LIMPOPO

PROVINCIAL GOVERNMENT

REPUBLIC OF SOUTH AFRICA

PROVINCIAL TREASURY

Quarterly Economic Bulletin 2016/17 Q1

The heartland of southern Africa - development is about people

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Abbreviations

GDP-Gross Domestic Product
LDP-Limpopo Development Plan
LED-Local Economic Development
LEDZ-Limpopo Economic Development Zone
NDP - National Development Plan
SA-South African
Stats SA-Statistics South Africa
QLFS- Quarterly Labour-Force Survey
COE- Compensation of Employees
SARB- South African Reserve Bank
PMG- Platinum Metal Group
PPP- Public Private Partnership

Foreword

This first Quarterly economic bulletin is presented in tough economic conditions, although the outcome is mainly due to exogenous factors such as weak global economic outlook. Government through the fiscal policy has the potency to stimulate economic growth and improve the living conditions of all citizens. Therefore there is merit in evidence based fiscal decision making and ensuring that the provincial fiscal policy responds to the imperatives outlined in both the National Development Plan (NDP) and the Limpopo development Plan (LDP).

This economic bulletin provides public economic analysis that offers valuable insights into factors that affect both the provincial economy and the long term fiscal sustainability of the provincial finances. The province is faced with poor performing economy due to low total output in the agriculture and mining sector and high provincial public sector wage bill that reduces fiscal space to divert resources towards investment expenditure.

Sub-national government has to aggressively implement developmental plans aimed at restructuring the provincial economy and advancing economic development in the province and in local municipalities. Performance measurement frameworks and monitoring tools will be necessary to also measure the impact of government expenditure in the local economy.

All the developmental goals and objectives in the LDP can be achieved when public resources are effectively allocated and efficiently utilised.

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1. Introduction

The responsibility and methods of calculating South African Gross Domestic Product (GDP) now reside with the official statistics provider Statistics South Africa (Stats SA). There is no significant variations between spending and production methods of calculating the GDP, nevertheless, the production method is the official GDP barometer for economic performance in the country. Due to unfavourable climatic conditions and challenging trading environment both the national and provincial economies suffered a series of contractions quarter on quarter.

The South African bonds survived adverse credit ratings. One of the major credit rating companies namely Moody's indicated that the South African economy is demonstrating signs of recovery in the medium to long run. The South African fiscal policy is indicating long term sustainability as the debt to GDP ratio is projected to be lower than the current 51 percent mark.

Provincial public sector wage bill is gradually eclipsing the provincial budget. This limits the latitude of discretionary budget that could alternatively be redirected to supporting economic growth in the province. The current 71 percent of the provincial budget constituting the provincial wage bill is unsustainable and compromises the long term fiscal sustainability of the province.

Though infrastructure is an important vehicle towards accelerating economic growth and development in a local economy, the Limpopo infrastructure expenditure is growing at a decreasing rate. This is amid road infrastructure backlogs and other basic service amenities, particularly in rural communities. An aggressive integrated infrastructure implementation programme is necessary to increase market linkages and accessibility in the marginalised regions of the province.

While the provincial unemployment rate is declining from 20.1 to 18.2 percent in 2016 year on year, there is a growing number of discouraged job seekers exiting the labour market. This phenomenon is a concern to government as this population inevitably become a burden to the state for the sustenance of their wellbeing while reducing the probabilities of communities servicing their municipal accounts and increase reliance on government public services such as health, education services and social welfare security.

2. SA Economic Growth

Stats SA has revised GDP estimates for the past few years to include not only production but spending in the local economy. Spending estimates was the responsibility of the South African Reserve Bank (SARB) for the past seventy (70) years. Authorities are aspire that measuring production and expenditure at the same time will improve GDP transparency.

2.1. Production Method (Main GDP indicator)

This method is also called the Net Product or Value Added method. The factor cost GVA is computed by firstly summing the gross value of output from all sectors, then subtracting the intermediate consumption such as cost of materials, supplies and services used in production of the final output. Adding indirect tax minus subsidies in GVA at factor cost results in GDP at producer prices. This is the official and most common used GDP indicator for measuring the size of an economy.

$$\text{GVA} = \text{f}\sum_{n-1}(\text{Value Of Output} - \text{Value Of Intermediate Consumption})$$

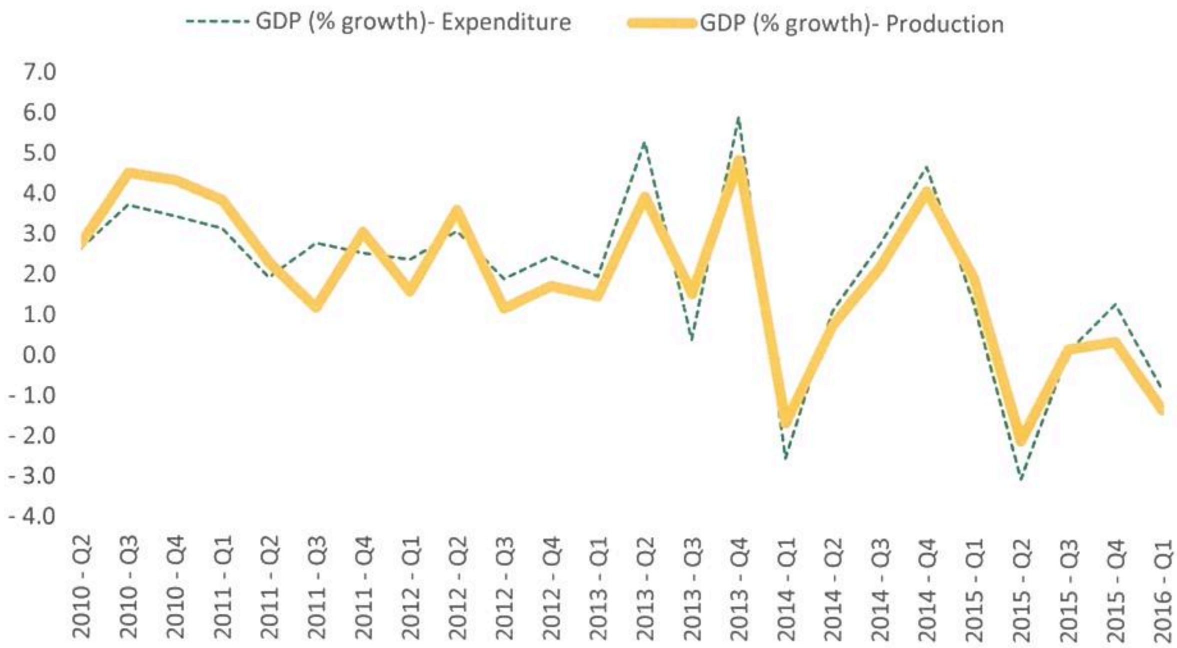
2.2. Expenditure Method

The advantage of this method is that expenditure is systematically broken down, firstly, by type of final use (final consumption or capital formation) and, secondly, by sectors making the expenditure. This method is mostly used in decision making. An equivalent definition is that GDP (Y) is the sum of final Consumption Expenditure (FCE), Gross Capital Formation (GCF), and Net Exports (X – M).

$$\text{GDP} = \text{f}\sum_{n-1}(\text{FCE} + \text{GCF} + (\text{X} - \text{M}))$$

South Africa's GDP growth rate (measured by production) is -1.2 percent in the first quarter of 2016. The main contributors to the negative GDP growth rate are the mining and quarrying industry, the transport, storage and communication industry. Mining and quarrying fell by 18.1 percent, largely as a result of lower production of platinum group metals and iron ore. Transport, storage and communication fell by 2.7 percent, largely as a result of a decline in land transportation (both passenger and freight).

Figure 1: SA Expenditure on GDP and Production GDP growth rate at Constant 2010 prices, seasonally adjusted, annualised (%)



Source: Stats SA GDP 2016 Q1

3. Limpopo Economic Growth

The Limpopo economy has been resilient growing at an average rate of 1.9 percent per annum between 2010 and 2014. Albeit, the local economy was not immune to weak international demand for commodities and low mineral prices. This has led to a down ward trending economic growth plummeting from 2.6 percent growth in 2010 to 0.9 percent in 2014. Although the supply side constraints such as energy supply have been circumvented, the province is faced with unrelenting and unfavourable climatic conditions that have constrained total agricultural output. Due to low business confidence levels and disheartening global economic conditions, private sector has been shy to increase private capital expenditure.

The 2014 weak economic growth in the province is attributed to contractions in the Mining, Construction, Personal Services and General Government Services which contracted by 5.9 percent, 1.5 percent, 0.8 percent and 0.7 percent respectively.

Table 1: Limpopo GDP Constant 2010 prices - percentage changes

Industry	2010	2011	2012	2013	2014	Trend
Primary Industries	**4.2**	**-1.1**	**-1.2**	**5.2**	**0.1**	
Agriculture, forestry and fishing	-1.8	-1.2	0.5	4.0	6.9	
Mining and quarrying	4.8	-1.0	-1.4	5.3	-0.6	
Secondary Industries	**3.5**	**0.9**	**1.5**	**1.2**	**1.4**	
Manufacturing	6.2	1.5	1.2	0.4	2.2	
Electricity, gas and water	4.2	0.9	0.1	-1.2	-0.5	
Construction	1.1	0.6	2.9	3.8	2.3	
Tertiary industries	**1.8**	**4.2**	**2.2**	**1.4**	**1.4**	
Trade, catering and accommodation	3.6	3.2	3.1	0.4	0.7	
Transport, storage and communication	1.0	2.8	0.9	0.9	3.0	
Finance, real estate and business services	0.8	3.5	2.0	1.2	1.3	
Personal services	-0.1	1.5	2.1	2.0	1.2	
General government services	1.7	6.5	1.9	2.4	1.7	
GDPR at market prices	**2.6**	**2.4**	**1.0**	**2.5**	**0.9**	

Source: Stats SA GDP 2016 Q1

3.1. Policy recommendations on the local economy

In order for the province to transform the local economy and achieve the LDP objectives, the province requires to do the following:

3.1.1. The provincial fiscal policy should be systematically synchronised with provincial economic framework and thereby inherently supporting the priorities in the LDP. To support accelerated economic growth, the fiscal policy needs to be biased towards the development of nodal economic growth centres or Special Economic Zones (SEZ). Conglomeration of economic activities make setting up of businesses less expensive thereby attracting new investments.

The benefits of conglomeration of economic activities directly and indirectly enhances rural development through the supply of labour, goods and services.

3.1.2. Due to the element of scarcity, government has to delicately balance meeting unlimited needs with limited resources. The provincial administration should adopt a phased approach were there are insufficient resources to respond to all the objectives simultaneously, immediately or to the desired scale.

3.1.3. The principle of utilizing linkages and leverage should be applied in the MTSF. It may be necessary to prioritize seemingly insignificant programmes in the medium term such as infrastructure maintenance programmes in order to unlock significant development impact in the long term.

3.1.4. Generate sufficient, reliable data for evidence based prioritization and choice making. The development of a performance measurement frame such as the LDP Indicator Dashboard can provide a basis of evaluating the provincial strategy from the outcome based approach.

The province needs to strengthen integration and coordination of the long term plans of departments and local municipalities. The multiplier effects of integrated development plans are vast and accelerate integrated service delivery.

4. Public Finance

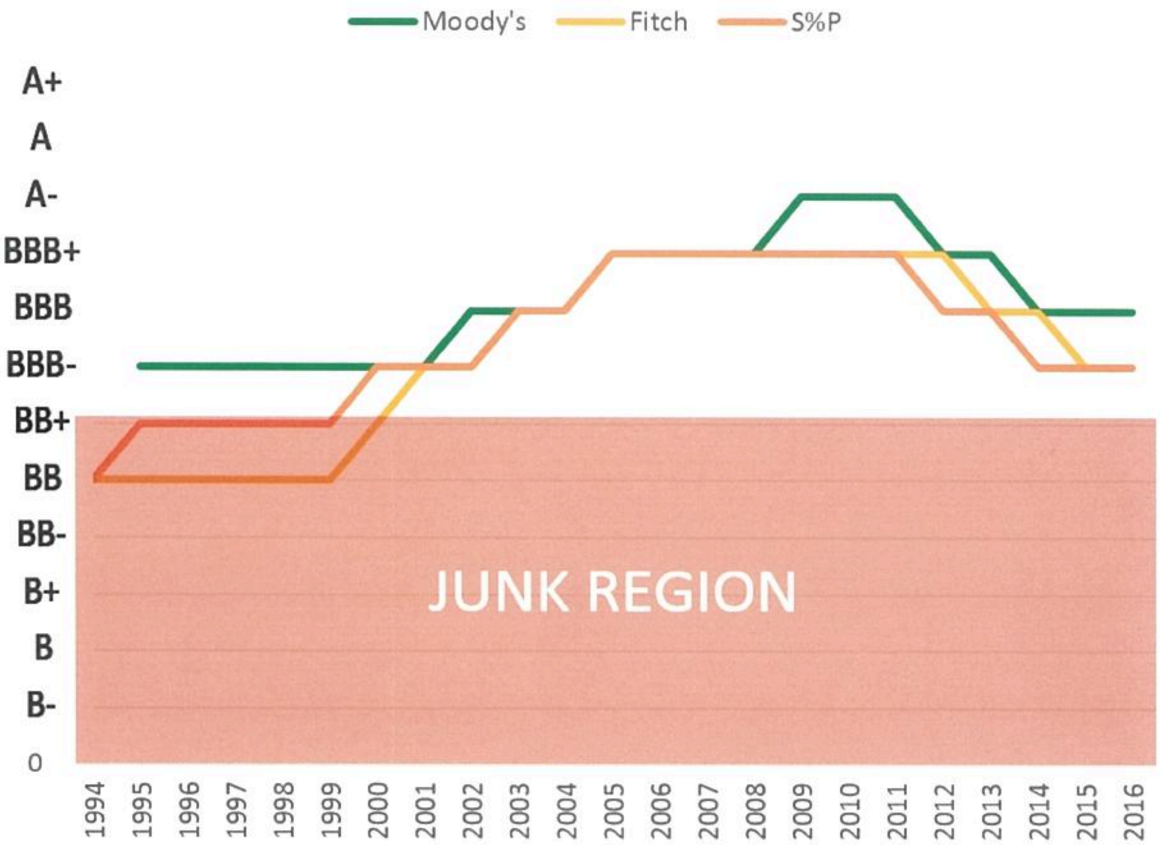
4.1. Credit Ratings

A credit rating agency also called a ratings service is a company that assigns credit ratings, which rate a debtor's ability to pay back debt by making timely interest payments and the likelihood of default. Rating agencies, or credit rating agencies, evaluate the creditworthiness of organizations in a particular country that issue debt in public markets.

Ratings are made on a descending scale: AAA is the highest, then AA, A, BBB, BB, B, etc. A rating of BB or below is considered a “junk bond,” because it is likely to default. The three largest credit rating agencies are Moody's, Standard & Poor's, and Fitch Ratings.

Moody's Investors Service confirmed South Africa's BBB long-term government bond. The confirmation of South Africa's ratings reflects Moody's view that the country is likely approaching a turning point after several years of falling growth, that the 2016/17 budget and Medium Term Fiscal Plan will likely stabilize and eventually reduce the general government debt metrics.

Figure 2: South African Sovereign Credit Ratings (1994 – 2016)



Source: National Treasury

4.2. Rationale for confirming the exiting ratings

The South Africa's credit rating outcomes by Moody's was confirmed after considering three major factors. Firstly, Moody's considered the South African economic growth trajectory which is demonstrating signs of recovery in the medium term. Secondly, the agency considered the Medium Term Fiscal Plan which is geared to stabilizing and reducing the national debt to GDP ratio and thirdly the geo-political stability and independence of state institutions such as the judiciary, which recently have demonstrated high degree of independence.

4.3. Policy recommendations on credit ratings

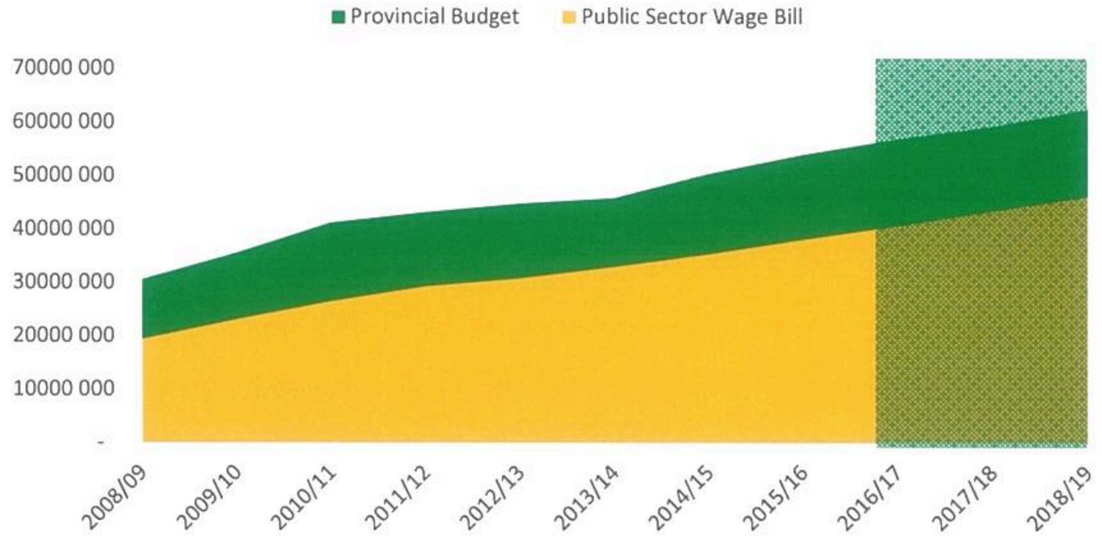
4.3.1. It is important for all the spheres of government to contribute towards maintaining a positive investment rating of the country's government bond through prudent fiscal discipline. Provincial and Municipal authorities have the responsibility to ensure that the national fiscal policy remains sustainable in the long run. This can be achieved by ensuring prudent fiscal plans that resonate with the provincial and national economic frameworks.

4.3.2. Ensure the rigorous implementation of the revenue enhancement strategies that continue to effectively and efficiently improve current sources of own generated revenue, also guide in the identification of new sources of own revenue which will increase fiscal autonomy of sub-national governments.

4.4. Provincial Public Sector Wage bill

The province is planning on spending an estimated R179 billion in the current Medium Term Expenditure Framework (MTEF), approximately R131 billion representing 73 percent, will be spent on the Public Sector wage bill. Over the years, the provincial wage bill eclipsed the provincial total budget with little room for discretionary spending. In the 2015/16 financial year, total appropriation was R53 billion of which R38 billion went to public sector wages.

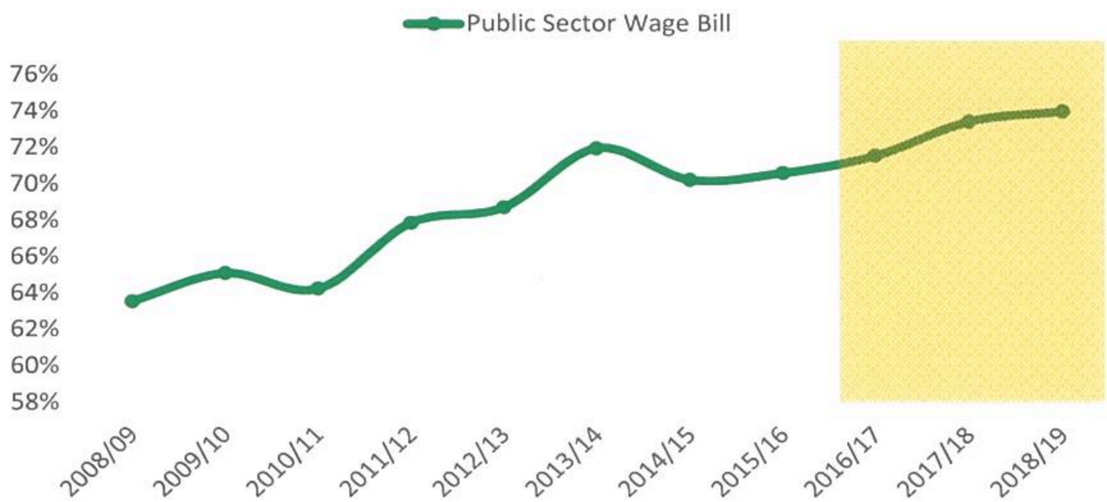
Figure 3: Limpopo Provincial Budget and Compensation of Employees (Actuals and MTEF Estimates)



Source: Limpopo Treasury 2016

The provincial wage bill is gradually eclipsing the provincial budget over the years. In 2008/09, the wage bill constituted 64 percent, which is gradually growing, in 2015/16 it accounted for 71 percent of the total budget. The trend is anticipated to grow to 74 percent in 2018/19 reflecting an unsustainable trajectory. If the trend is not reversed, the province risks diverting the limited resources from core service delivery imperatives to mainly paying wages of personnel.

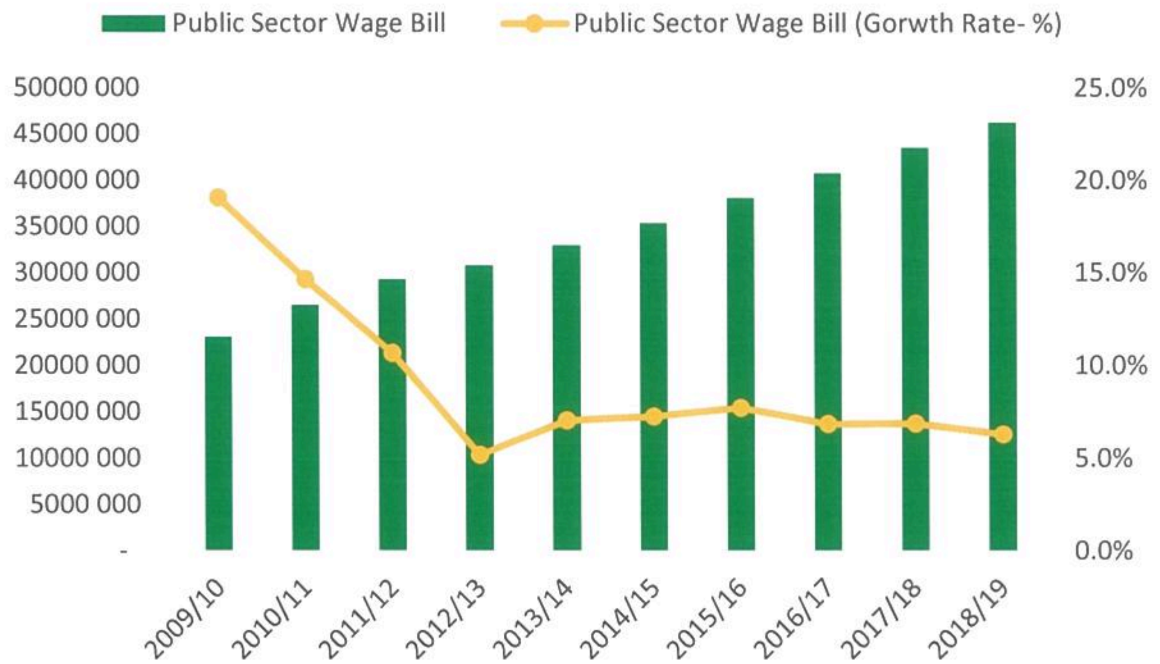
Figure 4: Contribution of CoE to provincial budget



Source: Limpopo Treasury 2016

The provincial wage bill is growing by an average of 9.2 percent per annum, 3.2 percent above the upper band of the inflation target. In 2009/10, wage bill grew by 19 percent declining to 7.7 percent in 2015/16. The growth rate is expected to average 6.7 percent into the MTEF.

Figure 5: Limpopo public sector wage bill and wage bill growth rate

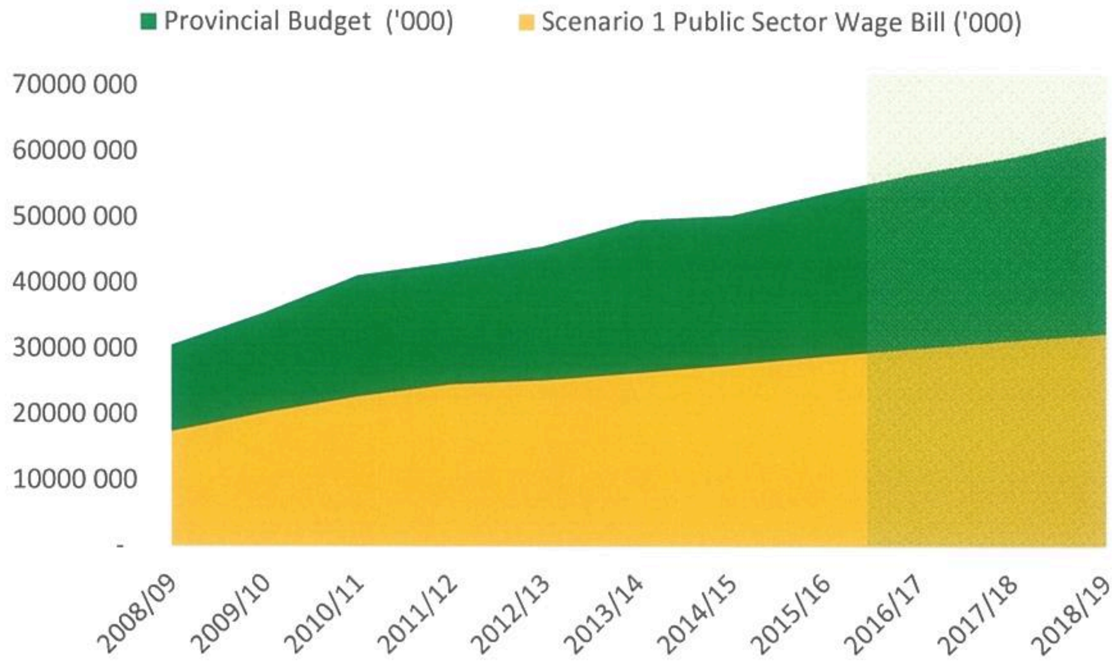


Source: Limpopo Treasury 2016

4.4.1. Modelled Scenario on CoE

The below scenario portrays a modelled public sector wages after the implementation of fiscal measures to reduce the wage bill. The scenario assumes that the Provincial Treasury implemented fiscal measures that led to a 10 percent decline in the compensation of employees in 2008/09 financial year. The model further assumes a 2 percent cumulative reduction in the COE in the subsequent years. The Provincial Treasury could have generated savings of R42 billion by 2015/16 and R78 billion in 2018/19 cumulatively illustrated by the divergence of the provincial budget and the public sector wage bill.

Figure 6: Limpopo budget and modelled public sector wages



Source: Limpopo Treasury 2016

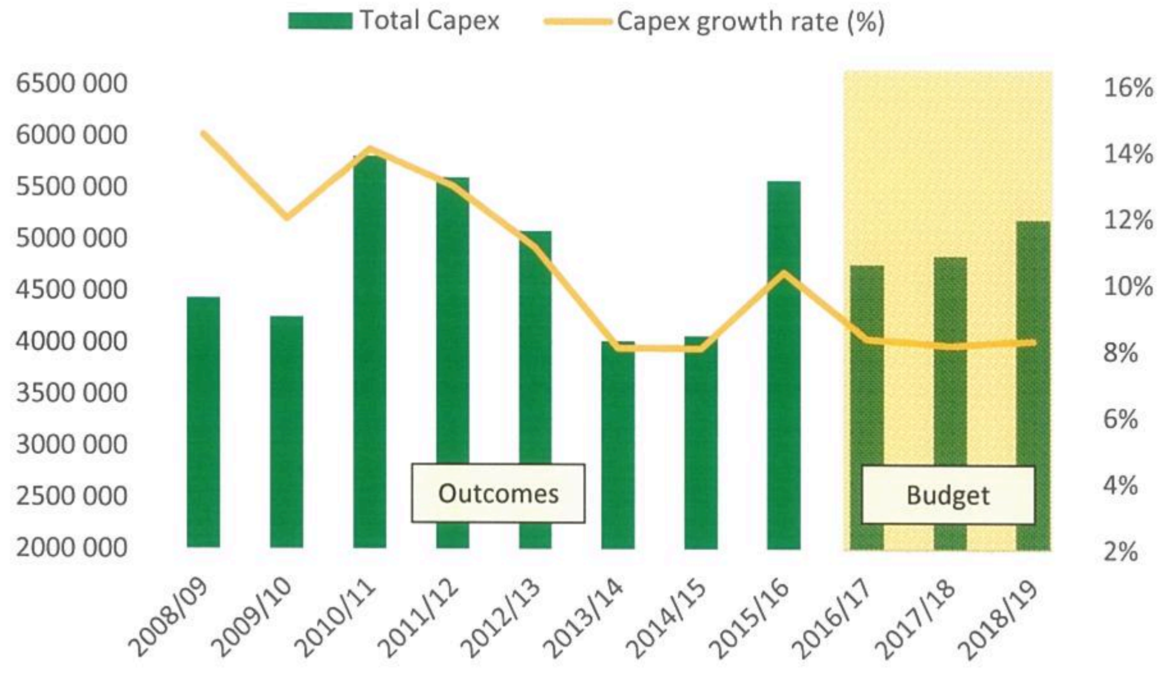
4.5. Policy recommendations on public sector wage bill

As much as the provincial government urgently needs to raise revenue, there is a need to decelerate and ultimately reduce the provincial wage bill. This will allow the provincial administration to free up resources to accelerate actual service delivery, infrastructure development and increase economic development in the province. If the high wage bill is not controlled provincially, the adverse consequences will strike back in terms of higher income taxes, increase in value added taxes (VATs) and fuel levies eventually eroding overall disposable income of an average household. High public sector wage bill accompanied by lacklustre economic growth compromises the national fiscal sustainability in the long run as current expenditure is likely to be financed through borrowings.

4.6. Public Sector infrastructure Investment

Limpopo provincial infrastructure is funded through conditional grants and Provincial Equitable Share (PES). The overall infrastructure percentage contribution to provincial budget abstains decline over the years from 2008/09 to 2015/16 and also anticipated to decline even further over the MTEF while Compensation of Employees is anticipated to increase further. The infrastructure budget decline from 15 percent in 2008/09 to 10 percent in 2015/16 and estimated to fall to 8 percent in 2018/19 financial year.

Figure 7: Limpopo Infrastructure Expenditure and MTEF projections



Source: Limpopo Treasury 2016

The importance of investment in infrastructure to the socio-economic advancement of a nation cannot be overemphasized. Insufficient or poor infrastructure limits citizens' access to markets, as well as livelihood opportunities and services such as clean water, education, health, transport and communication. Limpopo Province should prioritise the infrastructure budget as economic infrastructure investment is a vehicle for economic development and growth.

Public infrastructure such as highways, mass transit, water and sewer systems, etc. should be considered as a factor of production, along with labour and private capital, in the private sector production process. Therefore, to raise productivity growth the province should boost the rate of capital accumulation on tangible capital.

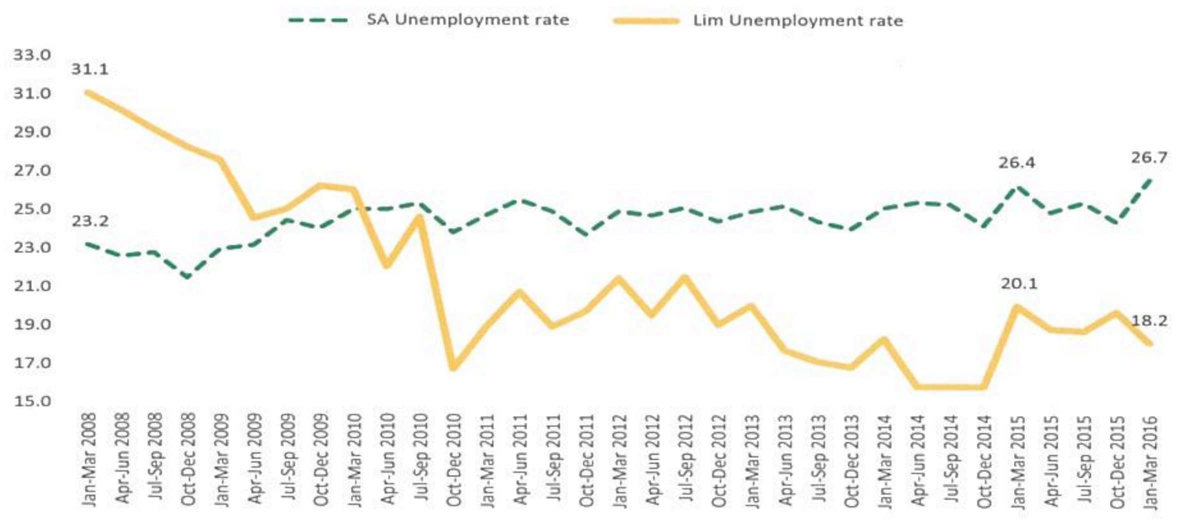
5. Labour Market

5.1. Unemployment overview

South Africa's official unemployment rate for the first quarter of 2016 stands at 26.7 percent, representing a 2.2 percentage point increase compared to the last quarter of 2015 (24.5 percent) . This means 5.7 million out of South Africa's 36.4 million people of working age cohort in the country were unemployed during the first three months of 2016. The largest job losses were recorded in the following three sectors, trade with 119 thousand, manufacturing 100 thousand and construction 77 thousand.

Young people continue to be the most vulnerable among unemployed people in South Africa as only 31.1 percent are employed. While skill levels among youth remain worryingly low. A total of 47.5 percent of the youth labour force did not complete secondary education and only 13.8 percent have a tertiary qualification.

Figure 8: Unemployment rate for South Africa and Limpopo



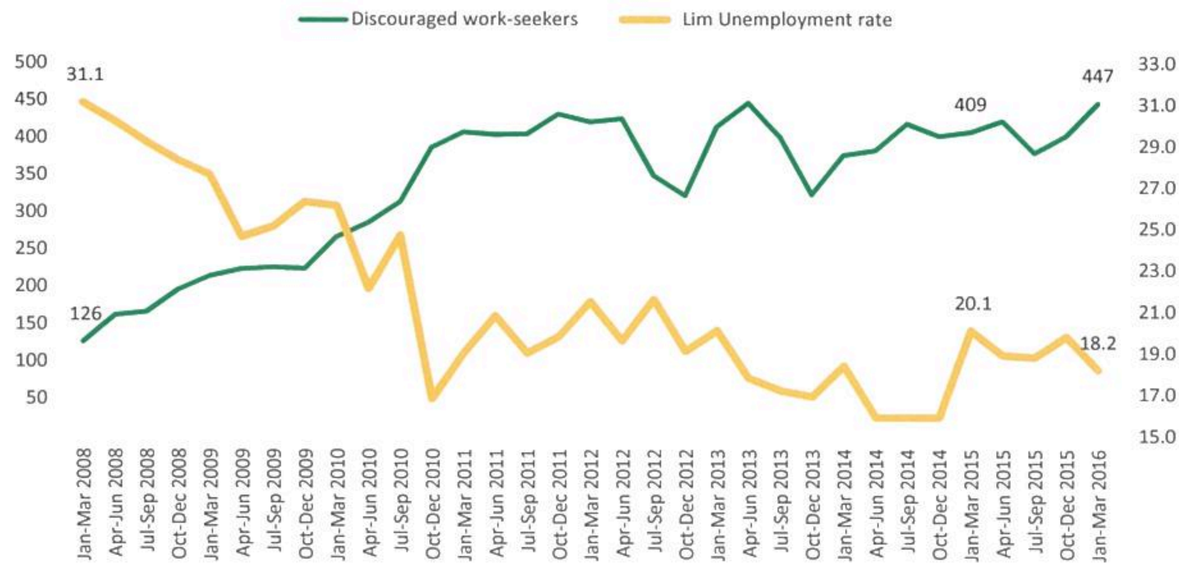
Source: Stats SA QLFS 2016 Q1

On the flip slide, Limpopo has experienced a decline in the unemployment rate year on year from 20.1 to 18.2 percent in the first quarter of 2016. The latest provincial unemployment growth rate is significantly lower than the national average of 26.7 percent in the first quarter of 2016.

5.2. Discouraged Work Seekers

Although the unemployment rate has been on the decline for the past decade, it is however concerning to observe that the number of discouraged work seekers have increased over the years. Due to structural unemployment, many people have given up searching for employment. The disheartening economic growth, weak international aggregate demand for exports and drought conditions deprived the private sector the leverage of expanding business in order to create employment opportunities.

Figure 9: Discouraged Work Seekers



Source: Stats SA QLFS 2016 Q1

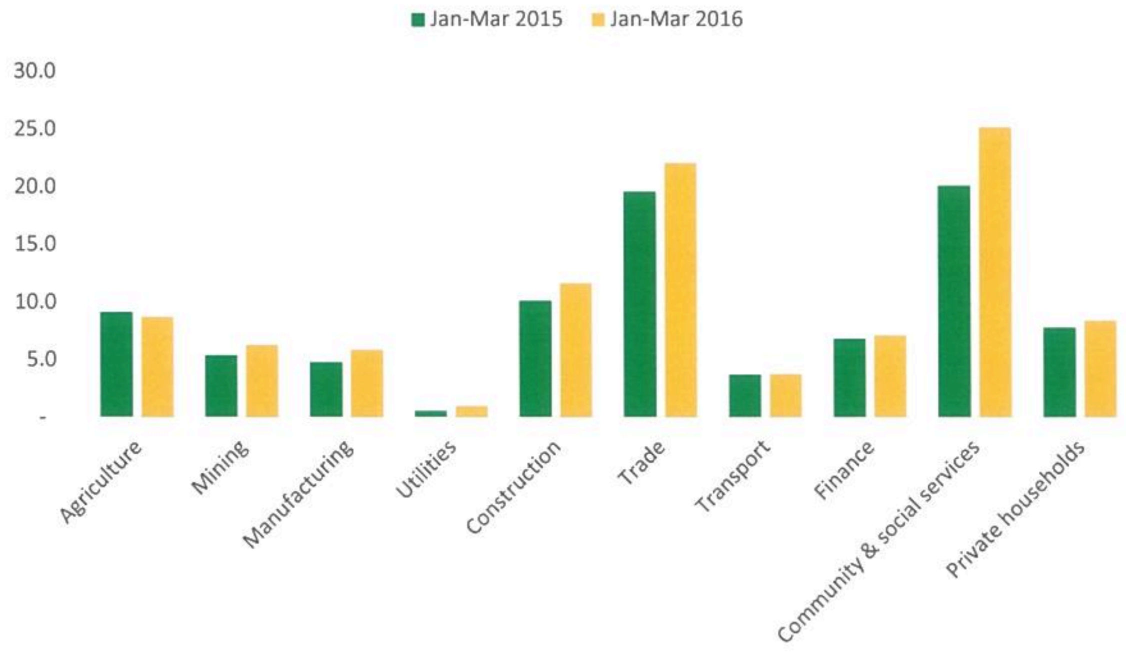
This rising number of people who are losing employment pose a worrying factor to both government and the private sector, especially when one considers that for every person who loses their job, approximately four people depend on them and the fact that unemployment is the major driver of poverty in Limpopo province.

The situation necessitate policy intervention that are pro-growth, that will create a conducive environment to attract both domestic and foreign direct investments, and job absorbing rural development projects.

5.3. Employment

Community Services and Trade sector remain the largest employing sectors in the province, both sectors in the first quarter of 2016 contributed 47.2 percent to the total number of employed people in the province. They were followed by Construction, Agriculture, Private Household and Finance contributing 11.6 percent, 8.7 percent, 8.4 percent, and 7.1 percent respectively. The least employing sector is Utilities and Transport contributing 1.0 percent and 3.7 percent respectively. Agriculture reduced its contribution share to total employment from 9.1 percent in the first quarter of 2015 to 8.7 percent in the first quarter of 2016. It goes without saying that the drought condition have reduced the possibilities of people obtaining jobs in the sector. In fact, it has led to job shedding affecting the low skilled labour force.

Figure 10: Limpopo employed people by industry



Source: Stats SA QLFS 2016 Q1

5.4. Policy recommendations for labour market

5.4.1. The EPWP is highly concentrated in the service sector or the tertiary sector therefore contributing less to the production sector. Given the asymmetric economic structure of the province, the EPWP needs to be restructured to be biased towards the productive sectors of the economy. The development of EPWP Special Purpose Vehicles (SPVs) in Agriculture, Manufacturing, and Construction sector could revolutionise and increase the scale of job creation and economic benefits in the province.

5.4.2. Small businesses are incontestably important for job creation and employment both in developed and developing economies, though the balance shifts between the formal and informal sectors. Nevertheless, sustainability of SMMEs should be a constant factor in government's support. Small business should be linked with large cooperates and other markets with the intent to expand and take advantage of economies of scale leading to increased production volumes and job creation.

5.4.3. Government should speed-up the implementation of the structural reforms of the National Development Plan recommended for economic growth and offer subsidies to employers to reduce the initial costs of hiring. Government should substantially grow funding for the likes of the National Empowerment Fund so they can continue to play their catalytic role and build a deeper pipeline for the Black Industrialist programme, while accelerating existing Black Industrialists.

5.4.4. The private sector should also implement urgent interventions, like making use of accumulating Skills Development Levies and the Employment Tax Incentive, which incentivise employers to not only improve the absorption rate but also enhance skills among the employed to boost their global competitiveness

6. Conclusion

The provincial economy is mainly driven by Community Services and Mining sector, Limpopo is one of the largest extractors and exporters of Platinum Group Metals (PMGs) in the country. Inevitably exposing the province to the risks of exogenous shocks. During the recent low commodity prices and weak exchange rate, the local economy suffered a contraction as miners reduced aggregate output due to low profit margins. This necessitate a structural shift in the composition of the local economy. The province should take advantage of its strategic location as the gate way to the sub-Saharan countries. Limpopo can be the industrial, technological and logistical hub of Africa sustained by the African markets. This will require strong alliance between government and private sector through Public Private Partnerships (PPP)

As much as the local economy requires restructuring, the provincial fiscal policy needs to undergo reforms in terms of the public sector wage bill. The unsustainable rise in the contribution of the wage bill to the provincial budget requires prudent management. More resources needs to be directed to core service delivery imperatives and economy propelling priorities to accelerate economic growth and development in the province.