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Economic outlook

In brief

- South Africa's economy continues to grow in a weak global economic environment. Real GDP growth is projected at 2.5 per cent in 2012 and 3.0 per cent in 2013, rising to 4.1 per cent in 2015. Global growth is expected to reach 3.6 per cent, and sub-Saharan Africa 5.7 per cent, in 2013.
- Over the medium term, sustained public-sector infrastructure investment, the activation of new electricity-generating capacity, low inflation and interest rates, and continued growth in the region will contribute to an improved economic performance.
- Although rising food and petrol prices, in combination with a weaker rand, will put upward pressure on prices, consumer price inflation should remain within the targeted band over the next three years.
- The current account deficit is expected to widen to 5.9 per cent of GDP in 2012 as the trade balance deteriorates, narrowing to 5.5 per cent in the outer year of the forecast.
- Domestic structural constraints and imbalances are the main obstacles to faster growth. Implementation of the National Development Plan will begin to address these challenges.

Introduction

The global economy is undergoing a difficult adjustment to the extended period of weaker growth and increased volatility ushered in by the financial crisis that began in 2008. A lengthy period of deleveraging in advanced economies is expected to act as a brake on growth, circumscribing trade and investment. These trends have resulted in a slowdown in developing economies – including China, India and Brazil.

The global economy is adjusting to a prolonged period of weaker growth and higher volatility

In this challenging environment, South Africa's economy has displayed resilience and has continued to expand at a moderate pace. The National Treasury projects real GDP growth of 2.5 per cent in 2012 – slightly lower than the 2.7 per cent forecast in the 2012 Budget. Economic growth is expected to remain muted in 2013 at 3.0 per cent, picking up to 3.8 per cent in 2014 and 4.1 per cent in 2015. Far more rapid growth is needed to draw large numbers of unemployed South Africans into economic activity.

Main obstacles to faster, more inclusive growth are largely rooted in domestic economy

Each country has its own history and economic challenges. As recent events have underlined, the primary obstacles to South Africa achieving faster, more inclusive growth and reducing inequality are rooted in the domestic economy. Strike activity in mining and other sectors, the balance between electricity supply and demand, weak business confidence and a widening current account deficit reflect a series of binding constraints and unsustainable imbalances that hold back investment and job creation.

South Africa has a sound foundation from which to address these challenges. Macroeconomic policy settings and institutions will continue to promote stability, certainty and confidence. Prudent fiscal policy will continue to promote countercyclicality, debt sustainability and intergenerational equity. Flexible monetary policy will balance low and stable inflation with support for growth and financial stability. Macroeconomic policy remains supportive of economic activity, but on its own cannot generate the growth or jobs required to make inroads into high levels of poverty and inequality. Complementary reforms that address structural impediments are vital to raise employment levels and broaden participation, lift competitiveness and promote social cohesion.

National Development Plan outlines an approach to eliminate poverty and reduce inequality

The National Development Plan, endorsed earlier this year by Cabinet, outlines an approach to eliminate poverty and reduce inequality by raising levels of employment, productivity and earnings. The key levers it identifies are creating jobs through faster growth, improving the quality of education, skills development and innovation, and building the capability of the state to implement policy and deliver services effectively.

The global economy

The global economic outlook has weakened, with a broad-based slowdown in both advanced and emerging economies. The International Monetary Fund (IMF) projects global growth of 3.3 per cent in 2012, down from 3.8 per cent in 2011, with a modest pick-up in 2013.

Table 2.1 Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2012 – 2014

Region / country	2012	2013	2014	2012	2013	2014
Percentage	GDP projections[1]			CPI projections[1]		
World	**3.3**	**3.6**	**4.1**	**4.0**	**3.7**	**3.6**
Advanced economies	**1.3**	**1.5**	**2.3**	**1.9**	**1.6**	**1.8**
US	2.2	2.1	2.9	2.0	1.8	1.8
Euro area	-0.4	0.2	1.2	2.3	1.6	1.4
UK	-0.4	1.1	2.2	2.7	1.9	1.7
Japan	2.2	1.2	1.1	0.0	-0.2	2.1
Emerging markets and developing countries	**5.3**	**5.6**	**5.9**	**6.1**	**5.8**	**5.3**
Brazil	1.5	4.0	4.2	5.2	4.9	4.8
Russia	3.7	3.8	3.9	5.1	6.6	6.5
India	4.9	6.0	6.4	10.3	9.6	8.3
China	7.8	8.2	8.5	3.0	3.0	3.0
Sub-Saharan Africa	**5.0**	**5.7**	**5.5**	**9.1**	**7.1**	**6.1**
South Africa[2]	2.5	3.0	3.8	5.7	5.5	5.1

1. IMF World Economic Outlook, October 2012
2. National Treasury forecasts

The IMF describes the chance of a steeper slowdown as "alarmingly high" given uncertainty about growth prospects in Europe and the United States. Economic growth in developed countries is expected to remain anaemic (1.3 per cent in 2012 and 1.5 per cent in 2013) compared with relatively stronger growth in developing countries (5.3 per cent and 5.6 per cent).

Developing countries are expected to achieve strong growth in comparison with developed countries

Weak near-term prospects for advanced economies

High bond yields, banking-sector distress and severe pressure on sovereign balance sheets have depressed growth in the euro area. This decline has been most severe in Greece, Portugal and Italy, while Spain remains at the centre of the crisis. There are also signs of faltering growth in Germany, Europe's largest economy. Economic growth in the euro area is projected at just 0.2 per cent in 2013. The effect of current policy measures to relieve the crisis, including intervention by the European Central Bank, is uncertain, as are initiatives to promote a fiscal and banking union.

Eurozone sovereign debt and banking crises remain major risks to global economic outlook

US economic growth remains weak, with consumption subdued in the face of a fragile labour market. The US Federal Reserve recently announced its third round of "quantitative easing", which aims to stimulate economic activity through the purchase of mortgage-backed securities from commercial banks. Interest rates will remain near zero until 2015. In coming months, the world's largest economy could face a new hurdle if it fails to avert a "fiscal cliff" – automatic spending cuts and tax increases due to come into effect from January 2013.

'A dramatic tightening of the deficit by about 4 per cent of GDP next year … would effectively plunge the [US] off a "fiscal cliff"'.
— Christine Lagarde, Managing Director, IMF

Unconventional measures employed by central banks in Europe, the US and Japan that aim to stimulate growth have provided some relief and contributed to market buoyancy. These measures, however, have not been able to offset the growth-reducing impact of front-loaded fiscal consolidation and austerity, alongside private-sector deleveraging.

Slowdown in emerging markets, but good prospects for Africa

Over the past year, economic growth has weakened in emerging markets. China, India and Brazil have experienced a slowdown in production and exports.

Policy responses to support growth in Brazil, India and China

In response to stalling growth, **Brazil** has cut its main interest rate by 5.25 percentage points to 7.25 per cent since August 2011 and eased controls on capital inflows. Large-scale infrastructure investment plans include significant private-sector concessions on federal roads and railways, while extended tax breaks and reduced electricity prices in 2013 should provide a boost for businesses and consumers.

China's leaders have reduced the government's growth target from 8 per cent to 7.5 per cent. Current policy measures aim to stabilise growth. Aggressive stimulus policies adopted early during the financial crisis generated large imbalances and excess capacity in the economy. The authorities are wary of similar outcomes arising from a response to the current slowdown.

In **India,** policy space is constrained by high inflation, and large fiscal and current account deficits. Authorities have announced several structural reforms, including a rise in fuel prices to reduce fiscal strains, small-scale privatisation and easing restrictions on foreign ownership in aviation, broadcasting, energy and retail.

Gold price has increased by 13 per cent since the start of the year to US$1 770/oz

Global commodity prices have softened over the past year in line with reduced demand from China and India. High levels of global liquidity, however, reinforced by aggressive actions by major central banks, have supported “safe-haven” assets such as gold. The gold price has increased by 13 per cent since the start of the year, reaching US$1 770/oz in mid-October. The oil price remains volatile and a risk to the recovery, while global food prices have risen significantly in response to supply shocks.

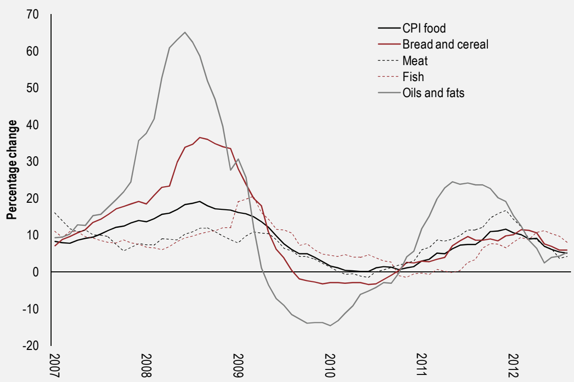
Sub-Saharan Africa will continue to benefit from marked increase in global investment

Sub-Saharan Africa has continued to grow, but exports will be affected by slower growth in China and lower commodity prices. Political stability, improved economic management and a sustained period of relatively high commodity prices have contributed to a marked rise in global investment into Africa. Growth in the region is projected to average 5.0 per cent in 2012 and 5.7 per cent in 2013; growth in Mozambique, Ghana and Zambia is expected to average above 7.5 per cent over the next five years.

Impact of global food price surge

World agricultural commodity prices have surged since July this year, following drought conditions in the US and Russia. Domestic prices of corn, wheat and soybean spiked in August and are currently 69 per cent, 10 per cent and 17 per cent higher than their levels in May.

Food inflation by category, 2007 – 2012



Source: Statistics South Africa

Global food prices are expected to push domestic inflation higher over the next six to 12 months, but not as dramatically as during the 2008 food price crisis. Food price inflation is expected to average about 9 per cent in 2013, up from 5.1 per cent in August 2012.

The poorest 20 per cent of households spend about 40 per cent of their income on food. Existing government measures, such as the school nutrition programme, help protect vulnerable households.

Over the long term, an adequate and affordable food supply depends on increasing productivity in agriculture and creating a favourable environment for investment to increase production. Ensuring competition in the food supply chain is important to reduce mark-ups and limit price shocks to consumers.

Domestic economic trends and outlook

Widespread strikes in the mining sector have had a significant effect on the economy in 2012. The events at Lonmin’s Marikana mine and the spread of industrial action since August have dented confidence and lowered growth prospects for the remainder of the year.

Capital investment, new power plants, low inflation and regional exports will boost GDP growth

GDP growth is expected to improve over the medium term. Real GDP growth is forecast to average 2.5 per cent in 2012 and 3 per cent in 2013, rising to 4.1 per cent in 2015. Factors expected to contribute to an improved performance include expanded infrastructure investment, the activation of new electricity-generating capacity, relatively low inflation and interest rates, and strong regional growth. A substantial accumulation of cash in the corporate sector can fund additional investment as business confidence improves. Government is actively working to find effective ways to partner with the private sector to promote investment.

Medium-term macroeconomic projections are set out below.

Table 2.2 Macroeconomic performance and projections, 2009 – 2015

Calendar year	2009	2010 Actual	2011	2012 Estimate	2013	2014 Forecast	2015
Percentage change unless otherwise indicated							
Final household consumption	-1.6	3.7	5.0	3.4	3.5	4.0	4.2
Final government consumption	4.7	4.9	4.5	3.7	3.5	3.5	3.2
Gross fixed-capital formation	-3.2	-1.6	4.4	5.2	4.5	5.1	5.8
Gross domestic expenditure	-1.6	4.2	4.3	4.1	3.8	4.4	4.7
Exports	-19.5	4.5	5.9	0.5	3.5	5.8	6.5
Imports	-17.4	9.6	9.7	6.3	6.4	7.4	7.6
Real GDP growth	**-1.5**	**2.9**	**3.1**	**2.5**	**3.0**	**3.8**	**4.1**
GDP inflation	7.7	7.9	8.0	5.4	6.5	6.1	5.8
GDP at current prices (R billion)	**2 398.2**	**2 661.4**	**2 964.3**	**3 202.5**	**3 513.5**	**3 868.9**	**4 263.9**
Headline CPI inflation	7.1	4.3	5.0	5.7	5.5	5.1	4.9
Current account balance (% of GDP)	-4.0	-2.8	-3.3	-5.9	-5.8	-5.5	-5.5

Source: Reserve Bank and National Treasury

Table 2.3 Macroeconomic projections, 2011/12 – 2015/16

Fiscal year	2011/12 Actual	2012/13 Estimate	2013/14	2014/15 Forecast	2015/16
Percentage change unless otherwise indicated					
Real GDP growth	2.8	2.7	3.2	3.9	4.2
GDP inflation	6.7	5.5	6.4	6.2	5.8
Headline CPI inflation	5.6	5.7	5.3	5.1	4.9
GDP at current prices (R billion)	**3 017.9**	**3 269.9**	**3 590.5**	**3 961.8**	**4 367.7**

Source: National Treasury

Impact of strikes in mining sector

The National Treasury estimates that the total value of production lost to platinum and gold mining strikes and stoppages since the opening of the year has amounted to about R10.1 billion. Declining mining output and the spread of strike activity have depressed activity in related industries including manufacturing, logistics and services, with negative consequences for GDP, tax revenues, exports and employment. The impact will be larger if strike activity is protracted.

Lost production in platinum and gold mining has amounted to about R10.1 billion

Real value added in mining contracted by 6.3 per cent in the first half of 2012 compared with the same period last year, following a sharp decline in platinum group metals output. The platinum price had declined by 14.2 per cent to US$1 427/oz between February and July, but rebounded above US$1 650/oz in September as supply was limited by strikes.

In the year to August, mining output fell by 3.3 per cent, with production of platinum group metals 15.3 per cent lower. Continued strong growth in iron ore, spurred by Chinese demand, has offset some of the decline in platinum, gold and coal.

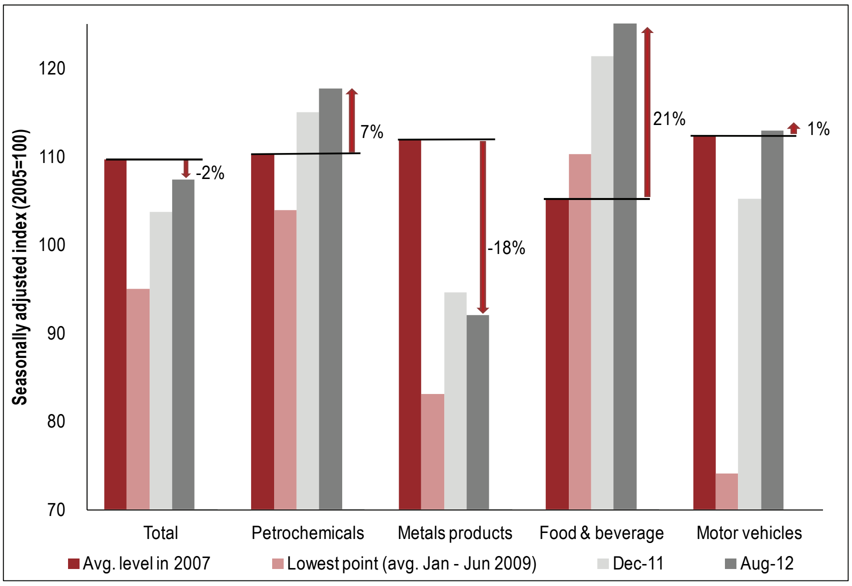
As Figure 2.1 shows, output growth in petrochemicals, food and beverages, and motor vehicles contrasts sharply with the metals subsector, where output has fallen sharply and remains significantly below pre-

Manufacturing performance varies widely, with strong performances in food and petrochemicals recession levels. The purchasing managers' index suggests that manufacturing output will remain muted in 2012.

Greater export potential into SADC countries can boost manufacturing exports

The relatively weaker currency, greater export potential into other Southern African Development Community (SADC) countries, and government support through incentives and local procurement targets should help lift production over time.

Figure 2.1 Manufacturing performance by subsector, 2007-2012



Source: Statistics South Africa

Domestic expenditure

Real gross domestic expenditure grew at an annualised rate of 4.6 per cent in the first half of 2012 compared with 4.0 per cent in the second half of 2011, supported by stronger public-sector gross fixed capital formation. Over the next three years, growth in real gross domestic expenditure is forecast to average 4.3 per cent.

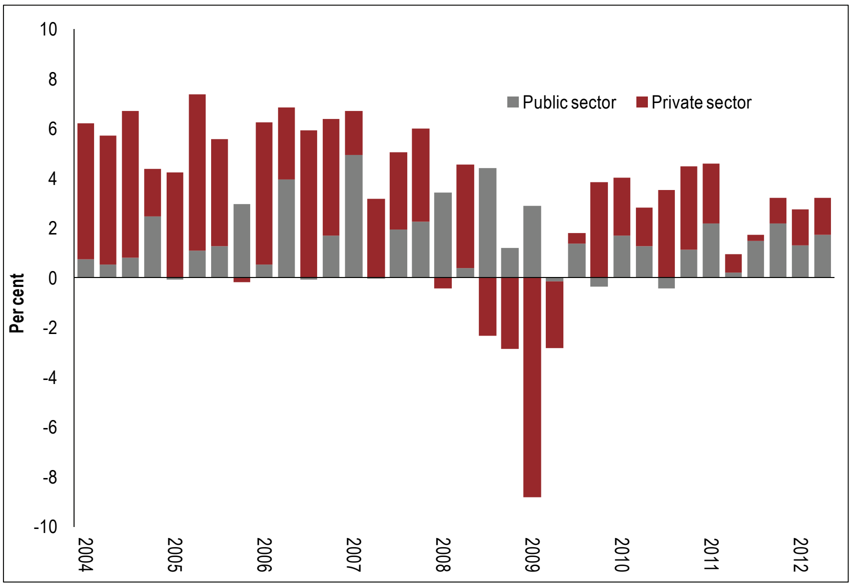
Table 2.4 Contribution to gross domestic expenditure growth, 2008 – 2012

Percentage points	2008	2009	2010	2011	2012[1]
Household consumption expenditure	1.4	-1.0	2.3	3.0	2.3
Government consumption expenditure	0.8	0.9	1.0	0.9	0.8
Gross fixed-capital formation	2.5	-0.7	-0.3	0.8	1.1
Change in inventories	-1.6	-1.0	1.4	0.3	0.1
Total (per cent)[2]	**3.5**	**-1.6**	**4.2**	**4.3**	**4.3**

1. First half of 2012 compared with first half of 2011
2. Totals may not add up due to residual items that represent unallocated gross domestic expenditure
Source: Reserve Bank

Figure 2.2 shows that the contribution of the private sector to domestic growth has slowed over the past 15 months. In the near term, private-sector domestic demand is expected to expand at a modest pace.

Figure 2.2 Public- and private-sector contributions to GDP growth, 2004 – 2012



Source: Reserve Bank and National Treasury calculations

Public- and private-sector investment

Private-sector investment continues to grow, but at a weaker pace than during 2011, as South African corporations refrain from significant new project developments in an environment of weaker business confidence, domestic supply constraints and low levels of demand.

Gross fixed-capital formation by the public sector expanded at an annual rate of 10.9 per cent during the first half of 2012

In contrast, gross fixed-capital formation by the public sector expanded at an annual rate of 10.9 per cent during the first half of 2012. Eskom, Transnet and the South African National Roads Agency Limited account for about 95 per cent of capital spending by state-owned enterprises. Government spending on water, health, sanitation and road infrastructure has also picked up, supporting a nascent recovery in construction.

As the economic environment strengthens, rising confidence should result in a gradual improvement in private-sector gross fixed-capital formation. The public-sector infrastructure programme will continue to support overall investment growth over the medium term.

Household consumption growth slows

Household consumption growth has slowed from 5.0 per cent in 2011, and is forecast to average 3.4 per cent in 2012 and 3.5 per cent in 2013 owing to sluggish job creation, elevated debt and limited growth in real disposable income.

Consumer indebtedness stands at 76 per cent of gross disposable income. The value of new unsecured credit granted to households in the second quarter of 2012 was 36 per cent higher than during the same period in 2011. Most of the increase reflects larger loans over longer time periods. Currently, levels of unsecured lending do not pose a significant risk to financial stability; however, measures to improve responsible lending and borrowing are required to support access and affordability of credit. In lower- and middle-income communities, concerns related to the garnishee system require attention. Financial sector regulators are investigating these matters. The forthcoming "twin peaks" regulatory reforms in the financial sector should help ensure better coordination among regulators.

Trade balance

Strong exports of coal and chemical products have partially offset declines in other areas

Export volumes contracted at an annual rate of 6.3 per cent in the second quarter after falling by 1.5 per cent in the first quarter of 2012. The value of exports of coal and chemical products remained robust, while platinum and base metals declined by 21.9 per cent and 6.7 per cent respectively over the first eight months of the year. Domestic supply constraints, including electricity rationing in manufacturing and disruptions to mining output, have exacerbated the pressure on exports.

The value of imports increased by 20 per cent over the same period, driven by strong increases in crude oil, machinery and appliances, vehicles and original equipment components. Import volumes are now almost 4 per cent above pre-2009 highs, while exports are 13 per cent below their highs. The widening trade deficit has been exacerbated by a steady decline in the price of exports relative to imports (terms of trade), which has fallen by almost 5 per cent since its peak in the third quarter of 2010.

Table 2.5 Performance of exports by destination, 2000 – 2012

	2011	2012[1]	2011	2012[1]	2000	2011	2012[1]
	Annual weighted % change		% change		% share		
European Union	2.6	-0.9	10.9	-4.0	31.2	22.0	21.0
Germany	0.1	-0.9	1.1	-13.9	7.8	6.2	5.5
UK	0.4	-0.0	8.5	-0.1	8.9	4.1	3.9
Netherlands	0.8	0.6	25.4	18.8	3.3	3.1	3.7
India	0.4	0.7	9.6	19.7	1.4	3.5	4.1
Brazil	0.1	0.1	13.9	6.7	0.7	0.9	0.9
China	4.6	1.1	45.7	9.2	2.0	12.3	12.0
SADC	2.2	2.7	20.7	26.2	9.8	10.6	12.2
Mozambique	0.6	0.3	24.0	10.9	2.3	2.5	2.7
Zimbabwe	0.4	0.3	13.5	13.1	2.2	2.5	2.5
Zambia	0.8	0.7	41.7	33.9	2.0	2.3	2.7
US	1.4	0.0	15.8	0.5	12.0	8.6	8.1
Japan	1.5	-1.7	19.3	-20.7	8.1	8.0	6.2
Unallocated[2]	2.4	1.4	20.9	13.3	15.2	11.5	11.3
Other	4.0	3.1	17.7	13.5	19.6	22.5	24.1
Total	**19.2**	**6.4**	**19.2**	**6.4**	**100**	**100**	**100**

1. First eight months of 2012
2. Consists of mostly commodities such as gold that are sold through commodities exchanges
Source: Quantec

The pattern of trade in the first half of 2012 shows declining exports to the European Union (EU) and Japan, flat exports to the US, and growing exports to China, India and the SADC. Disruptions to platinum output affected trade with Germany, Japan and the US, while China's higher demand for coal offset lower steel imports. There was a notable decline in exports of motor vehicles to Germany.

Exports to SADC countries have grown sharply, and the region could soon become the largest market for manufactured exports

The SADC is currently South Africa's second-largest export market after the EU. The share of manufactured exports to the region (21.8 per cent) has increased rapidly over the past few years, led by purchases of steel, chemical products, and machinery and appliances, especially mining equipment. With strong growth forecast for the next five years, the SADC region could soon become South Africa's biggest market for manufactured exports.

Export growth is expected to improve over the medium term as mining production stabilises, external demand strengthens, and trade with emerging and African economies becomes a larger share of total exports.

Current account

The current account deficit has widened sharply over the past year and is expected to average 5.9 per cent of GDP in 2012, up from 3.3 per cent in 2011. The trade deficit deteriorated to 1.9 per cent of GDP in the first half of 2012 and net transfer payments nearly doubled as a share of GDP due to an increase in net customs revenue payments to the Southern African Customs Union (SACU). Over the medium term, the current account deficit is projected to moderate to 5.5 per cent of GDP.

Improvement in financial account reflects continued global interest in government debt

The financial account recorded a large surplus in the first six months of the year, with net inflows worth R98.5 billion. Non-resident investors were net purchasers of bonds worth R83.8 billion in the year to mid-October, spurred by favourable yield differentials and South Africa's inclusion in Citigroup's World Government Bond Index. Overseas demand for bonds should remain robust owing to high levels of global liquidity seeking good returns.

Table 2.6 Balance of payments, 2007 – 2012

Percentage of GDP	2007	2008	2009	2010	2011	2012[2]
Total current account	**-7.0**	**-7.2**	**-4.0**	**-2.8**	**-3.3**	**-5.7**
Trade balance	-1.8	-1.6	0.1	1.0	0.6	-1.9
Net services, income and transfer receipts	-5.2	-5.6	-4.1	-3.8	-3.9	-3.8
Net service receipts	-0.9	-1.5	-1.0	-1.2	-1.2	-0.7
Net income receipts	-3.4	-3.3	-2.2	-2.0	-2.2	-2.2
Net dividend receipts	*-3.1*	*-2.6*	*-1.6*	*-1.5*	*-1.8*	*-1.8*
Net transfer payments (mainly SACU)	-0.8	-0.8	-0.9	-0.6	-0.5	-0.9
Current account excluding SACU transfers	-6.1	-6.3	-3.1	-2.2	-2.8	-4.8
Financial account balance[1]	**9.3**	**8.3**	**4.7**	**4.0**	**4.4**	**6.3**

1. Actual values including unrecorded transactions
2. Includes data for the first two quarters of 2012, seasonally adjusted and annualised
Source: Reserve Bank

Rand exchange rate

In real terms, the rand was 7 per cent weaker in the first half of 2012 compared with the same period in 2011

The rand has remained volatile as global risk appetite waxes and wanes in response to developments in major economies. Sentiment towards the rand has been negatively affected by the deterioration of the current account and wildcat strikes. The currency's exchange value depreciated from an average of R8.01 to the US dollar in January to R8.62 in October. The nominal trade-weighted rand was, on average, 10 per cent weaker in the first three quarters of 2012 compared with the same period a year ago. In real terms, the rand was 7 per cent weaker in the first half of 2012 compared to the same period in 2011. The weaker rand has so far provided little support for manufacturing export growth, which remains subdued in the present economic environment.

Inflation

CPI inflation is forecast to remain within target band over forecast period

Consumer price inflation (CPI) has averaged 5.7 per cent in the year to August. Core inflationary pressures remain contained and headline inflation is expected to stay within the 3 to 6 per cent inflation target band throughout the forecast period. Rising international food prices and higher petrol costs, combined with a weaker exchange rate, are expected to place upward pressure on consumer prices during the second half of 2012. Food price inflation is expected to average 9 per cent in 2013, up from 5.1 per cent in August 2012. Administered prices have risen by 10.3 per cent over the past year. Electricity prices are expected to continue rising in line with the move to cost-reflective tariffs.

Inflation targeting: keeping price increases under control

Low and stable inflation is a key determinant of economic competitiveness, with particular importance for preserving the purchasing power of poor households.

South Africa adopted inflation targeting in 2000. Since then, average levels of inflation and real interest rates have declined, growth in real GDP and fixed investment have been higher and less volatile, and inflation expectations have been lower and more stable than before. Reserve Bank independence and more transparent monetary policy have improved credibility and lowered the cost of long-term financing. The Bank also plays an important role in overseeing and maintaining financial stability.

The Reserve Bank's Monetary Policy Committee considers a range of factors when setting interest rates. These include the inflation forecast; level of GDP growth relative to potential; confidence levels; the pace of credit growth; trends in production and unit labour costs; commodity prices and capital flows; the exchange rate; the current account; and the fiscal position – enabling it to respond flexibly to economic shocks.

Macroeconomic performance before and after introduction of inflation targeting

	Average (%)[1]	Volatility (%)
Headline inflation[2]		
1990-1999 (pre-inflation targeting)	9.8	3.7
2000-2012 (inflation targeting)	5.9	2.9
Real GDP growth		
1990-1999 (pre-inflation targeting)	1.4	2.3
2000-2012 (inflation targeting)	3.5	1.9
Real repo rate[3]		
1990-1999 (pre-inflation targeting)	5.7	4.1
2000-2012 (inflation targeting)	3.2	2.5
Real investment growth		
1990-1999 (pre-inflation targeting)	1.6	7.2
2000-2012 (inflation targeting)	6.9	6.3

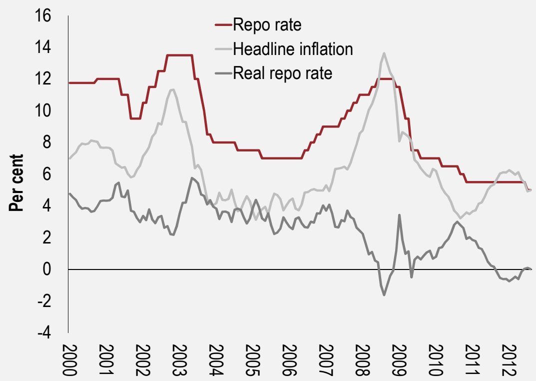
1. Average annual change, based on quarterly data

2. Headline inflation excluding mortgage interest costs (CPIX) for urban areas up to 2008, and headline inflation thereafter

3. Average repo rate minus average inflation

Source: Reserve Bank and National Treasury calculations

Inflation and interest rates since 2000



Source: Reserve Bank

Job creation

Economic growth is integral to job creation. Employment gains have decelerated in tandem with slower growth over the past year and the unemployment rate remains stubbornly high at 24.9 per cent. Formal non-agricultural employment has risen towards pre-2009 levels, with 125 000 jobs created over the past 12 months. Public-sector employment has risen by 38 000 jobs compared with 87 000 additional private-sector jobs. Labour force participation rates remain low, with more than 1.1 million additional South Africans classified as discouraged since the end of 2008. High levels of structural unemployment make labour market entry more difficult for the young and less skilled.

Nominal wage settlements averaged 7.4 per cent in the first nine months of 2012, from 7.7 per cent in 2011. Real wage growth has slowed to 1.8 per cent in the first half of 2012, from 2.7 per cent in 2011. Rising wage demands across the economy could put pressure on new hiring. The economy is projected to create 780 000 jobs over the next three years.

The economy is projected to create 780 000 jobs over the next three years

A path to higher growth

The crisis confronting the global economy is likely to persist for some years to come. Fault lines in the world financial system, massive public and private debt burdens, and high youth and long-term joblessness have combined to reduce potential growth rates around the world. In an extended period of weak growth, economies that are more productive and efficient, and that are not weighed down by unsustainable debt burdens, will gain competitive advantage.

More productive, efficient and fiscally balanced economies will gain competitive advantage

South Africa's potential growth rate: drivers and constraints

Michael Spence, Nobel economics laureate, argues that "longer-term growth requires investment by individuals (in education and skills), governments and the private sector. Shortfalls in investment eventually diminish growth and employment opportunities."

For some years government policy has focused on alleviating constraints to South Africa's potential growth – the fastest rate of growth that can be achieved sustainably without large macroeconomic imbalances developing. Potential growth is influenced by the strength of domestic institutions, market size, and structural policies that affect macroeconomic stability, productivity growth, job creation and private-sector investment.

Large public investments in energy, port infrastructure, export railway lines, and national and provincial roads maintenance and upgrading will help alleviate supply bottlenecks in the economy, and include:

- Ensuring adequate electricity generation capacity, by closing the demand-supply gap by mid-2014 with the addition of the Medupi and Kusile power stations.
- Improving the efficiency and capacity of local ports. It takes 30 days to clear exports through local ports compared with an upper-middle income country average of 19 days.
- Expanding and investing in the road network to support commercial freight transport and enhance rail efficiency. These must be accompanied by a cost-recovery mechanism to fund future expansion.

A similar focus on other structural reforms will support stronger growth and job creation:

- Strengthening trade and investment ties with fast-growing external markets, particularly in the region.
- Adopting a more open approach to high-skilled immigration to plug short-term skills gaps, building strong links between further education and training colleges and industry, and providing incentives to firms that give young people work experience.
- Promoting regulatory reforms to support new business creation and cut red tape.
- Strengthening partnerships between government and the private sector to promote risk sharing and cost sharing in areas such as electricity generation, and port and rail operations.

Private businesses account for about 71 per cent of economic activity and more than 75 per cent of jobs. Creating a buoyant private sector that works in partnership with an effective government will help South Africa to achieve faster growth and sustainable job creation.

There are no quick-fixes that can substitute for a long-term vision. Inclusive and sustainable growth requires the right policies, efficient institutions and effective implementation. In the short-term, macroeconomic stability, policy and regulatory certainty, and

Faster growth requires a focus on long-term reforms and a willingness to take tough decisions, rather than short-term fixes implementing infrastructure investments on time should help instil confidence and provide the platform for expanded private investment.

The National Development Plan recommends a series of actions to address structural constraints and bottlenecks in the economy. Urgent decisions across a range of policy areas are needed to translate the plan's vision into reality, start changing the structure of the economy and shift onto a higher growth trajectory. These should include measures that:

- Support sustainable long-term investment in competitive economic infrastructure through financing that combines cost-reflective tariffs, taxes, loans and private-sector participation.
- Introduce active labour market policies that enable young, unskilled job seekers to transition into employment, and ensure the price of labour relative to productivity and capital helps stimulate job creation.
- Encourage new business creation and small business expansion by reducing the cost of tax and regulatory compliance for small and medium-sized firms, streamlining processes for granting licenses and permits, and paying government invoices on time.
- Transform human settlements and develop functioning public transport networks to improve living conditions and support the country's rapid urbanisation.
- Provide policy certainty and predictability to encourage long-term investment in the mining sector, and structure the tax regime to expand the benefits accruing from South Africa's mineral wealth.
- Increase exports in areas where South Africa has natural endowments and comparative advantage, such as mining, construction, mid-skill manufacturing, agriculture and agro-processing, education, tourism and business services, and encourage export diversification.
- Take a more developmental approach to regional integration, emphasising efficient transport infrastructure, uniform competition rules and faster progress in removing trade barriers.

Achieving such results will require a willingness to manage difficult trade-offs, effective and efficient implementation, and broad partnerships between government, business, labour and civil society

Conclusion

Reforms needed to broaden economic participation, boost productivity and raise living standards

Domestic growth is expected to be modest next year and to gather pace over the medium term. Yet much faster growth is required to stimulate the job creation South Africa needs. Macroeconomic stability continues to provide a solid foundation for inclusive growth. Complementary structural reforms are required and progress in policy priorities is needed to broaden participation in the economy, boost productivity and raise living standards.