LIMPOPO

PROVINCIAL GOVERNMENT

REPUBLIC OF SOUTH AFRICA

PROVINCIAL TREASURY

QAURTERLY ECONOMIC BULLETIN

2015/16 - Q4

"We are the best in what we do"

the heartland of Southern Africa - Development is about people

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Foreword

Quarterly economic bulletin is presented in one of the most unfavourable economic condition where economic growth is sluggish, personal savings are low, gradually increasing consumer inflation, high household indebtedness, swiftly rising in interest rate, feeble commodity price and currency. The Limpopo economy possessed strategic comparative advantage in mining, agriculture and other tertiary sectors which can be used as cartelist for economic growth in these depressive economic condition by taking advantage of market linkages in African market particularly in Sub-Saharan region. Albeit these growth opportunities can be eroded by the unrelenting climatic pestilences which risk global food security and international trade.

In the medium to long term consumers in the province are going to feel pinch of a rise in petrol prices and food prices such as maize and other basic commodities, these lead to consumers becoming more vigilant and reduce appetite for credit obligations given the rise in cost of servicing debts (interest rates).

The Province has adopted macroeconomic fundamentals to address the triple challenges namely poverty, unemployment and income inequality. The achievement of the LDP priorities highly relies on policy coordination between fiscal policy and macroeconomic policy of the province. Among other things the province need to increase its support for Small Macro Medium Enterprises (SMMEs), Rural Development project, high value adding economic activities (Industrialisation) to achieve provincial prosperity and job creation.

It is important for provincial administration and local authorities to support national government in maintaining fiscal sustainability by ensuring fiscal discipline and prudent operational management. Sub national government risk diminishing national transfers due lacklustre economic growth and sub optimal revenue collections, these should lead to government institutions to practice cost cutting measures especially among non-core service delivery items and robustly implement revenue enhancement strategies.

Provincial government will support economic growth through infrastructure expenditure in building and maintaining of roads, schools, hospitals and other government facilities. This quarterly bulletins therefore seeks to provide economic insight to guide provincial policy developer and planners.

Mr Phukuntsi M.J.

DDG: Sustainable Resource Management

1. Introduction

The provincial economy has maintained positive growth since 2010, although the growth is diminishing over time due to supply side constraints and external shocks such as the regional drought conditions and low consumer confidence and investor confidence. Weak global growth and low commodity demand has not helped the province to achieve the anticipated growth levels in the LDP of 3 percent. The provincial economy is mainly driven by primary and tertiary sector of the economy with minimal high value economic activities. As indicated in the LDP, the mining development potential presents valuable growth, cluster promotion and employment opportunities in the province. Nevertheless, it is important to promote diversification in the local economy.

The consumer price inflation started assuming an upward trend both nationally and provincially between third quarter of 2015 to the first quarter of 2016. This was mainly influenced by input costs. The provincial CPI is project to be 7.2 percent in April 2015, a level above the upper 6 percent band of the inflation target.

According to credit rating agencies the assignment of a stable outlook reflects policymakers' commitment to managing government debt growth over the medium term and the broad political support for a macroeconomic strategy, including the National Development Plan (NDP), tighter monetary policy and fiscal restraint, which should help stabilize the debt burden over the medium term.

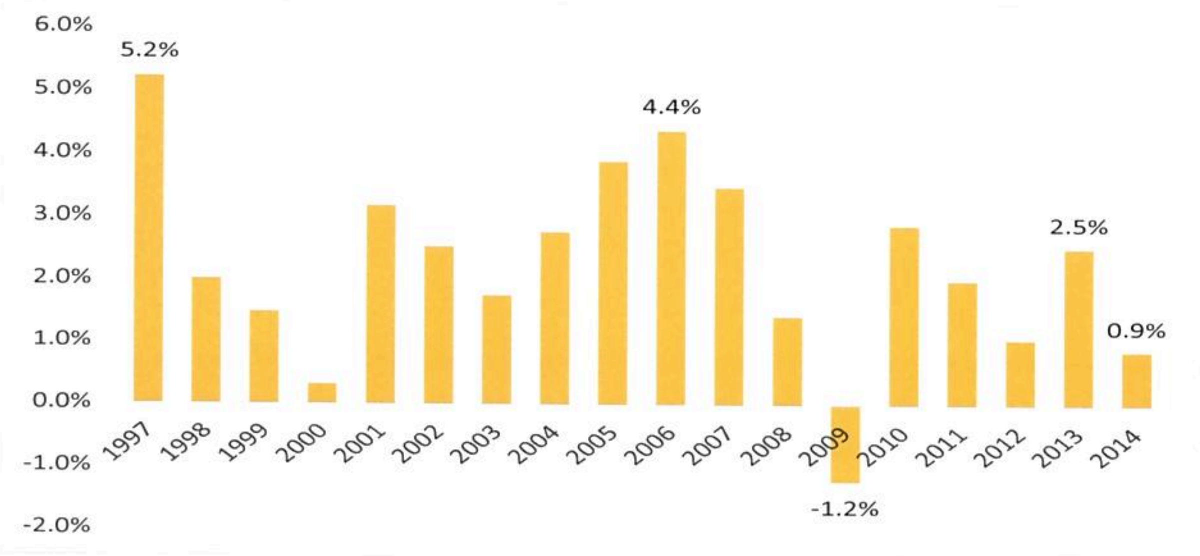
Given the low business expansions and new business ventures, government is under pressure to stimulate economic growth through the fiscal policy. Although government expenditure is rising gradually, the composition of the expenditure is what will determine fiscal sustainability. South African current expenditure is highly tilted towards social security and compensation of employees which has low returns on investment.

2. Economy

2.1. Limpopo Economic Overview

The Limpopo's economy managed to maintain positive growth over the years with few exceptions. The local economy contracted significantly between 2006 and 2009, the down-turn was largely influenced by global economic developments.

Figure 1 Limpopo GVA Average annual growth (Constant 2010 Prices)



Source: Regional Explorer 2015

The provincial economy suffered negative growth from 4.4 percent in 2006 to a low of -1.2 percent in 2009. Though the economy recovered from 2010, the growth was lacklustre as economic growth in 2014 was only 0.9 percent. Growth will remain sluggish into 2016 to 2017 due to the El Nino climate phenomenon and low aggregate demand for minerals globally.

2.2. Limpopo Economic Sector Contribution

Limpopo's economy is largely driven by Mining Sector, Community services and Trade sector which contribute 27, 24 and 16 percent respectively in 2014. The mining sector's contribution to the local economy has been increasing over the years, as it increased from 15 percent in 1996 to 28 percent in 2014. The least contributing sectors are Agriculture, Manufacturing and Construction sectors which contribute 2.6, 2.6 and 3.5 percent respectively to the provincial GVA.

Figure 2 Limpopo Economic Sector % Contribution (GVA)

Years	1996	1999	2004	2009	2014	2019
Agriculture	3.2%	3.0%	3.6%	3.2%	2.6%	2.5%
Mining	15.5%	20.3%	23.9%	28.4%	27.6%	25.4%
Manufacturing	5.4%	4.2%	4.2%	2.9%	2.6%	2.3%
Electricity	3.9%	3.1%	2.6%	2.6%	4.7%	5.4%
Construction	3.6%	2.5%	1.8%	4.0%	3.5%	4.1%
Trade	15.8%	13.8%	13.9%	15.7%	16.3%	17.3%
Transport	8.2%	8.4%	9.2%	5.1%	5.4%	5.6%
Finance	17.9%	16.5%	16.2%	15.5%	13.0%	13.3%
Community services	26.7%	28.3%	24.5%	22.5%	24.3%	24.2%

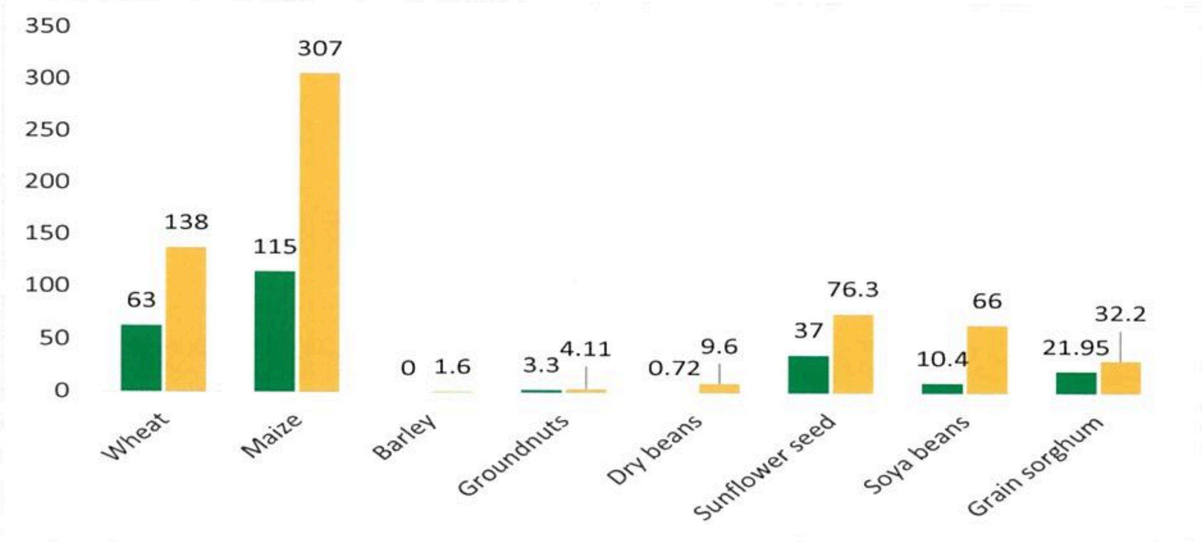
Source: Regional Explorer 2015

2.3. Agricultural Sector Analysis

2.3.1. Effects of drought in Agriculture Sector

Food security has always been a policy priority in South Africa which has led government to support small emerging farmers and rural development projects with the intention of augmenting food production in the country. The dawn of El Nino weather phenomenon has compromised food production and employment creation in the Agricultural sector. More rural farmers who still utilise traditional farming technology will barely survive the drought conditions. From an economic perspective, shortage in food supply will fuel food prices disadvantaging poor and low income households who will pay more for fewer consumable commodities. According to National Agricultural Marketing Council (NAMC) family spending would increase by at least 25 percent i.e. if a household of four and they are currently spending R240 for the basket of food, it will most probably increase to R350 per month for the same basket due to the draught effect.

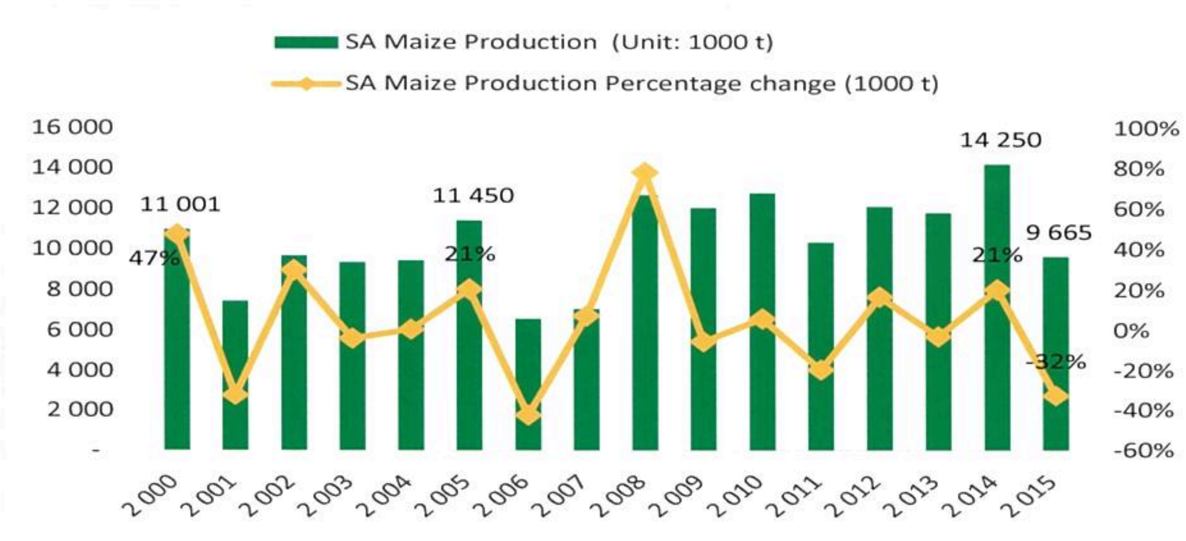
Figure 3 Limpopo Commercial Crop production: (Unit: 1000 t)



Source: EconoStat 2015

The provincial crop production is dominated by maize, wheat and sunflower production. Maize can be produced in areas where the rainfall exceeds 350 mm per year. Production is dependent on an even distribution of rain throughout the growing season. Medium and high potential soils are preferable for maize production. Dry land production mainly takes place in the Free State, North West, Mpumalanga and KwaZulu-Natal Provinces. The least crops produced are Barley, Groundnuts, and Dry beans.

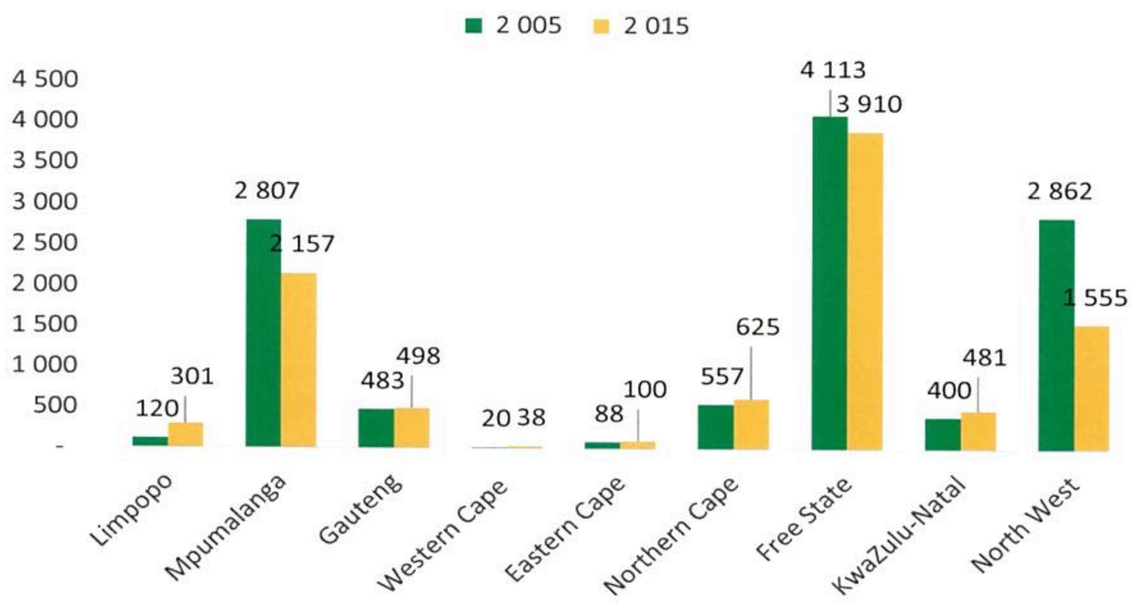
Figure 4 Commercial maize production: Total (Unit: 1000 t)



Source: EconoStat 2015

The country will need to import at least 5 to 6 million tons of maize needed to mitigate the effects the drought has had on crop production in the country. This is on the backdrop that South Africa is currently producing 9.67 million tonnes in 2015, a drop from 14.25 million in 2014. Combining with the predicted regional needs such as Zimbabwe, Lesotho, Namibia, Botswana and Swaziland, import needs will be at 10.9 million tons.

Figure 5 Commercial maize production: Production per province (Unit: 1000 t)



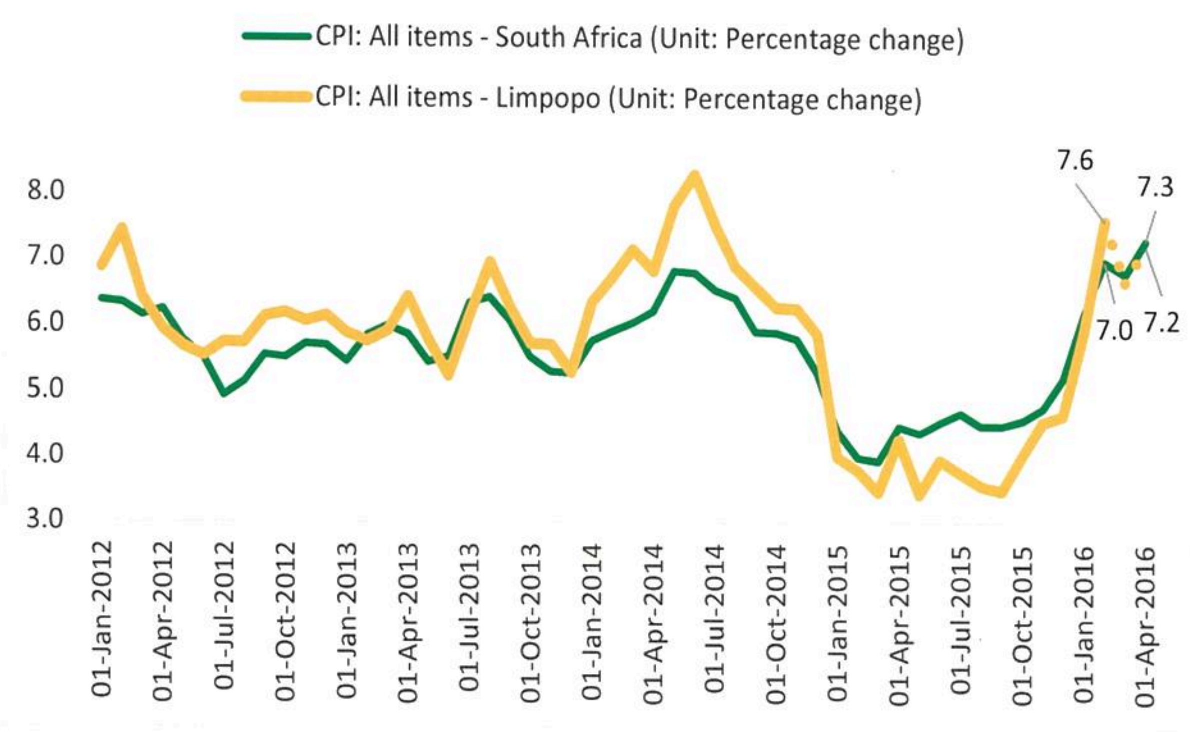
Source: EconoStat 2015

The three largest maize producing provinces in South Africa are the Free State, North West and Mpumalanga provinces, producing 78 percent of the total maize production. In 2015 the Free State province produced 3.91 million tonnes of maize, a decline from 4.1 million tonnes in 2014. Limpopo province is the third smallest producer of maize, contributing only 3 percent to the total maize production in the country. The province has sustained positive growth from 120 thousand tonnes to 301 thousand tonnes amidst the drought condition, nevertheless the growth may subside due to low levels of rainfall and souring temperatures.

3. South Africa and Limpopo Consumer Price Index

The Consumer Price Index or CPI measures changes in the prices paid by consumers for a basket of goods and services at a given point in time. Despite the decline in crude oil and other international commodity prices, the national consumer price inflation accelerated gradually from 6.2 percent in January 2015 to 7 percent in February 2015. Similarly, the Limpopo CPI rose from 5.9 percent in January 2015 to 7.6 percent in February 2015. Much of the inflation was influenced by exogenous factors such as the unrelenting drought conditions that drove food prices up. Other CPI drivers were health, Transport, clothing and utilities (Electricity and Water).

Figure 6 South Africa and Limpopo CPI



Source: EconoStat 2016

The provincial CPI is project to be 7.2 percent in April 2015, a level above the upper 6 percent band of the inflation target. Based on the assumption that the El Neno phenomenon does not abate and the economy fails to gain momentum in medium to long term. Unfortunately, this gives the monetary policy little room to relax the interest rate, which will subsequently leave a lot of consumers heavily debt trapped and decelerate economic growth at least from the consumption perspective.

3.1. Limpopo Inflation by category

The Health Inflation has been declining year on year from 9.5 percent in February 2010 to a low of 3.2 in February 2013. Due to rise in administered health price, health inflation rose to 7 percent in February 2016. Food and non-alcoholic beverages had an upswing from 4.8 percent in February 2015 to 12.6 percent in February 2016. While Transport, Communication and Electricity contributed to the fluctuation in the consumer price index in the first quarter of 2016.

Table 1 Inflation by category

CPI: Unit: Percentage change	28-Feb-2010	28-Feb-2011	29-Feb-2012	28-Feb-2013	28-Feb-2014	28-Feb-2015	29-Feb-2016	Trend
South Africa	5.5	3.6	6.3	5.9	5.9	4.0	7.0	
Limpopo	4.2	2.9	7.4	5.8	6.7	3.8	7.6	
Health	9.5	6.8	5.1	3.2	4.0	5.3	7.0	
Transport	4.9	2.2	8.4	9.2	6.2	-4.6	7.3	
Communication	-4.4	-2.5	-2.8	-2.0	1.3	-3.0	0.2	
Education	7.4	11.5	7.2	8.9	9.5	9.6	10.1	
Food and non-alcoholic beverages	1.3	0.0	14.4	2.5	10.0	4.8	12.6	
Clothing and footwear	3.9	0.4	6.1	5.4	6.2	6.6	7.0	
Housing and utilities	6.7	8.9	5.1	8.1	5.0	4.6	4.5	
Clothing and footwear	3.3	0.0	7.1	5.0	6.6	6.5	7.7	
Public transport	0.0	0.5	10.8	19.9	0.5	7.3	0.4	
Alcoholic beverages and tobacco	11.3	7.3	4.6	9.4	9.6	7.4	4.3	
Household contents and equipment	1.9	-2.3	1.2	4.7	2.7	3.9	0.9	
Water and other services	7.5	6.7	3.3	4.4	7.1	6.4	7.8	
Electricity and other fuel	12.3	26.7	8.3	13.8	6.4	6.1	10.6	
Food - Other food	6.2	2.5	12.9	2.9	6.6	6.2	7.4	
Food - Meat	1.0	-3.8	20.2	4.3	18.4	11.1	9.2	
Private transport operation - Petrol	22.1	12.3	21.9	11.9	14.1	-25.7	20.1	
Food - Bread and cereals	-4.7	4.6	15.2	-1.7	7.5	1.5	16.8	

Source: EconoStat 2016

4. South African Agency Ratings

A credit rating agency (CRA, 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. This includes the debts of corporations, nonprofit organizations, and governments, as well as securitized assets. Rating agencies assign a letter grade to each bond, which represents an opinion as to the likelihood that the organization will be able to repay both the principal and interest as they become due.

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. Many factors go into the assignment of ratings, including the profitability of the organization and its total indebtedness. The three largest credit rating agencies are Moody's, Standard & Poor's, and Fitch Ratings.

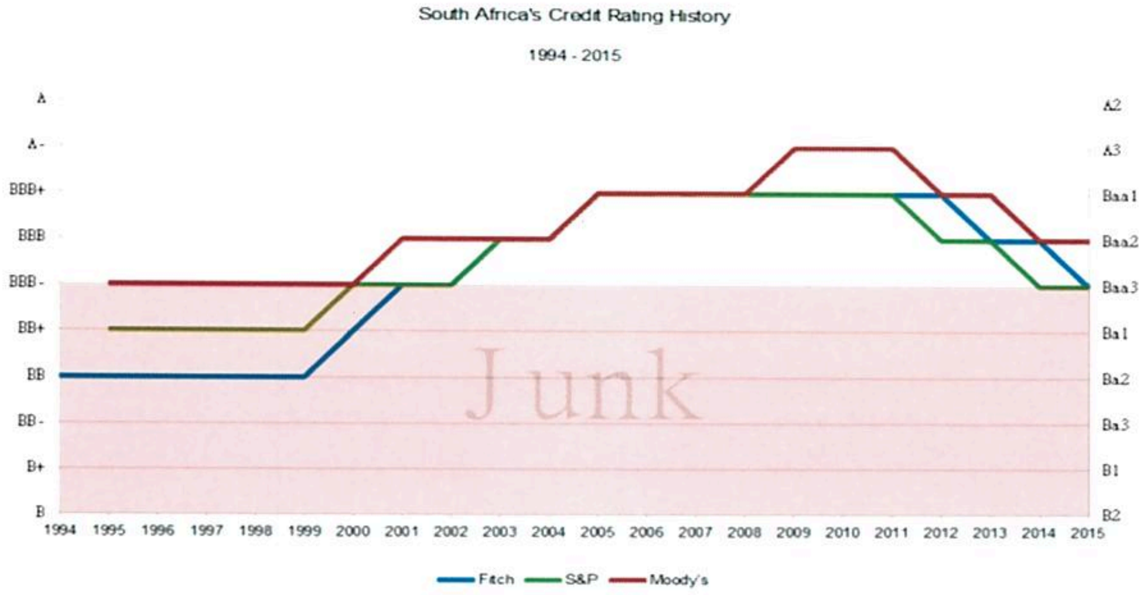
Ratings agency Standard & Poor's has warned that any deviation from the South African fiscal policy could lead to a credit downgrade, as a country's fiscal performance plays a major role in its credit rating. During the last quarter of 2015 ratings agencies downgraded South Africa's credit status to one notch above "junk" with little hope that the country will pick itself out of an economic slump. While during the last quarter of 2015 ratings firm Fitch downgraded South Africa's credit rating by one notch to BBB-, which is the lowest investment grade and this was due to a slowing economic growth and the rising debt. The group revised its growth prospects for the country down from 2.1 percent to 1.4 percent, and the projection for next year has been changed from 2.3 percent to 1.7 percent.

This puts South Africa at very real risk of becoming a junk country, which has substantial implications for investment as some Professional investors, such as hedge funds, pension funds and asset managers are prevented (by policy) from investing in junk countries and this will have serious economic implications and the country needs an "immediate defense mechanism" to avoid falling into a junk rating as the country cannot afford to become junk status country.

4.1. South Africa's credit rating levels 1994 to 2015

The ratings firms have laid South Africa's economic turmoil squarely at government's feet, meaning that if the administration does not change its tacks, the country is in serious risk of being junked in the next round of ratings.

Figure 7 South Africa's agency rating 1994 to 2015



Source: Business Tech 2015

Looking at South Africa's credit rating history from the diagram above, it is clear that the South Africa's credit rating levels peaked between 2008 and 2011 and the country has suffered ratings cuts consistently since 2011 and since the global recovery from the economic crunch, the country has not managed to overcome economic challenges such as widespread unemployment, corruption and labour unrest, and this further pushed the country rating towards junk status.

The prospects of the country to be in Junk status will translates automatically to high cost of borrowing. The immediate defense mechanism for South Africa should be based on three pillars i.e. a credible fiscal stance; re-enforce central bank independence; and finally, respect for all other independent institutions (the judiciary and chapter nine institutions)."

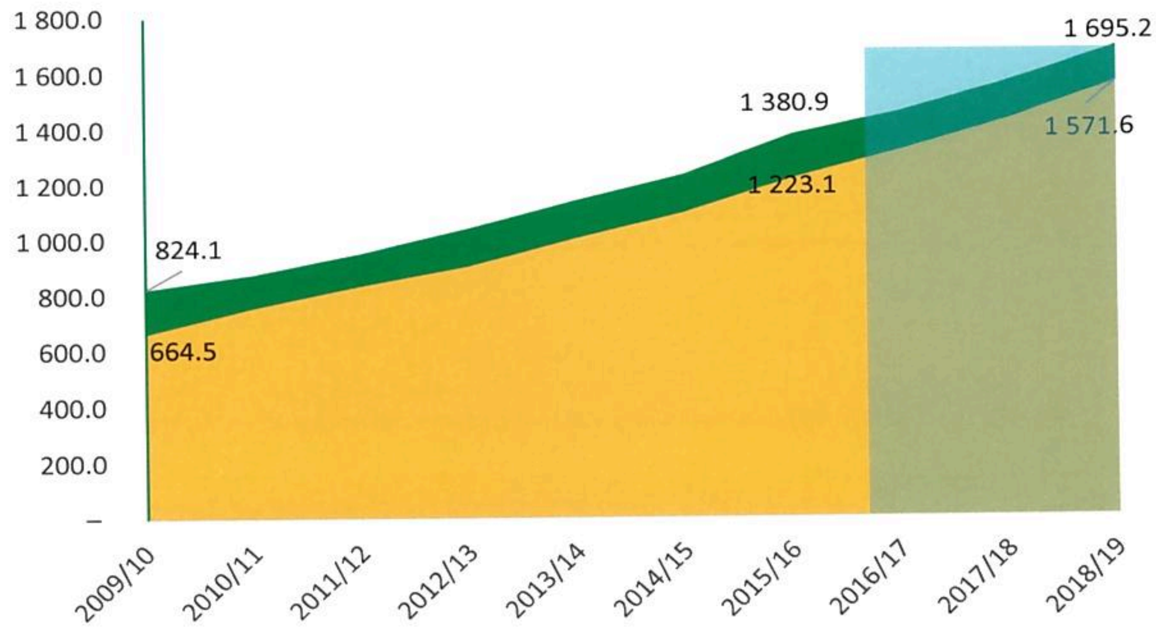
5. Fiscal policy framework

5.1. National Fiscal Framework

The sustainable fiscal policy characterised by a respectable government expenditure, a low and stable public debt/GDP ratio, a low budget deficit to GDP ratio and appropriate tax policy regime is the precondition for attracting domestic and Foreign

Direct Investment (FDI) that's in turn will provide the motivation condition for economic growth. Government propose to cut budget on non-core items that will reduce budget by R25 billion over the next three years and increase tax rates to adjust revenue by 48.1 billion in the MTEF period.

Figure 8 National Revenue and expenditure (R 000 000)



Source: National treasury 2016

Government expenditure has increased from 824.1 billion in 2009/10 to 1.380 trillion in 2015/16 and estimated to rise to R1.69 trillion by 2018/19 financial year. The growth in the current expenditure has been higher than the national receipts since 2009/10, leaving the budget balance to be negative. In 2015/16 the budget deficit was recorded at 3.9 percent. Due to the rising social security and occasional counter cyclical fiscal policy stance, the budget balance is projected to remain negative in the MTEF period exerting pressure on the net government debt.

5.1.1. National government debts

The borrowing requirement declined from 9.8 percent in 2009/10 to 6.2 percent to GDP ratio in 2015/16. Over the medium-term the estimated consolidation will stabilise and begin to reduce government's debt-to-GDP ratio from 6.2 percent to 3.9 percent.

Public sector debt accumulation will slow, in line with the narrowing of the consolidated deficit and revisions to the borrowing plans of state-owned companies. Consolidated government borrowing has increased to 157.9 billion in 2015/16 from 153.8 billion in 2009/10 and estimated to decline by 123.6 in 2018/19. State own companies also recorded increased to 87.2 billion in 2015/16 and estimated decline to 67.1 billion in 2018/19, while Local authorities deteriorated to 9.5 billion in 2015/16 and estimated to increase slightly by 10.9 in 2018/19.

Table 2 National government debts to GDP ratio

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Consolidated government	153.8	118.2	113.5	135.9	136.0	137.8	157.9	139.0	135.3	123.6
	6.3%	*4.3%*	*3.8%*	*4.1%*	*3.8%*	*3.6%*	*3.9%*	*3.2%*	*2.8%*	*2.4%*
Local authorities	10.5	8.9	6.2	7.3	7.8	9.0	9.5	9.8	10.0	10.9
	0.4%	*0.3%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*
General government borrowing										
Percentage of GDP										
State-owned companies	76.3	44.5	42.5	58.3	56.7	78.7	87.2	72.9	83.5	67.1
	3.1%	*1.6%*	*1.4%*	*1.8%*	*1.6%*	*2.0%*	*2.1%*	*1.7%*	*1.8%*	*1.3%*
Borrowing requirement	240.7	171.5	162.2	201.5	200.4	225.6	254.6	221.6	228.8	201.6
	9.8%	*6.3%*	*5.5%*	*6.1%*	*5.6%*	*5.9%*	*6.2%*	*5.1%*	*4.8%*	*3.9%*

Source: National treasury 2016

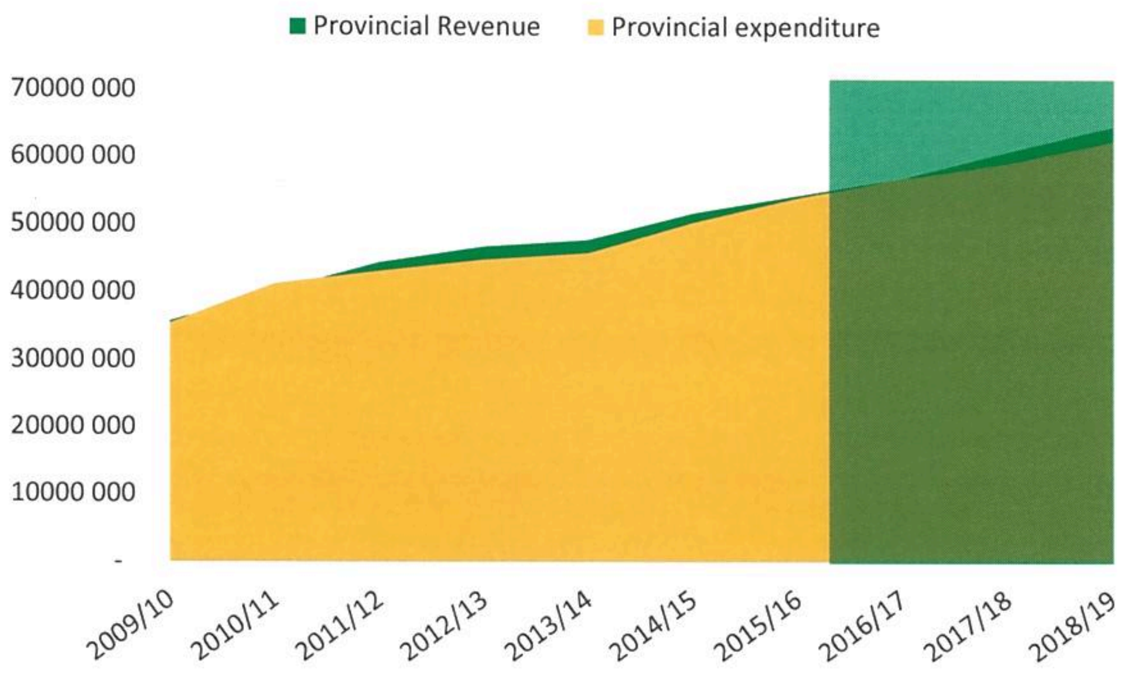
The risk of high national debts poses significant opportunity cost where resources are deviated from growth propelling expenditure to national debts repayment. This further deprive sub-national government from receiving optimal transfers from national government which may compromise optimal service delivery and attainment of developmental priorities.

5.2. The provincial receipts and expenditure

The provincial fiscal policy is one of the most important tool sub national government has is redressing the past injustices and promoting economic growth and development. It is therefore imperative that there be a very strong correlation between the provincial macro-economic policy, namely the Limpopo Development Plan (LDP) and the provincial fiscal policy (Budget).

The provincial sources of revenue comprises of equitable share, conditional grants, provincial own revenue and reserves. The province is basically reliant on national transfers to achieve its objectives. Equitable share and conditional grants from national transfer account more than 97 percent of budget while provincial own revenue account 2 percent of provincial revenue.

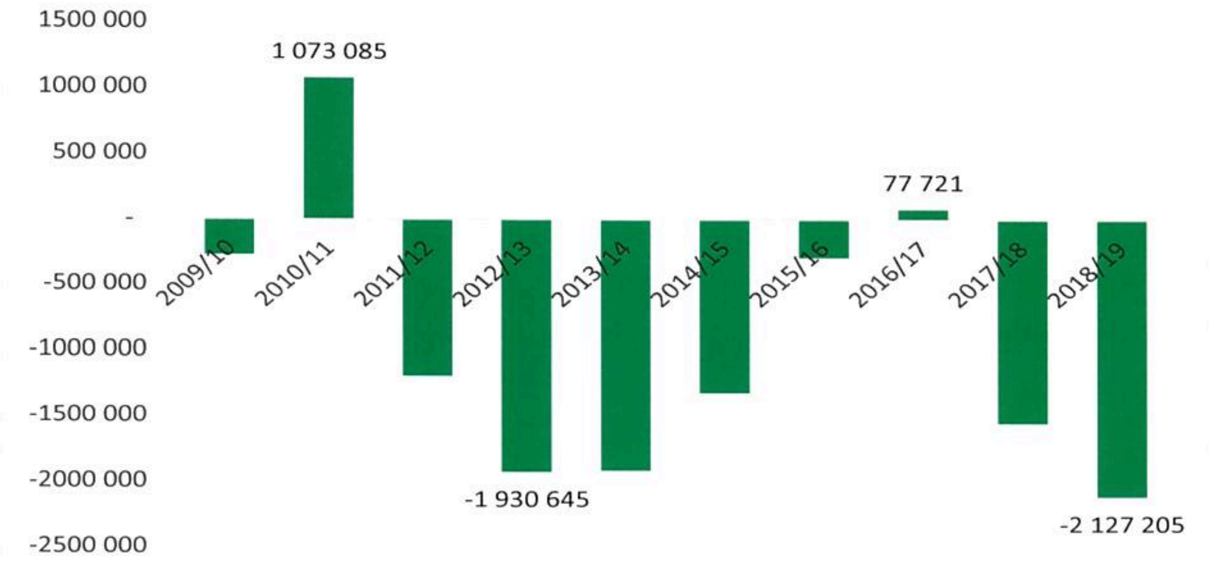
Figure 9 Provincial revenue and expenditure (R 000)



Source: National treasury 2016

Provincial expenditure and receipts have increased over the years, recording 6.8 and 6.6 percent respectively. Although provincial expenditure is relentlessly less than the receipts with few exceptions. In 2010/11 the province overspent by R 1.073 billion which instigated the implementation of Section 100 (1a) of the Constitution to abate the unsustainable fiscal stance of the province. The province is projecting a negative budget balance in 2016/17, although in outer years is its projecting a positive budget balance.

Figure 10 Provincial surplus/ (deficit) after financing (R 000)



Source: National treasury 2016

6. Conclusion

The provincial government has to reform the provincial economy by shifting from a raw material extracting economy to an industrialised economy with huge multiplier effects. The development of economic growth centres in the province will increase conglomeration of economies. SMMEs and Small Emerging Farmers (SEMs) needs both financial and non-financial assistance to remain profitable and preserve job cuts among the low skilled and income working group.

Both provincial administration and local authorities need to assist the national government by maintaining prudent fiscal management, this will reduce pressure on national government by committing less on net government debt. Socio-political stability and growing national debt to GDP will risk the country by decreasing its credit worthiness. Provincial fiscal policy can be used to support economic growth, job creation and improve the living standards of the citizens by prudent expenditure plans.

The province requires economic growth to be at least at 3 percent to create the much needed jobs and reducing the economic and income divide in the society. The LDP provides the policy fundamentals in taking the province' economy on a rising growth and development trajectory.