consistent increase from 4.4 million to

6.2 million in Q3:2017, before declining to 5.9 million in Q4:2017. Between Q1:2008 and Q4:2017, the number of employed increased by 12 per cent, while those unemployed has increased by 34.5 per cent, which has led to 3.5 percentage point increase in the unemployment rate, from 23.2 per cent to 26.7 percent, as the labour force increased by 17.2 per cent..

The high unemployment rate and the lack of job opportunities has led to very long unemployment spells. In 2016, around 57.0 per cent of the unemployed in South Africa had been out of a job for a year or more, compared with the OECD average of 33.8 percent.

Figure 3.1: Quarterly estimates of labour market aggregates



Source: Statistics South Africa, Quarterly Labour Force Survey, Quarter 4 2017

Table 3.2 below gives a broad view of the South African labour market for the fourth quarters of 2008 to 2017. In Q4:2017, there were 37 525 individuals in the working age population, having increased by 1.7 per cent from a year earlier. Employment levels increased by 0.9 percent year on year. In Q4:2017, close to a quarter (5.9 million) of the narrow labour force was unemployed, as were about one-third (8.2 million) of the expanded labour force. Narrow unemployment increased by 1.7 per cent (99 000) from a year earlier. Likewise, broad unemployment increased by 3.6 per cent (317 000). This increase in broad unemployment is primarily driven by growth in the number of searching unemployed rather than by the non-searching unemployed. During the same quarter, there were 2.5 million discouraged work-seekers, 10.7 per cent (or 246 000) more than in Q4:2016.

In Q4:2017, the labour force participation rate (LFPR) remained virtually unchanged under both definitions over the 12-month period. Of the working age population, nearly three-fifths (58.8 per cent) were part of the narrow labour force, while about two-thirds (67.7 per cent) were part of the broad labour force. With the labour force growing at just under two percent under both definitions and employment virtually unchanged from the previous year, unemployment rates have experienced some upward pressure. In Q4:2017, the narrow unemployment rate stood at 26.7 per cent (an increase of 0.2 of a percentage point from the previous year), whilst the expanded unemployment rate rose by 0.7 of a percentage point to 36.3 per cent. The 12-month period has, therefore, seen significant deterioration within the national labour market.

Now looking at the extended 10-year period provides an even gloomier picture of the South African labour market. During this period, the official and expanded unemployment rates increased by 5.2 and 7.6 percentage points respectively. The official unemployment rate increased from 21.5 per cent in Q4:2008 to 26.7 per cent in Q4:2017, whilst for the expanded definition it increased from 28.7 per cent to 36.3 per cent. Measured in terms of the official definition, the number of unemployed people increased by 44.3 per cent, from 4.0 million to 5.8 million.

What is also alarming is the more than doubling of the number of discouraged workers, from 1.1 million in Q4:2008 to 2.5 million in Q4:2017; a staggering increase of 113.5 per cent. Because “discouraged workers” do not count toward the unemployment rate, we can actually see the unemployment rate drop even when unemployed workers move into the “discouraged worker” category rather than move from being unemployed to employed. Therefore, decreasing discouraged working can paint a distorted picture of the rate of unemployment. The observed colossal increase in the discouraged work-seekers in South Africa is reflective of the lack of confidence in the country’s labour market by work-seekers, which can largely be attributed to a persistently weak economic growth.

Table 3.2: Labour Market Overview

	Q4:2008	Q4:2009	Q4:2010	Q4:2011	Q4:2012	Q4:2013	Q4:2014	Q4:2015	Q4:2016	Q4:2017
Population 15-64 yrs	31 987	32 584	33 184	33 792	34 405	35 022	35 643	36 272	36 905	37 525
Labour Force	18 817	18 402	18 266	18 804	19 233	20 007	20 228	21 211	21 849	22 051
Employed	14 769	13 973	13 898	14 336	14 524	15 177	15 320	16 018	16 069	16 171
Formal sector (Non-agricultural)	10 221	9 844	9 720	10 210	10 266	10 773	10 911	11 180	11 156	11 244
Informal sector (Non-agricultural)	2 365	2 249	2 317	2 232	2 351	2 446	2 448	2 684	2 695	2 808
Agriculture	807	647	649	671	718	713	742	860	919	849
Private households	1 376	1 232	1 212	1 224	1 189	1 244	1 219	1 294	1 299	1 270
Unemployed	4 048	4 429	4 368	4 467	4 709	4 830	4 909	5 193	5 781	5 880
Not economically active	13 170	14 182	14 918	14 988	15 172	15 015	15 415	15 061	15 055	15 474
Discouraged work- seekers	1 189	1 726	2 176	2 339	2 301	2 200	2 403	2 279	2 292	2 538
Other(not economically active)	11 982	12 456	12 742	12 650	12 870	12 815	13 012	12 782	12 763	12 936
Rates (%)										
and Unemployment rate	21.5	24.1	23.9	23.8	24.5	24.1	24.3	24.5	26.5	26.7
Absorption rate	46.2	42.9	41.9	42.4	42.2	43.3	43.0	44.2	43.5	43.1
Labour force participation rate	58.8	56.5	55.0	55.6	55.9	57.1	56.8	58.5	59.2	58.8

Source: Statistics South Africa, Quarterly Labour Force Survey, Quarter 1 and 4 2017

Table 3.3 is a snapshot that illustrates the job vacancies advertised per province from Q1 to Q4 in the financial year 2015/16. On average, during the 2015/16 financial year, over a quarter of advertised vacancies were in Gauteng (27.3 per cent) followed by Limpopo (19.7 per cent) and then Eastern Cape (15.5 per cent) provinces which had provided the scope to boost workforce participation over the same period. On the other hand the provinces that recorded the lowest number of job vacancies were the Northern Cape (4.6 per cent), North West (6.1 per cent) and Free State (6.5 per cent). However, the variation in the number of job vacancies by province is also understood by looking at the size and composition of the provincial labour market which is not the same across provinces. This is because of the level of innovation; investment and export that are effectively being implemented across provinces.

Table 3.3: Total number of vacancies by province, 2015/16

	Quarter 1		Quarter 2		Quarter 3		Quarter 4		Average	
	N	%	N	%	N	%	N	%	N	%
Eastern Cape	1013	14.4%	2132	19.7%	927	14.6%	726	13.2%	1200	15.5%
Free State	764	10.9%	387	3.6%	273	4.3%	398	7.2%	456	6.5%
Gauteng	1878	26.7%	3357	31.0%	1618	25.5%	1437	26.1%	2073	27.3%
KwaZulu-Natal	501	7.1%	952	8.8%	323	5.1%	331	6.0%	527	6.7%
Limpopo	2162	30.7%	1262	11.6%	1301	20.5%	875	15.9%	1400	19.7%
Mpumalanga	323	4.6%	574	5.3%	562	8.8%	440	8.0%	475	6.7%
North West	75	1.1%	733	6.8%	414	6.5%	553	10.0%	444	6.1%
Northern Cape	68	1.0%	573	5.3%	423	6.7%	309	5.6%	343	4.6%
Western Cape	253	3.6%	870	8.0%	511	8.0%	438	8.0%	518	6.9%
Total	7037	100.0%	10840	100.0%	6352	100.0%	5507	100.0%	7434	100.0%

Source: Department of Labour, Job Opportunities and Unemployment in the South African Labour Market, 2015-2016

All in all, a total of 29 736 vacancies were advertised in 2015/16. The largest number of job vacancies was recorded in Q2 of 2015/16 with 10 840 (36.5 per cent) vacancies. Both sources of vacancies data (newspapers and PNet) had shown that there was an increase in quarter two and a decrease in quarter three, and again a further decrease in quarter four of 2015/16. The increase in the number of job vacancy in quarter two (April-June) was also associated with a positive employment growth recorded in the formal and informal sectors. This has shown a slight employment recovery over the same period.

Box 1: Labour Market Regulations and Institutions

The key policies and institutions that govern the South African 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: Centre for Development and Enterprise, 2013

Box 2: Progress made in achieving employment creation in South Africa

- The implementation of the Employment Tax Incentive which was introduced in 2014 and directed mainly at the youth progressed very well. Some 29 000 employers to date claimed R2 billion for at least 207 000 young people.
- Government's intervention aimed at stopping the decline in the clothing, textiles, leather and footwear sectors resulted in the retention of 68 000 jobs.
- Government's environmental programmes such as Working on Waste, Working for Wetlands, Working for Water and Working on Fire have created more than 30 000 work opportunities and aim to create more than 60 000 jobs.
- The Department of Communications' digital migration will result in more than 23 500 jobs being created in the manufacturing value chain including installers and warehousing, logistics and repairs.
- The National Youth Development Agency (NYDA) recorded 36 164 young people receiving non-financial interventions, 1 833 young entrepreneurs funded through Economic Development Programmes (NYDA Micro, Small Medium Enterprise (SME) and external partners)
- Special Economic Zones (SEZ) were allocated R3.5 billion over the medium-term, mainly for infrastructure development.
- The Department of Environmental Affairs had an allocation of R11.8 billion to fund more than 107 000 full-time equivalent jobs and 224 000 work opportunities through environmental Extended Public Works Programme (EPWP) programmes.

Source: Department of Labour, Job Opportunities and Unemployment in the South African Labour Market, 2015-2016

3.2. PROVINCIAL LABOUR MARKET TRENDS

The current socio-economic situation in the Free State poses the challenge of providing opportunities for the integration of the marginalised and excluded population into productive activities and the general mainstream economy primarily through employment and general labour market participation. Eradicating unemployment is one of the major challenges faced by the Free State. This is not a problem limited to the provincial government to provide solutions, but to the people of the province as a collective; business, government and communities.

3.2.1. Demographic Profile

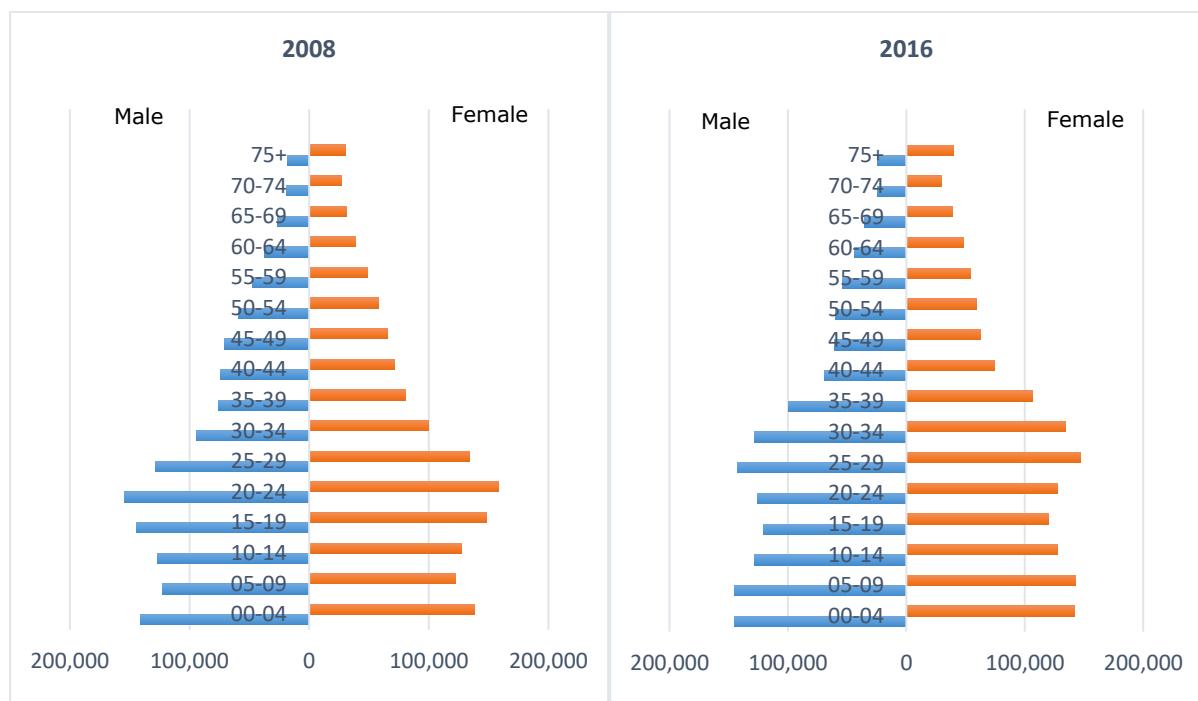
For decades, economists and social thinkers have debated the influence of population change on economic growth. Three alternative positions define this debate: that population growth restricts, promotes, or is independent of economic growth. Proponents of each explanation can find evidence to support their cases. However, all of these explanations focused on population size and growth. In recent years, however, the debate has under-emphasized a critical issue, the age structure of the population (see figure 3.2 below), which can change dramatically as the population grows. Due to the changes in people's economic behaviour at different stages of life, changes in a country's age structure can have significant effects on its economic performance. Countries or regions with a high proportion of children are likely to devote a high proportion of resources to their care, which tends to depress the pace of economic growth. By contrast, if most of a country's population falls within the working ages, the added productivity of this group can produce a 'demographic dividend' of economic growth, assuming that policies to take advantage of this are in place. In fact, the combined effect of this large working-age population and health, family, labour, financial, and human capital policies can create virtuous cycles of wealth creation. Lastly, if a large proportion of a nation's population consists of the elderly, the effects can be similar to those of a very young population. A large share of resources is needed by a relatively less productive segment of the population, which likewise can inhibit economic growth (Auerbach et al, 1989). The structure of the population is, therefore, as important as the size and growth of the population.

Demographic structure and its dynamics are external forces that serve as major parameters for the quantitative supply of labour. Because the geographical situation of a given country cannot

be changed, it represents one of the basic parameters for a country’s economic development. A favourable geographical situation offers many opportunities for the country’s development, whereas a problematic geography reduces the potential scope of economic action.

The size and composition of the population is the starting point of the analysis of labour supply. Population constitutes the human capital of the nation and defines its potential labour supply. From an economic point of view, the working population is a factor of production and its aptitude and skill level contributes to the productivity of the national economy. From a social point of view, different categories of the population form social groups of particular concern and meeting their needs are major challenges faced by public institutions and society at large (African Development Bank, 2012).

Figure 3.2: Population age pyramid



Source: IHS Markit Regional eXplorer version 1156

The current structure of the Free State’s population and to some extent its past evolution and future trend can be examined with the help of the population age pyramid. It shows the size distribution of the age categories of the population for men and women, separately. The age-sex structure of any population affects the labour 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. The Free State has what is

called an expansive population pyramid. Expansive population pyramids depict populations that have a larger percentage of people in younger age groups. Populations with this shape usually have high fertility rates with lower life expectancies. The implications of such a structure is excessive 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. 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.

In 2016, Free State had a relatively young population with roughly 46.3 per cent of the population aged under 25 years and 65.5 per cent of the population aged under 34 years. However, compared to 2008, the province's population appears to be aging, with the share of the youth (0 – 34 years age group) declining from 67.6 per cent to 65.5 per cent. With regard to the working age population, the share of the youth decreased from 59.3% in 2008 to 56.9 per cent in 2016; a decline of 2.4 percentage points (see figure 3.2). Although the share of youth is on a decline over the ten year period under review, youth targeting policies continue to be crucial for the reason that the youth remain a very vulnerable group as a substantial number of them are without employment and in need of government intervention.

Migration trends

The economic effects of migration vary widely. Sending countries may experience both gains and losses in the short term, but may stand to gain over the longer term. For receiving countries temporary worker programs help to address skills shortages, but may decrease domestic wages and add to public welfare burden. The economic effects of migration for both sending and receiving countries may also vary depending on who is moving, specifically with respect to migrant workers' skill levels.

Interprovincial migration warrants attention since it helps to grease the wheels of the national economy. Recessionary periods are typically accompanied by slowdowns in interprovincial migration as lack of employment opportunities and job uncertainty deter residents from moving to other provinces. Similarly, as economic expansions are not usually balanced across the South African provinces, incentives for migrants to move for better opportunities drive up migration levels across provinces. In the short-run, causality goes both ways, as new migrants are attracted to economies where job prospects are the brightest. At the same time, economies,

notably housing and retail activity, can receive a boost from a rising population base. The counterargument holds as well, with provinces losing residents falling further behind.

Table 3.4: Estimated provincial migration streams

	2011-2016 (Actual)			2016-2021 (Forecast)		
	Out-migrants	In-migrants	Net migration	Out-migrants	In-migrants	Net migration
Eastern Cape	499 543	173 372	-326 171	515 648	191 435	-324 213
Free State	154 405	133 492	-20 913	160 107	147 246	-12 860
Gauteng	481 263	1 462 553	981 290	544 875	1 595 106	1 050 230
KwaZulu-Natal	340 228	277 867	-62 360	360 830	307 123	-53 706
Limpopo	392 905	249 137	-143 767	417 453	278 847	-138 606
Mpumalanga	194 958	258 961	64 003	212 271	285 678	73 407
Northern Cape	72 441	75 752	3 311	76 832	82 502	5 670
North West	191 413	289 177	97 764	207 662	317 261	109 599
Western Cape	159 513	451 885	292 372	175 831	485 560	309 729

Source: Statistics South Africa, Mid-year Population Estimates, 2017

According to table 3.4 above, Gauteng (981 290) and Western Cape (292 372) received the highest number of migrants between 2011 and 2016. Similar trends are projected for the next coming five years with Gauteng recording a net-migration of over a million people between 2016 and 2021. In terms of out-migration, the Eastern Cape (499 543) and Gauteng (481 263) experienced the largest number of outflow of migrants. With regards to in-migration, the majority were from Gauteng (38 334 or 28.7 per cent) and Eastern Cape (17 461 or 13.0 per cent). Due to its relatively larger population size, Gauteng achieves the highest number of in and out flows.

Over the past 5 years the Free State recorded a net migration of 20 913. This is expected to decline to 12 860 over the next five years even though the province will still losing people to other provinces. For the period 2011-2016, the majority of the people leaving the Free State went to Gauteng (79 445 or 51.4 per cent) and North West (22 397 or 14.5 per cent). Together with decreasing fertility rates, negative net migration is contributing to a decreasing share of the Free State's population.

Box 3: Immigration and skill shortages

Skill shortages arise when demand for workers exceeds supply. This occurs as a result of an insufficient supply of appropriately qualified workers willing to work under existing market conditions, particularly at the prevailing wage. Over time the market should adjust to address such imbalances. However, a variety of causes might delay or hinder the adjustment process and the extent to which skill shortages are experienced in any particular sector, industry or occupation. These include:

- *Wages slow in adjusting* — for example, employers take time to recognise and respond to labour shortages or workers take time to recognise better opportunities elsewhere and react to them.
- *Labour supply slow in adjusting* — for example, education and training institutions take time to recognise skill needs, or there is a fundamental mismatch of skills and training provided and those demanded in the labour market. Moreover, many skills take years to acquire (especially professional and technical skills).
- *Information problems* — related to the above, there might be poor or unreliable information in the labour market, thereby dampening market signals to workers, industry, employers, and education and training institutions.
- *Technological change* — rapid technological change might lead to a structural shortage of workers in possession of needed skills.
- *Institutional* — for example, imperfect product market competition, contracts of employment between employers and employees, and social welfare arrangements.
- *Demographic* — for example, low female participation rates, population ageing and so forth.

The impact of immigration on skill shortages is complex. Immigration can provide a means of addressing skill shortages without the costs associated with time and training of the domestic workforce. However, immigration might also dampen the labour market price signals that encourage investment in training by domestic businesses and labour (exacerbating longer-term shortages).

Source: Productivity Commission, 2006

3.2.2. Labour Force Profile

The Free State's weak economic growth over the last ten years has had a major impact on the province's labour force. Employers are indicating shortages in skilled workers to respond to the changing structure of the provincial economy from a resource based to a modern services based economy. Low birth rates and an aging workforce have resulted in a slow growing pool of workers. Unemployment remains stubbornly high above 30 per cent although it has declined in the past year, as the number of the employed has increased, whilst the unemployed has decreased. Both the absorption and labour force participation rates have increased, though only marginally. This section of the publication analyses trends in the Free State labour force.

According to table 3.5 below, the number of people in the working age has increased by a mere 15 000 in the past six years, from 1 877 000 in Q4:2011 to 1 892 000 in Q4:2017. About 50.2 percent of the working age population are women, with men accounted for the remaining 49.8 percent. However, what is interesting is the fact that the number of men has increased by 14 000 (or 1.5 per cent), while women only increased by around 2 000 (0.2 per cent). This means that over 90 per cent of the increase in the working age population were men. Overall, the population of working age increased by 0.8 per cent between Q4:2011 and Q4:2017.

A further breakdown of the working age population by race reveals the dominance of the African population in the province. Around 90.8 per cent of the working age population were African in Q4:2017. Whites constituted about 6.0 per cent, followed by Coloureds (2.6 per cent) and then Indians/Asians (0.7 per cent). The share of Africans increased by 4.4 percentage points from 86.3 per cent in Q4:2011, mostly at the expense of Whites whose share declined by 4.2 per cent.

Table 3.5: Population of working age (15-64 years)

	Q4:2011	Q4:2012	Q4:2014	Q4:2015	Q4: 2016	Q4:2017
	Thousand					
Both sexes	1 877	1 891	1 862	1 875	1 885	1 892
Women	948	970	918	952	965	950
Men	929	921	943	924	920	943
Population groups						
Black/African	1 620	1 700	1 651	1 659	1 700	1 717
Coloured	66	41	59	65	49	49
Indian/Asian	1	3	7	5	20	14
White	190	147	144	147	115	113

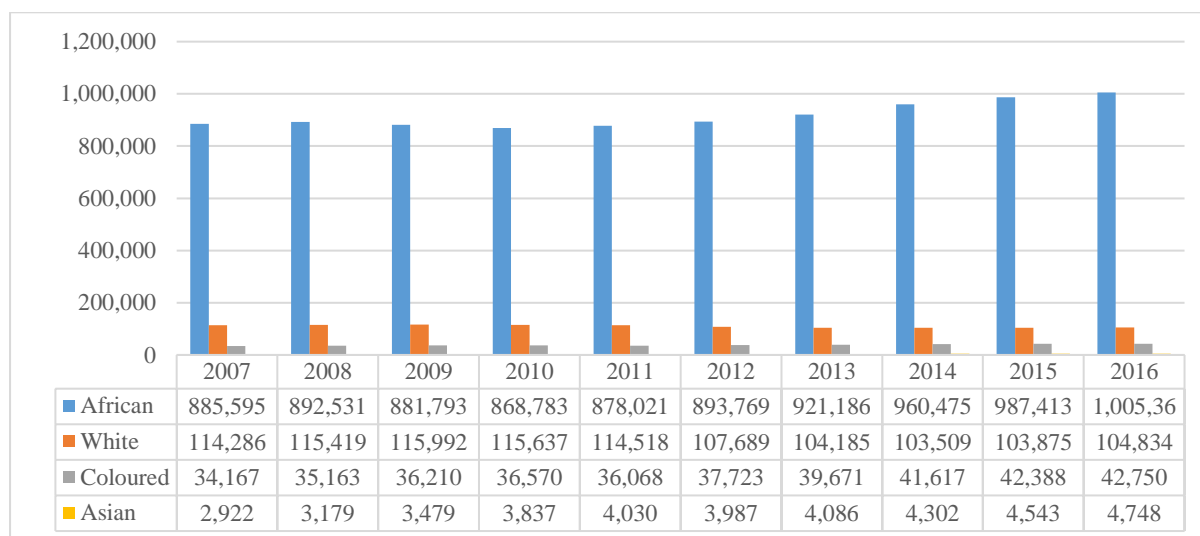
Source: Statistics South Africa, QLFS, Quarter 4 2017

Figure 3.3 below illustrate trends of the economically active population (EAP) by race over a ten year period. The EAP includes people from 15 to 64 years of age who are either employed or unemployed and who are seeking employment. It is clear from the table that the majority of the EAP are African, as would be expected given that Africans constitute an overwhelming majority of the Free State's population. The African population constitute of about 86.8 per cent of the province's EAP, followed by Whites (9.1 per cent), Coloureds (3.7 per cent) and Asians (0.4 per cent) respectively.

The number of Africans who are economically active increased from 885 595 in 2007 to 1 005 366 in 2016; an increase of 119 771 or 13.5 per cent. The number of economically active Coloureds increased by 8 583 (25.1 per cent), and Asians by 1 826 (0.1 per cent). Whites on the other hand decreased by 9 452 (-8.3 per cent). Overall, the Free State's EAP increased by 120 728 (11.6 per cent) during the period under review.

The Free State's EAP is growing, an indication that more people are coming into the labour force. However, the growth in the number of EAP does not correlate with the growth in the number of jobs created. While the EAP increased by 120 728 people between 2007 and 2016, the number of people employed only increased by 18 323 and the number of the unemployed increased by a staggering 105 685. This has resulted in the increasing unemployment rates over the period. It is, therefore, important that the number of jobs created in the economy at the very least keeps pace with the growing number of new entrants in the labour market.

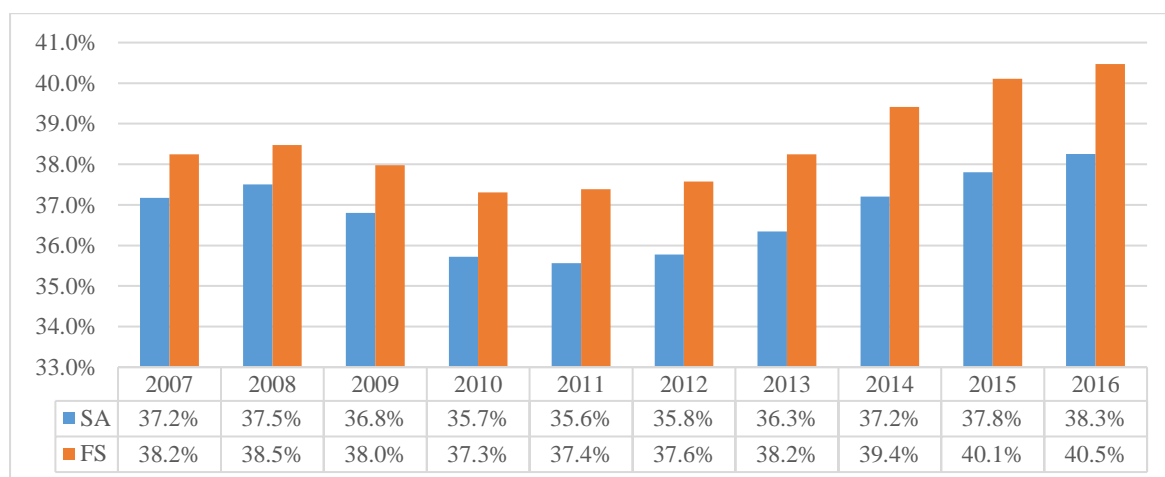
Figure 3.3: Number of Economically Active Population by race



Source: IHS Markit Regional eXplorer version 1281, 2018

In 2016, the EAP as a percentage of the Free State’s population was estimated at 40.5 per cent compared to the country’s 38.3 per cent. The province’s EAP as percent of the province’s population increased from 38.2 per cent in 2007 to 40.5 per cent on 2016; an increase of 2.3 percentage points. This means that during this period there was an increase in the number of new entrants in the labour market. During the same period, South Africa recorded an increase of 1.1 percentage points. Free State’s EAP as of population is 2.2 percentage points higher than that of the country. This growth is an opportunity to drive economic expansion and increase gross domestic product (GDP), but a growing workforce also presents many challenges if they are not absorbed in the labour market.

Figure 3.4: Economically Active Population as % of total population, official definition



Source: IHS Markit Regional eXplorer version 1281, 2018

Table 3.6 below summarises the most recent trends in the Free State's labour force. During 2017, the Free State's labour force increased by 7 000 people, from 1 188 000 in Q1:2017 to Q4:2017. Year on year, the labour force increased by 35 000 people (3.1 per cent). The number of employed people increased from 767 000 in Q1:2017 to 8036 000 in Q4:2017; an increase of 39 000 (6.4 per cent). On the other hand, the number of unemployed people decreased by 31 000 people. This has led to 2.9 percentage point decrease in the unemployment rate, from 35.5 per cent to 32.6 per cent. Year on year, the unemployment rate decreased by 2.1 percentage points, from 34.7 per cent in Q4:2016 to 32.6 per cent in Q4:2017.

The number of discouraged work-seekers increased by 1000 during 2017, but increased by 7 000 year on year. Theoretically, the number of discouraged work-seekers will increase during tough economic times. One popular explanation of this phenomenon is that during a recession, workers become discouraged and give up searching for work. Economists view this as the result of workers believing that their chances of finding a job are so low that the implied monetary and psychological costs of searching yield a utility of searching that is lower than the utility of being out of the labour force (Dagsvik et al, 2010). There are four reasons discouraged workers usually give up looking for work: Firstly, most of them have been unemployed for so long that they do not believe there are any jobs for them. Secondly, they do not think they have the schooling or training needed to get a good job. A third reason is age discrimination. They say a potential employer thought they were too young or old. Fourth, some believe they have been discriminated against because of their gender or race.

The Free State's absorption rate increased by 2.4 percentage points, year on year; from 40.2 per cent in Q4:2016 to 42.6 per cent in Q4:2017. The LFPR increased by 1.7 percentage points during the same period, from 61.5 per cent to 63.2 per cent (see table 3.7 below). LFPR in South Africa was estimated at 58.80 per cent in Q4:2017. The highest recorded LFPR is in Slovakia with 92.0 per cent. At the time of recession, it is generally seen that the labour force participation rate goes down. This is because, at the time of recession, the economic activity is very low which results in fewer jobs across the country. When there are fewer jobs, people are discouraged to focus on employment which eventually leads to lower participation rate. The participation rate is also important in understanding the unemployment rate in the economy. The increasing LFPR is indicative of an improving economy, as more people actively participate in the labour market.

Table 3.6: Labour force characteristics

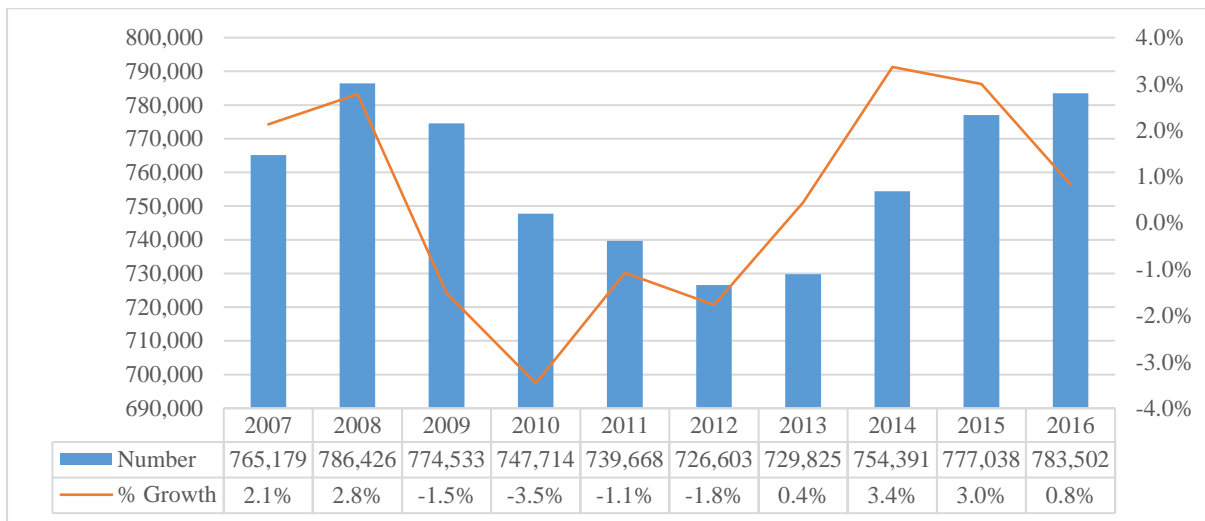
	Q4:2016	Q1:2017	Q2:2017	Q3:2017	Q4:2017	Qrt to Qrt change	Year on year change	Qrt to Qrt change	Year on year change
	Thousands							Percent	
Population 15-64 yrs	1 885	1 887	1 888	1 890	1 892	3	7	0.1	0.4
Labour Force	1 160	1 188	1 184	1 205	1 195	-10	35	-0.8	3.1
Employed	757	767	777	821	806	-16	48	-1.9	6.4
Formal sector (Non-agricultural)	460	458	463	497	488	-9	28	-1.8	6
Informal sector (Non-agricultural)	143	156	138	161	157	-5	13	-2.9	9.3
Agriculture	65	70	80	75	77	2	13	3	19.7
Private households	89	82	96	88	84	-4	-5	-4.8	-5.9
Unemployed	403	421	407	384	390	6	-13	1.5	-3.2
Not economically active	726	699	704	685	697	13	-29	1.8	-3.9
Discouraged work-seekers	82	88	84	81	89	8	7	10.3	8.6
Other(not economically active)	644	611	620	604	608	4	-36	0.7	-5.5
Rates (%)									
Unemployment rate	34.7	35.5	34.4	31.8	32.6	0.8	-2.1		
Absorption rate	40.2	40.6	41.1	43.5	42.6	-0.9	2.4		
Labour force participation rate	61.5	63	62.7	63.8	63.2	-0.6	1.7		

Source: Statistics South Africa, QLFS, Quarter 4 2017

3.2.3 Employment

According to figure 3.5 below, the number of employed people in the Free State reached a peak in 2008 at 786 426. However, as a result of the 2009 economic recession, employment levels in the province decreased for four consecutive years. A total of 59 823 jobs were lost between 2008 and 2012. During this period, employment decreased by just under 2 percent on average. From 2013 the level of employment started to increase gradually. Between 2013 and 2016, the number of employed people increased by 53 677 people. In spite of the recent surge in employment, the level of employment in the province is still below the pre-recession level. In fact, compared to 2008, the number of employed people was 2 924 lower in 2016, thus the labour market is still feeling the effects of the 2009 economic recession and the consequent poor economic growth since.

Figure 3.5: Total employment

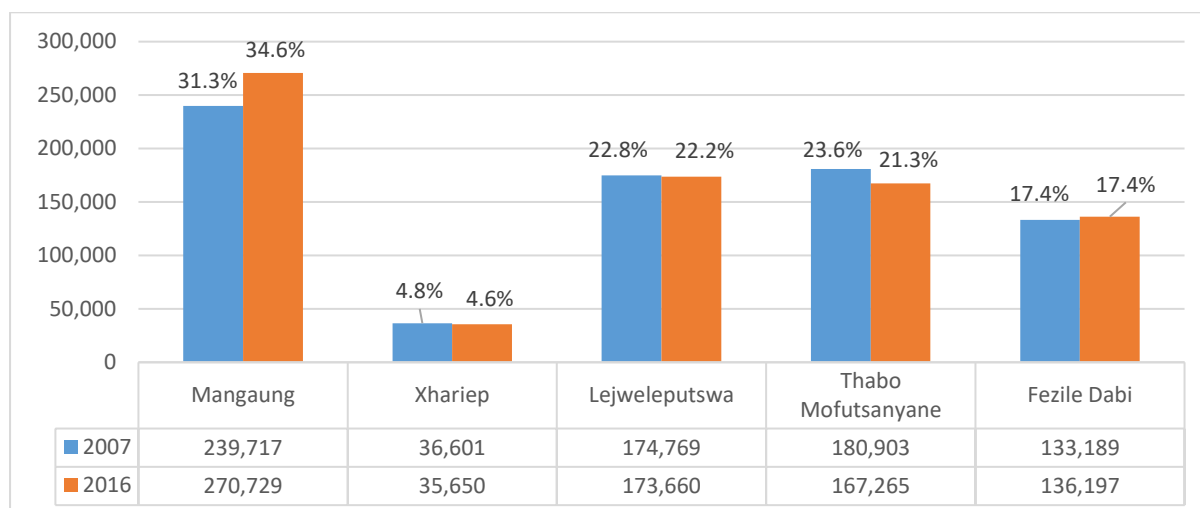


Source: IHS Markit Regional eXplorer version 1281, 2018

Figure 3.6 below shows the levels of employment in the Metro and districts of the Free State. The majority of the employed in the Free State are found in Mangaung (34.6 per cent) followed by Lejweleputswa (22.2 per cent), Thabo Mofutsanyana (21.3 per cent), Fezile Dabi (17.4 per cent) and then Xhariep (4.6 per cent). During the period 2007 to 2016, the share of Mangaung increased by 3.2 percentage points. Thabo Mofutsanyane’s share decreased 2.3 percentage points, followed by Xhariep (-0.2 per cent) and Lejweleputswa (-0.7 per cent). The share of Fezile Dabi remained constant at 17.4 per cent.

In terms of numbers, the level of employment increased only in Mangaung (31 013) and Fezile Dabi (3 007). The district of Lejweleputswa continues to bleed jobs as a result of the diminishing mining sector, but the biggest declines were in Thabo Mofutsanyana with 13 638 jobs shed between 2007 and 2016.

Figure 3.6: Employment by region, number and percentage share



Source: IHS Markit Regional eXplorer version 1281, 2018

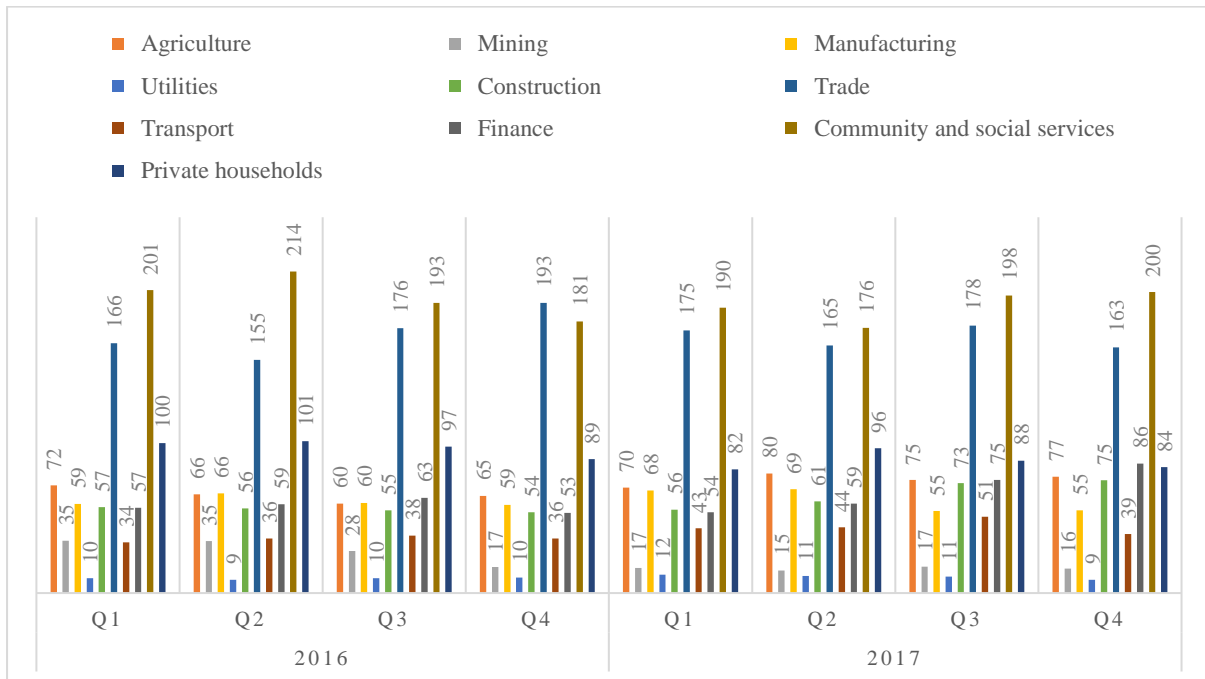
Figure 3.7 below shows quarterly employment levels by sector for 2016 and 2017 respectively. In 2016, the community services were the largest employers for all but the last quarter of the year, where most workers were in the trade sector. In the following year, 2017, the community services dominated employment across all four quarters of the year. The community services is clearly the biggest employer in the province, followed by trade, private households and agriculture. On the other end of the spectrum the smallest employers in the province are utilities and mining.

The effects of the transformation of the provincial economy is evident in the sectoral distribution of the employment. Structural change in a modern economy frequently manifests as a shift in emphasis from the extraction of raw materials to the production of services, i.e. from primary sectors to tertiary sectors. Under these circumstances, the demand for labour in the primary sector declines whereas demand for labour especially in the services sector increases. Primary extractive industries tend to employ relatively large proportions of low and unskilled labour, and services industries tend to employ a greater proportion of intermediate to high skills workers.

As illustrated in figure 3.7 the majority of the jobs in the Free State are in the tertiary industries, whilst the share of the primary industry continues to dwindle. This transformation is also demonstrated in figure 3.9, which looks at the employment by occupation. In Q4:2017, 71.0 percent of the Free State’s workers were employed in the tertiary industries, whilst the

secondary and primary industries employed 17.2 percent and 11.8 percent respectively. The biggest single employer was the community and social services (24.8 per cent), followed by trade (20.2 per cent), finance (10.7 per cent) and private households (10.4 per cent). On the other hand, the smallest employers were utilities (1.1 per cent), mining (2.2 per cent), transport (4.8 per cent) and manufacturing (6.8 per cent).

Figure 3.7: Sectoral employment



Source: Statistics South Africa, QLFS, Quarter 4 2017

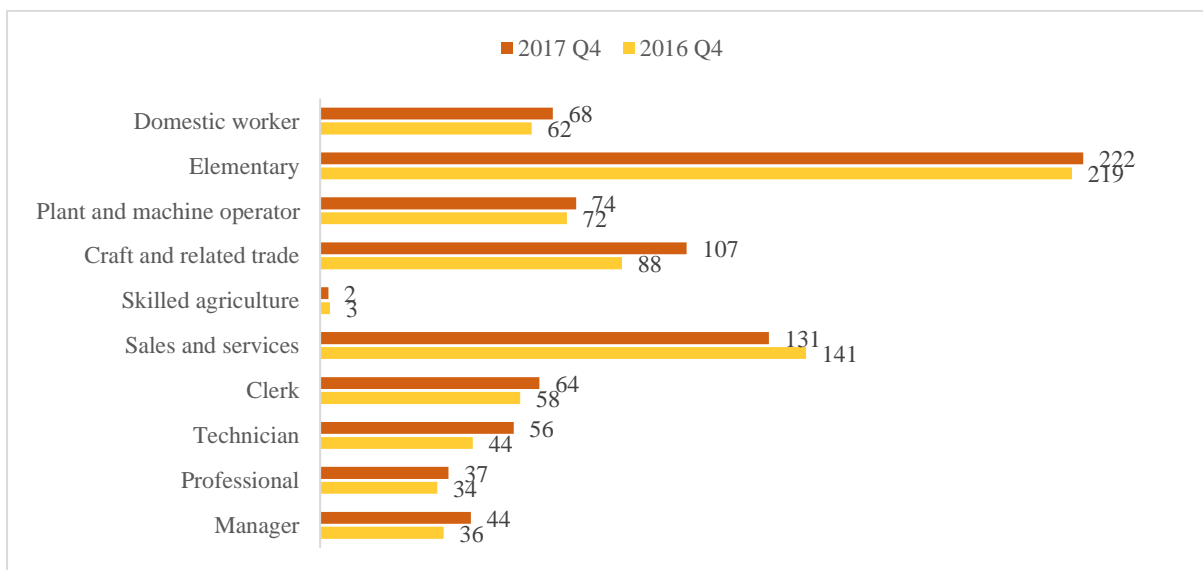
The shift from the primary to the tertiary sectors normally result in growing demand for highly skilled professionals, technicians and managers to develop, implement, operate and maintain new technologies associated with the services economies. At the same time, this technology is replacing the unskilled and low skilled labourers, farming workers, production workers and basic service workers. The declining share in production of these workers has also has the effect of increasing the share of the non-production workers; namely transport workers and clerical and sales workers. Therefore, the main beneficiaries of this structural change are the more highly skilled occupations and those associated with service sectors. The losers are the more low skilled occupations and those associated with the primary sectors. It is therefore fitting to conclude that the shift in the Free State economy's structure to a more knowledge-based economy has increased the need for workers with reasoning, problem-solving, and behavioural skills; a positive cognitive style; and specific occupational and professional competencies. This

structural transformation in the economy poses a real risk of increased marginalization of low-skilled workers in the labour market, but also creates an opportunity for the reskilling of the low skilled workers.

According to figure 3.8 below, only the sales and services occupation recorded job losses between Q4:2016 and Q4:2017. A total of 10 000 jobs were lost in this occupation. The majority of the jobs were created in the following occupations: craft and related trade (19 000), manager (8 000), and technicians (8 000).

In terms of percentage shares, an estimated 47.0 per cent are employed in the semi-skilled occupation, 36.0 per cent in the low-skilled occupations and only 17.0 per cent in the skilled occupation. A further breakdown, shows that an overwhelming proportion of the Free State’s workforce are employed in elementary occupation at a share of 30.0 percent, followed by sales and services (17.7 per cent) and craft and related trade (14.4 per cent) respectively. The smallest shares go to skilled agriculture (0.3 per cent), professional (5.0 per cent) and managerial (5.9 per cent). The Free State’s workforce remains largely unskilled which contributes to the problem of structural unemployment. This is particularly worsened by the continuing transformation of the provincial economy referred to in Chapter 2 above. The little light at the end of the tunnel is that the share of the skilled workers has increased by 2.0 percentage points, from 17.0 per cent to 15.1 per cent, year of year.

Figure 3.8: Employment by occupation



Source: Statistics South Africa, QLFS, Quarter 4 2017

3.2.4. Unemployment

Box 3: Defining unemployment

Statistics South Africa (Stats SA) uses the following definition of unemployment as its official definition. The unemployed are those people within the economically active population who: (a) did not work during the seven days prior to the interview, (b) want to work and are available to start work within two weeks of the interview, and (c) have taken active steps to look for work or to start some form of self-employment in the four weeks prior to the interview. The expanded definition of unemployment excludes criterion (c).

The question of who should be considered ‘unemployed’ is controversial. In 1998, Stats SA officially adopted a “strict” definition of unemployment that was in line with the International Labour Organisation definition “used by more than 80% of both developed and less developed countries, and South Africa’s major trading partners”.

The strict definition of unemployment considers a person to be unemployed only if they have “taken active steps to look for work or to start some form of self-employment in the four weeks prior to the interview”. They are sometimes referred to as the “searching unemployed”.

The expanded or broad definition of unemployment includes discouraged job-seekers: those that want to work but are not actively searching for a job as they have lost hope, wanted to work but there are no jobs in the area or were unable to find work that required their skills. They are sometimes referred to as the “non-searching unemployed”.

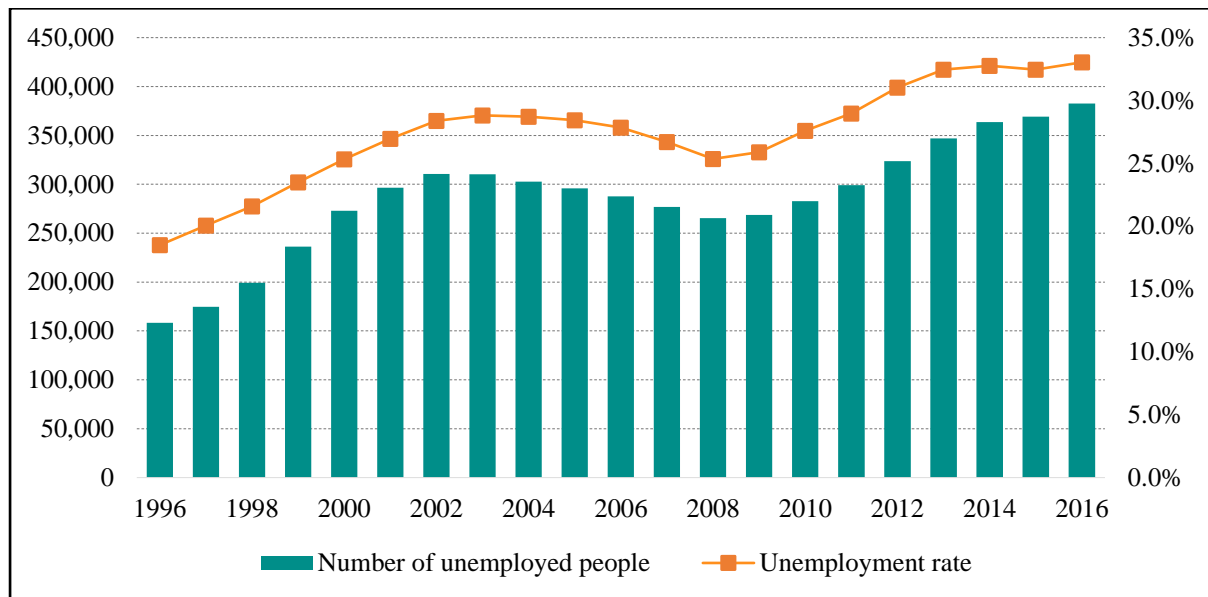
Therefore, the main difference between the official and the expanded definitions of unemployment is the requirement in the former that, in order to be classified as unemployed, a person must have engaged in job seeking in the four weeks prior to the interview.

Source: Statistics South Africa, 2018

Job creation has always been an important policy objective. For example, GEAR (Growth, Employment and Redistribution) aimed at creating 400 000 jobs per annum and thereby achieving an annual employment growth rate of 6 percent, while ASGISA (Accelerated and Shared Growth Initiative of South Africa) had the goal of reducing the narrow unemployment rate to below 15 percent by 2014. Moreover, the introduction of legislation such as the Employment Equity Act of 1998 and the Basic Conditions of Employment Act of 1997 was intended to help improve the employment prospects and working conditions of the previously disadvantaged groups (i.e., Africans, females, disabled). The New Growth Path targeted the creation of 5 million jobs over a 10 year period, with particular focus on creating jobs in infrastructure, agriculture, mining, green economy, tourism, business services as well as manufacturing. Most recently, the National Development Plan (NDP) aims to halve unemployment by the year 2030. In spite of these policy intervention, unemployment remains stubbornly high in South Africa, and more so in the Free State.

As illustrated in figure 3.9 below, Free State's unemployment levels have increased substantially since 1996. During the economic boom between 2002 and 2008, the number of unemployed people decreased significantly resulting in a drop in the unemployment rate from 28.4 per cent to 25.4 per cent. However, as a result of the economic recession, the number of unemployed people increased from 2009 and has not ceased to increase to date. By the year 2016 the provincial annual unemployment had reached a high of 33.0 per cent; 7.7 percentage point higher than it was in 2008. There were 117 139 more unemployed people in 2016 than there were in 2008. The persistently poor economic performance post the 2009 recession can be largely blamed for the huge and increasing unemployment levels in the province.

Figure 3.9: Unemployment overview



Source: IHS Markit Regional eXplorer version 1281, 2018

Table 3.7 below shows the characteristics of the unemployed in the Free State. In Q4:2017 the majority of the unemployed were new entrants (37.4 per cent) and job losers (34.6 per cent). These statistics point directly to the constraint provincial economy. Not only are new entrants failing to find employment, but the economy is also shedding jobs.

The number of those unemployed for more a year (long term unemployment) has increasing marginally by 0.1 percentage point year on year. Long term unemployment accounts for 69.3 percent of the unemployed, increasing from 67.0 in Q4:2016. The Free State is, therefore, facing a serious challenge of long term unemployment. The risks of long-term unemployment are dramatically higher for black youths, as they must often contend with adverse living conditions and social circumstances on top of the lack of availability of employment opportunities. With many black youths living on the outskirts of economic centres of activity, travel and administrative costs involved in a spirited job search quickly become expensive and unaffordable to those most in need of employment

Long-term unemployment in the Free State can be attributed to cyclical unemployment and structural unemployment. Cyclical unemployment itself is often caused by a recession. Structural unemployment occurs when workers' skills no longer meet the needs of the job market. Long-term cyclical and structural unemployment feed off of each other. A recession

causes a massive rise in cyclical unemployment. Those who cannot find jobs become long-term unemployed. If a person is out of work long enough, their skills become outdated. In time, this contributes to structural unemployment. They have less money to spend, resulting in reduced consumer demand. It further slows economic growth, leading to more cyclical unemployment. The Free State economy has experienced two recessions since 2009, and performed poorly in the years in between. This has contributed to cyclical unemployment in the province. The lack of skills and/or mismatch of skills has further contributed to structural unemployment the province is currently dealing with. The province, therefore, has to grow the economy and skill the labour force if it were to reduce the high unemployment levels it is facing.

Table 3.7: Characteristics of the unemployed

	Oct-Dec 2016	Jan-Mar 2017	Apr-Jun 2017	Jul-Sep 2017	Oct-Dec 2017	Qrt to Qrt change	Year on year change	Qrt to Qrt change	Year on year change
	Thousand					Percent			
Unemployed	403	421	407	384	390	6	-13	1.5	-3.2
Job losers	136	143	129	123	135	12	-1	9.9	-0.5
Job leavers	26	18	25	20	22	1	-4	6.9	-16.0
New entrants	139	158	155	152	146	-6	7	-4.1	5.4
Re-entrants	8	6	12	8	6	-2	-2	-27.5	-25.6
Other	95	96	86	80	81	1	-14	0.7	-14.5
Unemployed	403	421	407	384	390	6	-13	1.5	-3.2
Long-term unemployment (1 year and more)	270	283	289	266	270	4	0	1.7	0.1
Short-term unemployment (less than 1 year)	133	138	118	118	119	1	-13	1.1	-10.0
Long-term unemployment (%)									
Proportion of the labour force	23.3	23.8	24.5	22.0	22.6	0.6	-0.7		
Proportion of the unemployed	67.0	67.2	71.1	69.2	69.3	0.1	2.3		

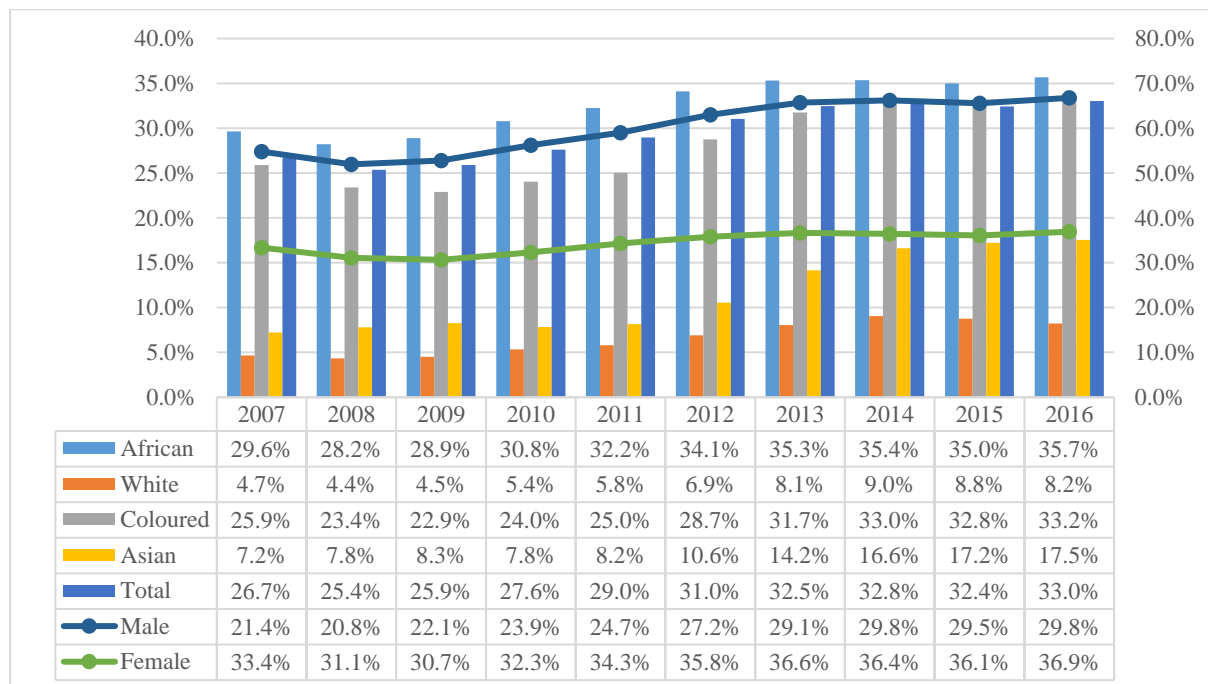
Source: Statistics South Africa, QLFS, Quarter 4 2017

Transformation of the Free State labour market in terms of race and gender has stalled. The face of the unemployed remains African and female. Approximately 35.7 per cent of Africans

were unemployed in 2016, compared to just 8.2 per cent of the Whites. However, there has been an increase in unemployment rates across all population groups between 2007 and 2016. The biggest increase in the unemployment rate was by Asians (10.3 per cent) followed by Coloureds (7.3 per cent), Africans (6.1 per cent) and Whites (3.5 per cent). Given that the Asians constitute just 0.4 per cent of the Free State’s labour force, the increase in their unemployment rate is not as significant as the increase in the unemployment rate of Africans who constitute 86.8 per cent of the provincial labour force.

The female population remain more affected by unemployment than males. The female unemployment rate increased from 33.4 percent in 2007 to 36.9 percent in 2016; representing an increase of 3.5 percentage points. On the other hand, the unemployment rate for males increased by 8.4 per cent from 21.4 per cent to 29.8 per cent during the same period. The gap between the male and female unemployment rate has decreased by 4.9 percentage points. Although the decline in the gap between the two is welcome, the fact that it decreased because of a faster increased in the male unemployment rate rather than a decline in the female unemployment rate is a problem. Increasing unemployment levels in the province have affected both males and females, but more so males.

Figure 3.10: Unemployment rates by Population Group and Gender

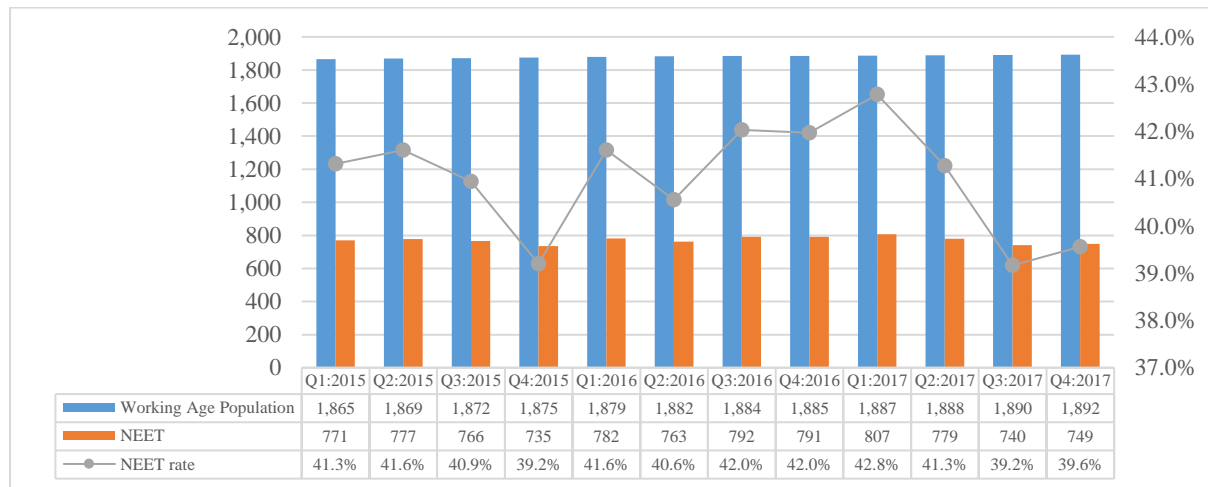


Source: IHS Markit Regional eXplorer version 1281, 2018

3.3. NOT IN EMPLOYMENT, EDUCATION OR TRAINING (NEET)

The Not in Employment, Education or Training (NEETs) are defined as people who are not employed and who are not in education or training. The NEETs are considered to be disengaged from both work and education. As a result, information about NEETs is of interest to many countries world-wide due to the possible implications that being NEET may have on their future labour market opportunities and experiences. Information about the NEET is also used to monitor the labour market and the social dynamics of young people in particular. According to the Organisation for Economic Co-operation and Development (OECD) (2013), the state of NEETs in a country implies a stagnation or decline in human capital, which is particularly worrying if it affects low-educated youth with little or no work experience. Periods out of employment or education can have negative long-term consequences by giving rise to potentially ‘scarring’ effects, i.e. by permanently reducing a person’s future employment and earnings potential.

Figure 3.11: Number and percentage of persons who are NEET

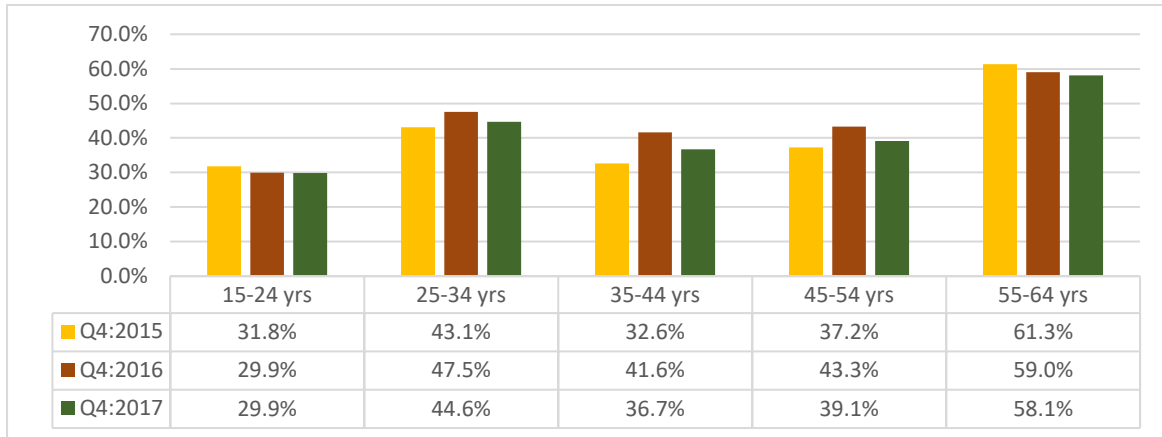


Source: Statistics South Africa, QLFS, Quarter 4 2017

As indicated in figure 3.11 above, approximately 749 000 people aged 15-64 years were NEET in the Free State in Q4:2017, down from 791 000 in the same quarter of the previous year; a decrease of 43 000 people. This figure translates to 39.6 percent of the number of the 15-64 year olds who were NEET in Q4:2017. The number of NEETs fluctuated between 2015 and 2017, reaching a high of 807 000 in Q1:2017, but has since been declining steadily. NEET rate has declined steadily in the first three quarters of 2017, before increasing slightly in the last

quarter closing the year at 39.6 per cent. During the review period, the NEET rate peaked in Q1:2017 at 42.8 per cent. .

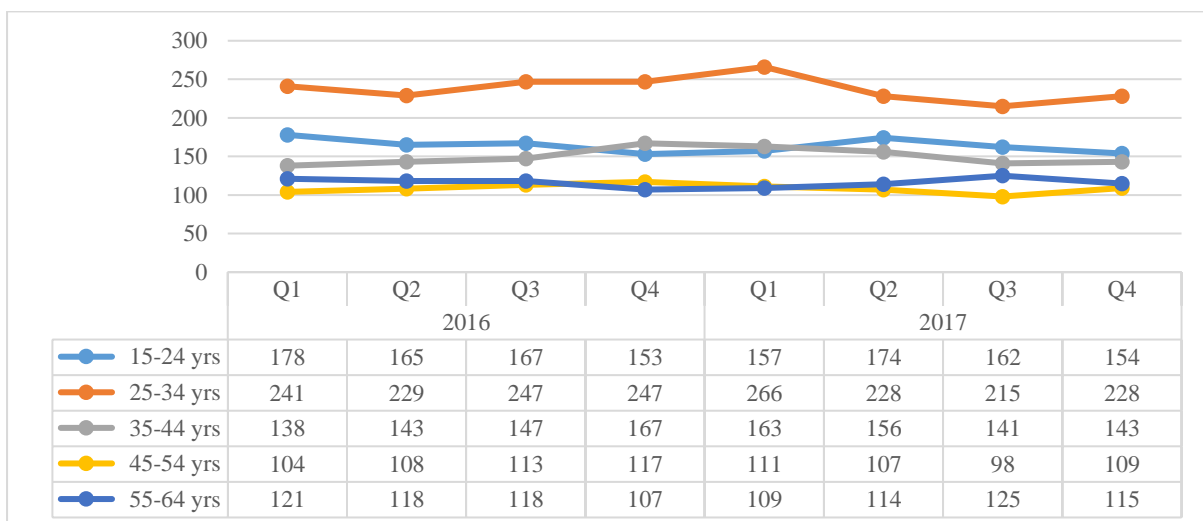
Figure 3.12: NEET rate by age group



Source: Statistics South Africa, QLFS, Quarter 4 2017

Figure 3.2 above shows the NEET rate by age group from Q4:2015 to Q4:2017. Adults aged 55-64 years recorded the highest NEET rate when compared with the other age groups. In 2017, the NEET rate for the adults aged 55-64 years was 58.1 per cent, followed by the youth aged 25-34 years with 44.6 per cent and the adult aged 45-54 years with 39.1 per cent respectively. The NEET rates for the youth aged 15-24 years reported a declining trend from 31.8 per cent in Q4:2015 to 29.9 per cent in Q4:2017. Age group 55-64 years also recorded a decline from 61.3 per cent to 58.1 per cent during the same period.

Figure 3.13: Number of people not in employment, education or training by age group



Source: Statistics South Africa, QLFS, Quarter 4 2017

Figure 3.13 above shows that the latest highest number of NEETs was recorded among youth aged 25-34 years with 228 000 people, followed by persons aged 15-24 years with 154 000 people, while the adult category aged 35-44 years recorded 143 000 people in Q4:2017. The number of NEETs for adults aged 45-54 years and 55-64 years was 109 000 and 115 000 persons respectively. The number of youth aged 15-24 year old who are NEET, increased slightly by about 1 000 persons year on year (Q4:2016 compared to Q4:2017), while for those aged 25-34 years dropped by 19 000 people. Figure 3.13 demonstrates that the prevalence of NEET is higher among the youth. This is probably because many persons aged 15-34 are inexperienced and struggle to find employment particularly during tough economic times. Youth tend to experience more hardship during economic slowdowns as they are usually the first to lay off. This group is arguably the most vulnerable to chronic unemployment, poverty and social exclusion, as they are neither improving their skills through education nor gaining the work experience needed to progress in the labour market.

3.4. LEVEL OF EDUCATION

Having a larger, healthier and better-educated workforce will only bear economic fruit if the extra workers can find jobs. A paper by Mosala (2016) on the transforming economy and skills development in the Free State clearly indicates lack of skills and/or skills mismatch as a major contributor to unemployment in the Free State. The paper concluded that the majority of the unemployed are those without the necessary qualifications and skills needed by the modern economies. Education and training, therefore, plays a critical role in combating unemployment and consequently fight poverty and inequality in the Free State. Table 3.8 below shows the levels of education of the unemployed and the employed over the past year (i.e.2017).

In Q4:2017, an overwhelming majority (82.1 per cent) of the employed had no tertiary qualification. Only 17.7 per cent of the employed had completed a tertiary qualification. These statistics indicate the poor education level of the Free State's workforce. Turning to the unemployed, only 5.4 per cent of the unemployment has a tertiary education; the majority of the unemployed are the less educated. A staggering 63.1 per cent of the unemployed have not completed secondary schooling. An estimated 94.4 per cent of the labour force has matric or less, while only 5.4 per cent 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. 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.

Over the past year, those with a tertiary education have found it relatively easier to secure employment. Employment in the “tertiary qualification” group increased by 24.2 per cent year on year, whilst unemployment decreased by 33.3 per cent. A key feature of structural unemployment is that unemployment is not universal, pockets experience close to full employment while other groups have high unemployment. Clearly, the Free State is struggling with structural unemployment, which needs to be addressed as a matter of urgency

Table 3.8: Highest level of education of the employed and the unemployed

	Oct-Dec 2016	Jan-Mar 2017	Apr-Jun 2017	Jul-Sep 2017	Oct-Dec 2017	Qrt to Qrt change	Year on year change	Qrt to Qrt change	Year on year change
	Thousand					Percent			
Employed	757	767	777	821	806	-16	48	-1.9	6.4
No schooling	19	23	19	19	19	0	0	1.9	1.0
Less than primary completed	78	76	85	85	77	-8	-1	-9.1	-1.1
Primary completed	39	43	43	50	44	-6	5	-12.4	11.6
Secondary not completed	299	297	295	292	288	-5	-11	-1.5	-3.8
Secondary completed	204	195	220	225	234	9	30	4.1	14.8
Tertiary	115	131	114	150	143	-6	28	-4.1	24.2
Other	2	2	1	1					
Unemployed	403	421	407	384	390	6	-13	1.5	-3.2
No schooling	6	5	5	5	5	0	0	-5.0	-8.5
Less than primary completed	26	31	25	25	27	2	1	7.6	3.9
Primary completed	21	19	21	15	15	-1	-6	-3.9	-30.0
Secondary not completed	207	224	207	191	199	8	-8	4.3	-3.6
Secondary completed	111	115	120	121	122	1	11	0.7	9.7
Tertiary	31	26	30	26	21	-5	-10	-19.7	-33.3
Other	1				1		0		-22.1

Source: Statistics South Africa, QLFS, Quarter 4 2017

Skill development must, therefore, become an integral part of the broader strategy to reduce the level of unemployment in the Free State. To address the problem of structural

unemployment in the Free State, Mosala (2016) recommended the development of a comprehensive provincial skills development strategy that would:

- Reduce skills mismatches by raising the number of skilled people (including the reskilling of the unskilled) in the provincial economy, at a rate and magnitude that has not been achieved in the past;
- Aim to retain the skilled people within the province;
- Address racial dynamics in the province's Labour Force;
- Keep learners in school at least up until the end of the secondary level;
- Provide for a diversified approach in terms of technical and vocational education and tertiary education; and
- Improving coordination amongst all the role players.

3.5. CONCLUSION

Weak economic performance continue to constrain job creation in the province. The province has not recovered from the 2009 economic recession and this has translated to weak labour market indicators. The Free State's unemployment rate remains stubbornly high. Although the number of employed people has increased in the past four years, it remains below the pre-recession level. On the other hand the number of unemployed people is persistently on the increase. Unemployment in the province exhibits certain demographic characteristics, in particular, unemployment is concentrated amongst black Africans, the less educated, the youth, women and those without prior work experience. Policy intervention should be aimed particularly at these groups. Skills development remains critical in the province as the majority of the province's labour is ill-equipped to take advantage of the transforming economy. Job creation continues to be a central priority in the Free State!

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