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The Parliamentary Budget Office (PBO) has been established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act no. 9 of 2009). The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money bills. The PBO supports the implementation of the Act by undertaking research and analysis for the finance and appropriations committees.
The PBO provides a quarterly analysis of economic developments for Members of Parliament following the release of quarterly economic data by Stats SA, the South African Reserve Bank and the National Treasury.

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Table of Contents

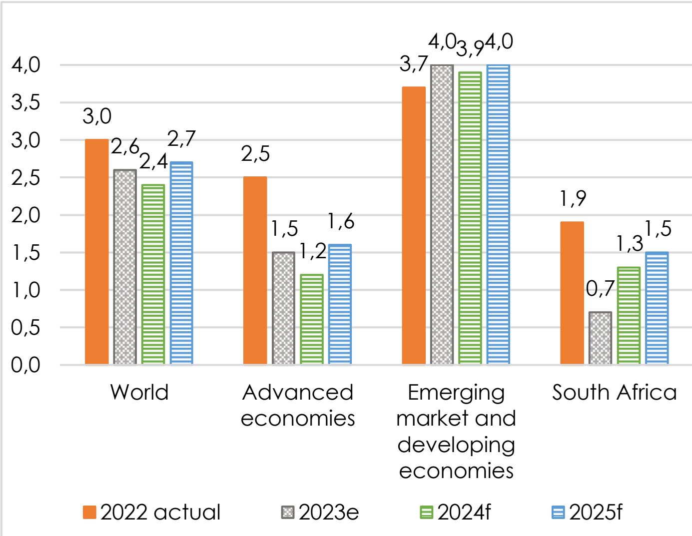
Introduction

This Quarterly Economic Brief (QEB), compiled by the Parliamentary Budget Office (PBO), provides an update on the performance of the South African economy for the fourth quarter of 2023. The QEB provides economic updates, particularly on macroeconomic performance, based on the most recent quarterly and monthly data releases from organisations such as Statistics South Africa (Stats SA), the South African Reserve Bank (SARB), the United Nations and the International Monetary Fund (IMF). This edition of the QEB is the 40th edition, which commemorates the 10th anniversary of the QEB.

Global economic outlook

In 2023, the world experienced turbulence as the impacts of the polycrisis, referring to a series of interconnected crises, took a toll on both developed and developing countries. The outlook for the global economy is relatively poor. While the average growth for emerging and developing economies (E&DE) seems to drag up average global growth levels, geopolitical instability and problems in the Chinese economy and other relatively large E&DE countries, such as Brazil and Turkey, create uncertainty with regard to the growth forecasts. South African economic growth is well below the average for the world and is even worse when compared to the average for E&DE.

Figure 1: Real annual economic growth estimates and forecasts in percentages

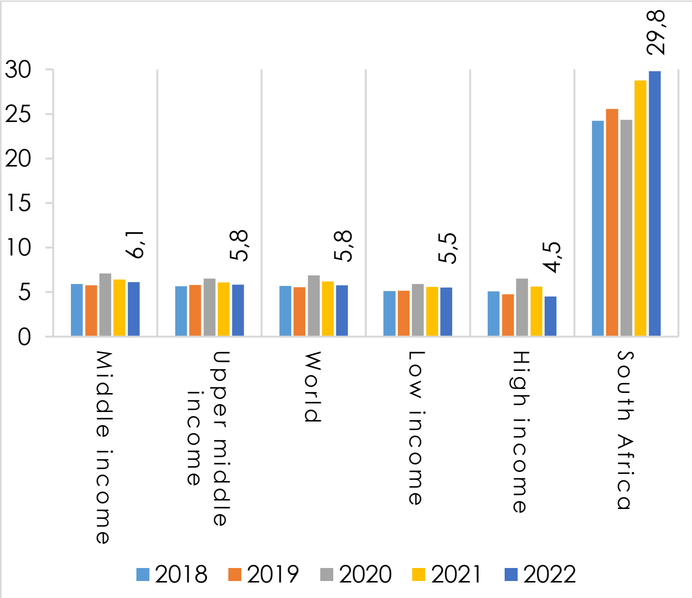


Source: World Bank Global Economic Prospects, January 2024

The ongoing impact of the COVID-19 pandemic continues to affect recovery across the world. However, the recovery was faster in developed countries, which provided strong fiscal stimulus and support to households and businesses while cornering the market on vaccines. Most E&DEs were unable to use government finances to support economic recovery to the extent that the developed countries could. These countries also had to wait longer to secure adequate supplies of the vaccines. Overall, the levels of public debt across E&DE countries grew as they borrowed more to respond to the pandemic. The high public debt levels have raised concerns that the risk has increased that some E&DE countries may suffer sovereign debt crises.

Global supply chain problems have been improving but the geopolitical conflict related to the Russian invasion of Ukraine, the escalating tensions between the USA and China over Taiwan and rising tensions in the Middle East create potentially new, huge risks to global stability and supply chains. Since 2021, central banks have chosen to respond to inflation with monetary tools that constrain investment, employment and growth. Interest rates were increased at a pace last seen during the 1980s. The actual causes of inflation were disruptions to the supply of goods due to conflict, supply chains breaking down and corporate excess profit-seeking behaviour.

Figure 2: Unemployment, total (% of total labour force) (modelled ILO estimate)

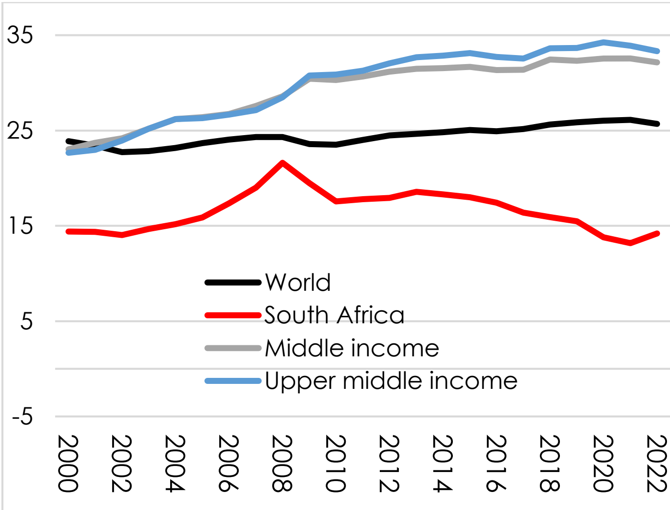


Source: World Bank World Development Indicators (which used ILO data)

Even though inflation has declined faster than expected across the world, it is not clear whether central banks will further increase interest rates in 2024. It is also uncertain whether central banks, once they start to lower interest rates, will be lowering them at the pace at which inflation reduces. The impact of the rapid and large increases in interest rates in so many countries has exacerbated the cost-of-living crises for the poor globally and has a negative impact on global aggregate demand levels. The higher interest rates have benefited the wealthy and increased inequality, which is a constraint on growth. The high public debt levels have increased pressure on E&DE countries to pursue fiscal austerity. Combined with the interest rate increases these pressures will have long-term negative socio-economic consequences on the economic performance of E&DE countries.

The global average unemployment rate has declined since 2020 after increasing during the pandemic. However, the relatively low declines in average unemployment rates, attributed to austerity policies and higher interest rates, have interacted with aspects of the polycrisis, including heightened geopolitical tensions, increased climate change events, and volatility of global financial flows. South Africa remains a significant outlier relative to all income groups of countries due to its extremely high unemployment rate, which appears set to continue increasing.

Figure 3: Gross fixed capital formation as a percentage of GDP



Source: World Bank World Development Indicators

The growth of gross fixed capital formation (GFCF) as percentages of GDP for average global, middle, and upper-middle-income countries slowed during the COVID-19 pandemic. Their GFCF levels declined from 2021 to 2022 for the same reasons outlined above, contributing to the poor declines in levels of unemployment since the pandemic. Once again, South Africa's poor performance regarding investment as a percentage of GDP stands out relative to the averages shown for the world and middle and upper-middle-income countries.

At a time of heightened interrelated global crises, continued austerity measures and high interest rates are some of the factors that are likely to further contribute to poorer economic growth and higher public debt-to-GDP levels across the world. Austerity and high interest rates negatively impact expectations regarding job creation and investment.

The South African economic situation: Gross domestic product[1]

South Africa's gross domestic product (GDP) increased by 0.1 per cent in the fourth quarter of 2023 after a 0.2 per cent contraction in the third quarter of 2023. The marginal growth means South Africa's economy grew by 0.6 per cent in 2023, following an increase of 1.9 per cent in 2022. The country experienced fewer days (3 days) of stage 5 and 6 loadshedding in the fourth quarter than in the third quarter (20 days). While the economy escaped a technical recession in the fourth quarter, the performance and outlook remain poor.

Output increased in six of the ten economic sectors between the third and the fourth quarter of 2023. Logistics[2] and mining were the largest contributors to growth. The increase in electricity production and consumption also reflected positively in the fourth quarter GDP figure. Trade[3] and agriculture were the main negative contributors to GDP growth.

Gross value added by the agriculture sector decreased by 9.7 per cent in the fourth quarter, following a contraction of 11.7 per cent in the third quarter. According to Stats SA, the decrease was due to lower field crop production due to excessive heat and limited rainfall across the major crop-growing regions. A reduction in economic activity for horticulture and animal products was also reported.

Table 1: Quarterly economic performance by industry

% change q/q	Agriculture	Mining	Manufacturing	Utilities*	Construction	Trade	Logistics**	Business services***	Government	Personal services	GDP
2021Q1	5,0	4,1	0,1	-0,8	0,3	0,8	-2,5	0,6	0,1	1,0	**0,6**
2021Q2	10,1	2,0	-1,3	0,6	-1,3	3,3	6,6	-0,9	-0,5	2,5	**1,3**
2021Q3	-25,8	-1,2	-3,7	0,3	-1,1	-4,6	-1,5	0,8	0,3	0,2	**-1,9**
2021Q4	15,3	-3,2	1,9	-3,1	-2,7	4,0	2,6	-0,5	-0,2	2,6	**1,4**
2022Q1	-0,9	-2,6	4,3	2,5	-0,6	2,9	1,3	1,9	1,3	0,2	**1,5**
2022Q2	-11,8	-3,1	-5,6	-1,4	-2,6	-1,1	2,7	2,1	-1,5	0,3	**-0,8**
2022Q3	31,4	1,9	1,6	-2,6	4,1	1,2	3,4	1,1	0,4	-1,0	**1,8**
2022Q4	-2,4	-3,0	-1,2	-2,0	0,4	-2,2	0,9	-1,6	-0,7	-0,1	**-1,1**
2023Q1	-14,3	1,4	1,0	-0,9	1,0	0,8	1,3	0,8	0,4	0,8	**0,3**
2023Q2	3,7	0,6	2,1	-0,7	-0,1	-0,4	-1,5	0,6	0,6	1,4	**0,7**
2023Q3	-11,7	-1,0	-1,1	0,3	-3,3	-0,3	0,8	0,9	0,5	0,7	**-0,2**
2023Q4	-9,7	2,4	0,2	2,3	-1,4	-2,9	2,9	0,6	-0,6	0,9	**0,1**

Source:StatsSA
*Utilities includes electricity, gas and water
**Logistics includes transport ,storage and communication
***Business services includes finance, real estate and business services

Gross value added in the mining sector increased by 2.4 per cent in the fourth quarter. Growth in the mining sector occurred despite the sector facing various challenges, including transport bottlenecks, strikes, and crime. The largest positive contributors to the increase were platinum group metals (PGMs), coal, chromium ore and diamonds.

The manufacturing sector's gross value added increased by 0.2 per cent. Six of the ten manufacturing subsectors reported positive growth rates, including food and beverages; wood, paper, publishing and printing; and transport equipment (driven by auto exports). Furthermore, the fourth quarter increase in electricity production provided some relief for the sector. In terms of outlook, the manufacturing sector may be weighed down by the closure of ArcelorMittal South Africa (AMSA)'s long steel products operations.

Gross value added by the transport, storage and communication sector recorded a 2.9 per cent positive growth. The expansion was due to increased economic activity in land and air transport. In terms of the outlook, output from the sector may improve further if the approved freight logistics roadmap is implemented successfully and Transnet is provided with the necessary financial assistance by the government.

Gross value added in the trade, catering, and accommodation sector declined by 2.9 per cent in the fourth quarter of 2023. A decrease in output was reported for wholesale trade, retail trade and accommodation. We suspect that higher interest rates may be affecting demand in a country where poverty and joblessness are constraints on aggregate demand.

Expenditure on GDP

South Africa's expenditure on GDP increased by 0.1 per cent in the fourth quarter of 2023, following a 0.1 per cent contraction in the third quarter. The marginal increase in growth was primarily due to a 0.2 per cent increase in household final consumption expenditure and inventory accumulation (not shown in Table 1). The main negative contributor was a decline in net exports.

[1] All expenditure/growth data is seasonally adjusted and annualised unless otherwise stated

[2] Logistics includes transport, storage and communication

[3] Trade includes trade, catering and accommodation

Table 2: Quarterly sector performance of expenditure components of GDP

% change q/q	Household consumption	Government Consumption	Invesment*	Exports	Imports	Exp on GDP
2021Q1	0,5	-0,6	-2,7	1,2	6,6	**0,7**
2021Q2	1,7	0,5	-0,2	3,1	0,3	**1,4**
2021Q3	-2,9	0,6	-0,1	-6,8	-3,4	**-1,8**
2021Q4	2,9	0,2	1,5	8,3	8,5	**1,5**
2022Q1	1,2	0,9	2,9	3,7	6,2	**1,5**
2022Q2	0,1	-0,9	0,4	0,2	4,9	**-0,9**
2022Q3	-0,1	0,5	0,4	2,0	0,2	**1,7**
2022Q4	0,7	-0,7	1,5	-3,2	-0,8	**-1,1**
2023Q1	0,4	1,0	1,8	4,2	4,6	**0,3**
2023Q2	-0,2	1,9	4,0	0,5	3,2	**0,8**
2023Q3	-0,2	0,5	-3,8	0,6	-8,7	**-0,1**
2023Q4	0,2	-0,3	-0,2	0,6	4,0	**0,1**

Source: Stats SA
*Investment refers to gross fixed capital formation

Household consumption spending, which makes up 67 per cent of expenditure on GDP, contributed positively to GDP after contracting for two consecutive quarters. However, the performance was not broad-based across the major spending components. Consumers prioritised spending on durable goods and services, transport, communication and education – with the reopening of schools. In contrast, as inflation remained elevated for certain food items, spending on non-durable goods (restaurants and hotels, as well as food and non-alcoholic beverages) declined. Households also reduced spending on semi-durable goods (mainly clothing and footwear) as well as housing and utilities.

Gross fixed capital formation (GFCF) decreased by 0.2 per cent in the fourth quarter, following a sharp 3.8 per cent contraction in the third quarter. For the full year of 2023, GFCF grew by 4.2 per cent from 4.8 per cent in 2022. Fixed investment by the general government and public corporations declined, though at a slower pace. Private enterprises, on the other hand, recorded no growth. This decline is part of a broader trend of declining investment during the decade-long period of fiscal consolidation.

The breakdown of GFCF according to its asset components showed a decrease in capital expenditure on residential buildings, transport equipment, construction works, machinery and other equipment. The decrease in the GFCF asset components is suggestive of a decline in fixed investment by the private sector.

Government consumption expenditure (GCE) decreased by 0.3 per cent in the fourth quarter, following a 0.5 per cent increase in the third quarter. In 2023, GCE grew by 2.1 per cent from 1.0 per cent in 2022. The decrease in GCE was due to lower spending on goods and services as well as compensation of employees. In terms of the outlook, although the government has proposed additional spending for the compensation of employees, government spending will be limited by continued fiscal consolidation, including the introduction of fiscal anchors.

A significant 4.0 per cent quarter-on-quarter increase in imports, coupled with a 0.6 per cent expansion in exports, meant that net exports contributed negatively to expenditure on GDP in the fourth quarter owing to faster-growing imports. Exports of food, beverages and tobacco, vegetable products, chemicals products and base metals increased. China's patchy recovery continues to present risks to export prices. Meanwhile, the imports of mineral products, chemicals and vegetables increased.

Employment

The official unemployment rate increased to 32.1 per cent in the fourth quarter of 2023 from 31.9 per cent in the third quarter of 2023. On an annual basis, the unemployment rate declined by 0.6 per cent from 33.8 per cent in 2022 to 33.2 per cent in 2023. According to Stats SA, a number of persons moved from the "not economically active" and "unemployed statuses" to the employed category between the two quarters, resulting in a 0.2 percentage point increase in the unemployment rate. The number of employed persons decreased by 22 000 while the number of those who are unemployed increased by 46 000 to 7.9 million in the same quarter.

According to Stats SA, formal sector employment decreased by 128 000 in the fourth quarter of 2023 while informal sector employment increased by 124 000 over the same period. The formal sector job gains were mainly in Financial Intermediation, Insurance, Real Estate and Business Services (128 000), Transport (up by 57 000), Mining (37 000) and Utilities (9 000). Formal sector job losses were recorded in Community and Social Services (171 000), Construction (36 000), Agriculture (down by 35 000), Trade (28 000) and Manufacturing (1 000). The decline in investment in machinery and equipment and productive sector employment during the last quarter continues to cause concern about the impact of a prolonged period of high interest rates on the economy.

Table 3: Key labour statistics – Quarterly Labour Force Survey (QLFS)

	3Q 2023	4Q 2023
Labour force ('000s)	**24 594**	**24 619**
Employed	16 756	16 723
Unemployed - official	7 849	7 895
Unemployed - broad*	11 733	11 665
Not economically active ('000s)	**16 292**	**16 403**
Discouraged job-seekers	3 156	3 049
Other (not economically active)	13 136	13 354
Unemployment rates		
Official unemployment rate (narrow)	31.9%	32.1%
Broad unemployment rate*	41.0%	40.8%
Labour Force Participation Rate	60.2%	60.0%
* The broad unemployment rate includes discouraged job seekers		
**Data Source: Quarterly Labour Force Survey, Stats SA		

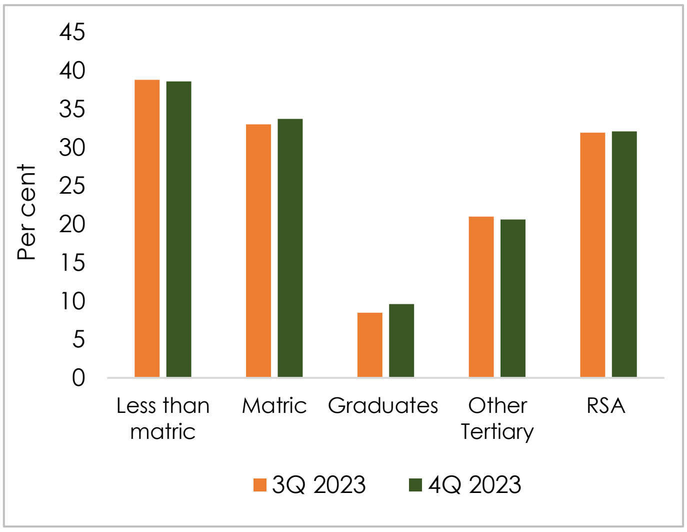
The expanded unemployment rate (which includes individuals who desire employment regardless of whether they actively seek work) remains excessively high even after it decreased by 0.2 per cent to 40.3 per cent in the fourth quarter of 2023.

At a provincial level, the largest employment increases were recorded in KwaZulu-Natal (62 000), Mpumalanga (48 000), Western Cape (23 000) and Free State and Gauteng (15 000). Employment losses were recorded in Eastern Cape (111 000), Limpopo (40 000), Northwest (35 000) and Northern Cape (2 000) in the fourth quarter of 2023.

Gender and racial disparities continue to persist in South Africa's labour market. In the fourth quarter of 2023, the unemployment rate for women stood at 34.4 per cent, while it was 30.1 per cent for men. Moreover, the unemployment rate for the black population was 36.1 per cent during the same period, significantly higher than the 8.5 per cent unemployment rate for the white population.

Youth in South Africa have an unemployment rate higher than the national average and continue to suffer due to labour market conditions. According to the Quarterly Labour Force Survey (QLFS), South African Youth aged 15-34 years recorded an unemployment rate of 44.3 per cent.

Figure 4: Unemployment rate by education level – fourth quarter of 2023



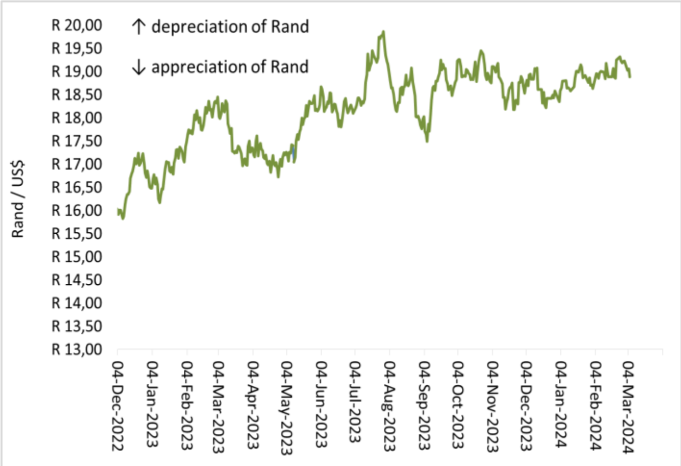
Source: Stats SA

The most recent unemployment data indicates that having a tertiary education, particularly a degree, increases the probability of finding employment. In the fourth quarter of 2023, individuals with educational attainment below matric recorded an unemployment rate of 38.6 per cent, while graduates experienced an increased unemployment rate of 9.6 per cent compared to 8.5 per cent in the previous quarter.

Exchange rate

The South African rand depreciated by 11 per cent against the US dollar over the first two months of 2024 reaching R19.21 to the US dollar on the 28th of February 2024. The weakness in the rand largely reflected a strengthened US dollar amid higher interest rates maintained by the US Federal Reserve Bank. High interest rates in the US often result in large capital outflows out of developing countries, including South Africa. The rand's depreciation may also reflect weaker economic growth prospects in China (the largest importer of SA's commodities). In other words, the rand may have weakened because of the expectation by currency traders that SA would export fewer commodities to China. Domestically, sentiment for the rand in speculative currency markets may be negatively affected by the impact of severe electricity loadshedding and logistical constraints at Transnet's ports on the domestic economic growth outlook.

Figure 5: The rand-dollar exchange rate



Source: SARB

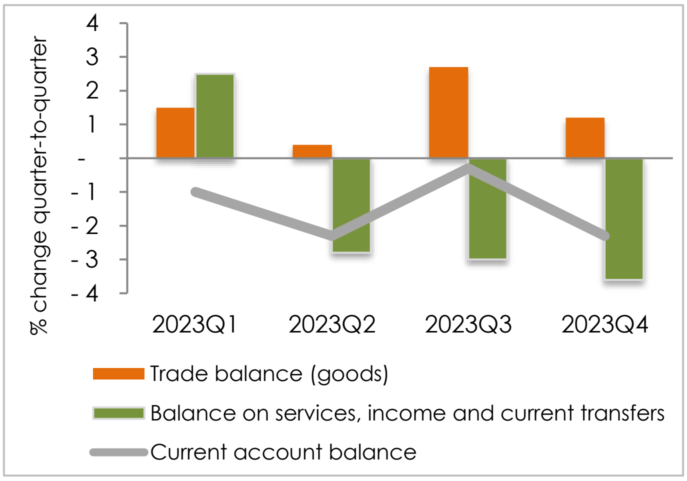
The PBO attributes the long-term weakness of the rand to policies by the South African Reserve Bank and National Treasury, such as deregulated controls over cross-border financial flows and Regulation 28 of the Pension Funds Act, which enable major South African companies to shift their primary listings offshore. This continuous outflow of wealth, combined with a primary income deficit where foreign investors earn more from their investments in South Africa than South African investors earn from their investments offshore, contributes to the rand's depreciation and drives the country's current account into deficit despite a trade surplus.

Current account

South Africa's current account remained in a deficit in the fourth quarter of 2023. The deficit in the current account widened to R165.5 billion (2.3% of GDP) in the fourth quarter from a revised R34.4 billion (0.5% of GDP) in the third quarter. While the deficit on services and secondary income accounts narrowed, the fourth quarter deficit was higher due to noticeably wider deficits in the primary income account. The primary income account includes income from interest, profits, and dividends generated from foreign investment. It also includes remittances – these are payments from people living and working abroad and sending money back to their country of origin.

The shortfall in the services, income, and current account widened from R215.4 billion (3.1% of GDP) in the third quarter to R253.7 billion (3.6% of GDP) in the fourth quarter. South Africa's trade surplus while remaining positive narrowed between the two quarters from R181.1 billion to R88.1 billion, with the value of merchandise imports growing faster than exports. The main reason for the negative current account balance remains net outflows due to the balance on the primary income account and current transfers.

Figure 6: Change in the balance of the current account (as a percentage of GDP)

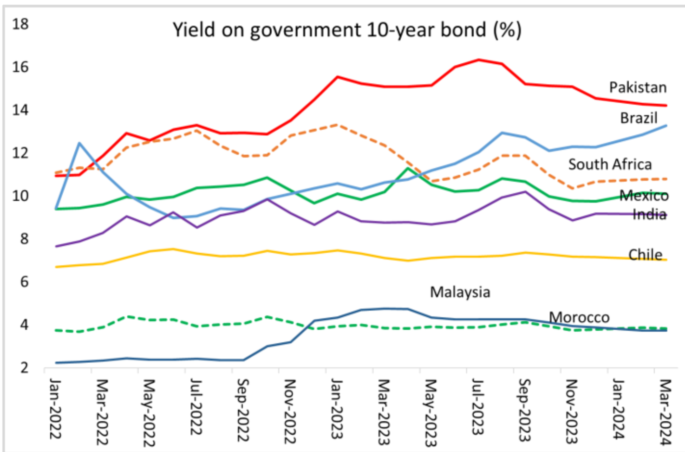


Source: SARB

Sovereign debt

The 10-year bond yields of emerging market economies – an indicator of market attitudes about the riskiness of government bonds – remained elevated for much of 2023. Emerging market economies' bond yields, including South Africa, were largely impacted by global events over this period, including geopolitical conflict, higher inflation and international bond yields as well as elevated global interest rates in advanced economies. These higher interest rates draw money into advanced economies and often trigger capital outflows from emerging market economies.

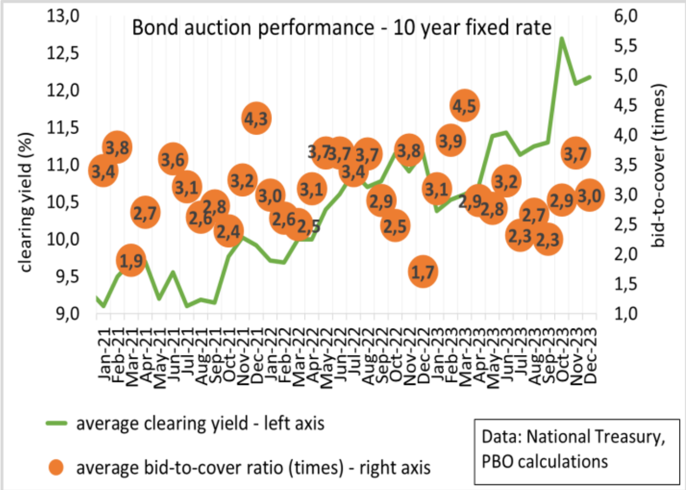
Figure 7: Comparing yields on 10-year bond



Source: Global Bond Indices

The yield on South Africa's 10-year bond reached 12.1 per cent in December 2023 compared to 10.4 per cent in January 2023. The increase in domestic bond yields reflects speculative behaviour in global markets, which may be affected by the expectations of bond traders about a range of domestic challenges.

Figure 8: Bond auction performance - 10-year fixed rate



Source: National Treasury, PBO calculations

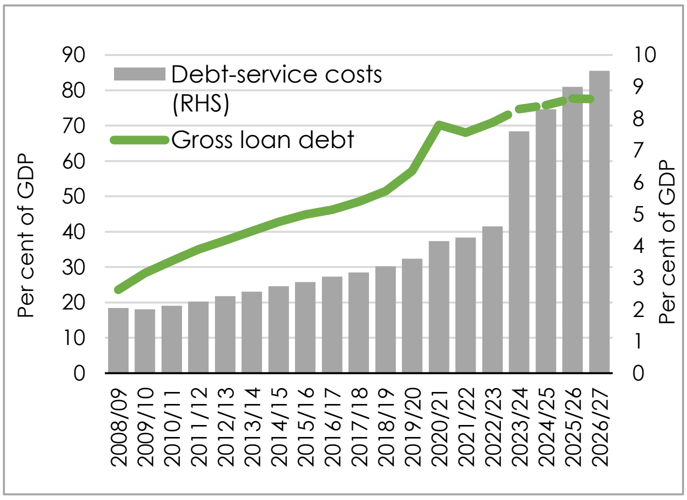
In December 2023, the average clearing yields (the interest government has to pay to finance the budget deficit and refinance maturing debt) increased. At the same time, the demand for domestic bonds at the government's weekly bond auctions decreased. However, a bid-to-cover ratio of three indicates that SA's government bonds were oversubscribed. Bond oversubscription occurs when the demand for a bond offering exceeds the amount of bonds available for sale.

South Africa and other developing countries remain vulnerable to a shift in risk perceptions, speculation and surges in financial outflows. In response to these embedded and often unjustified risk perceptions, the National Treasury elects to increase offered interest rates on newly issued bonds to ensure that all auctioned bonds are sold. At the same time, higher interest rates disproportionately benefit the profits of the financial sector while adversely impacting the working class.

The 2024 Budget expects debt to stabilise at a lower level of 75.3 per cent of GDP in 2025/26 compared with the 77.7 per cent estimated in the 2023 Medium Term Budget Policy Statement (MTBPS). The decline in debt is mainly due to better-than-expected revenue collections and the government's decision to transfer R150 billion from the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). The use of GFECRA is expected to reduce the borrowing requirements, as well as the growth of the debt stock and debt service costs.

The government expects debt service costs (interest payments) to increase from 20.8 per cent of overall main budget revenue in 2023/24 to 21.1 per cent during 2026/27. Higher debt service costs are mainly due to the higher budget deficit and interest rates and the depreciation of the rand against the dollar. The PBO is of the view that high debt service costs can be curbed through several interventions including yield curve management (more short-term borrowing), targeted debt renegotiation, preferential or prescribed lending, and accessing capital on more favourable terms even via the SARB.

Figure 9: Gross loan debt and debt-service costs

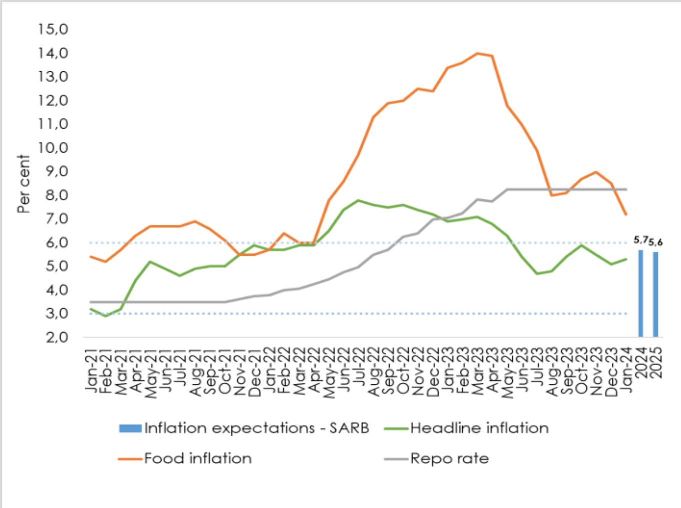


Source: National Treasury

Inflation and monetary policy

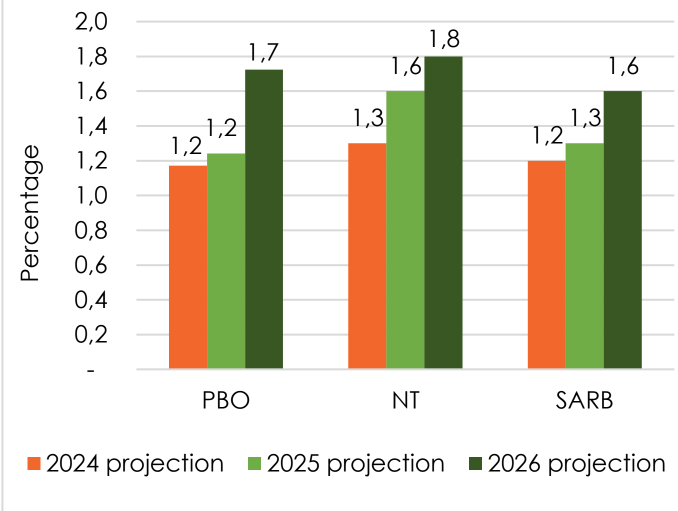
Headline consumer price inflation (CPI) for all urban areas increased to 5.3 per cent in January 2024, from 5.1 per cent in December 2023. This increase follows two months of consecutive declines. The most notable contributors to the annual inflation rate were food and non-alcoholic beverages (NAB) as well as transport, which increased by 7.2 per cent and 4.6 per cent, respectively. Health costs, prices of restaurants and hotels as well as those of miscellaneous goods and services also increased in January 2024.

Figure 10: Inflation is within the SARB's target range



Source: Stats SA, BER

Figure 11: Projections for South Africa's real economic growth



Source: PBO, National Treasury and IMF

Headline inflation remains within the SARB's inflation target range of 3 to 6 per cent, but has moved away from the SARB's preferred 4.5 per cent midpoint. As a result, the SARB's Monetary Policy Committee (MPC) maintained the repurchase rate at its current level of 8.25 per cent in their January 2024 committee meeting. At the current repurchase rate level, monetary policy remains restrictive, with severe implications for economic growth and employment.

Not only are high interest rates constraining already weak domestic demand, but they are also increasing the government's debt levels and service costs. According to the 2024 Budget Review, a 1.0 percentage point increase in inflation and interest rates, combined with a R1 depreciation of the rand against the dollar, results in a R50.7 billion increase in gross loan debt and a R7.9 billion increase in debt-service costs. Banks and the wealthy continue to be the primary beneficiaries of this restrictive monetary policy stance adopted by the SARB.

Domestic economic and fiscal outlook

The macroeconomic projections by the PBO show that the outlook for GDP growth over the medium term is relatively poor. GDP growth is expected to be 1.2 per cent in 2024 and is forecast to average 1.4 per cent over the medium term. GDP growth is not only significantly below the National Development Plan (NDP) target of 5.4 per cent but is inadequate to tackle the high levels of unemployment, poverty and inequality that are constraining aggregate demand in the economy.

The 2024 Budget provided little support for economic development with aggregate demand and investment likely to remain low over the medium term. Moreover, the budget has not taken adequate account of the serious domestic and global risks that affect the South African economy, particularly risks to political and socio-economic stability associated with hunger, deprivation and poor access to basic services.

The South African economy remains extremely concentrated (in terms of market share and wealth) with a high level of financialisation. In addition, the government's supply-side structural reforms are insufficient for stimulating investment and economic growth in a nation with serious demand-side constraints due to structural inequality, poverty, and unemployment. Therefore, structural economic transformation rather than austerity is required to steer the economy onto a new economically just path. The budget could contribute towards achieving inclusive economic growth and fiscal sustainability by directing more resources towards struggling poor households, industrialisation, public services, and infrastructure development in pursuit of a new demand-led growth trajectory.

The government can also leverage its full public sector balance sheet, including the Unemployment Insurance Fund (UIF) reserves and the Government Employees Pension Fund (GEPF), to fund a fiscal stimulus for the economy. A well-spent fiscal stimulus can reduce the debt-to-GDP ratio by spurring economic growth and building state capacity.

Box 1: Unpacking the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) and its implications

The 2024 Budget includes a proposal to withdraw R250 billion from the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). Of the R250 billion, R100 billion will be distributed to the Reserve Bank's contingency reserve. The R150 billion will be used to lower the government's borrowing requirement over the medium-term expenditure framework (MTEF) with R100 billion allocated in the fiscal year 2024/25, and additional allocations of R25 billion earmarked for each of the subsequent fiscal years 2025/26 and 2026/27. National Treasury projects that, as a result, debt-service costs will decline by R30.2 billion over the 2024 MTEF period.

What is the GFECRA?

The government's foreign exchange reserves can be thought of as a form of self-insurance against instability, financial crises and contagion that may harm the South African economy, particularly the financial sector and other businesses. South Africa maintains open financial accounts and a floating exchange rate, which means that we are vulnerable to sudden shifts in sentiment in global financial and exchange rate markets, including panic and herding behaviour. The GFECRA can, therefore, be thought of as a service that the South African government through the South African Reserve Bank (SARB) provides to the economy, particularly the financial services sector.

The GFECRA was established in terms of the SARB Act, 1989 (Act No. 90 of 1989) to manage the account on behalf of the National Treasury. Sections 25 to 27 of the SARB Act provide for the management by the South African Reserve Bank (''the Bank'') of a:

- Gold Price Adjustment Account
- Foreign Exchange Adjustment Account
- Forward Exchange Contracts Adjustment Account

The Acts allows the Minister of Finance and the SARB Governor to settle positive balances in the GFECRA by mutual agreement. When there is a debit balance in GFECRA it counts as a loss to the government, which is paid to the account from the National Revenue Fund (NRF). If the Minister and Governor agree, a credit balance on GFECRA would be paid into the NRF. According to the 2024 Budget Review, the GFECRA is estimated to reach R503.3 billion by 31 March 2024.

The proposed GFECRA settlement agreement

The government and SARB have reached an agreement on a new framework for managing GFECRA that will require an amendment to the 2003 GFECRA Settlement Act. The National Treasury and SARB have explained that even after the R250 billion is withdrawn from GFECRA (and converted into realised gains by the SARB) the size of South Africa's foreign exchange reserves will be large enough to ensure adequate reserves in the case of unforeseen events. GFECRA has operated in a way where growth into the account went unsettled. The National Treasury and SARB have agreed to a new framework for distributing the GFECRA balances into a "waterfall arrangement" into three pools:

1. A GFECRA buffer pool large enough to ensure that funds in the account will always be positive
2. SARB's contingency reserve as a buffer to the SARB and to cover interest payments
3. The remaining funds will be paid to the National Treasury on an annual basis

The above is reflected in the allocations made in the MTEF.

Concerns about the current GFECRA arrangement

Concerns have been raised that the government is drawing on unrealised gains in the GFECRA account to reduce its debt. While the initial payments will be R150 billion over the medium term, subsequent payments into this final pool will very likely be zero over several years or much lower, given that it took about two decades to build up the R503.3 billion projected reserve.

The PBO is also concerned with the use of the GFECRA to solely reduce debt. Using the GFECRA to achieve a primary budget surplus will do little for the South African economy and its people. The PBO has continuously highlighted that fiscal sustainability has to be seen beyond just decreasing the budget deficit and managing the debt-to-GDP ratio. Fiscal sustainability must include addressing unemployment, poverty, and inequality. The PBO has cautioned about the disproportional impact of fiscal consolidation on vulnerable populations, income inequality, social disparities, and the negative consequences for employment and long-term economic development. While GFECRA may help guarantee a primary budget surplus, the primary budget surplus will be achieved in the context of real per capita expenditure declines on health, education, and other sectors critical to the basic survival of the majority who rely on public services. GFECRA should be strategically allocated to finance a targeted fiscal stimulus for the economy to reduce suffering related to high levels of poverty and to support a developmental approach that will increase growth and future revenue.

It is a concern that the SARB has decided not to sell foreign exchange reserves to finance the distribution to National Treasury but to finance these funds with new SARB liabilities, mainly in the form of bank reserves. Therefore, a part of the GFECRA funds flowing to the second pool will be used to pay interest to the banks and financial sector. By holding large levels of foreign exchange, the government provides a free service to the entire economy from which the banks and financial sector gain disproportionately huge benefits. Therefore, the PBO is concerned that the SARB has chosen to pay for the transfer to the National Treasury by increasing reserves of banks and financial institutions that will be remunerated at the high policy interest rate. However, the National Treasury and SARB's use of GFECRA does not indicate a move to consider the broader balance sheet to deal with the current UPI crisis and is negative on development and growth prospects. The current framework is likely to create more constraints on the government accessing GFECRA to deal with other emergencies.

The PBO views the use of GFECRA as a positive step, as it illustrates the government's ability to utilise its entire public sector balance sheet to generate fiscal space. The leveraging of the GFECRA demonstrates that the government can leverage its full public sector balance sheet.