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Economic overview

In brief

- Economic growth is forecast to reach only 0.5 per cent in 2019, rising gradually to 1.7 per cent by 2022. This level of growth is far too low to support meaningful increases in employment and welfare.
- World economic growth is slowing – largely in response to mounting trade conflict – in both developed and developing economies. Global economic growth is the lowest it has been since the 2008 financial crisis.
- Inflation is expected to remain within the target band of 3 to 6 per cent over the medium term, while the current account deficit remains at 3.5 per cent. Investment is expected to recover gradually.
- Short- and medium-term reforms are urgently required to improve economic performance over the next several years. The discussion document released by the National Treasury in August 2019 put forward an approach to restore growth momentum.

Introduction

Growth falls far short of what is needed to create jobs and boost living standards

South Africa's economic growth continues to fall well short of what is needed to create jobs and raise living standards. The economy is now expected to grow by just 0.5 per cent in 2019, compared with 1.5 per cent forecast at the time of the 2019 Budget. Per capita gross domestic product (GDP) is expected to stagnate over the medium term.

Since 2013, as the global economy and most of our developing-country peers experienced a rebound in economic activity, South Africa's GDP growth trend has continued to decline. Failure to implement structural reforms and improve the composition and quality of spending meant that potential gains from persistent fiscal support were not realised. In turn, weak economic growth resulted in repeated revenue shortfalls, higher budget deficits and mounting government debt.

Some short-term economic reforms do not require significant state capacity or legislative changes

Government's overriding economic policy priority is to enact reforms that will enable South Africa to break from the spiral of anaemic growth and deteriorating public finances. At the same time, government is working to reverse the impact of state capture, rebuild the capacity of the public service and improve spending efficiency. These initiatives will take time to yield results. Government's economic reform agenda has been enhanced by debate around the discussion document titled *Economic Transformation, Inclusive Growth, and Competitiveness: Towards an*

Economic Strategy for South Africa, which the National Treasury released in August 2019. A series of short- and medium-term reforms are required to promote investment and job creation.

The growth puzzle: why so weak for so long?

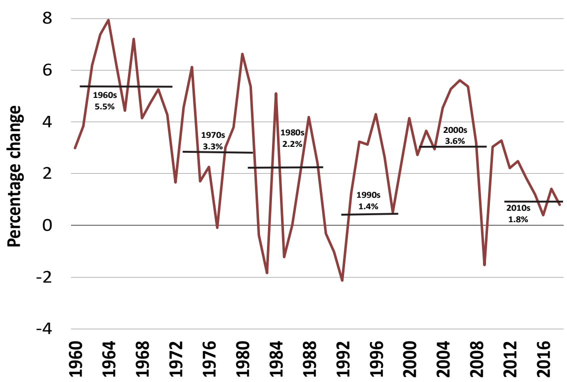
Poor growth performance results from structural challenges, economic shocks and uncertainty

South Africa faces a number of structural problems that are well understood and are identified in the National Development Plan. These include high levels of inequality, spatial disparities, low levels of education, the uneven quality of public services and inadequate state capacity. Although a wide range of policies aim to address these problems, progress has been limited.

Since 2013, global growth has risen steadily and global interest rates remained low. The exchange rate has depreciated – making South African exports cheaper – and bond yields have remained contained, signalling investor interest and confidence in South Africa. The Reserve Bank's anchoring of inflation expectations has helped to support competitiveness.

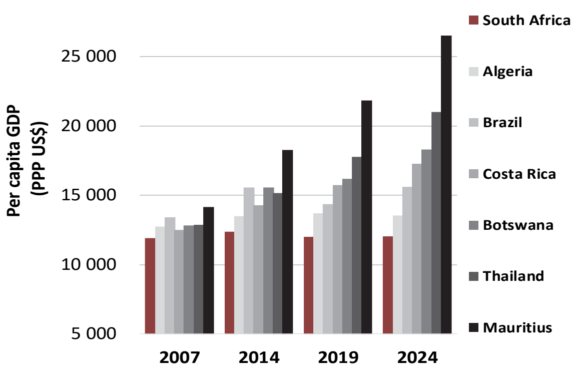
But economic growth has remained subdued. South Africa is experiencing its longest business cycle downturn since 1945. Business and consumer confidence remain near historical lows, and manufacturing capital stocks have fallen to decade lows. In this environment, there is little chance of the country's 9.4 million unemployed adults finding a job. As a result, per capita incomes continue to stagnate in comparison with our peers.

Figure 2.1 Long-term GDP growth



Source: National Treasury and Reserve Bank

Figure 2.2 Comparative per capita incomes*



**Countries selected on basis of similar 2007 GDP per capita incomes to South Africa*

Source: IMF World Economic Outlook, October 2019

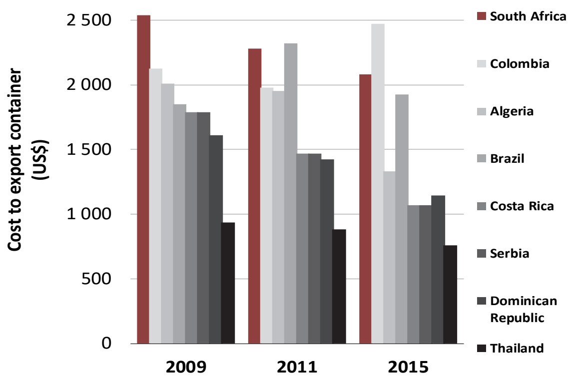
Policy and political uncertainty have weighed on confidence, compounded by drought and electricity supply shocks. Inefficient and ineffective investment spending by Eskom and other state-owned companies has weighed on productivity growth and confidence. Poor outcomes in education have left young workers vulnerable. Relative competitiveness has declined because South Africa has not moved as rapidly as its peers, for example in reducing exporting costs (Figure 2.3). As Figure 2.4 shows, citizens in more competitive countries enjoy higher per capita income.

The current slowdown is particularly concerning because it is associated with a sharp decline in expected long-term average economic growth, from nearly 4 per cent before the global financial crisis to between 1 and 1.5 per cent most recently.

Long-term average growth has declined from nearly 4 per cent to between 1 and 1.5 per cent

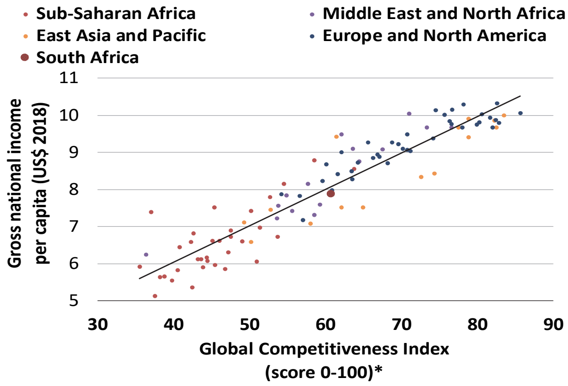
Reversing these trends requires urgent action. Short-term boosts to economic activity will not resolve the fundamental problems underlying weak long-run growth.

Figure 2.3 Container export costs*



**Countries selected on basis of similar 2007 GDP per capita incomes to South Africa*
Source: World Bank Ease of Doing Business

Figure 2.4 Competitiveness and income



**A score of 100 is most competitive*
Source: Global Competitiveness Report, 2018

Raising expected long-run growth requires an increase in state capacity and economic competitiveness. Government has two main levers to raise competitiveness:

- Macroeconomic policy supports higher long-term growth by ensuring low inflation and clarifying long-term fiscal choices, which serve to reduce the cost of borrowing and support investment. Sustainable fiscal policy is intended to address risk perceptions, lower borrowing costs and create room to respond to unforeseen shocks. Monetary policy has focused on ensuring low inflation and reducing long-term inflation expectations. The flexible exchange rate has been an important shock absorber for volatility.
- Microeconomic policy supports higher long-term growth by ensuring a well-regulated, efficient business environment that encourages innovation and the creation of new businesses. Such reforms have been highlighted repeatedly in the medium-term strategic framework and forums such as the Jobs Summit, but remain mostly unrealised.

Economic reforms to implement without delay

Government has made progress on the measures that the President announced in September 2018. To support tourism, the Minister of Home Affairs has withdrawn the requirement for unabridged birth certificates for foreign minors. The electronic visa platform will be piloted in November 2019 and four more countries have been granted visa waivers, bringing the total to 82 of 193 United Nations members. Cabinet has approved a revised Integrated Resources Plan for energy, which provides certainty around government's preferred energy mix. In addition, the final telecommunications policy directive for spectrum licensing was released in July 2019, providing a framework to enable the regulator to issue licences.

Treasury's economic reform proposals aim to boost competitiveness and job creation

While encouraging, further progress is required. The discussion document titled *Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa*, released in August 2019 by the National Treasury, presents an approach to boost potential growth. It focuses on areas which address our largest microeconomic binding constraints:

- Network industries, such as road, rail and telecommunications, need to be modernised and reformed so that lower costs and increased efficiency can improve business competitiveness.
- Export-focused reforms are needed to boost exports, employment and innovation, and enhance regional growth. Focused and flexible industrial and trade policy can support such reforms, alongside promoting labour-intensive sectors such as tourism and agriculture.
- Raising competition in the economy will make it easier for businesses – particularly small firms – to compete against large, dominant players.

Ideally, these structural reforms would have been implemented during a period of strong cyclical growth, and with ample fiscal space. The country, however, cannot wait any longer. It typically takes between two and four years for reforms to bolster growth.

The following reforms should be implemented without delay. They do not require significant state capacity, and should boost economic growth over the next two years:

- Tourism: Accelerate progress on the Yamoussoukro open skies agreement to reduce the cost of flying to South Africa, and support tourism by cutting red tape and the regulatory burden for entrepreneurs and small businesses.
- Electricity: Finalise the granting of licences for small-scale power generation projects approved by the Minister of Energy. The fifth round of the Independent Power Producer (IPP) programme for renewable energy should begin, with estimated revenue gains of between R40 billion and R50 billion two to four years after the bid window is opened.
- Telecommunications: Issue guidelines and enforce open-access conditions to support the rapid expansion of fibre infrastructure.
- Costs of doing business: Develop a single platform to register a business and automate the deeds registry.

Medium-term reforms may be completed in next three years if begun immediately

Other reforms also need to begin immediately, although they will likely only be completed over the medium term. These include reforms in modernising ports and rail; in water, rehabilitating municipal infrastructure linked to industrial activity; and in telecommunications, releasing spectrum to facilitate a licensing process over the next two years.

Industrial policy should actively promote an export orientation, broadening the focus from state-led demand programmes such as local procurement. In trade policy, government should establish, alongside the private sector, an automated licensing system for export documentation and improved border control procedures to meet global standards. Enhanced reciprocity can strengthen African market access and counter the impact of intensified overseas competition in manufactured goods markets.

Global outlook

Marked slowdown in global growth has tangible consequences for South Africa

Economic growth has weakened in both developed and developing countries. The International Monetary Fund (IMF) estimates that trade tensions will reduce growth by 0.8 percentage points in 2020, offset by supportive monetary policy. Expected growth in the euro area, which accounts for 23 per cent of all South African exports, has been revised down since January by 0.4 and 0.3 percentage points in 2019 and 2020 respectively, as uncertainty about the direction of Italy's finances and lower external demand in Germany reduced growth more than previously forecast. China's trend growth continues to slow, with important implications for resource exporters such as South Africa.

Table 2.1 Economic growth in selected countries

Region/country	2018	2019	2020	2021	2022-2024
Percentage	Actual	Average GDP (forecast)			
World	**3.6**	**3.0**	**3.4**	**3.6**	**3.6**
Advanced economies	**2.3**	**1.7**	**1.7**	**1.6**	**1.6**
United States	2.9	2.4	2.1	1.7	1.6
Euro area	1.9	1.2	1.4	1.4	1.3
United Kingdom	1.4	1.2	1.4	1.5	1.5
Japan	0.8	0.9	0.5	0.5	0.5
Developing countries	**4.5**	**3.9**	**4.6**	**4.8**	**4.8**
China	6.6	6.1	5.8	5.9	5.6
India	6.8	6.1	7.0	7.4	7.4
Brazil	1.1	0.9	2.0	2.4	2.4
Russia	2.3	1.1	1.9	2.0	1.9
Mexico	2.0	0.4	1.3	1.9	2.3
Sub-Saharan Africa	**3.2**	**3.2**	**3.6**	**3.7**	**4.1**
South Africa[1]	0.8	0.5	1.2	1.6	1.7

1. National Treasury forecasts. Note: Final numbers are for 2022
Source: IMF World Economic Outlook, October 2019, and IMF World Economic Outlook database

In response to the deteriorating growth outlook, central banks have either begun to reduce interest rates from already low levels, or to communicate they are less likely to raise rates. In Europe and Japan, long-term bonds are trading at negative interest rates.

"Hunt for yield" has contained borrowing costs, but South Africa's risk premium has risen

The extremely low interest-rate environment in developed economies has supported a "hunt for yield" that has supported investment in developing-country government bonds and contained their borrowing costs. South Africa has benefited from this interest rate differential, although our performance compares unfavourably to peer countries. Compared to average 2018 levels, South Africa's risk premium – the additional amount that investors demand to compensate for perceived risk in the economy – has risen by about 0.3 percentage points, compared to an average decline of 0.3 percentage points in peer countries.

Rand is 3.2 per cent lower against US dollar in 2019

Currency movements have been relatively subdued. Developing-country currencies have strengthened by 0.4 per cent since the start of the year.

The rand is 3.2 per cent lower compared to the US dollar, as domestic risks have weighed on investor sentiment.

Weak global growth has favoured precious metals prices as investors seek a safe haven, with strong purchases supporting gold and, to a lesser extent, platinum. Palladium prices have risen. Coal prices have fallen 33.8 per cent since January, while oil prices have risen 7 per cent.

Figure 2.5 Developing-economy risk premiums

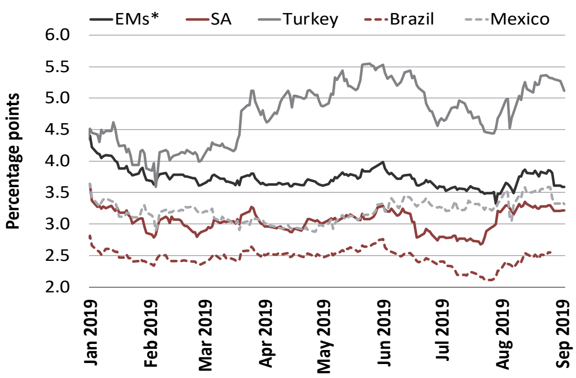
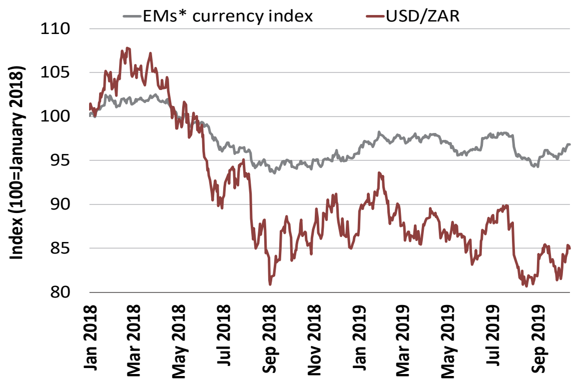


Figure 2.6 Currency movements in peer economies



*Emerging markets
Source: Bloomberg

Domestic outlook

South Africa's growth outlook has declined significantly since the 2019 Budget was tabled in Parliament. Growth in the first half of the year was flat, as the rebound in the second quarter offset the contractionary effects of power outages and prolonged strike action in the first quarter.

Treasury forecasts growth of 0.5 per cent in 2019, rising to 1.7 per cent in 2022

The National Treasury forecasts that growth will now be 0.5 per cent in 2019 and only 1.2 per cent in 2020. Given the fiscal deficit, borrowing costs are expected to remain elevated. Government projects a very gradual recovery in confidence. Replacement investment in key sectors will support modest employment, wage and investment gains over the medium term. The current account deficit is expected to remain at 3.5 per cent of GDP over the next three years, given low investment and import growth.

Table 2.2 Macroeconomic performance and projections

Calendar year	2017	2018	2019	2020	2021	2022
Percentage change	**Actual**		**Estimate**		**Forecast**	
Final household consumption	2.1	1.8	1.3	1.3	1.5	1.7
Final government consumption	0.2	1.9	1.8	1.8	1.1	0.6
Gross fixed-capital formation	1.0	-1.4	-0.8	0.8	1.3	1.8
Gross domestic expenditure	1.9	1.0	1.4	1.1	1.5	1.7
Exports	-0.7	2.6	-1.7	2.5	2.8	3.1
Imports	1.0	3.3	1.1	1.9	2.6	3.0
Real GDP growth	**1.4**	**0.8**	**0.5**	**1.2**	**1.6**	**1.7**
GDP inflation	5.3	3.9	4.8	4.9	4.9	4.8
GDP at current prices (R billion)	**4 654**	**4 874**	**5 132**	**5 449**	**5 804**	**6 187**
CPI inflation	5.3	4.7	4.3	4.9	4.8	4.8
Current account balance (% of GDP)	-2.5	-3.5	-3.4	-3.5	-3.5	-3.5

Source: National Treasury, Reserve Bank and Statistics South Africa

Alternative scenarios

The National Treasury has modelled two alternative scenarios to the baseline economic forecast.

In Scenario A, if government proves unable to undertake sustainable reforms to the operations of state-owned companies, the resultant sharp rise in borrowing costs would reduce private investment, dampen confidence and employment, and lower household consumption. This in turn would result in a widening budget deficit and mounting debt. Growth would eventually recover to 1.4 per cent in 2022 as the economy adjusts to higher costs, but there would be a substantial loss of welfare and GDP per capita would decline.

Scenario B envisions successful implementation of a meaningful set of structural policy reforms. This would boost confidence, and lower the costs of living and doing business. In turn, this would generate incentives for business to invest and hire workers. Growth would rise to 2.4 per cent in 2022. A well-structured fiscal consolidation strategy could raise long-term growth further. As is the case internationally, the full benefits of growth-enhancing reforms would emerge over five to seven years, moving South Africa to a new trend growth level.

Macroeconomic assumptions

The forecast incorporates assumptions outlined in Table 2.3. The main changes since the 2019 Budget include upward revisions to the sovereign risk premium and iron ore, gold and platinum prices. Downward revisions were made to global growth, coal, oil and metals prices and real investment by public corporations.

Table 2.3 Assumptions used in the economic forecast

	2017	2018	2019	2020	2021	2022
Percentage change	**Actual**		**Estimate**		**Forecast**	
Global demand[1]	4.8	4.4	3.6	4.0	4.2	4.0
International commodity prices[2]						
Brent crude oil (US$ per barrel)	54.8	71.0	63.8	57.8	56.2	56.1
Gold (US$ per ounce)	1 257.7	1 269.3	1 397.8	1 523.9	1 545.5	1 564.8
Platinum (US$ per ounce)	950.4	880.7	861.7	919.2	939.5	960.2
Coal (US$ per ton)	77.3	93.1	71.4	69.8	73.1	75.8
Iron ore (US$ per ton)	70.6	66.4	90.7	74.2	68.6	66.3
Food inflation	6.9	3.6	3.5	5.3	4.7	5.0
Electricity inflation	4.7	5.2	9.8	10.3	7.5	7.0
Sovereign risk premium (percentage point)	2.7	3.1	3.2	3.3	3.2	3.1
Real public corporation investment	-11.7	-12.5	-1.7	0.5	1.6	2.0

1. Combined growth index of South Africa's top 15 trading partners (IMF World Economic Outlook, October 2019)
2. Source: Bloomberg futures prices as at 2 October 2019
Source: National Treasury

Risks to the growth outlook

Risks to the growth outlook remain skewed to the downside. Domestically, a prolonged under-recovery in investment and disruptions to electricity supply, as well as renewed labour unrest, could threaten activity. Operational underperformance and resultant bailout risks in state-owned companies, as well as concerns about an unsustainable fiscal trajectory, could further weaken the currency and raise the cost of borrowing.

Global risks include a larger than currently projected slowdown in growth due to intensified US-China trade tensions, prolonged Brexit uncertainty and a disorderly unwinding of monetary policy in advanced economies.

Household consumption

Consumption expenditure grew by 1 per cent in the first half of 2019 compared with the corresponding period of 2018. Although household spending remains the main support for growth, spending on non-essential items has fallen dramatically due to rising unemployment, successive fuel price hikes and tax increases. Retailers are responding by keeping prices low and margins tight.

Mild pickup in consumption expected

A mild acceleration in consumption is forecast over the medium term as employment and income growth are expected to recover only gradually.

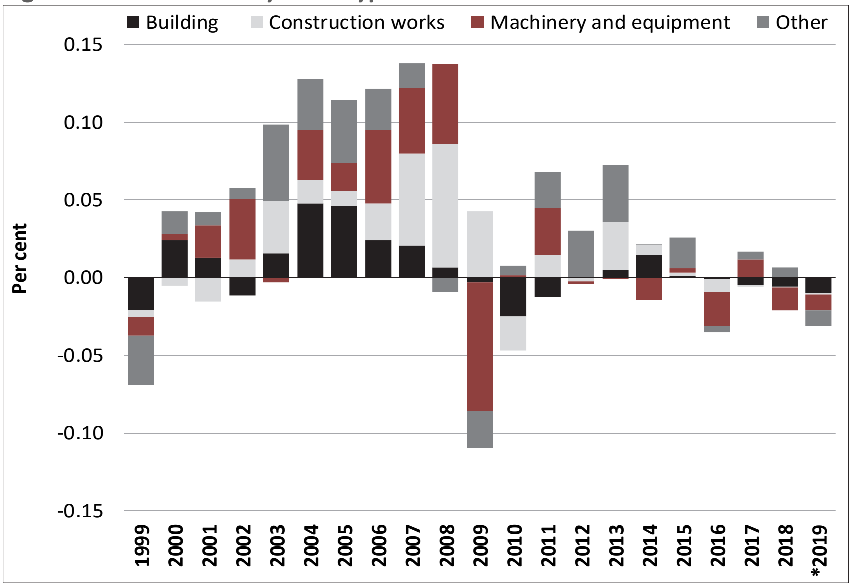
Investment

Investment contracted by 1.6 per cent in the first half of 2019, offset by a 15.2 per cent recovery in private-sector investment in the second quarter, partly linked to the fourth bid window of the IPP programme. Spending by government and state-owned companies continued to contract in the first half of 2019. Investment by state-owned companies has been constrained by lack of access to markets for borrowing, as well as processes to contain illegal and wasteful expenditure.

Gradual improvement in business confidence will support higher levels of investment

Low confidence and growth have weighed heavily on private investment activity. The forecast assumes a gradual improvement in confidence as well as the need to rebuild eroded capital stock. Investment from IPPs is likely to support private investment, particularly in the two outer years of the medium-term expenditure framework period. Commitments from the Investment Summit continue to be implemented.

Figure 2.7 Investment by asset type



**2019 figures reflect the first six months of the year*
Source: Reserve Bank and National Treasury calculations

Employment

The labour market remains extremely weak. The number of people employed has risen by 25 000 compared to a year ago. Although informal employment is 219 000 higher than a year ago, the trend towards informality in the context of low growth is of concern.

Official unemployment rate has increased to 29 per cent, up from 27 per cent a year ago

Weak job growth and an expanding labour force have seen the official unemployment rate increase from 27.2 per cent in June 2018 to 29 per cent in June 2019. The proportion of people unemployed for more than a year has risen to 71.5 per cent in the second quarter, up from 60.8 per cent in the second quarter of 2009.

Average annual wage growth per worker in the private sector was 2.1 per cent in the first half of 2019, compared to 10.4 per cent in the public sector.

Inflation

Inflation pressures have been subdued in 2019, with inflation averaging 4.3 per cent from January to August, mainly due to weak demand.

Within its flexible inflation-targeting mandate, the Reserve Bank is focused on anchoring inflation expectations at the midpoint of the 3 to 6 per cent target band. The repurchase (repo) rate stands at 6.5 per cent, after a 0.25 percentage point cut in July to support growth. Reserve Bank modelling suggests a further 0.25 percentage point cut in rates before the end of 2019. The Reserve Bank has expressed concerns about risks of global financial market disruptions, as well as the effect that a loss of confidence could have on the rand and inflation.

Reserve Bank is anchoring inflation expectations at midpoint of 3 to 6 per cent target band

Inflation is forecast to increase gradually as a result of electricity tariff hikes, and higher meat and grain prices. Administered price inflation remains high, with electricity and water producer price inflation reaching 14.6 per cent in July 2019.

The relationship between the repo rate and other interest rates

Concerns about the cost of borrowing have led to a focus on the repo rate, which is set by the Reserve Bank. The repo rate is the “policy rate” that affects how interest rates are set across the economy. However, borrowing costs are influenced by a range of factors, including the creditworthiness of the borrower, inflation expectations, and the willingness of savers to place deposits in bank accounts or in the money market.

As a result, the actual rates paid by consumers vary. Mortgages and vehicle loans tend to move alongside changes in the repo rate; unsecured loans by contrast tend to be linked to the policy rate only at the time of the loan being extended, thereafter the interest rate is fixed. If the repo rate moves down but the risks of lending have risen, for example with higher inflation or higher risk of default, lending rates will not decline.

Government provides concessionary finance to improve access to finance through development finance institutions such as the Land Bank, the Development Bank of Southern Africa and the Small Enterprise Finance Agency.

Sector performance and outlook

Mining

Despite second-quarter growth of 14.4 per cent, mining output in the first half of the year was still 3.3 per cent lower than in the first half of 2018. Production is expected to decline again in 2019, despite higher precious metals prices, as weak global demand and strikes weigh on production. The medium-term production outlook is constrained by lingering domestic regulatory uncertainty and slowing global economic growth, particularly in China, which is a large commodity importer.

Lingering regulatory uncertainty and slower global growth constrain outlook for mining

Agriculture

Real agricultural output was 9.2 per cent lower in the first half of 2019 than in the corresponding period of 2018. Late plantings and patchy rainfall are expected to negatively affect grains, while herds recover following the outbreak of foot-and-mouth disease. Agricultural production is expected to receive a short-term boost from higher global prices in 2020, but the

Growth in citrus and high-value produce expected to remain strong need to rebuild herds is likely to constrain total output over the medium term. Growth in citrus and other high-value produce such as macadamia nuts and avocados is forecast to remain strong over the period.

Manufacturing

Despite uptick in manufacturing output in first half, competitiveness concerns weigh on outlook

Real manufacturing output in the first half of 2019 was 0.5 per cent higher than in the corresponding period of 2018. However, monthly production contracted in May and June 2019, and the seasonally adjusted Absa Purchasing Managers' Index declined to 45.7 index points in August 2019. All sub-indices in the index are below the neutral 50 mark, including business conditions expected in six months. Weaker growth in Sub-Saharan Africa and Europe, together with rising competition and limited improvements in domestic competitiveness, are expected to weigh on demand over the medium term.

Electricity

Electricity sector output rose 3.2 per cent in the second quarter, suggesting some recovery, but is 0.9 per cent lower than a year ago. The energy availability factor from coal-fired power stations has continued to decline from 70.2 in September 2018 to 67.3 in September 2019.

27 IPP projects under construction expected to add nearly 2.4 gigawatts to national grid

Looking ahead, continued maintenance problems, cost overruns and delays at Eskom pose risks to the outlook for electricity generation. Other sources of generation continue to grow: of the 91 active renewable energy IPP projects, 64 were in operation as at March 2019, adding 3 976 megawatts of power to the national grid. Once completed, the 27 IPP projects that are currently under construction are expected to add nearly 2.4 gigawatts to the grid.

Financial and business services

The financial and business services sector grew by 2.7 per cent in the first half of 2019, a major contributor to faster growth. The sector has been buoyed by banking activity and a rebound in equity market activity in the second quarter, which offset first-quarter declines.

Conclusion

Promoting faster, job-creating growth remains government's central economic policy priority

The growth outlook is weak. Promoting faster, job-creating growth remains government's central economic policy priority. A series of short- and medium-term interventions, if enacted now with speed and determination, can promote higher growth outcomes over the next several years.