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Economic outlook

In brief

- South Africa’s projected GDP growth for 2017, forecast at 1.3 per cent at the time of the 2017 Budget, has been revised down to 0.7 per cent. Over the medium term, GDP growth is expected to increase slowly, reaching 1.9 per cent in 2020.
- Despite substantial risks, the global economic outlook is improving, with growth of 3.7 per cent forecast in 2018. Higher global growth can benefit South Africa’s medium- to long-term growth prospects if the country can boost investment and export competitiveness.
- Concerns about policy and political uncertainty, along with weak domestic demand, weigh heavily on business and consumer confidence, deterring investment and job creation.
- Government’s economic policy, guided by the objectives of the National Development Plan, centres on inclusive growth, transformation and competitiveness. Progress has been registered on the 14 confidence-boosting measures announced earlier this year. A series of microeconomic reforms would provide impetus to confidence and investment.

Transformation, inclusive growth and competitiveness

Slow economic growth severely constrains efforts to transform the economy

The South African economy grew by an annual average of 1.9 per cent between 2010 and 2016, well below the target of 5.4 per cent envisaged in the National Development Plan (NDP). Per capita GDP has declined for two consecutive years, severely constraining efforts to transform the economy, and threatening the sustainability of the public finances.

Persistently weak economic growth reinforces the country’s legacy of socioeconomic exclusion. Today, 30.4 million South Africans are living in poverty. Unemployment is 27.7 per cent – the highest level since September 2003. The share of total income going to the top 10 per cent of income earners is between 60 and 65 per cent. Wealth inequality is even more pronounced. Low levels of economic opportunity for a large proportion of the population undermine growth potential and the realisation of the constitutional vision of a more equal society.

Inclusive growth, transformation and competitiveness form a virtuous circle

Government is focused on inclusive growth, transformation and competitiveness. These three policy objectives form a virtuous circle. Inclusive growth reduces poverty and inequality, and provides the resources to support critical social spending. Broad-based economic transformation opens up the economy to those previously marginalised, generating new businesses and wealth. A competitive economy sells goods and services to the rest of the world and attracts investment to support its own development.

Guided by the NDP and the nine-point plan announced in February 2015, government aims to break down structural impediments to new economic activity, deconcentrate industries dominated by few participants, accelerate the inclusion of millions of black South Africans into jobs and businesses, and return to a path of rising incomes for all.

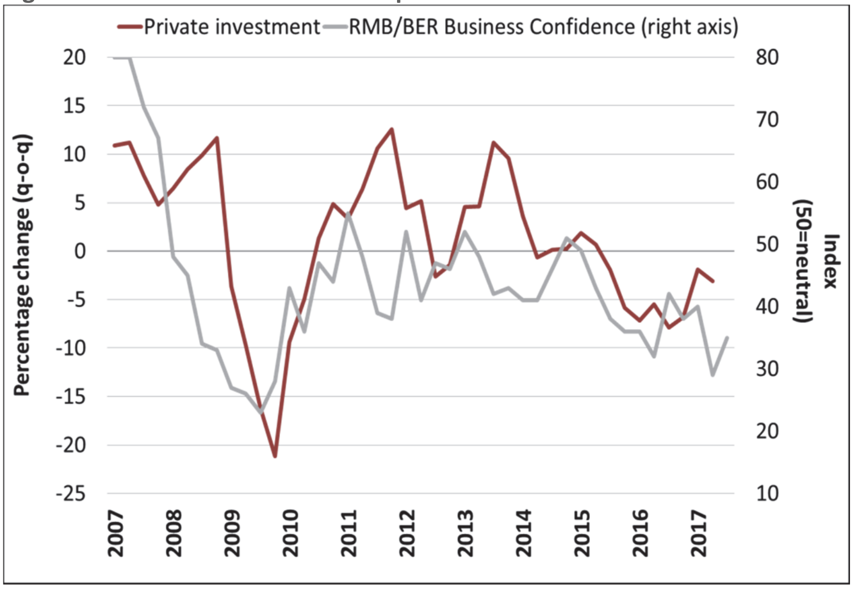
The central challenge for economic policy remains effective implementation.

Rebuilding confidence

Weak business and consumer confidence reduce investment, job creation and household spending

Business and consumer confidence have been exceptionally weak in recent years, with direct consequences for investment, job creation and household spending. At present, concerns about policy and political uncertainty, along with weak domestic demand, weigh heavily on business and consumer confidence.

Figure 2.1 Business confidence and private investment



Source: RMB/BER Business Confidence Index and Statistics South Africa

Delays in finalising key regulatory processes, as well as a pattern of poor governance in several large state-owned companies, contribute to concerns about policy uncertainty. Addressing these concerns would bolster confidence, supporting higher levels of investment and growth.

Restoring South Africa’s potential growth rate, which has fallen below 2 per cent since 2014, requires additional policy measures. Rapid implementation of a range of microeconomic reforms, as outlined in the NDP, would boost confidence and provide support to the economy.

South Africa's macroeconomic framework is underpinned by fiscal sustainability and credibility, inflation-targeting and a flexible exchange rate. This approach protects the public finances for generations to come, and shields businesses and households from a range of economic shocks.

Update on government's short-term confidence-boosting measures

Restore the sustainability of fiscal policy:

– The Budget Facility on Infrastructure run by the National Treasury and the Presidential Infrastructure Coordinating Commission received 59 project submissions with an aggregate funding requirement of R135 billion. Several projects have been recommended for detailed appraisal.

– Negotiations on the next public-service wage agreement are under way.

Promote transformation and competitive outcomes by implementing sector reforms:

– The Preferential Procurement Policy Framework Act Regulations took effect on 1 April 2017.

– The Financial Sector Regulation Act was signed into law on 21 August 2017.

– The Government Technical Advisory Centre has been commissioned to set up a fund to benefit small and medium enterprises, with a particular focus on start-ups.

Manage fiscal and economic risks associated with state-owned entities:

– Government granted South African Airways R5.2 billion to address debt obligations. This allowed SAA to avoid default, roll over some debt and continue negotiations with lenders. A permanent chief executive officer has been appointed and the appointment of a chief restructuring officer is under way.

– A private-sector participation framework and a template to determine and cost developmental mandates have been approved by Cabinet.

– An energy task team resolved not to provide balance sheet support to Eskom. The Minister of Energy announced that Eskom will sign power-purchase agreements with independent power producers at a tariff not exceeding 77c/kWh.

Create policy certainty by finalising key legislative and policy processes:

– The Council for Scientific and Industrial Research completed a study on spectrum availability and open access.

– The Competition Commission launched a market inquiry to investigate data prices.

– Draft legislation is being finalised to facilitate the licensing of Postbank.

– Implementation of the revised Mining Charter has been postponed to December 2017.

– Government is consulting stakeholders on the Regulation of Agricultural Land Holdings Bill.

Global outlook

The world economy continues to strengthen. According to the International Monetary Fund (IMF), global growth is projected to reach 3.6 per cent in 2017 and 3.7 per cent in 2018, up from 3.2 per cent in 2016.

World economy is strengthening, with projected growth of 3.7 per cent in 2018

The outlook largely reflects a recovery in demand and trade in Europe and Asia. World trade volumes are expected to increase by 4.2 per cent in 2017. Low interest rates in the United States, Europe and Japan remain supportive of growth. The euro area should benefit from strong domestic demand, and better-than-expected growth in Japan's net exports will improve its performance in 2017. Brazil and Russia have returned to growth after lengthy recessions, supported by a strong export performance (Brazil), and stabilising oil prices and improved confidence (Russia).

These upward revisions in growth projections offset lower estimates for the US and the United Kingdom. The UK economy slowed more than anticipated in the first half of the year. The US growth forecast for 2017 has been trimmed from 2.3 per cent to 2.2 per cent, because an expected fiscal stimulus driven by tax cuts did not come about. US growth is projected to reach the pre-crisis average of 2.3 per cent in 2018.

Growth in sub-Saharan Africa projected to tick upwards in 2017, reaching 2.6 per cent.

Growth in sub-Saharan Africa has been depressed as a result of underperformance in the region's two largest economies – Nigeria and South Africa. Economic growth in the region is projected to tick upwards, reaching 2.6 per cent in 2017 and 3.4 per cent in 2018, in response to improved oil production and agricultural output. The Angolan economy is expected to grow by 1.5 per cent in 2017. Growth outcomes for fuel-importers in the region are generally better. Kenya and Ethiopia are expected to grow at 5.0 and 8.5 per cent respectively in 2017 due to strong domestic demand and infrastructure investment.

Table 2.1 Economic growth in selected countries

Region / country	2000-2008	2010-2015	2016	2017	2018
Percentage	Pre-crisis	Post-crisis		Average GDP[1]	
World	**4.3**	**3.9**	**3.2**	**3.6**	**3.7**
Advanced economies	**2.4**	**1.9**	**1.7**	**2.2**	**2.0**
US	2.3	2.2	1.5	2.2	2.3
Euro area	2.0	1.0	1.8	2.1	1.9
UK	2.5	2.0	1.8	1.7	1.5
Japan	1.2	1.5	1.0	1.5	0.7
Developing countries	**6.5**	**5.5**	**4.3**	**4.6**	**4.9**
Brazil	3.8	2.2	-3.6	0.7	1.5
Russia	7.0	2.2	-0.2	1.8	1.6
India	6.8	7.4	7.1	6.7	7.4
Chile	4.8	4.2	1.6	1.4	2.5
Mexico	2.6	3.2	2.3	2.1	1.9
Indonesia	5.3	5.7	5.0	5.2	5.3
China	10.4	8.3	6.7	6.8	6.5
Sub-Saharan Africa	**5.9**	**5.0**	**1.4**	**2.6**	**3.4**
South Africa[2]	4.2	2.3	0.3	0.7	1.1

1. *IMF World Economic Outlook Update, October 2017*
2. *National Treasury Forecasts*

Yet despite the cyclical upturn, there are considerable risks to the global outlook. These include high levels of debt, continued political and policy uncertainty in advanced economies, imbalances in the Chinese financial system and a more rapid tightening of global financial conditions.

Risks to global outlook include changes to US trade policy, Brexit and tightening global financial conditions

Possible changes to US trade policy and uncertainty about the terms of the UK's exit from the European Union pose risks to global trade. Tighter global financial conditions could result from higher interest rates in advanced economies or developments that prompt global risk aversion, raising external financing risks and reducing capital flows to developing economies. Lower capital inflows could lead to currency depreciation, higher inflation and rising interest rates. A debt crisis in China's banking sector would lower global growth significantly, particularly for countries that are reliant on trade with China.

The improved global outlook can strengthen South Africa's medium- to long-term growth prospects, provided the country can boost export competiveness. South Africa's post-crisis growth outcomes were marginally better than those of Brazil and Russia, but worse than Chile and Indonesia, which undertook a range of microeconomic reforms.

Improved world outlook can benefit South Africa, provided economy can boost investment and export performance

Review of domestic economic performance

The South African economy grew by an annualised 2.5 per cent in the second quarter of 2017, following a recession that began in the fourth quarter of 2016. The stronger-than-expected rebound was underpinned by a return to growth in the services sector and robust agricultural output.

Overview of major economic sectors

Agriculture

Real value added in the agriculture, forestry and fishing sector grew by 21.2 per cent in the first half of 2017 compared with the same period in 2016. Good rains in the summer rainfall region led to a recovery following a severe drought, which caused agriculture to contract in 2015 and 2016. Maize production is expected to reach 16.7 million tons in 2017 – a 115 per cent increase from the 2016 crop of 7.8 million tons. Soybean production is expected to increase by 77 per cent. Wheat production, however, is expected to decline by 10 per cent in 2017 due to continued drought in the Western Cape. An ongoing outbreak of avian flu in June 2017 may lead to higher poultry prices. Growth in the sector is expected to be sustained throughout 2017.

Strong rebound in agriculture following good season in summer rainfall regions

Mining

Mining value added expanded by 4.3 per cent in the first half of 2017 compared with the same period in 2016. The sector is recovering from the contraction of 2016, supported by higher commodity prices and growth in iron ore, manganese and copper. Mineral sales increased by 6.8 per cent in the first half of 2017 compared with the same period last year, driven largely by coal and iron ore. Gold sales fell by 16.2 per cent over the same period.

Mining recovering from low of 2016, but policy uncertainty limits growth

Declining fixed investment in mining undermines sustainable growth. Elevated operating costs and uncertainty related to the Mining Charter and the Mineral and Petroleum Resources Development Amendment Bill continue to constrain growth. South Africa is currently ranked 13th in Africa on the mining Investment Attractiveness Index. The mining outlook remains subdued due to continued domestic policy uncertainty and rising production costs.

Manufacturing

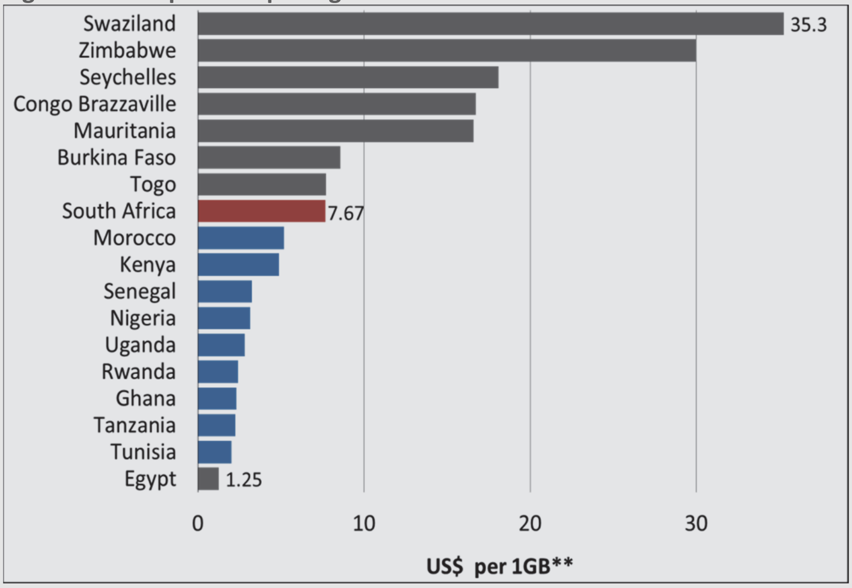
Real value added in manufacturing declined by 1.5 per cent and production contracted by 1.8 per cent in the first half of 2017 compared to the same period last year. Production in petrochemicals and wood and paper fell by 6.1 per cent and 2.9 per cent respectively. Capacity utilisation in manufacturing moderated slightly from 81.5 per cent in the

Manufacturing remains subdued and fixed-capital stock continues to decline first quarter of 2017 to 81.3 per cent in the second. Fixed-capital stock in manufacturing has declined every year since 2009, indicating a gradual erosion of capacity.

Realising the benefits of a well-designed telecommunications spectrum auction

The delay in allocating telecommunications spectrum constrains growth across the economy. Lack of radio frequency limits the ability of businesses to deploy new technologies and contributes to the high cost of broadband. A well-designed spectrum auction can promote transformation and improve competition as new participants enter the market. Universal service conditions can improve access for low-income households. And a competitive auction can sharply reduce data costs. The bulk of additional spectrum is ready to be allocated immediately, without requiring the migration of existing spectrum users to digital television.

Figure 2.2 Comparative pricing of 1GB of data across Africa*



**Bars highlighted in blue indicate countries that have allocated spectrum*
***1GB data based on prepaid data top-ups or bundled top-ups*
Source: Research ICT Africa and Robb (2017)

Finance

Bank profitability remains resilient despite declining growth in interest income

Financial and business services grew by 1 per cent in the first half of 2017 compared with the same period in 2016. Lacklustre growth reflects high levels of household debt and slowing income growth, which affects banks and insurance companies. Bank profitability remains relatively resilient despite declining growth in interest income, which averaged 3.8 per cent in the first half of 2017 compared with 14.8 per cent a year earlier. Tier 1 capital adequacy, denoting high-quality reserves, rose from 12.5 per cent to 13.5 per cent in the year to July 2017. Asset quality is strong, with impaired advances as a share of outstanding loans at 2.9 per cent.

Employment

Formal employment declined by 0.2 per cent in first half of 2017, and about 6.2 million people are searching for work

Formal non-agricultural employment declined by 0.2 per cent in the first half of 2017 compared to the same period last year. Employment in community services fell by 41 041 during the first half of the year. Financial and business services lost 7 681 jobs over the same period, mostly in banking and insurance. Employment prospects in manufacturing remain constrained. Similarly, employment growth in the trade sector is likely to remain under pressure given low consumer confidence and weak credit growth. Mining recovered some jobs in the first half of 2017, expanding employment by 1.6 per cent. The ability of the economy to absorb new workers peaked in 2008 and has not recovered. An estimated 6.2 million South Africans are actively looking for work.

Table 2.2 Sector growth trends

Percentage	2012	2013	2014	2015	2016	2017[1]
Agriculture, forestry and fishing	1.8	4.5	6.9	-6.1	-7.8	21.2
Mining and quarrying	-2.9	4.0	-1.4	3.9	-4.7	4.3
Manufacturing	2.1	1.0	0.2	-0.2	0.7	-1.5
Electricity and water	-0.4	-0.6	-1.1	-1.5	-3.5	-0.5
Construction	2.6	4.6	3.6	1.7	0.7	0.3
Wholesale and retail trade	4.0	2.0	1.6	1.4	1.2	-1.1
Transport and communication	2.4	2.9	3.2	1.1	0.4	1.3
Finance, real estate and business services	3.0	2.6	2.2	2.8	1.9	1.0
Personal services	2.1	2.6	2.0	1.1	1.2	0.8
General government	3.0	3.2	2.9	0.8	1.4	0.4
GDP	**2.2**	**2.5**	**1.7**	**1.3**	**0.3**	**1.1**

1. The first 6 months of 2017
Source: Statistics South Africa

Macroeconomic outlook

South Africa's projected GDP growth for 2017, forecast at 1.3 per cent at the time of the 2017 Budget, has been revised down to 0.7 per cent. GDP growth is expected to increase slowly, reaching 1.9 per cent in 2020.

GDP growth projected to grow moderately, reaching 1.9 per cent in 2020

Revisions to the forecast reflect a significant deterioration in business and consumer confidence over the past year. Other contributing factors include weaker-than-anticipated growth in the fourth quarter of 2016, a large contraction in the finance sector in the first quarter of 2017 and a higher risk premium, reflected in higher bond yields. The impact of domestic factors on economic growth has been partially offset by improved global growth and commodity prices.

Table 2.3 Macroeconomic performance and projections

Calendar year	2014	2015	2016	2017	2018	2019	2020
Percentage change		**Actual**		**Estimate**		**Forecast**	
Household consumption	0.7	1.7	0.8	1.0	1.2	1.6	1.9
Government consumption	1.1	0.5	2.0	0.9	1.7	1.0	1.0
Gross fixed capital formation	1.7	2.3	-3.9	-0.6	0.5	3.0	3.5
Gross domestic expenditure	0.6	1.8	-0.8	1.2	1.1	1.5	2.0
Exports	3.2	3.9	-0.1	2.5	3.2	3.4	3.5
Imports	-0.5	5.4	-3.7	4.0	3.1	3.5	3.8
Real GDP growth	**1.7**	**1.3**	**0.3**	**0.7**	**1.1**	**1.5**	**1.9**
GDP inflation	5.8	5.0	6.8	5.1	5.0	5.3	5.5
GDP at current prices (R billion)	**3 807.7**	**4 049.8**	**4 338.9**	**4 601.8**	**4 888.8**	**5 222.3**	**5 611.9**
CPI inflation	6.1	4.6	6.3	5.4	5.2	5.5	5.5
Current account balance (% of GDP)	-5.3	-4.4	-3.3	-2.3	-2.6	-2.9	-3.1

Source: National Treasury

Household consumption

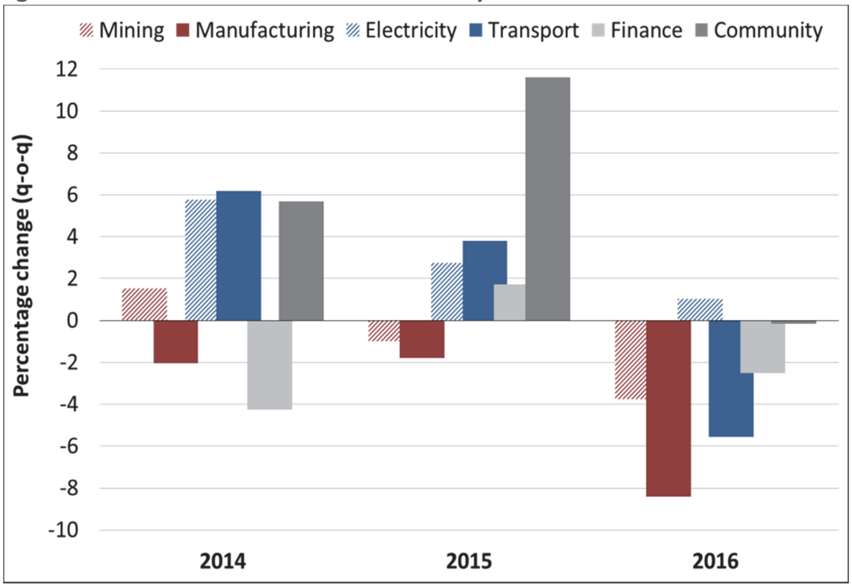
Growth in household spending increased marginally to 1.1 per cent in the first half of the year from 0.6 per cent over the same period of 2016.

Notably, expenditure on durable goods, such as vehicles and washing machines, contracted during the first half of 2017.

Household consumption expenditure is projected to grow by 1 per cent in 2017

A 2.1 per cent contraction in real household disposable income in the first quarter was followed by growth of 4.5 per cent in the second, supported by rising real wages. Nominal year-on-year growth in employee compensation was 7 per cent in the second quarter, with strong increases in general government services. High debt levels continue to constrain household spending. The ratio of household debt to disposable income was 73 per cent in the first half of 2017, compared with 75 per cent in the same period in 2016. Growth in household consumption expenditure is projected to increase to 1 per cent in 2017, reaching 1.9 per cent in 2020 as employment growth strengthens and confidence improves.

Figure 2.3 Growth in fixed investment in key sectors



Source: Reserve Bank

Fixed investment

Capital investment by public corporations has declined for four quarters

Total capital investment fell by 1.1 per cent in the first half of 2017 compared with a 2.7 per cent decline in the corresponding period of 2016. Investment by general government grew by 6.3 per cent. Investment by public and private corporations fell by 3.7 per cent and 2.5 per cent respectively. Capital investment by public corporations has declined for four consecutive quarters. In 2016, total capital investment declined for the first time since 2010, with large decreases in mining and manufacturing.

Private-sector investment accounts for 60 per cent of South Africa's total investment. Weak domestic demand and continued policy uncertainty continue to curb investment plans. Over the long term, this reduces the economy's potential growth rate. Gross fixed capital formation is expected to average 2.3 per cent growth over the next three years.

Net exports and the current account

Current account deficit narrowed to 2.2 per cent of GDP in first half of 2017

The current account deficit narrowed to 2.2 per cent of GDP in the first half of 2017 from 3.8 per cent over the same period in 2016. Imports declined, and the trade surplus improved to 1.3 per cent of GDP in the first half of 2017, compared with 0.1 per cent of GDP in the same period in 2016. Merchandise exports saw an uptick from R541.5 billion in the first half of 2016 to R563.3 billion in the first half of this year. Increased mining and manufactured exports were supported by higher commodity prices. The shortfall in the net services, income and transfers balance narrowed from 3.9 per cent of GDP in the first half of 2016 to 3.6 per cent during the same period in 2017.

The current account deficit is projected to increase to 2.3 per cent of GDP in 2017, reaching 3.1 per cent in 2020.

Inflation

CPI inflation fell back within the target band, reflecting lower core inflation and food prices

Consumer price index (CPI) inflation returned to within the 3 to 6 per cent target band in the second quarter of 2017. CPI inflation declined from 6.6 per cent in January to 4.8 per cent in August. Core inflation, which excludes price-volatile items such as food, fuel and electricity, fell from 5.9 per cent in December 2016 to 4.6 per cent in August 2017, reflecting weak domestic demand. Food price inflation declined from 12 per cent in December 2016 to 5.7 per cent in August 2017 as drought conditions subsided. Noting the improved inflation outlook, the Reserve Bank cut the repurchase (repo) rate from 7 per cent to 6.75 per cent in July 2017.

Inflation expectations remain near the upper end of the target band. However, the inflation outlook has improved since the 2017 Budget. Headline inflation is now expected to average 5.4 per cent in 2017, down from 6.4 per cent. The revisions to the inflation outlook reflect lower oil and food prices, and a slightly stronger exchange rate assumption. The risks to the inflation outlook remain currency depreciation, higher oil prices, rising electricity tariffs and further sovereign rating downgrades.

Risks to the outlook

Policy and political uncertainty, coupled with weak confidence, discourage investment and consumption

Policy and political uncertainty remain central risks to the domestic economic outlook. Elevated policy and political uncertainty, coupled with weak confidence, discourage investment and consumption. Further risks include a downgrade of the local currency rating and higher administrative prices, which would lead to higher inflation. In contrast, improving commodity prices can benefit mining, especially if policy certainty is restored. Better rainfall, especially in the Western and Northern Cape, can result in stronger-than-expected growth in agriculture.

Economic assumptions

Assumptions underpinning forecast cover global growth, inflation, trade and commodity prices

The macroeconomic forecast is underpinned by a set of assumptions. Those related to growth and inflation for key trading partners are sourced from the IMF. Commodity prices and global exchange rates are informed by futures curves, and calculated as a moving monthly average. Public investment assumptions are based on approved infrastructure expenditure plans. Food inflation assumptions are informed by high-frequency indicators and analysis.

Table 2.4 Assumptions used in the economic forecast

Percentage	2015	2016	2017	2018	2019	2020
	Actual		Estimate	Forecast		
Global demand[1]	4.2	4.0	4.3	4.4	4.2	4.2
International commodity prices[2]						
Oil (US$ per barrel)	52.7	44.2	52.0	51.6	52.1	52.7
Gold (US$ per ounce)	1 160.4	1 247.9	1 267.6	1 320.0	1 342.0	1 363.6
Platinum (US$ per ounce)	1 055.4	988.3	967.7	992.2	1 014.5	1 037.4
Coal (US$ per ton)	57.1	64.4	83.8	79.8	74.6	71.8
Iron ore (US$ per ton)	56.1	58.6	73.8	67.8	61.6	57.9
Food inflation	5.1	10.5	7.3	5.1	5.9	6.0
Electricity inflation	9.2	9.2	4.7	5.1	8.0	8.0
Sovereign risk premium	2.9	3.4	2.9	2.8	2.4	2.3
Real public corporation investment	6.0	0.7	-1.3	0.0	3.0	4.3
Real private residential investment	8.4	-1.8	0.4	-2.1	1.2	4.4

1. Combined growth index of South Africa's top 15 trading partners (IMF World Economic Outlook, October 2017)
2. Source: Bloomberg futures prices as at 8 September 2017
Source: National Treasury

The main revisions to the assumptions since the February 2017 forecast include greater global demand and improved commodity prices, mainly due to higher-than-expected iron ore prices. The risk premium – a measure of the extra return required by global buyers of South African bonds – is higher to reflect domestic policy uncertainty. Investment by public corporations is lower as capital projects are delayed due to weak economic conditions.

Alternative scenarios

The National Treasury has generated three alternate scenarios quantifying some of the risks to the baseline economic forecast.

Scenarios model effects of risk premium increases, as well as higher-than-expected global growth

Two scenarios involve downgrades to the local currency debt by global ratings agencies. In both scenarios, the risk premium increases to varying degrees. Global developments leading to broad aversion towards developing-country debt, or a sharp deterioration in the balance sheet of a state-owned company, could have similar effects. A moderate increase in the risk premium could see growth slow to 0.6 per cent in 2018 and 0.9 per cent in 2019. A large increase in the risk premium could see growth contracting by 1.2 per cent in 2018 and 0.8 per cent in 2019.

In the third scenario, global growth improves by an annual average of 0.5 percentage points over the medium term. Export commodity prices are 5 per cent higher than the baseline. The risk premium and bond yields are lower. Growth reaches 1.4 per cent in 2018 and 2.4 per cent in 2020.

The scenarios are presented in Annexure A.