2

Economic overview

In brief

- GDP growth has been revised from 1.5 to 0.7 per cent in 2018 following a recession in the first half of the year. The economic outlook is weaker than projected in the 2018 Budget, although GDP growth is expected to recover gradually to 2.3 per cent by 2021 as confidence grows and investment gathers pace.
- The global economy is expected to continue growing at 3.7 per cent in 2018 and 2019. Global risks, however, are becoming more pronounced. Small and open developing economies, such as South Africa, are increasingly vulnerable to financial volatility and trade disruption.
- Government's economic stimulus and recovery plan is intended to support a return to higher growth over the medium term. A combination of policy certainty, growth-enabling economic reforms, improved governance, and partnerships with business and labour will be key to restoring confidence and investment. Infrastructure spending will also support economic activity and job creation.

Boosting growth, investment and job creation

Strong, sustained economic growth needed to sharply reduce unemployment

South Africa needs strong, sustained economic growth to sharply reduce unemployment, and to encourage inclusive development and transformation. The National Development Plan (NDP) put forward the goal of 5.4 per cent GDP growth to support these objectives. Over the past decade, however, GDP growth has averaged 1.8 per cent – well below the level needed to transform the economy.

At the time of the February 2018 Budget, a synchronised global recovery was expected, and there was a sense of optimism that confidence and investment would recover on the strength of improved political certainty. This contributed to higher business confidence, a strengthening rand, declining bond yields and a positive outlook.

Yet the economy has not performed as expected. GDP grew by 0.6 per cent in the first half of 2018 compared with the same period in 2017. On a quarter-on-quarter basis, however, GDP fell during the first half of 2018, leading to a technical recession. Mining and agricultural production have contracted, import growth has accelerated and investment growth remains muted. Per-capita GDP continues to decline as the economy grows more slowly than the population.

Global concerns include mounting trade disputes and tightening financial conditions

Over the medium term, concerns about sharpening global trade disputes, volatile commodity prices and tightening financial conditions will weigh on investor confidence. If these risks materialise, they could prompt renewed risk aversion and financial volatility, leading to a less favourable environment for investment in and exports from developing countries.

Confronted by low domestic growth and an uncertain global environment, government is taking steps to bolster economic activity, investment and job creation in the short to medium term. The economic stimulus and recovery plan announced by the President in September 2018 seeks to focus public spending in areas that can grow the economy, create jobs, accelerate necessary growth-enhancing reforms, promote infrastructure development, and tackle problems in education and healthcare.

Building partnerships that promote investment is central to government's agenda

The October 2018 Jobs Summit followed extensive consultation in the National Economic Development and Labour Council, and underscores the importance of effective partnerships between the public and private sectors and civil society. The forthcoming Investment Conference will be complemented by an infrastructure fund being designed to attract private and development-finance capital to well-run public infrastructure projects that contribute to economic growth and development.

Policy certainty in areas such as mining and energy is being restored, and the governance of state-owned companies and entities such as Eskom, Transnet and the South African Revenue Service (SARS) is being strengthened.

Government is committed to macroeconomic stability and prudent fiscal management. Sustainable public finances, inflation targeting and a flexible exchange rate provide a platform to attract investment and absorb external shocks. To make the most of these macroeconomic building blocks, reforms are needed to transform the structure of the economy – raising productivity, increasing competition and reducing the cost of doing business.

Global outlook

Global growth expected to remain at 3.7 per cent in 2018 and 2019, decelerating thereafter

The world economy grew by 3.7 per cent in 2017, up from 3.3 per cent in 2016. Stronger growth in developed economies contributed to rising global trade and several developing economies (Russia, Brazil and Nigeria) emerged from recession. The International Monetary Fund (IMF) projects that global growth will remain at 3.7 per cent in 2018 and 2019.

US economic growth is expected to slow from 2.9 per cent in 2018 to 1.8 per cent by 2020 as the effects of fiscal stimulus wane. In the euro area, growth is expected to ease from 2.4 per cent in 2017 to 1.9 per cent by 2019 in response to reduced external demand. Uncertainty about the arrangements by which the United Kingdom will leave the European Union continues to undermine confidence.

World trade volume growth is expected to slow to 4.2 per cent in 2018 and 4 per cent in 2019, from 5.2 per cent in 2017, as trade tensions unfold.

The growth outlook for developing economies has been revised down to 4.7 per cent in 2018 and 2019, from 4.9 per cent and 5 per cent, respectively. Rising US interest rates, a stronger dollar and concerns over mounting US-China trade tensions have increased market volatility and reduced appetite for investment in developing economies. Countries with large twin deficits and high levels of external debt – notably Turkey and Argentina – experienced sharp currency depreciation, rising credit spreads and large capital outflows. In some cases, responses by developing-country governments exacerbated market volatility. On balance, risks to the global outlook have become more pronounced.

Countries with large twin deficits and high external debt experienced sizeable capital outflows

Table 2.1 Economic growth in selected countries

Region/country	2000-2008	2010-2016	2017	2018	2019
Percentage	Pre-crisis	Post-crisis	Actual	Average GDP (forecast)	
World	**4.3**	**3.9**	**3.7**	**3.7**	**3.7**
Advanced economies	**2.4**	**1.9**	**2.3**	**2.4**	**2.1**
United States	2.4	2.2	2.2	2.9	2.5
Euro area	2.0	1.1	2.4	2.0	1.9
United Kingdom	2.5	2.0	1.7	1.4	1.5
Japan	1.2	1.5	1.7	1.1	0.9
Developing countries	**6.5**	**5.4**	**4.7**	**4.7**	**4.7**
China	10.4	8.1	6.9	6.6	6.2
India	6.8	7.3	6.7	7.3	7.4
Brazil	3.8	1.4	1.0	1.4	2.4
Russia	7.0	1.9	1.5	1.7	1.8
Mexico	2.2	3.3	2.0	2.2	2.5
Indonesia	5.3	5.6	5.1	5.1	5.1
Chile	4.8	3.8	1.5	4.0	3.4
Sub-Saharan Africa	**5.8**	**4.5**	**2.7**	**3.1**	**3.8**
South Africa[1]	4.2	2.1	1.3	0.7	1.7

1. National Treasury Forecasts

Source: IMF World Economic Outlook, October 2018, and IMF World Economic Outlook database

Commodity prices

Commodity price movements have been mixed in 2018. Prices for oil and coal have increased sharply. Brent crude oil prices rose from US$67/barrel at the beginning of the year to US$83/barrel at the end of September 2018 in response to output disruptions in a number of oil-exporting countries and concerns over renewed US sanctions targeting Iran's oil exports.

Metals and minerals prices have declined in US-dollar terms as a result of lower demand, tariffs put in place by the US government and uncertainty over global trade policy. The gold price has eased from US$1 306/oz at the end of 2017 to US$1 193/oz at end-September 2018. The platinum price fell from US$931/oz to US$821/oz over the same period.

Domestic outlook

The National Treasury forecasts that GDP growth will slow to 0.7 per cent in 2018, down from 1.3 per cent last year, before rising to 1.7 per cent in 2019 and 2.1 per cent in 2020. The economic outlook is weaker than projected in the February 2018 Budget, which forecast 1.5 per cent and 1.8 per cent GDP growth in 2018 and 2019 respectively. The revisions

GDP growth of 0.7 per cent in 2018, increasing to 2.1 per cent in 2020 reflect lower production by agriculture and mining in the first half of the year, as well as a lack of new investment.

Table 2.2 Macroeconomic performance and projections

Calendar year	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Percentage change		**Actual**		**Estimate**		**Forecast**	
Final household consumption	1.8	0.7	2.2	1.6	1.9	2.3	2.6
Final government consumption	-0.3	1.9	0.6	0.8	0.2	1.2	0.9
Gross fixed-capital formation	3.4	-4.1	0.4	0.9	1.5	2.1	2.9
Gross domestic expenditure	2.1	-0.9	1.8	1.1	1.8	2.3	2.4
Exports	2.8	1.0	-0.1	1.0	2.7	2.9	3.3
Imports	5.4	-3.8	1.6	2.2	2.9	3.3	3.4
Real GDP growth	**1.3**	**0.6**	**1.3**	**0.7**	**1.7**	**2.1**	**2.3**
GDP inflation	5.1	6.8	5.5	5.6	5.6	5.4	5.3
GDP at current prices (R billion)	**4 051.4**	**4 350.3**	**4 651.8**	**4 949.1**	**5 317.2**	**5 724.1**	**6 167.2**
CPI inflation	4.6	6.3	5.3	4.9	5.6	5.4	5.4
Current account balance (% of GDP)	-4.6	-2.8	-2.4	-3.2	-3.2	-3.7	-3.9

Source: National Treasury and Reserve Bank

Agriculture and mining are expected to return to moderate growth in the next 12 months, and business and consumer confidence are expected to improve gradually over the medium term. Despite lower commodity prices, the resolution of several longstanding policy issues over the past six months is expected to support investment in mining and energy. Higher agricultural output is expected as a result of improved rainfall in the Western Cape this year.

Household consumption

Moderate improvement in credit conditions during 2018

Household consumption grew by 2.3 per cent in the first half of 2018, up from 1.6 per cent over the same period in 2017. Lower food inflation and the stronger rand in the first quarter of 2018 helped boost purchasing power and demand for durable and semi-durable goods. Credit conditions have improved moderately: household credit growth continues to tick up and the rejection rate for new applications has eased. An optimistic growth outlook supported higher consumer confidence in the first half of 2018.

Growth in household consumption expenditure is projected to reach 1.6 per cent in 2018, rising to 2.6 per cent in 2021. It is supported by a moderate recovery in wage and employment growth, and further improvements in household credit growth.

Investment

Growth in gross fixed-capital formation has averaged only 1.5 per cent since 2010

South Africa has experienced an extended period of weak investment. Growth in gross fixed-capital formation, after slowing to 0.1 per cent in the first half of 2018, is expected to measure 0.9 per cent for the year as a whole, and 2.9 per cent by 2021. Excluding investments in the utilities sector – primarily in electricity – growth in gross fixed-capital formation has averaged 1.5 per cent per year since 2010, compared with average annual growth of 5.7 per cent in the 2000s.

Low levels of demand and prolonged policy uncertainty have contributed to anaemic investment growth. In recent months, government has worked actively to improve the investment climate by strengthening governance in state institutions and removing policy bottlenecks in energy and mining. The infrastructure fund will promote investment in major capital projects.

Exchange rate

In the first three quarters of 2018, the rand weakened by 12.4 per cent against the US dollar. The currency depreciated largely in response to a strengthening of the dollar, negative investor sentiment induced by market volatility in Turkey and Argentina, and wider concerns about trade tensions. Low levels of domestic economic growth contributed to rand weakness.

Rand depreciated by 12.4 percent against US dollar in first nine months of 2018

Balance of payments

The current account deficit widened to 4 per cent of GDP during the first half of 2018 from 2.4 per cent over the same period in 2017. This was largely due to a smaller trade surplus, higher net income payments and deteriorating terms of trade. The value of total exports of goods and services rose by 1.3 per cent in the first half of 2018, while that of imports of goods and services rose by 4.4 per cent. The current account deficit is expected to average 3.2 per cent of GDP in 2018, rising to 3.9 per cent over the medium term, as a result of import growth and weaker terms of trade.

Employment

Unemployment remains extremely high. Government recognises the centrality of private-sector job creation in sustainably reducing joblessness. Changes in employment levels over the past year have been marginal, with unemployment at 27.2 per cent in the second quarter of 2018. Formal non-agricultural employment grew by 0.3 per cent in the first half of the year, compared with the same period in 2017. Average employment in the government sector, which accounts for about 21 per cent of total formal non-agricultural employment, rose by 1.8 per cent in the first half of the year, mostly as a result of temporary employment for voter registration. Employment outside government declined by 0.1 per cent in the first half of 2018.

Private-sector job creation is central to sustainably reducing unemployment

Inflation

Headline inflation continued to ease in 2018, averaging 4.5 per cent over the first eight months of the year compared with 5.5 per cent over the same period in 2017. This trend was largely driven by lower food inflation. Core inflation, which excludes food, fuel and electricity prices, slowed from 4.9 per cent in the first eight months of 2017 to 4.2 per cent over the same period in 2018. Inflation expectations have eased slightly in 2018 but remain near the upper end of the 3 to 6 per cent target range.

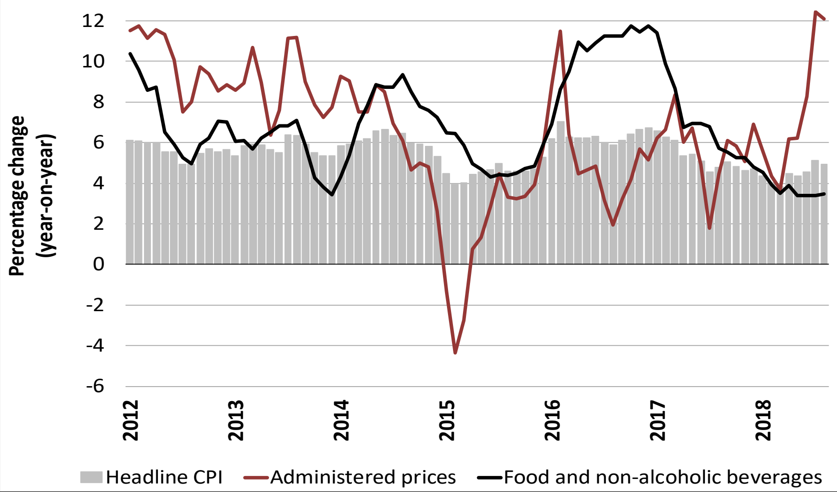
Inflation has eased, but is expected to increase in response to higher oil and administered prices

Higher inflation is expected during the remainder of 2018 in response to administered price increases. In recent months, rising oil prices and a weaker currency led to a sharp increase in fuel prices. Electricity prices, which rose by 2.1 per cent in August 2017, increased by 7.8 per cent in August 2018.

Headline inflation is projected to average 4.9 per cent in 2018, rising to 5.4 per cent by 2021 as food price inflation returns to its historic average. The medium-term outlook has adjusted the assumption of electricity price inflation from 8 per cent to 10 per cent.

Medium-term inflation projections remain within targeted range

Figure 2.1 Headline, food and administered price inflation



Source: Statistics South Africa

Macroeconomic assumptions

The updated assumptions used in the National Treasury's economic forecast are published in Table 2.3. The main changes since the 2018 Budget include upward revisions to oil and coal prices, electricity inflation and the sovereign risk premium, and downward revisions to metals prices and real investment by public corporations.

Table 2.3 Assumptions used in the economic forecast

	2016	2017	2018	2019	2020	2021
Percentage change	**Actual**		**Estimate**		**Forecast**	
Global demand[1]	4.1	4.2	4.5	4.3	4.4	4.3
International commodity prices[2]						
Brent crude oil (US$ per barrel)	44.2	54.8	72.7	73.7	70.5	67.7
Gold (US$ per ounce)	1 247.9	1 257.7	1 268.2	1 243.2	1 279.1	1 317.1
Platinum (US$ per ounce)	988.3	950.4	877.2	827.1	852.8	879.4
Coal (US$ per ton)	64.4	78.9	97.7	96.3	90.7	88.2
Iron ore (US$ per ton)	58.6	72.9	70.2	59.5	58.2	57.8
Food inflation	10.5	6.9	3.9	5.5	6.0	6.0
Electricity inflation	9.2	4.7	5.4	9.0	10.0	10.0
Sovereign risk premium (percentage point)	3.2	2.7	2.9	3.0	2.9	2.8
Real public corporation investment	-0.7	-1.3	-0.4	0.7	1.5	2.2

1. Combined growth index of South Africa's top 15 trading partners (IMF World Economic Outlook, October 2018)
2. Source: Bloomberg futures prices as at 7 September 2018
Source: National Treasury

Risks to the growth outlook

External risks to the growth outlook include rising trade tensions, as well as financial volatility and risk aversion, which could prompt capital flow reversals, currency depreciation and higher borrowing costs. Domestic risks include policy uncertainty in some areas, the financial position of some state-owned companies, inflation risk related to a depreciating exchange rate, and higher fuel and electricity prices. While the outlook for sovereign ratings remains stable, a downgrade of the rating of local-currency debt could lead to higher risk premiums and capital outflows.

Annexure A includes a summary of three alternative economic growth scenarios illustrating the resilience of the public finances if the growth outlook presented in the MTBPS does not materialise.

Sector performance and outlook

Mining

In the first eight months of 2018, mining production fell by 1.7 per cent. By contrast, production rose by 4.5 per cent over the first eight months in 2017. Lower gold production has contributed most to this decline, but copper and nickel production have also decreased.

Greater regulatory certainty in mining, oil and gas will help to strengthen investment

In recent years, policy uncertainty in the mining sector constrained investment and growth. The revised Mining Charter has been gazetted, and the Department of Mineral Resources has indicated that it will withdraw the Mineral and Petroleum Resources Development Act Amendment Bill, bringing much-needed regulatory certainty to the sector. The creation of separate oil and gas legislation will also improve the investment environment.

Agriculture

Over the first half of 2018, real value added in agriculture, forestry and fishing declined by 4.8 per cent compared with the same period in 2017. Maize production eased following record output in 2017 and drought continued to weigh down production in the Western Cape. The short-term outlook for the sector has improved. Higher rainfall in the Western Cape has led to expectations of increased winter crop production. The domestic maize market remains well-supplied and South Africa is not expected to import maize during the year ahead.

Work to strengthen the agricultural value chain can boost employment and exports

The agricultural value chain has high growth, employment and export potential. The combined export value of labour-intensive crops such as citrus, grapes and macadamia nuts increased by an annual average of 7.5 per cent over the period 2015 to 2017. The Department of Agriculture, Forestry and Fisheries and the Department of Rural Development and Land Reform will transfer R4.4 billion to the Land Bank over the MTEF period to support emerging farmers. The private sector is also developing financing models that use private- and public-sector money to help potential beneficiaries of redistribution access capital to acquire land.

Manufacturing

Manufacturing production grew by 1.1 per cent in the first eight months of 2018 compared with a decline of 1.2 per cent in the first eight months of 2017. This expansion was mainly supported by food and beverages, and motor vehicles. The sector remains under pressure from weak domestic demand, rising costs and exchange rate volatility.

Jobs Summit committed to procure locally made, competitively priced goods

Manufacturing capacity utilisation remains low, at 80.6 per cent in the first half of 2018, virtually unchanged from the same period a year earlier. The erosion of capital stock over the past decade is likely to constrain the long-term growth of the sector. Government and business have committed through the Jobs Summit to work together to support the procurement of locally manufactured, competitively priced goods.

Financial and business services

Real value added in the finance, insurance, real estate and business services sector rose by 2 per cent in the first half of 2018, compared with 1.8 per cent over the same period in 2017. Formal employment in the sector rose by 0.5 per cent, with most jobs contributed by real estate, and legal and accounting services.

Legislation to assist over-indebted households being considered in Parliament

Government has introduced legislation to promote new products and protect consumers of financial services. The National Credit Amendment Bill, which aims to assist over-indebted low-income households, is under consideration in the National Council of Provinces. The Insurance Act (2017), which came into effect in July 2018, introduces a legal framework for the micro-insurance industry and aims to promote formal insurance for low-income households. Cabinet approved the Financial Sector Laws Amendment Bill in September 2018 and has released it for public comment. The bill seeks to strengthen curatorship provisions for financial institutions to protect vulnerable depositors and reduce systemic risk.

Implementing growth-enhancing reforms

Reforms to change structure of economy could boost growth by three percentage points over next decade

A decade of poor economic performance and high unemployment has reinforced the urgent need for a comprehensive programme of reforms to change the underlying structure of the economy. Necessary structural reforms include modernising the energy, water, transport and telecommunications industries; lowering barriers to entry and addressing distorted patterns of ownership through increased competition and small business growth; enabling growth in labour-intensive sectors such as agriculture and tourism; promoting export competitiveness; harnessing regional growth opportunities; and reducing the cost of doing business.

National Treasury modelling suggests that such reforms can raise GDP growth by as much as three percentage points over the next decade. In recent months, progress has been made in these areas. For example:

- The Department of Telecommunications and Postal Services has gazetted a proposed policy for the licensing of high-demand spectrum. The communications regulator plans to auction spectrum for 4G services by April 2019, and simultaneously establish a wholesale open-access network to lower the cost of data.
- The departments of Energy and Public Enterprises, and the National Treasury, have begun work to determine how a restructured electricity sector can support long-term growth, a secure energy supply, a sustainable electricity utility and higher investment in electricity generation, transmission and distribution.
- The Economic Regulation of Transport Bill, now before Parliament, will contribute to competitive pricing and improved service quality in transport. Administered transport prices will be reviewed to reduce the cost of doing business. Reviews of administered prices in other sectors, such as energy, are under way.

Such reforms can boost long-term growth. In the short term, government is focusing its actions in three areas: Establishing policy certainty and restoring investor confidence; strengthening public institutions and state-owned companies; and creating partnerships for growth.

Establishing policy certainty and restoring investor confidence

Since the 2018 Budget was tabled in Parliament, government has acted to restore investor confidence by:

- Finalising the Mining Charter, and preparing to withdraw the Mineral and Petroleum Resources Development Act Amendment Bill. These steps, which followed consultation with business, labour and communities, reduce uncertainty that has held back mining investment.
- Ensuring that Eskom concluded 27 outstanding power-purchase agreements with independent power producers. This will bring benefits to the communities where those projects are located by creating an estimated 61 000 jobs and enabling investments of R56 billion.
- Re-establishing a sustainable approach to energy planning by updating the Integrated Resource Plan for consideration by Parliament.
- Revising the Public Procurement Bill, currently awaiting Cabinet approval for public consultation, which will replace existing regulations. The bill allows small firms and those operating in rural and township economies to participate more effectively in public procurement.
- Creating a panel to advise government on measures to effect fair and equitable land reform that will increase agricultural output and build self-sufficiency in food production.

To boost tourism, the Department of Home Affairs is amending regulations for the entry of minors into South Africa, reviewing the list of countries whose citizens require visas to enter South Africa and implementing an e-visa pilot platform. The department has also extended ten-year multiple-entry visas to several countries. To facilitate skilled immigration, the department is working on a critical skills list to enable foreign students to be granted permanent residence on graduation or be issued with visas.

Onerous visa regulations to be modified by Home Affairs to encourage tourism

Strengthening public institutions and state-owned companies

Government has initiated reforms to restore good governance and financial stability at public institutions and state-owned companies. They include measures to strengthen the boards and senior management teams of Eskom, Transnet, South African Airways and the Passenger Rail Agency of South Africa. Steps have also been taken to improve governance and renew public confidence in SARS. The Department of Trade and Industry will improve the capacity of the South African Bureau of Standards to certify local content and consider simplifying the verification process.

Reforms aim to restore good governance at Eskom, Transnet, SAA and SARS

Creating partnerships for growth

The October 2018 Jobs Summit strengthened the partnership between government, business, labour and communities. Highlights included:

- Improving the efficiency of government spending, for example by increasing placement ratios in the private sector for beneficiaries of public employment programmes, and receiving local procurement commitments from the private sector.

- Project-specific collaboration, as demonstrated by partnerships between commercial farmers, lenders and black farmers.
- Improving policy certainty through consultations that respond to affected groups, evidenced in both the extension of the employment tax incentive as well as changes in the training lay-off scheme.

Business-led youth employment initiative offers work experience, training and job placement services

The Youth Employment Service, a business-led initiative launched in March 2018, offers one-year work experience and training alongside job placement services. Government supports the initiative, which also benefits from the employment tax incentive and enhanced broad-based black economic empowerment recognition.

The National Minimum Wage Bill, which introduces a minimum wage of R20/hour, was approved by the National Council of Provinces in August 2018, and awaits ratification. Embedded in the Labour Relations Amendment Act, also awaiting ratification, are reforms aimed at reducing workplace conflict, and the duration and severity of industrial action. The Jobs Summit resulted in an agreement to extend the employment tax incentive, due to lapse in 2019, for 10 years. The incentive, which encourages the hiring of younger workers, supported about 690 000 jobs in the 2016 tax year.

Small Business and Innovation Fund and CEO Initiative's SME Fund support entrepreneurship

The Small Business and Innovation Fund will help entrepreneurs and small businesses to navigate the pre-start-up phase and provide support as they scale up their enterprises. This will complement the work of the CEO Initiative's SME Fund, which has raised R1.4 billion to date, with about R500 million expected to be committed for debt and equity investments in SMEs by the first quarter of 2019.

The financial sector has committed to invest R100 billion over five years in black industrial enterprises and firms. The Financial Sector Transformation Council is working with the Department of Trade and Industry to finalise guidelines for the disbursement of this funding.

The infrastructure fund announced as part of the President's economic stimulus and recovery plan is intended to encourage capital investment by the private sector and development finance institutions in public infrastructure. The fund will build on work under way in government to improve the planning and management of large infrastructure projects.

Strengthening the planning and rollout of public infrastructure projects

Many public infrastructure projects have been marred by weak project preparation, planning and execution caused by lack of technical expertise and institutional capacity. These institutional weaknesses often translate into lengthy delays, over- or underspending, and quality concerns. Government has established a project preparation facility, with funding set aside over the medium term. The facility will combine the efforts of the National Treasury, the Government Technical Advisory Centre, the Presidential Infrastructure Coordinating Commission, the Development Bank of Southern Africa, the Association for Savings and Investment South Africa, the Banking Association of South Africa, the South Africa Venture Capital and Private Equity Association, and the New Development Bank. It will deploy technical experts to sponsoring departments to support development of investment-ready projects.

Conclusion

To increase the economy's ability to grow sustainably at higher levels, South Africa requires a series of reforms that will raise productivity, increase competition and reduce the cost of doing business.