2

Economic outlook

Overview

International economic conditions remain unsettled. While there are signs of a revival in the US economy, much of Europe is expected to fall into recession during 2012. Emerging markets continue to perform strongly, but growth in China and India is projected to moderate in the year ahead. A high degree of risk clouds the global outlook.

Global economy: hints of recovery alongside substantial risk

The South African economy has demonstrated resilience in this environment. While global developments are likely to hold back higher growth over the short term, the domestic outlook remains positive. Gross domestic product (GDP) growth is expected to slow from 3.1 per cent in 2011 to 2.7 per cent in 2012. As the world economy strengthens, GDP growth will accelerate to 3.6 per cent in 2013 and 4.2 per cent in 2014, led by robust household consumption, and stronger public- and private-sector investment. Government will focus on capital investment in infrastructure projects and reducing the cost of doing business through targeted interventions, including lowering port charges and broadband costs.

The domestic economy has proven resilient; growth is expected to reach 4.2 per cent in 2014

Strengths in the domestic economy will help to sustain growth. Household spending remains robust, private-sector investment is gradually rising and interest rates are low. There are encouraging signs of employment growth in the formal sector, with a net increase of 365 000 jobs reported over the past year. South Africa's banks are well-capitalised. High levels of corporate saving are expected to enable increased investment spending as global uncertainty eases and business confidence strengthens.

Strengths of the South African economy will help to sustain growth

Fiscal and monetary policies remain supportive of growth. Government will continue to monitor and adjust policy to changes in the domestic and global environment, while stabilising public debt at sustainable levels.

South Africa needs to reduce costs of doing business, diversify exports and raise productivity

To reduce unemployment and poverty on a mass scale, the economy needs more rapid and broad-based growth. This requires policy reforms and actions by business and labour to reduce the cost of doing business, cut red tape, raise productivity, diversify exports, tap new markets for trade and take advantage of opportunities presented by enhanced regional integration.

Over the medium term and beyond, large-scale public-sector infrastructure investments, discussed in detail in Chapter 7, will expand the capacity of the economy to grow more rapidly. Government is also implementing an economic support package to boost productivity, competitiveness, and research and development across the agriculture, mining, manufacturing and technology sectors.

National Planning Commission proposals for economic growth and employment

In June 2012, following broad public consultation, the National Planning Commission will submit a revised draft national development plan to Cabinet. The Commission's proposals include:

- Raising exports in areas where the economy has endowments and comparative advantage
- Increasing the size and effectiveness of the innovation system
- Improving the functioning of the labour market to make it more labour absorbing
- Supporting small business through better coordination of support agencies, development finance institutions, and public and private incubators
- Improving the skills base through better education and vocational training
- Increasing infrastructure investment to lower costs, raise productivity and broaden economic participation
- Reducing regulatory burdens in sectors where the private sector is the main investor
- Improving the capacity of the state to effectively implement economic policy.

Policy aims to provide efficient infrastructure and create an environment favourable for investment

Since the onset of the financial crisis in 2008, the state has played a more prominent role in the economy. Sustained spending growth through the 2009 recession supported demand and allowed the public sector to serve as a key source of employment. More rapid and sustainable growth and job creation is reliant on increased private-sector activity. Government will play a supportive role over the medium term by providing high-quality, efficient and affordable network infrastructure, and creating a more favourable environment for business expansion and investment.

Domestic outlook

Growth in private fixed capital formation is projected to rise from 4 per cent in 2012 to 6.8 per cent by 2014

The South African economy grew by an estimated 3.1 per cent in 2011. GDP growth is expected to slow to 2.7 per cent in 2012 before accelerating to 3.6 per cent in 2013 and 4.2 per cent in 2014 as the world economy recovers, and stronger domestic consumption and investment support rising job creation. Growth in private fixed capital formation is projected to rise from 4 per cent in 2012 to 6.8 per cent by 2014, underpinned by improving business confidence. Public investment growth will average 4.3 per cent per year over the next three years.

While export growth will accelerate over the medium term, imports are projected to grow more quickly in response to robust domestic demand. This will contribute to the current account deficit widening from an estimated 3.3 per cent of GDP in 2011 to 4.4 per cent of GDP in 2014. This level of deficit should be comfortably financed through a combination of foreign direct investment (FDI), international investment in the bond and equity markets, long-term foreign loans to public entities and trade finance.

The trade-weighted rand exchange rate depreciated by 13.2 per cent between July and December 2011. In the year ahead, the currency will remain subject to swings in global risk appetite as investors choose between low-yield “safe-haven” assets such as US government bonds and higher-yield investments in emerging markets.

Higher food, administered and import prices will push CPI inflation to 6.2 per cent in 2012

Headline consumer price index (CPI) inflation is projected to increase from an average of 5 per cent in 2011 to 6.2 per cent in 2012 as a result of high food prices, rising administered prices and higher prices of imported goods due to the weaker rand. After temporarily rising above the upper limit of the 3-6 per cent target band, inflation is forecast to fall to 5.3 per cent in 2013 and 5.1 per cent in 2014.

Table 2.1 Macroeconomic projections, 2008 – 2014

Calendar year	2008	2009	2010	2011	2012	2013	2014
		Actual		Estimate		Forecast	
Percentage change unless otherwise indicated							
Final household consumption	2.2	-1.6	3.7	4.9	3.6	3.8	4.2
Final government consumption	4.5	4.7	4.9	4.6	4.1	4.1	4.1
Gross fixed capital formation	13.3	-3.2	-1.6	4.3	4.1	4.5	6.0
Gross domestic expenditure	3.5	-1.6	4.2	4.1	3.9	4.2	4.9
Exports	1.8	-19.5	4.5	6.0	2.9	5.8	6.6
Imports	1.5	-17.4	9.6	9.4	7.2	7.1	8.3
Real GDP growth	**3.6**	**-1.5**	**2.9**	**3.1**	**2.7**	**3.6**	**4.2**
GDP inflation	8.3	7.7	7.9	7.2	6.1	6.2	6.1
GDP at current prices (R billion)	**2 263**	**2 398**	**2 661**	**2 941**	**3 204**	**3 526**	**3 897**
Headline CPI inflation	9.9	7.1	4.3	5.0	6.2	5.3	5.1
Current account balance (% of GDP)	-7.2	-4.0	-2.8	-3.3	-4.3	-4.5	-4.4

Table 2.2 Macroeconomic projections, 2008/09 – 2014/15

Fiscal year	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
		Actual		Estimate		Forecast	
Percentage change unless otherwise indicated							
Real GDP growth	2.5	-0.8	3.1	2.7	3.0	3.8	4.3
GDP inflation	8.3	6.8	9.4	5.9	7.0	5.7	5.8
Headline CPI inflation	9.9	6.4	3.8	5.7	5.9	5.3	4.9
GDP at current prices (R billion)	**2 304**	**2 440**	**2 754**	**2 996**	**3 301**	**3 622**	**3 997**

Global developments

Weaker global economy expected in 2012, with emerging markets providing most growth

The world economic outlook has weakened since the October 2011 *Medium Term Budget Policy Statement*. The International Monetary Fund (IMF) expects global growth to decelerate from an estimated 3.8 per cent in 2011 to 3.3 per cent in 2012, down from the previous forecast of 4 per cent. Emerging markets are expected to remain the primary sources of economic expansion, though growth will be slower than in recent years. Advanced economies are projected to grow by only 1.2 per cent in 2012.

In many developed countries, the process of reducing debt in the public and private sectors will be a considerable drain on growth in the decade ahead. Growth prospects have also declined as a result of rising structural unemployment and lower investment.

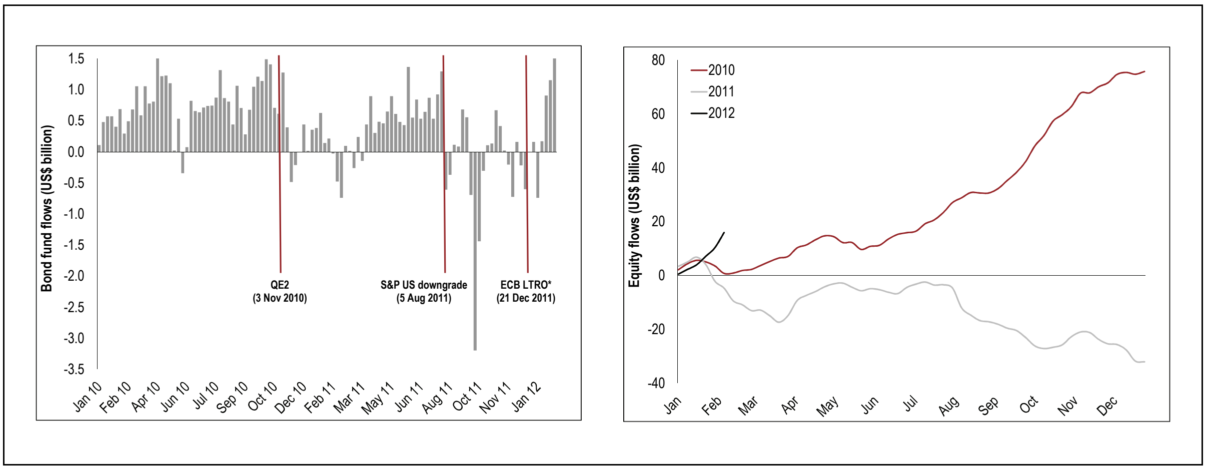
Recent global trends, however, are not linear. There are signs of a nascent recovery in the United States, with growth accelerating in the second half of 2011 and stronger-than-expected employment data. The latest global manufacturing surveys show that activity is picking up. Interventions by the European Central Bank to provide liquidity to banks have helped to calm markets, buying time for a resolution of the debt crises facing Greece, Italy, Spain and Portugal.

Capital flows will remain volatile, but interest rate differentials will support investment in emerging markets

Interest rates will remain low in most developed countries over the medium term. The US Federal Reserve has said that interest rates will stay near zero until mid-2014. This should support capital flows to countries where investment returns are higher and underpin demand for commodities, including gold.

The challenges stemming from high levels of global liquidity will continue. While much of the capital flowing to emerging markets reflects structural dynamics and stronger growth prospects, short-term capital flows are highly sensitive to fluctuating interest rate differentials and risk appetite. As seen during the second half of 2011, sharp reversals may occur as a result of uncertainty and swings in investor sentiment, fuelling macroeconomic instability in developing countries.

Figure 2.1 Weekly bond flows and cumulative equity flows to emerging markets, 2010 – 2012*



Source: Emerging Portfolio Fund Research

** Flows are estimates constructed using global fund flows and country allocation shares for funds*

** LTRO means Long Term Refinancing Operation*

Trends in major economies and regions include the following:

- US growth is projected to remain at 1.8 per cent in 2012. Non-agricultural employment has expanded by almost 2 million jobs over the past 12 months, supporting demand and reducing unemployment to 8.3 per cent. The housing market, however, remains weak, and fiscal consolidation will reduce demand as public spending slows.
- The eurozone grew by an estimated 1.6 per cent in 2011, but much of the region is expected to experience recession in 2012. The

combination of fiscal austerity, stressed credit markets and concerns about the capitalisation of banks has reduced confidence. The potential for default by Greece is a significant risk that could precipitate dislocation in financial markets and a break-up of the currency union.

- GDP growth in China is projected to slow to 8.2 per cent in 2012, down from an estimated 9.2 per cent in 2011. Brazil's GDP is forecast to grow at 3 per cent in 2012 (2011: 2.9 per cent). GDP growth in India is projected to be 7 per cent in 2012 (2011: 7.4 per cent).
- Sub-Saharan Africa continues to benefit from high commodity prices. Growth in the region is projected to increase from an estimated 4.9 per cent in 2011 to 5.5 per cent in 2012.

Table 2.3 Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2011 – 2013

Region / Country	2011	2012	2013	2011	2012	2013
Percentage		GDP projections[1]			CPI projections[1]	
World	**3.8**	**3.3**	**3.9**	**5.0**	**3.7**	**3.2**
Advanced economies	**1.6**	**1.2**	**1.9**	**2.7**	**1.6**	**1.3**
US	1.8	1.8	2.2	3.0	1.2	0.9
Euro area	1.6	-0.5	0.8	2.5	1.5	1.7
UK	0.9	0.6	2.0	4.5	2.4	2.0
Japan	-0.9	1.7	1.6	-0.4	-0.5	0.0
Emerging and developing economies	**6.2**	**5.4**	**5.9**	**7.2**	**6.2**	**5.5**
Developing Asia	**7.9**	**7.3**	**7.8**	**7.0**	**5.1**	**4.4**
China	9.2	8.2	8.8	5.5	3.3	3.0
India	7.4	7.0	7.3	10.6	8.6	7.1
Latin America and the Caribbean	**4.6**	**3.6**	**3.9**	**6.7**	**6.0**	**5.4**
Brazil	2.9	3.0	4.0	6.6	5.2	4.2
Sub-Saharan Africa	**4.9**	**5.5**	**5.3**	**8.4**	**8.3**	**6.4**
South Africa[2]	3.1	2.7	3.6	5.0	6.2	5.3

1. IMF, World Economic Outlook, January 2012 and October 2011

2. National Treasury forecasts

Long-term shifts in global trade and investment

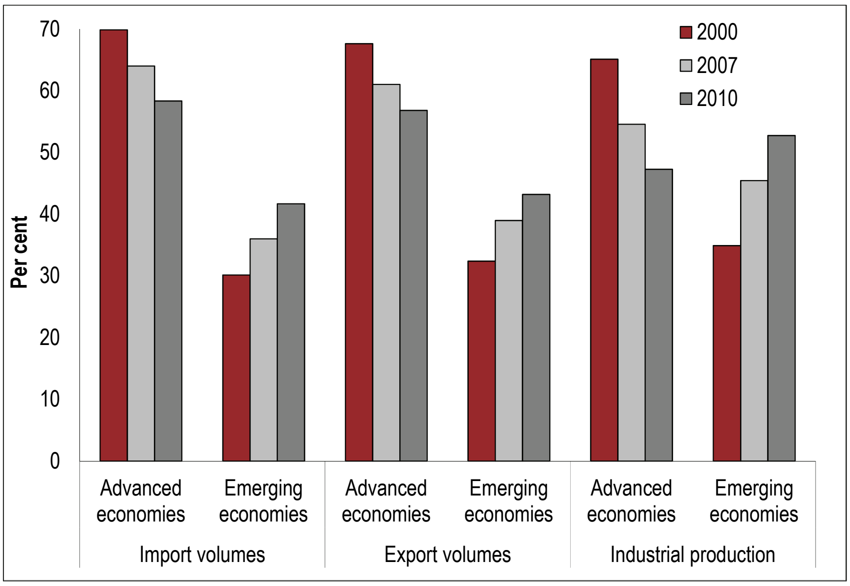
For some time a shift in the composition of global trade, production and investment has been under way. Emerging markets now account for more than 40 per cent of global imports, exports and industrial production.

By 2016, BRICS economies will account for 24 per cent of global GDP

Last year, Brazil overtook the UK to become the sixth-largest economy in the world. By 2016, the IMF expects BRICS (Brazil, Russia, India, China and South Africa) economies to account for 24 per cent of global GDP, up from 7 per cent in 1993, and China is projected to be the largest economy in the world based on purchasing power parity.

Shifts in the global economy provide considerable opportunities for growth and employment in South Africa and the African continent. For example, the World Bank projects that China could shed 85 million manufacturing jobs in the coming years as the economy's comparative advantage moves away from labour-intensive production and as wages for unskilled labour rise. South Africa can capture a greater share of world manufacturing through focused efforts to achieve a competitive position in global production networks and supply chains.

Figure 2.2 Global shares of import volumes, export volumes and industrial production, 2000 – 2010



Source: United Nations and CPB Netherlands Bureau for Economic Policy

South Africa's regional and global comparative advantages in mining, infrastructure development, retail, distribution, tourism, and financial and professional services offer significant potential for jobs and growth, particularly if underpinned by innovation and productivity gains.

African growth: past, present and future

The commodity boom, improved political stability and prudent macroeconomic policies have fuelled a sharp increase in African growth over the past decade. GDP growth averaged nearly 5 per cent in the 2000s compared with just over 2 per cent over the preceding two decades.

- Between 2000 and 2016, Sub-Saharan Africa is forecast to almost double its share of global GDP, with per capita incomes rising by 110 per cent based on purchasing power parity.
- Africa's share of global FDI inflows has increased from an average of 1.9 per cent in the 1990s to 4 per cent between 2005 and 2011, and totalled US$54.4 billion in 2011. FDI inflows are strongest into East Africa, Central Africa and increasingly West Africa.
- Spending on infrastructure is projected to increase sharply over the next 20 years in Nigeria (506 per cent), Angola (347 per cent), Kenya (328 per cent) and Egypt (138 per cent).
- The number of internet users increased from 19 million in 2005 to 91 million in 2010. Mobile phone subscriptions more than tripled to 393 million over the same period.
- Some 70 per cent of Africa's population is under age 30, representing a potential demographic dividend.

South Africa's stock of FDI in Africa has increased more than five-fold, from US$3 billion in 2005 to US$16.6 billion in 2010. South African investment has focused on natural resources in Southern and Eastern Africa, along with telecommunications, finance, retail and construction. South African companies in these sectors have operations in more than 15 countries.

Efforts to foster closer economic integration should focus on developing regional infrastructure, one-stop border policies and systems, removing non-tariff barriers such as import permits and reducing barriers to the movement of skilled labour.

Sources: IMF, World Bank, UN Conference on Trade and Development, Royal Bank of Scotland, Eskom

Real output trends

Agriculture

Real value added in the agricultural, forestry and fishing sectors expanded by 3.5 per cent in the first nine months of 2011 compared with the same period in 2010. Growth was supported by high prices and greater production of cash crops. Maize, wheat, sunflower seed and soya bean prices rose significantly, with a commensurate increase in production for most of these crops. Wheat production during 2011 is estimated to be 29.4 per cent higher than 2010 and maize farmers have increased planting areas for the 2012 season by 10.9 per cent.

Agricultural growth was supported by high prices and greater production of cash crops

Mining

Mining production was broadly stable, growing by 0.3 per cent in 2011. Production was weighed down by strikes, safety stoppages and maintenance on the Mpumalanga to Richards Bay coal line. Manganese, other metallic minerals and nickel recorded the strongest output growth in response to demand for industrial commodities in Asia. Performance in the largest export commodities was mixed, with platinum group metals and coal expanding by 1.6 and 1.4 per cent respectively, while gold output contracted by 4.1 per cent, despite favourable gold prices.

Metallic minerals and nickel recorded the strongest output growth in response to Asian demand

Robust growth in China and other emerging markets should support commodity demand and high prices for some time to come. Large-scale investments in public-sector infrastructure, complemented by private investment, will expand production and export capacity for coal, platinum, palladium, chrome and other minerals from Limpopo and other regions.

Table 2.4 Growth in mining output by sector, 2007 – 2011

Percentage	Weights	Change from pre-recession highs[1]	2011	Q4 2011[2]
Platinum group metals	27.0	-13.5	1.6	-22.0
Coal	24.9	0.8	1.4	28.1
Gold	17.2	-32.4	-4.1	19.5
Diamonds	7.6	-57.8	-21.3	-43.2
Other non-metallic minerals	5.7	-22.5	-2.3	-19.0
Iron ore	5.3	43.3	-1.3	5.0
Nickel	2.8	9.5	7.2	-30.1
Other metallic minerals	2.8	20.7	10.3	7.6
Building materials	2.1	-14.8	1.8	62.6
Copper	1.8	-25.9	5.4	28.7
Manganese	1.5	36.4	21.3	15.3
Chromium	1.3	9.4	-0.8	15.3
Total	**100.0**	**-10.7**	**0.3**	**1.7**

1. Second half of 2011 compared with first half of 2007
2. Quarter on quarter, seasonally adjusted and annualised
Source: Statistics South Africa

Promoting clarity and certainty for the mining sector

In 2009, the Department of Mineral Resources commissioned a task team to review factors impeding the competitiveness of the South African mining sector. A competitiveness strategy has been developed outlining several reforms aimed at improving investor confidence. The strategy recognises that simplifying the regulatory framework and policy certainty will support higher investment in mining.

To streamline the processing of applications for prospecting and mining rights, government launched a new licensing system in April 2011. Applications can now be made through the department's website. Complementary amendments to the Mineral and Petroleum Resources Development Act (2004) are to be legislated in the second half of 2012 to provide clarity and certainty about administrative processes for transferring mining rights and to speed up applications for water licences. Amendments to the Mine Health and Safety Act will simplify administrative processes.

Manufacturing

Near-term outlook for manufacturing has improved, and purchasing managers' index anticipates growth in 2012

Manufacturing production increased by 2.5 per cent during 2011, supported by production of motor vehicles and parts, basic iron and steel, and petrochemicals. Although production in most subsectors remains below pre-2008 levels, the near-term outlook has improved, with the Kagiso purchasing managers' index rising to a seven-month high in January 2012 as a result of strong business activity and new sales orders.

Table 2.5 Growth in manufacturing output by sector, 2008 – 2011

Percentage	Weights[1]	Change from pre-recession highs[2]	2011	Q4 2011[3]
Basic iron and steel	22.9	-19.0	2.8	35.9
Petrochemicals	22.1	-6.6	1.4	0.2
Food and beverages	15.4	11.4	2.5	2.4
Motor vehicles and parts	10.9	-12.2	7.4	-31.6
Wood and paper	10.2	-8.9	1.3	38.1
Furniture and other	5.2	-24.9	1.1	-31.4
Textiles and clothing	4.9	-23.2	-2.9	-9.4
Glass, etc	4.8	-14.6	2.4	2.5
Electrical machinery	2.5	5.8	1.9	17.2
Radio and television	1.1	3.2	11.8	-8.9
Total	**100.0**	**-9.3**	**2.5**	**4.1**

1. Weights are based on Statistics South Africa 2005 Large Sample Survey
2. Second half of 2011 compared with first half of 2008
3. Quarter on quarter, seasonally adjusted and annualised
Source: Statistics South Africa

Manufacturing competitiveness enhancement programme

The manufacturing competitiveness enhancement programme will begin in 2012/13. It will provide production and distressed funding support to boost productivity and competitiveness, raise investment and create jobs. Investment in capital (machinery, plant and equipment), product development, process redesign, standards accreditation, and feasibility and marketing studies will qualify for the incentive. The programme is aimed at labour-intensive industries, excluding sectors already covered by incentives (clothing, textiles, leather and footwear, and motor vehicles). Government has allocated R5.75 billion to the Department of Trade and Industry over the MTEF period to administer the programme.

Special economic zones programme

Designated special economic zones will provide infrastructure and incentives to develop clusters of firms, encouraging private investment and employment growth. Incentives will target improvements to business conditions and productivity through skills development, business incubation, reducing red tape, technology transfer and adaptation, and providing assistance with access to markets and logistics. The Development Bank of Southern Africa will support infrastructure development and leverage private investment in the zones. Government has allocated R2.25 billion to this programme over the medium term.

Electricity, gas and water

Eskom's reserve margin has improved owing to softer industrial activity but will face renewed pressure as demand picks up

Value added in the electricity, gas and water sector grew by 1.6 per cent in the first nine months of 2011 compared with the same period in 2010. The electricity reserve margin – a measure of spare capacity – stood at 16.8 per cent, up from 14.9 per cent in 2010, in part due to disruptions in mining and manufacturing activity. The reserve margin has increased from 5.1 per cent in 2007 but will face renewed pressure as demand picks up. The first units of Eskom's Medupi and Kusile power plants are due to be completed in 2013 and 2014 respectively.

Over the medium term, growth in the electricity and gas sector will be supported by investments by independent power producers.

Improving efficiencies in network infrastructure

Chapter 7 discusses the scope of South Africa's major public-sector infrastructure projects. The private sector can play a complementary role in improving the implementation and efficiency of these investments.

- In the electricity sector, private firms can generate more power and reduce reliance on fossil fuels. Following a competitive bidding process, the Department of Energy has identified 28 preferred independent power producers of renewable energy with a combined potential capacity of 1 416MW.
- Amendments to regulations in the telecommunications sector have allowed more than 400 companies to gain electronic communications network service licences since March 2009. Private firms have made large investments in undersea fibre optic cables, helping to expand broadband access. Further interventions directed at local loop unbundling and regulation of interconnection tariffs will confer significant benefits to consumers and the economy.
- The Ports Regulator has announced an average tariff increase of 2.8 per cent for 2012/13 – well below inflation. Government will work with the regulator and Transnet to improve competitiveness and reduce port charges on manufactured goods by R1 billion during 2012/13. Private firms can help improve the performance of ports with investment and skills, if provided with concessioning opportunities.

The role of transparent regulation in getting prices right

The correct pricing of utility services provides incentives for efficient production and consumption, spurs productivity gains and ensures cost-reflective tariffs across the value chain.

Government is considering setting up an oversight unit to clarify the roles of regulators and update policy to ensure efficient, transparent regulation of network industries. In addition:

- New regulators in water and transport (including rail) are being considered.
- The Department of Energy is reviewing its electricity pricing policy to provide appropriate guidelines to the National Energy Regulator of South Africa for the third multi-year price determination.
- The Independent System and Market Operator Bill is in the final drafting stages. The bill is intended to ensure that independent power producers have open, competitive access to the electricity grid.

Transport and communication

Investments in rail, roads and ports, and increased capacity in telecommunications, support sector growth

In the first nine months of 2011, the transport, telecommunications and storage sector grew by 3.2 per cent compared with 2010. Growth in the sector can be attributed to investments in rail, roads and ports, as well as increased capacity and competition in telecommunications. The volume of land freight increased by 6.5 per cent in the first three quarters of 2011, helped by improved infrastructure and increased demand.

The number of individual internet users in South Africa surpassed 9.5 million in mid-2011, up from 5.3 million in 2009. Broadband costs have declined somewhat and mobile phone technology has increased accessibility. But South Africa still lags behind peer countries in the quality and cost of telecommunications, with the average price of broadband at US$39.09 per Mbps – significantly higher than the world average of US$9.64 per Mbps.

Construction

Construction has not performed well but is expected to pick up from the second half of 2012

Value added in construction grew by 0.6 per cent in the first nine months of 2011 compared with the same period in 2010, underpinned by infrastructure investment by public corporations. Activity in the residential subsector has been depressed due to weak demand. Similarly, the commercial sector is still characterised by oversupply, though conditions have begun to improve. Construction is projected to begin expanding again in the second half of 2012, gradually accelerating as infrastructure expenditure picks up and residential investment slowly improves.

Greening the economy

"Green" growth policies promote economic advancement in an environmentally sustainable manner. The shift towards a more resource efficient, low-carbon economy can lead to new sources of growth and complement economic reforms that support greater competitiveness.

Internationally, policies such as carbon pricing, environmental taxes, permits and performance standards, along with support for research and innovation, have achieved more efficient outcomes than direct subsidies to green industries. The major challenge is to make green technologies accessible and affordable.

Sectors with green jobs potential include renewable energy, building and construction, and natural resource management. These sectors also offer opportunities to expand labour-intensive employment. Green job growth expectations should be tempered by the observation that, in the short term, the impact on net job creation can be overestimated, partly because there are no clear definitions of such jobs.[1,2]

- Many green jobs will not be new, because existing jobs may be reclassified as companies shift activities to produce greener goods and services.
- In some cases, the shift will come at the expense of jobs in industries with high carbon emissions.

Government is committed to a more environmentally sustainable economy through a range of policies and programmes. The National Treasury is considering the role of market-based instruments, including a carbon tax, to incentivise the transition to a greener economy.

[1] Gulen, G., 2011. *Defining, Measuring and Predicting Green Jobs*, Copenhagen Consensus Centre

[2] Hughes, G., 2011. *The Myth of Green Jobs*, The Global Warming Policy Foundation (GWPF)

Finance, insurance, real estate and business services

Banking-sector profitability increased and the banking sector remains well capitalised

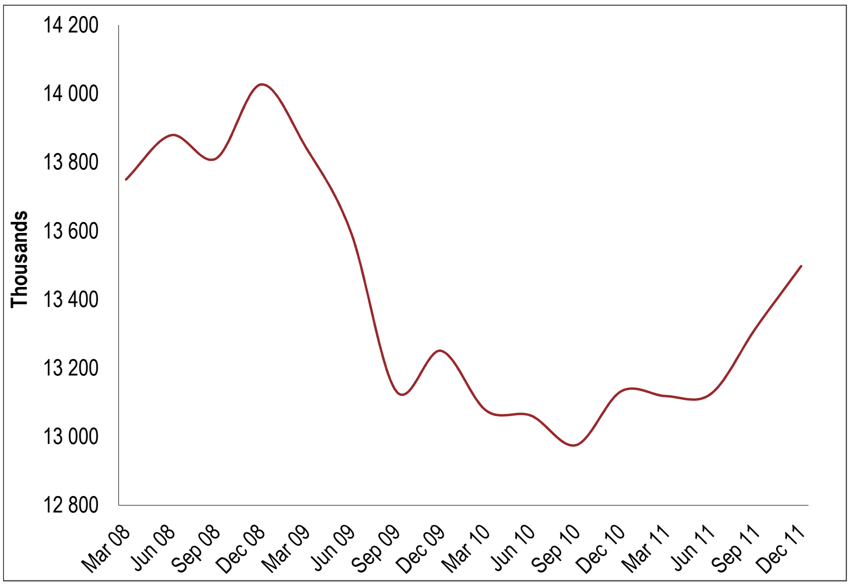
The finance, insurance, real estate and business services sector grew by 3.5 per cent in the first nine months of 2011 compared with 2 per cent during 2010. As impaired advances – a measure of loans that may not be fully repaid – and economic activity have improved, the profitability of the banking sector has recovered, rising by 20.9 per cent year-on-year over the first 11 months of 2011. The banking sector remains well capitalised, with tier one capital adequacy – the highest-quality capital reserves – at 12 per cent in November, well in excess of the 7 per cent required by the international Basel III agreement.

Employment and remuneration

Job creation has been concentrated in the formal private sector over the last 12 months

The labour market has shown signs of improvement over the past year, with total employment rising by 2.8 per cent between December 2010 and December 2011. Job creation has been concentrated in the formal private sector. The economy is projected to add 850 000 new jobs over the next three years, with 80 per cent of these in the private sector, lowering the unemployment rate to about 23 per cent in 2014. Most of these jobs are likely to be concentrated in services and construction as a result of steady growth in domestic demand and infrastructure expenditure, and a pickup in residential investment expected during the outer years of the forecast.

Figure 2.3 Total employment, 2008 – 2011



Source: Statistics South Africa, Quarterly Labour Force Survey

Figure 2.3 shows that pre-recession employment peaked in December 2008 at about 14 million. After a period of rapid job losses, about 520 000 new jobs were created between September 2010 and December 2011. Private-sector job creation – which accounted for 60 per cent of new jobs – is gathering pace and has been strongest in finance, real estate and business services, wholesale and retail trade, construction, and mining.

About 520 000 new jobs created between September 2010 and December 2011

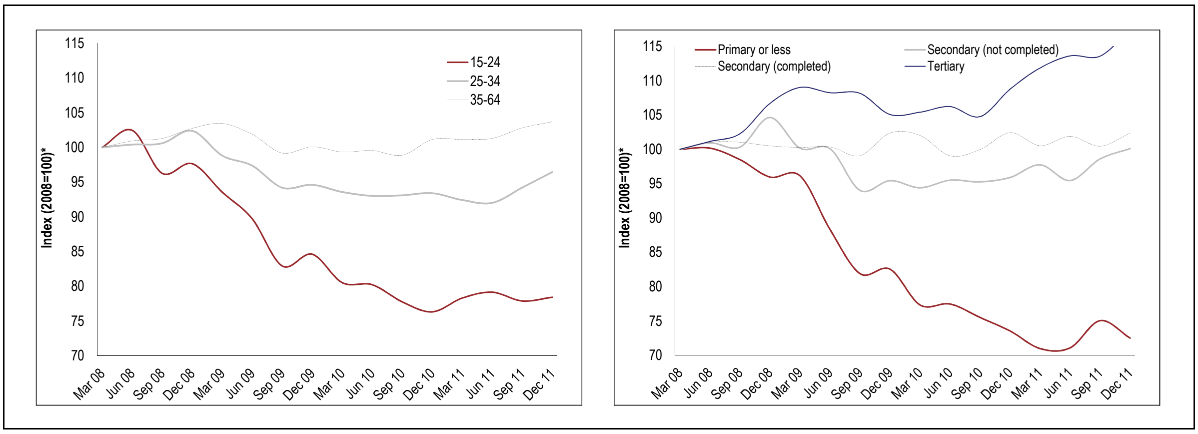
Table 2.6 Formal sector non–agricultural employment

	Total employment		Change in employment			
	Thousands	%	Thousands	%	Thousands	%
	Sept 2011		Dec 2008 to Mar 2010		Sept 2010 to Sept 2011	
Mining	521	6.2	-27	-5.2	16	3.2
Manufacturing	1 151	13.8	-88	-6.9	-8	-0.7
Utilities	59	0.7	-3	-5.1	2	3.5
Construction	434	5.2	-56	-11.8	28	6.9
Wholesale and retail trade	1 666	19.9	-117	-6.7	16	1.0
Transport and communications	363	4.3	-7	-1.9	8	2.3
Finance and business services	1 836	22.0	-172	-9.0	53	3.0
Community and personal services	2 329	27.9	44	2.0	89	4.0
Total	**8 359**	**100.0**	**-426**	**-5.0**	**204**	**2.5**

Source: Statistics South Africa, Quarterly Employment Statistics

Unemployment remains high at 23.9 per cent. Labour force participation is low, with almost 15 million South Africans not economically active. After doubling between 2008 and 2011, the number of discouraged work seekers has stabilised at about 2.3 million, and the broad unemployment rate stands at about 33 per cent. Weak job creation for young people and those who have not completed matric has exacerbated the challenge of low-skill and youth unemployment.

Figure 2.4 Employment trends by age and education level, 2008 – 2011

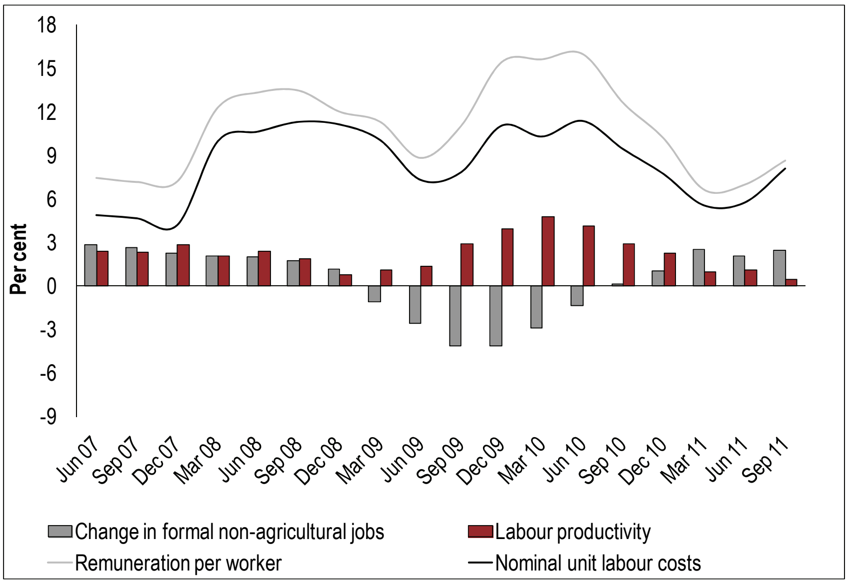


Source: Statistics South Africa, Quarterly Labour Force Survey
** Base for index is March 2008*

Moderation in real wage growth and nominal unit labour costs supported labour market improvements

Moderation in the growth of real wages and nominal unit labour costs since September 2010 has supported recent improvements in the labour market. Nominal wage settlements averaged 7.7 per cent in 2011 compared with an average settlement level of 8.2 per cent in 2010. More recently, slowing labour productivity growth has contributed to accelerated growth in nominal unit labour costs, which grew from below 6 per cent in the first quarter of 2011 to 8.3 per cent in September 2011.

Figure 2.5 Annual change in remuneration, unit labour costs, productivity and employment, 2007 – 2011*



Source: Statistics South Africa, Quarterly Employment Statistics and Reserve Bank
** National Treasury estimates for third quarter of 2011*

Domestic expenditure

Real gross domestic expenditure expanded by an estimated 4.1 per cent between 2010 and 2011, supported by growth in household and government consumption, and renewed growth in fixed capital formation following two years of contraction. Domestic expenditure is expected to expand at an annual average of 4.2 per cent over the medium term.

Household debt and consumption expenditure

Household consumption growth supported by higher real disposable income and low interest rates

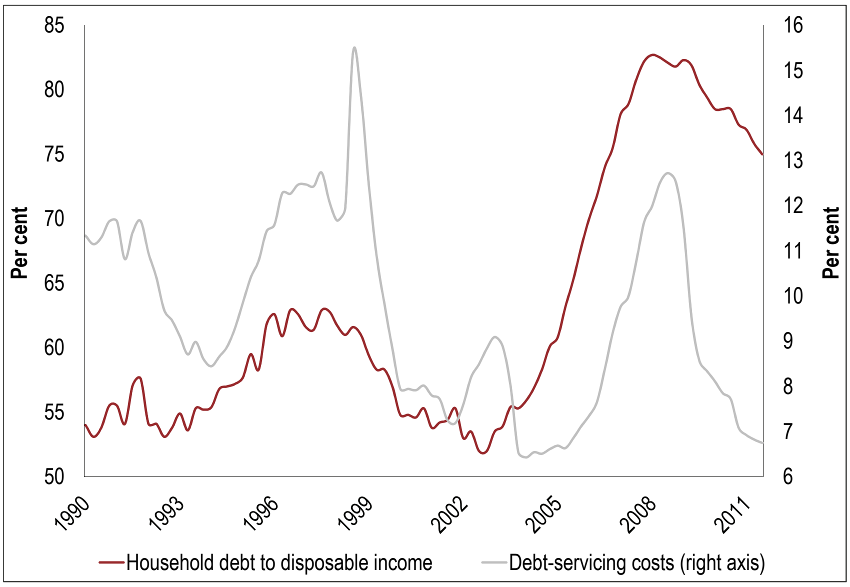
Household consumption rose by 5.2 per cent in the first three quarters of 2011, supported by higher real disposable incomes, an uptick in employment and low interest rates. The expansion was tempered in the final months of the year by weaker consumer confidence and rising inflation.

Household indebtedness continued to decline in 2011. Lower debt-service costs and strong nominal income growth saw the ratio of debt to disposable income fall from 82.7 per cent in the first quarter of 2008 to 75 per cent in the third quarter of 2011. Despite this improvement, debt levels remain elevated and may restrain household consumption growth if interest rates and debt-service costs rise.

Concerns about whether strong gains in household consumption can be sustained over long term

Expenditure on durable goods grew at a robust pace in 2011, continuing a shift in consumption expenditure away from non-durable goods over the past two years. Middle- and high-income households, which account for an increasing share of total consumer spending, were responsible for this shift. High real wage settlements, rather than job creation, have underpinned household disposable income gains, presenting a risk to the sustainability of strong household consumption over the long term.

Figure 2.6 Ratios of household debt and debt-service costs to disposable income, 1990 – 2011*



Source: Reserve Bank

** Data for 2011 is for first three quarters*

Gross fixed capital formation

Low interest rates and relatively strong exchange rate supported investment during first half of 2011

Real gross fixed capital formation increased by 4.1 per cent in the first three quarters of 2011 compared with the same period in 2010. This recovery reflects accelerated private-sector real investment expenditure, with the fastest rates of growth in mining and manufacturing. Private-sector investment was supported by low interest rates and a relatively strong exchange rate during the first half of 2011, encouraging machinery and equipment imports.

Table 2.7 Real investment growth by economic activity, 2007 – 2011

Percentage	2007	2008	2009	2010	2011[1]
Mining and quarrying	31.3	27.5	5.8	-5.5	6.6
Manufacturing	5.8	12.9	-22.1	3.3	11.7
Electricity, gas and water	34.2	44.3	35.2	-1.0	3.7
Transport, storage and communication	15.2	30.3	-0.6	7.3	4.8
Financial intermediation, insurance and real estate	5.7	-6.1	-6.7	-6.3	-3.8
Community, social and personal services	22.1	6.3	-2.5	-7.0	2.7

1. First three quarters of 2011 compared with same period in 2010
Source: Reserve Bank

Private-sector investment is expected to lose some momentum, growing by 4 per cent in 2012 compared with an estimated 5.4 per cent in 2011, as a result of slower growth in South Africa and continued global uncertainty. Fixed capital formation by the private sector is expected to pick up in 2013, rising by 5 per cent.

Public corporations continue to invest in large-scale infrastructure projects, including Eskom's Medupi, Kusile and Ingula power stations, and Transnet's construction of its multiproduct pipeline. Major projects to expand mining and minerals export capacity through energy, rail, road and water infrastructure will increase public investment over the longer term.

Table 2.8 Contribution to overall investment growth, 2007 – 2011

Percentage	2007	2008	2009	2010	2011[1]
General government	3.3	1.7	-0.5	-1.5	0.0
Public corporations	4.2	5.1	3.7	0.4	0.6
Private enterprises	6.5	6.4	-6.4	-0.5	3.4
Total[2]	**14.0**	**13.3**	**-3.2**	**-1.6**	**4.1**

1. First three quarters of 2011 compared with same period in 2010
2. Totals may not add up due to rounding
Source: Reserve Bank

Balance of payments

Moderate widening of the current account deficit over the next several years as demand boosts imports

The current account deficit widened to an estimated 3.3 per cent of GDP in 2011 from 2.8 per cent in 2010. While the trade balance maintained a small surplus, net income payments were pushed up by higher dividend payments to non-residents. The current account deficit is projected to widen to 4.3 per cent of GDP in 2012 and reach 4.4 per cent in the outer year of the forecast as domestic demand boosts imports.

Table 2.9 Summary of South Africa's current account, 2007 – 2011

Percentage of GDP	2007	2008	2009	2010	2011[1]
Total current account	**-7.0**	**-7.2**	**-4.0**	**-2.8**	**-3.1**
Trade balance	-1.8	-1.6	0.1	1.0	0.9
Net services, income and current transfer payments	-5.2	-5.6	-4.1	-3.8	-4.0
Net service payments	-0.9	-1.5	-1.0	-1.2	-1.2
Net income payments	-3.4	-3.3	-2.2	-2.0	-2.3
Net dividend payments	*-3.1*	*-2.6*	*-1.6*	*-1.5*	*-1.9*
Net current transfer payments (mainly SACU)	-0.8	-0.8	-0.9	-0.6	-0.5
Current account excluding net current transfers	-6.1	-6.3	-3.1	-2.2	-2.6

1. Includes data for the first three quarters of 2011, seasonally adjusted and annualised
Source: Reserve Bank

The financial account recorded a large surplus in the first half of 2011, reflecting strong portfolio inflows and modest FDI. In the second half of the year, the deterioration in the global environment weighed on portfolio inflows as investors reduced exposure to emerging market equities.

Table 2.10 Summary of South Africa's financial account, 2007 – 2011

Percentage of GDP	2007	2008	2009	2010	2011[1]
Net portfolio investment	3.6	-6.0	3.9	2.8	-0.3
Net foreign direct investment	1.0	4.4	1.5	0.4	1.0
Net other investment	3.0	5.8	-0.7	-0.5	2.3
Financial account balance	**7.6**	**4.2**	**4.7**	**2.6**	**3.0**
Unrecorded transactions	1.7	4.0	0.0	1.4	2.1
Change in net reserves due to BoP transactions	**2.4**	**1.2**	**0.7**	**1.2**	**1.6**

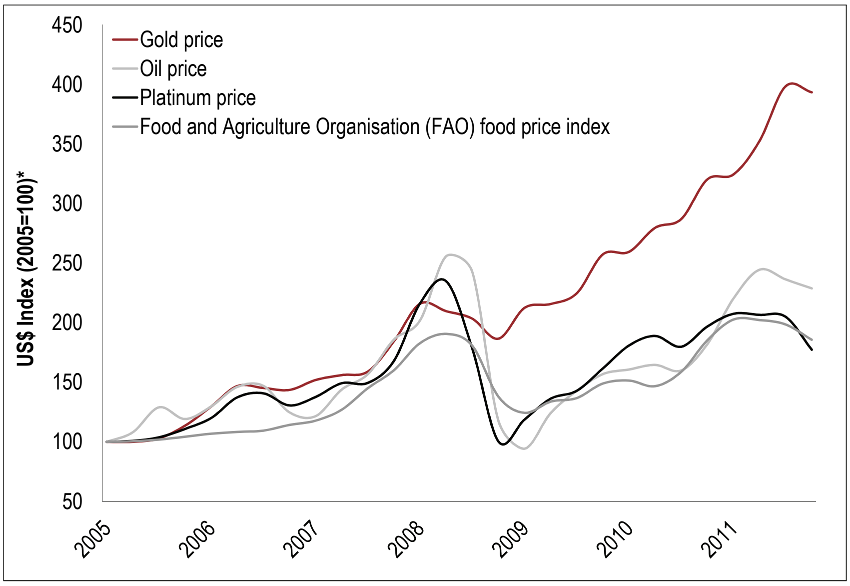
1. Includes data for the first three quarters of 2011
Source: Reserve Bank

Current account

South Africa's trade balance recorded a surplus of 0.9 per cent of GDP in the first three quarters of 2011 compared with 1 per cent in the whole of 2010. Export volumes grew 5.8 per cent compared with the previous year, while imports of goods and services increased by 9.3 per cent.

Exports volumes showed positive growth during first three quarters of 2011

Figure 2.7 Gold, platinum, oil and food price trends, 2005 – 2011



Source: Bloomberg, United Nations Food and Agriculture Organisation
** Base for index is March 2005*

Factors affecting the current account included the following:

- Relatively high commodity prices benefited the terms of trade, which were up by 4.1 per cent in the first nine months of 2011 compared with the same period in 2010.
- The price of platinum averaged US$1 720/oz in 2011, compared with US$1 612/oz in 2010.

- The gold price soared 34 per cent from January 2011 to a record US$1 900/oz in September 2011. In January 2012, the average price of US$1 655/oz was more than double the average for the past decade.
- After spiking to US$127/bbl at the beginning of 2011, the price of Brent crude oil softened but remained above US$100/bbl. Geopolitical tensions centred in the Middle East and Persian Gulf are expected to keep the oil price high in the near term.
- The United Nations Food and Agriculture Organisation index of global food prices was 36 per cent higher in the first half of 2011 compared with the same period in 2010. Prices declined moderately in the second half of 2011.

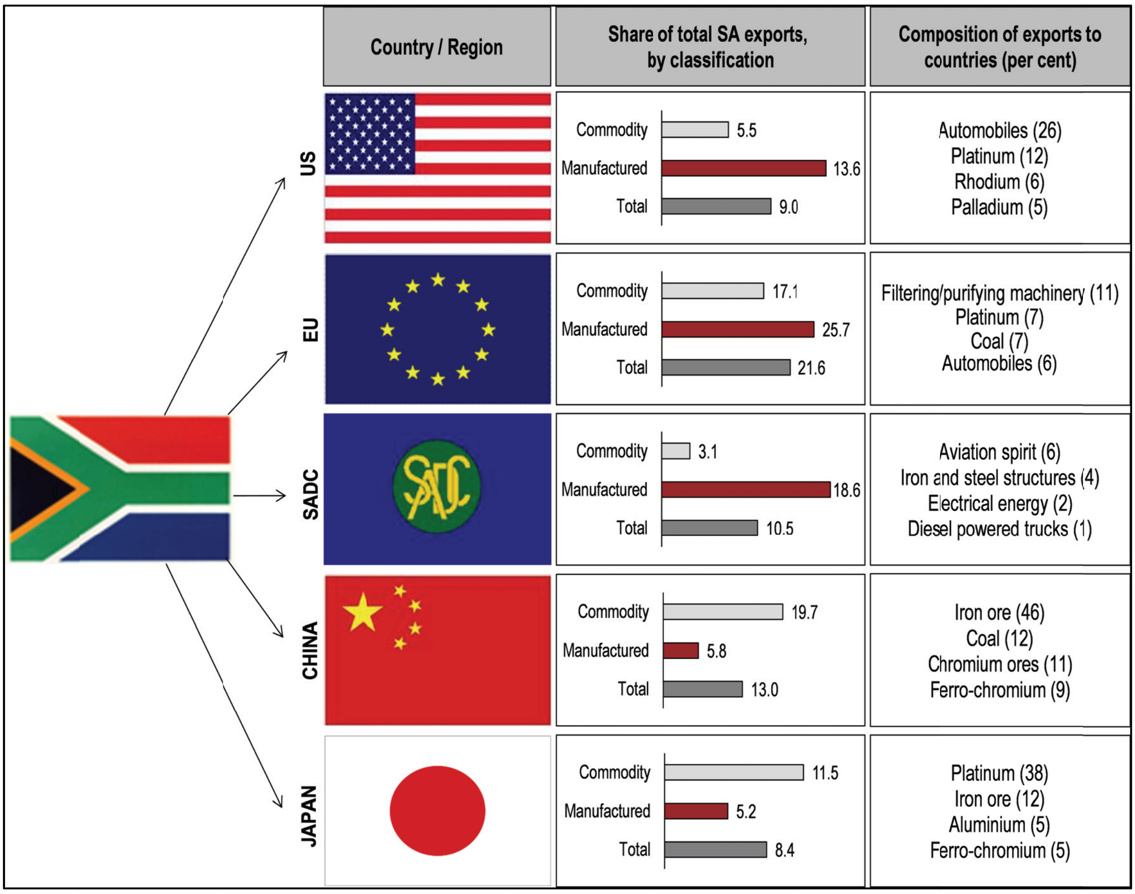
High commodity prices pushed up the share of resources such as gold, platinum, coal and iron ore in South Africa's export basket to 40 per cent in the first 11 months of 2011 from 36 per cent in 2010.

Shifting trade patterns

South Africa's share of exports to China and the SADC countries has grown

South Africa's trade patterns have changed significantly in response to global growth trends. A rising share of exports to China (from an average of 4.2 per cent between 2005 and 2008 to 13 per cent in 2011) and to Southern African Development Community (SADC) countries has been accompanied by a decline in exports to the European Union, from 33 per cent in 2005 to 21.6 per cent in 2011.

Figure 2.8 Mapping South Africa's exports, 2011



Source: Quantec

Strong growth in developing countries, which absorb about 60 per cent of South Africa's commodity exports and half of its manufactured exports, will continue to support demand. Over the past five years, the strongest export growth has been for mineral products (iron ore), fats and oils, chemical products (soaps and plastics), and transport equipment. Imports of machinery and equipment, chemicals, and motor vehicles components increased strongly in 2011 as domestic demand and investment recovered.

The deficit on the services, income and current transfer account widened marginally to 4 per cent of GDP in the first three quarters of 2011 from 3.8 per cent in 2010 as a whole, primarily due to a strong increase in dividend payments to non-residents as corporate profitability improved. As a share of GDP, net dividend payments remain well below the 2007 peak. Net transfer payments to the Southern African Customs Union are expected to rise as import volumes respond to higher investment.

Table 2.11 Composition and performance of South Africa's trade with major regions, 2005 – 2011

	% change in exports 2010–2011[1]	% share of exports			% share of imports			% change in imports 2010–2011[1]
		Average 2005–2008	2010	2011[2]	Average 2005–2008	2010	2011[2]	
EU	4.5	31.2	23.5	21.6	34.4	32.0	30.9	14.7
Germany	*0.2*	*6.9*	*7.4*	*6.5*	*12.4*	*11.3*	*11.1*	*16.2*
UK	*0.1*	*7.9*	*4.5*	*4.0*	*4.9*	*3.8*	*4.2*	*33.7*
Netherlands	*14.4*	*4.3*	*3.0*	*2.9*	*1.5*	*1.8*	*1.5*	*0.2*
Spain	*-3.0*	*2.6*	*1.4*	*1.2*	*1.4*	*1.6*	*1.4*	*2.8*
China	51.6	4.2	10.2	13.0	10.3	14.2	13.5	13.1
SADC	15.2	9.4	10.4	10.5	4.5	4.7	4.3	6.9
Mozambique	*19.2*	*1.8*	*2.4*	*2.5*	*0.3*	*0.7*	*1.1*	*88.3*
Zimbabwe	*6.3*	*2.0*	*2.6*	*2.4*	*1.0*	*0.2*	*0.5*	*124.1*
Zambia	*37.2*	*2.0*	*2.0*	*2.4*	*0.4*	*0.4*	*0.4*	*34.1*
USA	15.7	10.3	8.9	9.0	7.7	7.1	8.2	38.5
Japan	17.0	10.5	8.0	8.4	6.4	5.3	4.6	2.9
Other	10.2	34.5	38.9	37.5	36.8	36.5	38.5	26.2
Total	**14.5**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**19.3**

1. January – November 2011 compared with same period in 2010
2. The first 11 months of 2011
Source: Quantec

Financial account

International investors were net buyers of South African bonds in 2011, but portfolio investment declined

The financial account of the balance of payments recorded a net increase of R64.8 billion in the first nine months of 2011, despite a net outflow of portfolio assets. The decline in portfolio investment occurred as non-residents sold off equities and South African investors took advantage of higher offshore investment allowances. International investors were net buyers of local bonds worth R47.6 billion in 2011 – down from R55.9 billion in 2010 – and were net sellers of equities worth R19.1 billion, compared with net purchases of R36.2 billion in 2010.

In the first three quarters of 2011, net FDI inflows more than doubled relative to 2010. Most of these inflows emanated from the US, China and Japan, and were directed primarily to the domestic wholesale and retail trade, mining and manufacturing sectors.

The South African bond market is expected to remain attractive to international investors because domestic interest rates will be higher than developed market rates for some time to come. Equities should also remain attractive, particularly while commodity prices are high.

Exchange rate and international reserves

Global volatility will continue to fuel exchange rate fluctuations

High levels of uncertainty in the global environment fuelled exchange rate volatility in 2011. Most emerging market currencies weakened against the US dollar in the second half of the year, when risk aversion increased and previously strong capital inflows reversed; the rand, Turkish lira and Indian rupee recorded the largest losses.

The nominal trade-weighted rand declined by 15.4 per cent from the start of 2011 to the end of December, but strengthened somewhat in the first six weeks of 2012. In real terms, the depreciation over the past year has been slightly less pronounced, owing to South Africa's higher inflation compared with its trading partners.

Gross foreign exchange reserves rose to US$48.9 billion at the end of December 2011 from US$43.8 billion a year earlier.

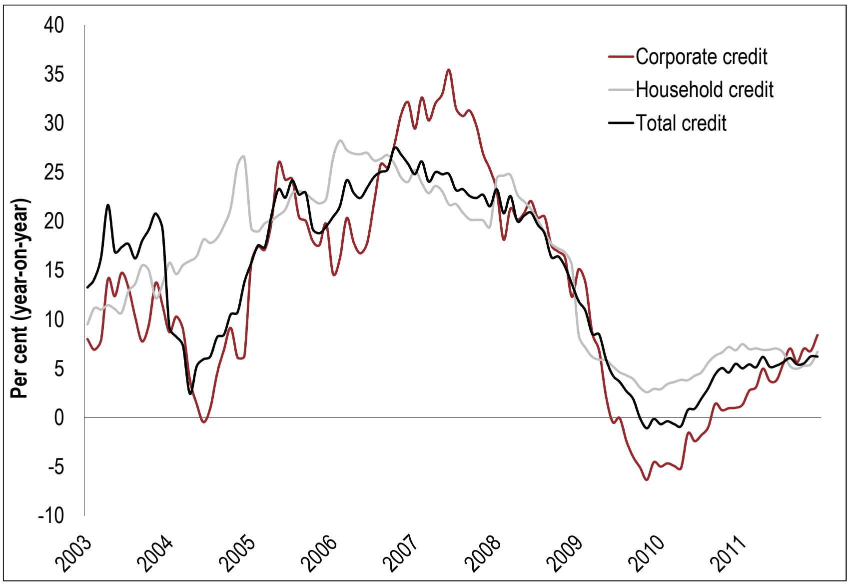
Monetary and financial sector developments

Private-sector credit extension

Growth in private-sector credit extension averaged 5.6 per cent in 2011

Growth in private-sector credit extension averaged 5.6 per cent in 2011 compared with 2 per cent in 2010. Two factors supported this modest increase: credit extended to the corporate sector grew more quickly in response to revived investment growth, and higher household borrowing was supported by gradual economic recovery, low interest rates and more relaxed lending criteria. Strong demand for unsecured credit and vehicle finance has offset weak growth in mortgage advances.

Figure 2.9 Credit extension by classification, 2003 – 2011



Source: Reserve Bank

The ratio of impaired advances to total loans and advances declined from a peak of 6 per cent in November 2009 to 4.8 per cent in November 2011. Despite an improvement in overall debt levels, the number of consumers with impaired records increased to 8.8 million in the third quarter of 2011 – almost half (46 per cent) of total credit-active consumers. The subdued property market, and risk aversion by households and banks, may limit growth in credit extension in 2012.

Monitoring shifts in the composition of household debt

Unsecured loans accounted for 21.4 per cent of all new loans in the third quarter of 2011, up from 7.8 per cent at the end of 2007. Over the same period, mortgage loans have fallen to 30.3 per cent of new loans from 51.9 per cent, as uncertainty, high levels of household debt and falling house prices have made banks less willing to extend longer-term credit.

Growth in unsecured lending partly reflects changes in the regulatory framework governing short-term loans following the introduction of the National Credit Act (2005). Previous limits on loan size (R10 000) and repayment duration (up to 36 months) fell away.

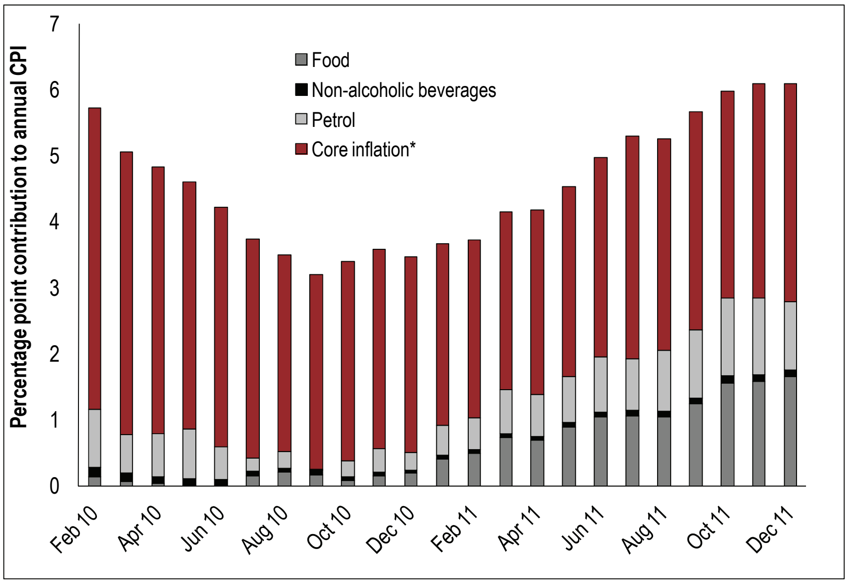
Most unsecured lending is directed towards high-income earners who have more job security, which may reduce household and bank vulnerability. The National Credit Regulator is satisfied that banks are complying with the principles of the act and not engaging in reckless lending. These trends should be monitored to ensure that consumers' growing reliance on unsecured debt does not become a systemic risk.

Inflation and interest rates

By end-December 2011, CPI inflation was just above the target band

Inflationary pressures intensified during 2011. CPI inflation increased from a low of 3.2 per cent in September 2010 to 6.1 per cent in December 2011 – the result of rising food and fuel prices, and the weaker rand exchange rate. Core inflation (headline inflation excluding food, non-alcoholic beverages and petrol) remained well contained, increasing from 3.6 per cent in September 2010 to 4.4 per cent in December 2011. Administered price inflation remains high, with 14 of the 18 components in the administered price index increasing by more than 6 per cent in 2011. Inflationary pressures are expected to persist in 2012 in response to rising food prices, sustained weakness of the rand, wage pressures and continuing increases in administered prices, including electricity tariffs.

Figure 2.10 Contributions to CPI inflation, 2010 – 2011



Source: Statistics South Africa

** Core inflation is headline inflation excluding food, non-alcoholic beverages and petrol*

Inflation expectations are rising in tandem with the CPI. According to the Bureau for Economic Research, trade unions, businesses and analysts expect inflation to average 6.1 per cent in 2012, up from the June 2011 survey figure of 5.8 per cent.

The Reserve Bank kept the repurchase (repo) rate unchanged at 5.5 per cent during 2011. Real interest rates have been negative since September 2011 as inflation has risen. The challenge for monetary policy is to balance weaker economic prospects and significant global risks alongside rising inflationary pressures.

New steps to strengthen South Africa's financial regulatory system

In the 2011 Budget, the Minister of Finance proposed reforms to strengthen the financial regulatory system. Cabinet has approved the principles, technical work is under way and legislation is expected by 2013. The legislation will propose a new prudential regulator in the Reserve Bank, transform the Financial Services Board into a market conduct regulator and formalise the existing Financial Stability Oversight Committee.

Four related bills will also be tabled in Parliament during 2012:

- Amendments to banking legislation to introduce stronger Basel III capital requirements and introduce "dedicated" banks, which specialise in retail activities such as deposit-taking and/or lending.
- The Financial Markets Bill will replace the Securities Services Act, strengthen the fight against market manipulation (including insider trading) and regulate over-the-counter derivatives.
- The Credit Rating Services Bill will regulate the governance and practices of credit rating agencies.
- A general bill will address gaps in the regulation of pension funds, insurance companies and friendly societies.

Government is working with the financial services industry to improve product disclosure and lower costs.

Gateway into Africa and cross-border investments

Government has undertaken a range of reforms to promote investment into Africa through South Africa. However, significant financial and non-financial barriers still impede the flow of investment between South Africa and the rest of the continent. The National Treasury will consult interested parties to address such blockages, and will also release a new draft of its consultation paper on cross-border investment. The Reserve Bank will make minor refinements to reduce red tape on cross-border transactions.

Conclusion

The economy has shown resilience and growth prospects are forecast to improve over the medium term

The South African economy has shown resilience and growth prospects are forecast to improve over the next several years. Over the short term, global uncertainty is likely to hold back higher growth. In this environment, South Africa needs to move forward by building on the inherent strengths of our economy to achieve higher levels of inclusive growth. To do this, government will build on its record of prudent macroeconomic and fiscal management; use public resources more effectively to alleviate poverty and improve service delivery; expand capital infrastructure projects that boost capacity and productivity over the longer term; lower the costs of doing business; take steps to promote a well-regulated environment for the private sector to expand and thrive; and focus on regional and international partnerships to expand and diversify trade and investment. Success in these areas will lay the foundation for strong, sustainable growth and job creation for years to come.