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department of
economic, small business development,
tourism and environmental affairs
FREE STATE PROVINCE

[An Economic Intelligence Report]

[**Gross Domestic
Product 2018**]

[**DEC 2018**]

[The Gross Domestic Product (GDP) is a vital indicator to gauge the health of a country's economy. By definition it represents the monetary value of all goods and services produced within a region over a particular period.

This Economic Intelligence Report looks into the GDP trends from the first to the third quarter of 2018. The report aims to provide insight on the factors affecting movements within the various economic sectors for both South Africa and the Free State Province]

[**Compiled by:**

Palesa Kgwale

Economic Research

Directorate]

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The issue of the *Economic Intelligence Report* focuses mainly on the three quarters ending *December 2018*.

Comments and enquiries relating to this *Report* are welcomed and should be addressed to:

Email: kgwalep@destea.gov.za

The report was compiled by:

Palesa Kgwale

Researcher: Economic Intelligence Sub-Directorate

Economic Research Directorate

Signature: _____

Date: _____

Verified by:

Abram Jansen

Deputy Director: Economic Intelligence Sub-Directorate

Economic Research Directorate

Signature: _____

Date: _____

Approved by:

Jonas Mosia

Director: Economic Research Directorate

Signature: _____

Date: _____

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INTRODUCTION

The Gross Domestic Product (GDP) is a vital indicator of economic performance used to compare economies and economic states. By definition it represents the value of all goods and services produced within a region including net taxes, over a particular period. In their textbook, economists Paul A. Samuelson and William Nordhaus liken the ability of GDP to give an overall picture of the state of the economy to that of a satellite in space that can survey the weather across an entire continent. As an economic indicator, the GDP allows policy makers and central banks to assess if the economy requires a boost or restraint, if it is expanding or contracting and whether the economy is approaching a threat such as a recession.¹

For emerging economies such as South Africa, GDP growth is imperative for sustainable economic growth. This is entrenched in various policy and strategic documents such as the New Growth Path and the National Development Plan. The Free State Province is no different in this regard. One of the five pillars spelled out in the Free State Growth and Development Strategy is “Economic Restructuring, Growth and Employment Creation”. According to this strategic document the province aims to increase its contribution to the South African economy from 5 percent in 2010 to 15 percent in 2030 as well as to increase GDP per capita income per person from R32 304 in 2010 to R110 000 in 2030. This is set to be achieved through focussed efforts in the various priority sectors namely; mining, manufacturing, agriculture, tourism and transport.²

This Economic Intelligence Report looks into the GDP trends from the first to the third quarter of 2018. The report aims to provide an insight on the factors affecting movements within the various economic sectors. The Free State Province does not function in isolation from South Africa and the world. It is crucial to observe the provincial economic landscape against the backdrop of both national and global events. As such the report presents the economic state of the Free State Province comparing it on a spatial level with its neighbouring provinces and South Africa as a whole.

¹ Investopedia. nd. The GDP and its Importance
<https://www.investopedia.com/articles/investing/121213/gdp-and-its-importance.asp>

² Free State Provincial Government. 2013. Free State Growth and Development Strategy

This information will enable decision makers to plan and implement policies that will contribute to the socio-economic development of the province.

SOUTH AFRICA GDP 2018

In 2018 the National GDP experienced a series of slumps and upswings. In the first quarter of the year real GDP growth was recorded at -2.2 percentage points and later revised further down -2.6 percentage points quarter to quarter. This negative growth was mainly influenced by a profound decline in the primary sectors' growth between the final quarter of 2017 and the first quarter of 2018. Both the agriculture and mining sectors experienced a negative growth of -24.2 and -9.9 percentage points respectively. Decreased production for field crops and horticultural products was cited as the cause behind the fall in agricultural output, while decreased production for gold and other metal ores, predominantly the platinum group metals and iron ore explained the decline in mining production.³

Similarly, real GDP growth in the second quarter was recorded at a negative 0.7 percentage points and later revised to negative 0.4 percentage points quarter to quarter. This contraction in GDP pushed the local economy into a technical recession in the second quarter of the year.⁴ Again, the primary sectors were responsible for the negative output growth. The Agriculture sector once more recorded the largest drop, declining by 31.9 percentage points between the two quarters. Other sectors reporting negative growth during the same period included Government (down 0.4 percentage points), Trade (down 1.4 percentage points) and Transport (down 4.9 percentage points).⁵

Despite the bumpy start to the year, both the South African Reserve Bank (SARB) and the International (IMF) accurately predicted that the local economy would turn around over the remainder of 2018. The SARB projects a growth rate of 1.2 percent for 2018 and 1.9 percent in 2019, while the IMF has projected a constant growth of 0.9 percent for both years. Likewise, the Organisation for Economic Co-operation and Development (OECD) Economic Outlook projected that the National GDP would grow

³ Statistics South Africa. 2018. Gross Domestic Product Q1:2018

⁴ South African Reserve Bank. MPC Statement 20th September 2018

⁵ Statistics South Africa. 2018. Gross Domestic Product Q2:2018 (Revised figures)

by 0.73 percent in 2018. Predicted improvements to the local economy are associated with increased political stability reflected in rising consumer confidence, private investment and rising exports.⁶ Additionally the economic stimulus and recovery plan announced by President Cyril Ramaphosa in September 2018 includes important structural reforms proposed in the budget for example cutting down barriers to competition in several network sectors which could boost economic growth. If implemented timeously these reforms are expected to increase investor confidence and overall investment in the South Africa. Notwithstanding the anticipated positive turnaround, growth is expected to remain vulnerable to policy uncertainties and external shocks. External factors predicted to dampen economic growth include the National economy's vulnerability to the exceptional normalisation of US and European monetary policies, mounting global protectionism, global financial constriction and negative investor views towards developing markets.⁷

As predicted by a number of Economists, South Africa exited the recession phase in the third quarter of 2018.⁸ Statistics South Africa announced that the GDP grew by 2.2 percentage points in real terms in the third quarter of 2018, following a decrease of 0,4% in the second quarter of 2018. Nominal GDP for the third quarter was estimated at R1.27 trillion, R40 billion more than the second quarter. The general consensus among experts was that the Manufacturing sector would play a major role in the economy's recovery. This was indicative of the sector's positive month to month performance over the duration in question. Indeed, the GDP report showed that among all other sectors, manufacturing performed the best recording a quarter to quarter growth rate of 7.5 percentage points. Positive growth in manufacturing was largely driven by basic iron and steel, metal products and machinery; petroleum and chemicals; wood and paper; and motor vehicles. The sector's nominal contribution to the National GDP in the third quarter increased by R14 billion to R154 billion. Manufacturing is the 4th largest sector in South Africa, contributing 14 percent to the National GDP.

⁶ Organisation for Economic Co-operation and Development. South Africa - Economic forecast summary May 2018

<http://www.oecd.org/southafrica/south-africa-economic-forecast-summary.htm>

⁷ Ibid

⁸ Fin24. 2018. Have we exited the recession? 7 economists share their GDP growth estimates <https://www.fin24.com/Economy/South-Africa/have-we-exited-the-recession-7-economists-share-their-gdp-growth-estimates-20181204-2>

The third largest contributor to overall growth in the third quarter was the transport, storage and communication sector. After contracting in the second quarter, the sector improved by 5.7 percentage points. An increase in freight transportation supported the rise in activity. This is the largest quarter-on-quarter increase for transport, storage and communication sector since the third quarter of 2007.

Another strong supporter of GDP growth was the finance, real estate and business services sector. The sector's 2.3 percentage point increase was due specifically to activities related to financial intermediation, insurance and real estate which performed better in the third quarter.

After two consecutive quarters of negative growth the agriculture sector bounced back to record a 6.5 percentage point rise in the third quarter. Solid growth in the production of field crops, horticultural cultivation and animal products contributed to the sector's recovery.

In contrast, the mining industry was the biggest detractor from overall economic growth. The sector weakened by 8.8 percentage points. This decline was as a result of lower production levels recorded for platinum group metals, iron ore, gold, copper and nickel.

Figure 1: Quarter to Quarter Sector Growth in Q3:2018

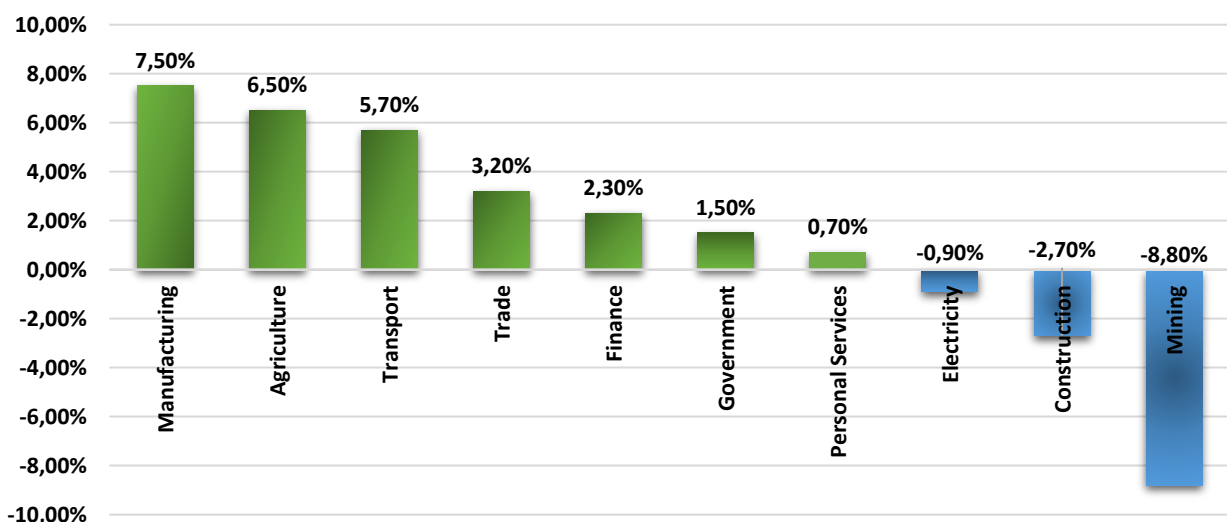


Image adapted from: Statistics South Africa. 2018. Gross Domestic Product Q3: 2018 Media

Expenditure on GDP increased by 2.3 percentage points between the second and third quarters of 2018; this after two consecutive quarters of negative growth. The positive growth in Expenditure on GDP was largely attributable to growth in both Imports (26.7 percentage points) and Exports (24.2 percentage points). Household Expenditure also increased quarter on quarter with South Africans spending more on Restaurants and Hotels (10.0 percentage points) ; Alcohol Beverages, Tobacco and Narcotics (7.3 percentage points) ; and Furnishings and Household Equipment (6.6 percentage points) among others.⁹

The image below illustrates the trend in GDP and Expenditure on GDP over a four year period.

Figure 2: GDP and expenditure on GDP growth rates, seasonally adjusted and annualised

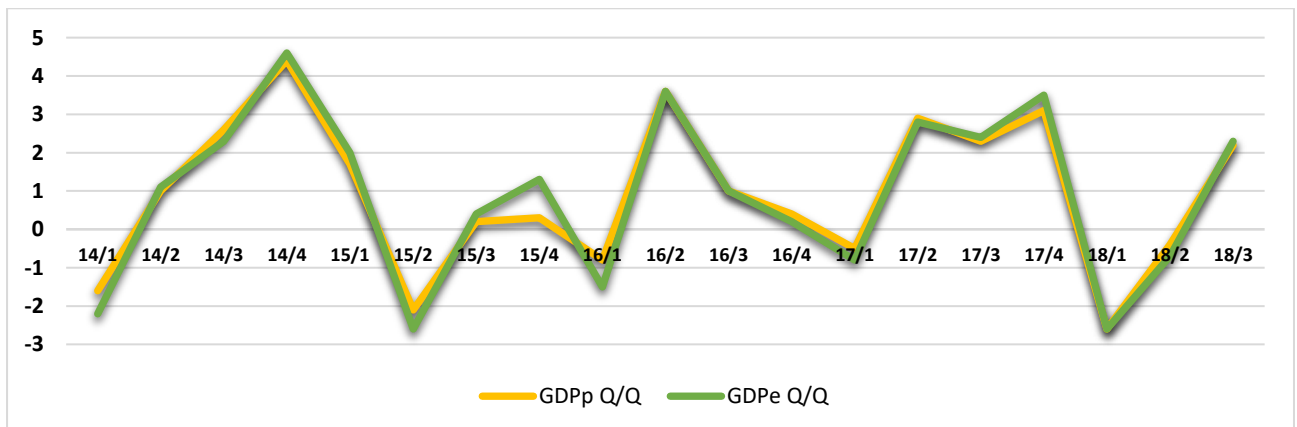


Image adapted from: Stats SA. 2018. Gross Domestic Product Q3: 2018 Media Presentation

FREE STATE GDP

Although GDP data on a provincial is not readily available, deductions can be made using trends observed over a number of years. The following section presents the latest GDP data available for the Free State Province and predictions based on information available from the a National economy's performance.

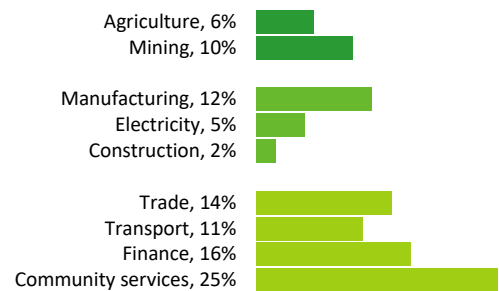
⁹ Statistics South Africa. 2018. Gross Domestic Product Q1:2018

Figure 3: Snapshot of Free State GDP and GVA 2017

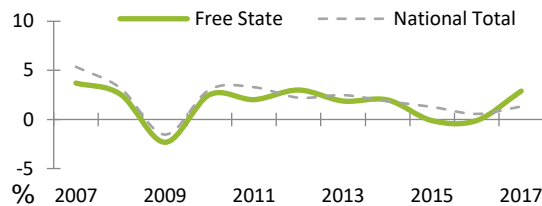
Gross Domestic Product



Sector Composition



Economic growth: 2007- 2017



Top 10 sectors (GVA) - R billions

	2017
Finance and Insurance	18.32
Public administration and defense activities	18.31
Land and Water transport	16.58
Education	16.24
Retail trade and repairs of goods	14.86
Fuel, petroleum, chemical and rubber products	13.06
Mining of gold and uranium ore	12.85
Health and social work	12.10
Agriculture and hunting	11.41
Electricity, gas, steam and hot water supply	8.98

Economic growth (annual % change)

	2016-2017	10 year avg.
Free State	2.9%	1.4%
National Total	1.3%	1.8%

Image adapted from: IHS Markit Regional eXplorer version 1417. 2018. Free State at a Glance

In 2017 the Free State Province had a total GDP of R234 billion in current prices as per table 1 below. The 2017 GDP figure reported represents an increase from the ten years prior when the provincial GDP was R114 billion. The Free State Province contributed 5.03 percent to the South Africa GDP of R 4.65 trillion in 2017 comparing to the share of the National Total of 5.40 percent in 2007. The Province’s contribution to the National economy has remained in the same range since 2007, but it is currently lower than the peak of 5.48 percent in 2008.

Table 1: Gross Domestic Product (GDP) - Free State and National Total, 2007-2017 [R billions, Current prices]

	Free State	National Total	Free State as % of national
2007	114.0	2,109.5	5.4%
2008	129.7	2,369.1	5.5%
2009	135.9	2,507.7	5.4%
2010	147.2	2,748.0	5.4%
2011	157.6	3,023.7	5.2%
2012	163.9	3,253.9	5.0%
2013	176.9	3,540.0	5.0%
2014	190.9	3,805.3	5.0%
2015	205.6	4,051.4	5.1%
2016	217.8	4,350.3	5.0%
2017	233.9	4,651.8	5.0%

Table Source: IHS Markit Regional eXplorer version 1417

The annualised GDP growth has struggled to reach the pre-global financial crisis levels. The Free State economic growth reached its highest level of 3.7 percent in 2007. While the Free State GDP had been hovering below the National average between 2007 and 2017, it however surpassed the National average in 2012 when it reached 3 percent and in 2014 at 2 percent. For a period of ten years (between 2007 and 2017) the Free State economy has experienced real annualised average growth rate of 1.42 percent.

In 2017, the Free State Province achieved an annual growth rate of 2.90 percent which is a significantly higher growth rate than that of the country as a whole, where the 2017 GDP growth rate was 1.30 percent. Contrary to the short-term growth rate of 2017, the longer-term average growth rate for Free State (1.42 percent) is slightly lower than that of South Africa (1.76 percent). The economic growth in Free State peaked in 2007 at 3.71 percent.¹⁰

Figure 4 below presents the Free State Province's GDP against the National GDP from 2007 to 2017.

¹⁰ IHS Markit Regional eXplorer. 2018. Free State Province Statistical Overview

Figure 4: Gross Domestic Product (GDP) - Free State and National Total, 2007-2017 [Annual percentage change, Constant 2010 prices]

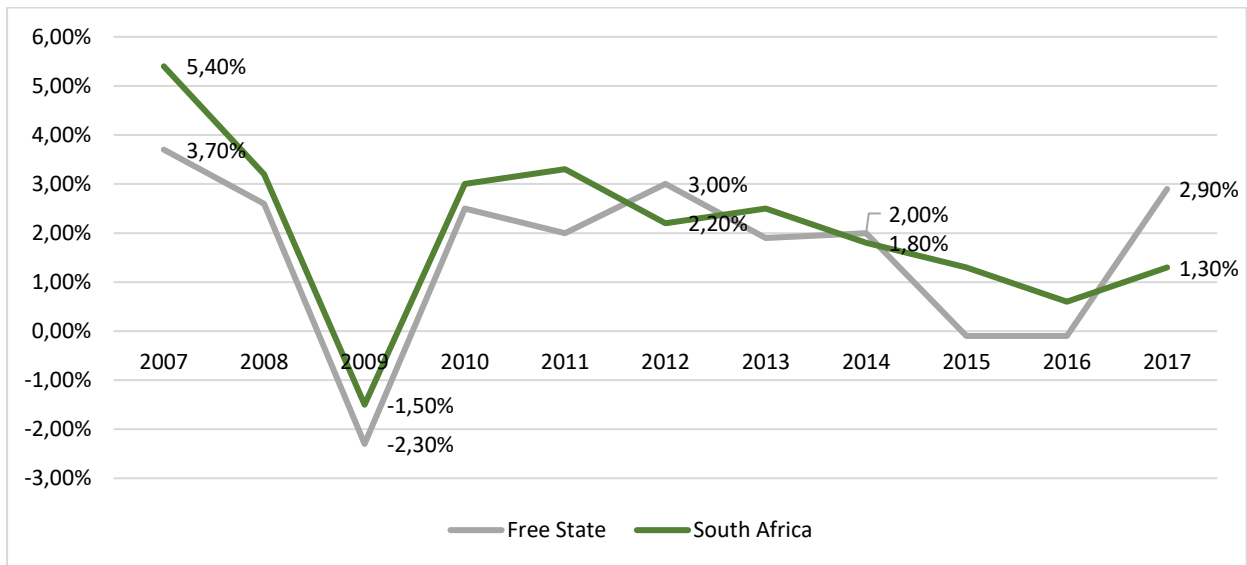


Figure Adapted: IHS Markit Regional eXplorer version 1417

GDP per Municipality

The figure below shows the contribution of each district municipality to total Free State GDP. The largest contribution came from the Mangaung Metropolitan Municipality (R93,32 billion), followed by the Fezile Dabi District Municipality (R53,51 billion) which is the industrial hub of the Free State economy. Thabo Mofutsanyana District Municipality's (R42,43 billion) was the third largest followed by Lejweleputswa District Municipality's (R36,83 billion) the fourth and Xhariep District Municipality's (R7,87 billion) was the fifth in size of contribution.

Figure 5: GDP contribution - Municipalities of Free State Province, 2017 [Current prices, percentage]

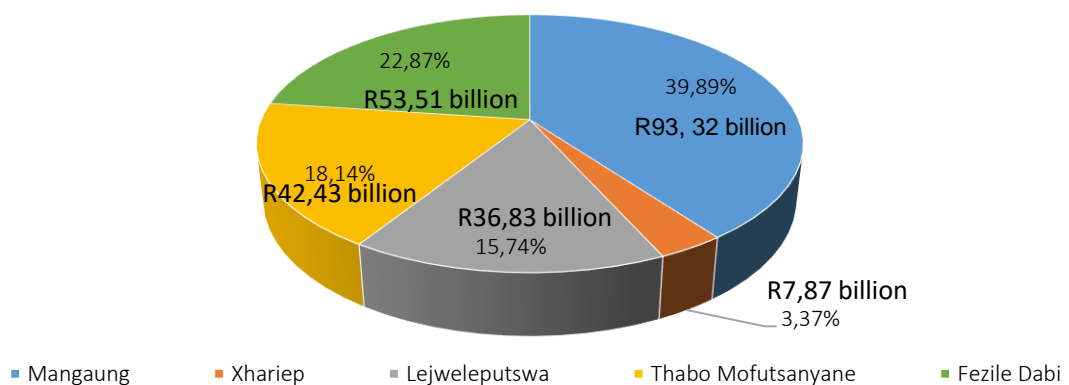


Figure Adapted from: IHS Markit Regional eXplorer version 1417

Given the growth trend and a number of unfavourable domestic and global factors, the Free State GDP is forecast to grow at an average annual rate of 0.51 percent from 2017 to 2022. Over the same period South Africa as a whole is forecasted to grow at an average annual growth rate of 1.48 percent, which is higher than that of the Free State Province.¹¹ On the other hand, the National Development Plan's ambition is to attain an annual National growth rate of 5.4 percent by 2030, while the FSGDS aims for a 7 percent provincial growth rate in the same period. This 0.51 percent growth rate forecast, when viewed together with the 1.48 percent, growth rate in ten years (between 2007 and 2017), suggests that unless bold measures are implemented in the economy, the growth ambitions set by the policy may not be attainable.

It is predicted that the Free State Province's GDP will be approximately R169 billion (constant 2010 prices) in 2022, therefore accounting for 5.0 percent of the National GDP. The prediction of the Province's GDP contribution remains in the current range. At a 0.51 percent average annual GDP growth rate between 2017 and 2022, Free State ranked the lowest compared to the other regional economies.

The table below provides the growth forecast for the metropolitan municipality as well as the four district municipalities.

Table 2: Gross Domestic Product (GDP) - Municipalities of Free State Province, 2017 to 2022, share and growth

	2022 (Current prices)	Share of province	2017 (Constant prices)	2022 (Constant prices)	Average Annual growth
Mangaung	138.44	41.71%	65.1	69.2	1.23%
Xhariep	11.5	3.47%	5.8	6.1	1.15%
Lejweleputswa	44.9	13.53%	27.7	25.1	-1.98%
Thabo Mofutsanyane	62.1	18.73%	29.1	30.4	0.89%
Fezile Dabi	74.9	22.57%	37.3	38.4	0.57%
Free State	331.8		165.0	169.2	

Table Source: IHS Markit Regional eXplorer version 1479

It is expected that from 2017 to 2022 the Mangaung Metropolitan Municipality will achieve the highest average annual growth rate of 1.23 percent. The Xhariep District Municipality follows closing in with an expected average growth rate of 1.15 percent

¹¹ IHS Markit Regional eXplorer. 2018. Free State Province Statistical Overview, Version 1479

between 2017 and 2022. In contrast, the Lejweleputswa District Municipality is estimated to have the lowest average annual growth rate (-1.98%) during this period.

GDP per Sector

The Free State Province's economy is made up of various industries. The GVA-R variable provides a sector break-down, where each sector is measured in terms of its *value adding* in the local economy. The summary below puts the Gross Value Added (GVA) of National in relation to that of the Free State Province.

Table 3: Gross Value Added (GVA) by broad economic sector - Free State Province, 2017 [R billions, current prices]

	Sector contribution in R billions	% of Free State GVA	National Total	Free State sector GVA as % of national
Agriculture	11.6	5%	106.4	10.9%
Mining	21.8	10%	334.7	6.5%
Manufacturing	24.4	12%	551.6	4.4%
Electricity	10.0	5%	155.2	6.4%
Construction	5.1	2%	163.3	3.1%
Trade	29.2	14%	626.8	4.7%
Transport	22.1	11%	411.5	5.4%
Finance	33.1	16%	840.7	3.9%
Community services	52.9	25%	981.6	5.4%
Total Industries	210.2		4,171.7	5.0%

Table Source: IHS Markit Regional eXplorer version 1479

In 2017, the largest sector within the Free State Province accounting for R 52.9 billion or 25 percent of the total GVA in the Province's economy was the community services sector. The finance sector came in second contributing 16 percent to the provincial followed by the trade sector with 14 percent. The construction sector contributed the least to the economy of Free State Province making up 2.41 percent (R 5.07 billion) of the total GVA. Worth noting is that although the Free State Agriculture sector has a location quotient of 2.2, indicating that the Province has a competitive advantage in agriculture, the sector only contributes 5 percent of the provincial GVA and to 10.9 percent of the National figure. This indicates that the Province is not exploiting the sectors full potential.

GDP Forecasts

It is expected that the total industries in the Free State will grow at an average annual rate of 0.59 percent from 2017 to 2022 as per the table below.¹²

Table 4: Gross value added (GVA) by broad economic sector - Free State Province, 2017-2022 [R billions, constant 2010 prices]

	2017	2018	2019	2020	2021	2022	Average Annual growth
Agriculture	7.3	6.3	6.4	6.6	6.7	6.9	-0.99%
Mining	20.2	18.2	17.3	16.4	15.5	14.8	-5.96%
Manufacturing	15.7	15.6	15.8	16.0	16.3	16.6	1.17%
Electricity	4.4	4.4	4.5	4.5	4.6	4.7	1.21%
Construction	4.2	4.1	4.1	4.1	4.2	4.3	0.43%
Trade	26.0	25.8	25.9	26.1	26.5	27.0	0.75%
Transport	12.9	13.0	13.4	13.8	14.3	14.8	2.77%
Finance	23.3	23.5	24.2	24.9	25.6	26.4	2.49%
Community services	35.6	35.9	35.8	35.8	35.8	36.1	0.23%
Total Industries	149.6	146.9	147.3	148.2	149.6	151.5	0.26%

Table Source: IHS Markit Regional eXplorer version 1479

The transport sector is expected to grow fastest at an average of 2.77 percent annually from R 12.9 billion in Free State Province to R 14.8 billion in 2022. The community services sector is estimated to be the largest sector within the Free State Province in 2022, with a total share of 23.8 percent of the total GVA (as measured in constant 2010 prices), growing at an average annual rate of 0.2 percent. The sector that is estimated to grow the slowest is the mining sector with an average annual growth rate of -5.96 percent. The provincial manufacturing industry is forecasted to record a positive annual growth rate. This is similar to the actual national results for the sector. The Free State province has a large petroleum and chemicals sub-sector which could possibly play a major role in the Manufacturing sector's growth.

When looking at the primary (agriculture & mining), secondary (manufacturing, electricity & construction) and tertiary sectors (trade, transport, finance & the community services sector) as in indicated in figure 6 below, the primary sector is

¹² IHS Markit Regional eXplorer. 2018. Free State Province Statistical Overview

expected to grow at an average annual rate of -4.04 percent between 2017 and 2022, with the secondary sector growing at 1.33 percent on average annually. In 2018 the Free State primary sector is expected to have a negative growth rate of -8.37 percent. This prediction is in line with the National GDP results presented by Statistics South Africa over the first three quarters of 2018, which have indicated a negative growth in the primary sector with the biggest drop in the first quarter (-13.8 percent).¹³ The Free State secondary sector is predicted to grow only slightly (0.04 percent) in 2018. National results have presented a more significant growth in the secondary sector with a 4.5 percent peak in the third quarter. The provincial tertiary sector is expected to grow at an average annual rate of 1.58 percent for the same period reaching 0.09 percent in 2018.¹⁴ Again this figure is less than the actual results presented on a National level for the same period. The tertiary sector's contribution to the National GDP has been on the rise in 2018, reaching its highest point of 2.6 percent in the third quarter.

Figure 6: Gross value added (GVA) by aggregate economic sector - Free State Province, 2017-2022 [Annual growth rate, constant 2010 prices]

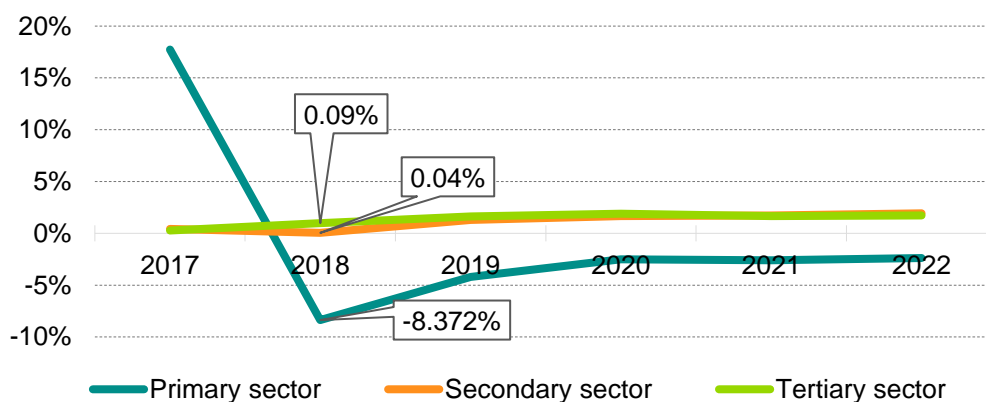


Figure Source: IHS Markit Regional eXplorer version 1417

¹³ Statistics South Africa. 2018. Gross Domestic Product Q1:2018

¹⁴ IHS Markit Regional eXplorer. 2018. Free State Province Statistical Overview

CONCLUSION AND RECOMMENDATIONS

The National economy experienced adverse conditions during the first half of 2018, but pulled through the recession in the 3rd quarter of 2018.

The manufacturing sector played a major role in South Africa's GDP growth recording a quarter to quarter growth rate of 7.5 percent.

After two consecutive quarters of negative growth the agriculture sector bounced back to record a 6.5 percentage point rise in the third quarter. Solid growth in the production of field crops, horticultural cultivation and animal products contributed to the sector's recovery.

The South African Reserve Bank (SARB), the International (IMF) and the Organisation for Economic Co-operation and Development (OECD) are all in agreement that the local economy will continue to improve throughout the remainder of the year. These predicted improvements are likely to be associated with increased political stability reflected in rising consumer confidence, private investment and rising exports.

Although actual data on the Provincially GDP has not yet been released, based on comparison and past trends it is predicted that while the Free State province's real GDP will rise despite the province's contribution to the national total remaining within the 5 percent range. The Agriculture sector is predicted to record a negative year-on-year growth, while the Provincial Manufacturing sector is expected to perform well lead by petroleum and chemicals.

The mining sector is still experiencing a negative growth rate, but the transport sector as one of the priority sectors as per the FSGDS shows positive growth up to 2022.