2

Economic outlook

In brief

- The South African economy is forecast to grow by 2 per cent in 2015, with a gradual improvement to 3 per cent in 2017.
- Weaker global growth prospects and slower growth in key emerging markets introduce a degree of uncertainty into the forecast, with volatility expected in capital markets and exchange rates.
- Lower oil prices over the short term should boost global growth, trade and consumption. South Africa's terms of trade will benefit from the decline in the oil price.
- Real exchange rate depreciation and low inflation should support the competitiveness of South African firms, but the electricity supply constraint will curtail mining and manufacturing output, and exports.
- Low investor confidence could hinder investment in South Africa this year, but businesses with strong balance sheets are expected to upgrade machinery and equipment, and to continue investing in fast-growing African markets.
- The medium-term strategic framework supports a range of programmes that, in combination with infrastructure investment and structural changes in the real economy, will ultimately raise growth potential.

Overview

Global economic growth projections have been revised down in recent months, and the pattern of slow growth is likely to persist, with consequences for all developing economies.

Moderate improvements to growth outlook expected in period ahead

South Africa's gross domestic product (GDP) forecast for 2015 has also been revised down. The National Treasury projects GDP growth of 2 per cent in 2015, rising to 3 per cent by 2017. The moderately improving growth outlook will be supported by continued economic growth in much of sub-Saharan Africa, as well as better terms of trade and inflation gains associated with the lower oil price, and a more competitive rand exchange rate. Inadequate electricity supply, however, will impose a serious constraint on output and exports over the short term.

Government has invited new bids for independent power producers and seeks to secure gas and renewables supply

Government is working with Eskom to mitigate the impact of power cuts. The measures include stepping up maintenance to ensure reliability of supply, renewing existing co-generation agreements and entering into new ones with private firms, and expediting the completion of new power stations. At the end of 2014, government invited independent power producers to build coal-fired power stations providing up to 2 500MW of electricity. Efforts are also under way to secure additional supply from gas and renewable sources. In combination, these efforts will improve the availability of electricity over the medium term, and plans are under way to ensure that South Africa can generate sufficient energy to power its economy over the long term.

Economic growth and the National Development Plan

Achieving faster sustainable growth and job creation requires structural shifts

The slowdown in economic growth since 2012 has highlighted structural constraints in the domestic economy. While progress has been made on several fronts – such as talks to establish a more sustainable labour relations environment, and administrative reforms to reduce red tape in certain areas – the fundamental obstacles to more rapid growth remain in place. Achieving faster sustainable growth and large-scale job creation will require structural shifts in the economy, stronger supply-side value chains, higher exports, moderation in wage increases and, crucially, growing private-sector investment based on confidence in the long-term business environment.

National Development Plan and MTSF target infrastructure investment, private-sector partnerships

The integrated reforms required to achieve these goals are outlined in the National Development Plan, and are addressed in the medium-term strategic framework (MTSF). Initiatives under way include large public-sector infrastructure investments in electricity and transport; expanded partnerships to encourage private investment; better cooperation between government, the private sector, trade unions and civil society; incentives to attract new entrants in the economy; special economic zones to boost exports; programmes to reshape the urban spatial landscape; and programmes to improve the quality of education and skills development.

Maintaining a prudent macroeconomic and fiscal policy stance that promotes low inflation, low interest rates and a competitive real exchange rate – and which narrows the budget deficit and stabilises the public-sector debt ratio – will provide a platform to strengthen structural change across the economy.

Global outlook

A protracted period of weak global growth is expected

A weak global economic recovery is projected over the next several years, with growth forecast to rise from 3.3 per cent in 2014 to 3.5 per cent in 2015 and 3.7 per cent in 2016. Volatility in capital flows is expected to continue.

Among advanced economies, growth is picking up in the United States, but economic activity remains tepid in Europe and Japan. Weak domestic demand and falling inflation expectations have prompted the central banks of Europe and Japan to introduce additional monetary stimulus, which should support growth rates slightly above 2014 levels. However, the outcome of negotiations between Greece and its creditors could have destabilising economic and political consequences for the European Union.

The forecast growth rates of large emerging markets have been revised downwards. In emerging markets and developing economies, growth is projected to dip to 4.3 per cent in 2015, improving to 4.7 per cent in 2016. China's GDP growth rate is projected to slow to 6.8 per cent in 2015.

Table 2.1 Annual percentage change in GDP and consumer price inflation in selected regions/countries, 2013 – 2016

Region/country	2013	2014	2015	2016	2013	2014	2015	2016
Percentage	GDP projections[1]				CPI projections[2]			
World	**3.3**	**3.3**	**3.5**	**3.7**	**3.9**	**3.8**	**3.9**	**3.8**
Advanced economies	**1.3**	**1.8**	**2.4**	**2.4**	**1.4**	**1.6**	**1.8**	**2.0**
United States	2.2	2.4	3.6	3.3	1.5	2.0	2.1	2.1
Euro area	-0.5	0.8	1.2	1.4	1.3	0.5	0.9	1.2
United Kingdom	1.7	2.6	2.7	2.4	2.6	1.6	1.8	2.0
Japan	1.6	0.1	0.6	0.8	0.4	2.7	2.0	2.6
Emerging markets and developing economies	**4.7**	**4.4**	**4.3**	**4.7**	**5.9**	**5.5**	**5.6**	**5.2**
Brazil	2.5	0.1	0.3	1.5	6.2	6.3	5.9	5.6
Russia	1.3	0.6	-3.0	-1.0	6.8	7.4	7.3	6.0
India	5.0	5.8	6.3	6.5	9.5	7.8	7.5	6.7
China	7.8	7.4	6.8	6.3	2.6	2.3	2.5	3.0
Sub-Saharan Africa	**5.2**	**4.8**	**4.9**	**5.2**	**6.6**	**6.7**	**7.0**	**6.5**
South Africa[3]	2.2	1.4	2.0	2.4	5.8	6.1	4.3	5.9

1. IMF World Economic Outlook, January 2015
2. IMF World Economic Outlook Update, October 2014
3. National Treasury forecasts

Robust economic growth outlook for sub-Saharan Africa

The growth outlook for sub-Saharan Africa remains robust, averaging 5 per cent over the next three years, despite lower commodity prices. Economies in the region have diversified over the past decade, attracting increased foreign direct investment and benefiting from rising investment in ports, electricity capacity and transportation. Buoyant growth in agriculture and services has also broadened economic activity. For net oil importers, the decline in oil prices should offset lower non-oil commodity export prices over the short term. However, the region faces significant risks. These include uncertainty about the consequences of lower commodity prices on investment, unresolved security issues and weak demand from Europe.

How will the price of oil affect South Africa and the region?

The International Monetary Fund (IMF) estimates that lower oil prices could raise global growth by between 0.3 and 0.7 percentage points. Fitch Ratings estimates that the price decline could boost sub-Saharan African growth to 5 per cent in 2015. South Africa, Kenya, Tanzania, Cote d'Ivoire and Ethiopia spend 20 per cent or more of their import bill to buy oil.

South Africa is an oil-intensive country, meaning that it uses a relatively high proportion of oil to produce a unit of GDP, particularly for transportation. Lower oil prices are expected to boost the South African economy as inflation falls and disposable income rises due to improved terms of trade. The net effects of a lower oil price, however, depend on several factors, including the duration and extent of the price decline, currency depreciation, the oil intensity of trading partners, the ability of local firms to respond to increased demand, and taxes and subsidies on oil products.

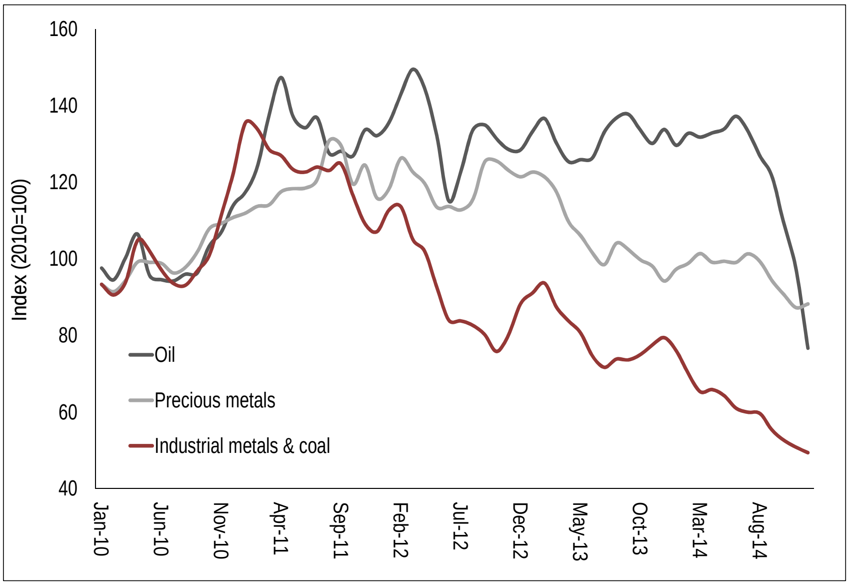
Commodity prices

In recent months, crude oil prices have declined sharply, falling from US$102/barrel in August 2014 to US$48/barrel in January 2015. There is, however, great uncertainty over the long-term trajectory of oil prices, which have already begun to rise from the January trough.

Non-oil commodity prices have declined, driven by weaker growth in China

Non-oil commodity prices have declined significantly since 2012, and most are expected to remain at similar levels for much of 2015. The common factor behind these price trends is weak global growth, particularly the slowing Chinese economy. Coal prices declined by 20 per cent year on year to US$66 per ton at the end of 2014, and are expected to remain subdued in 2015. Platinum prices are projected to recover in 2015, supported by a supply deficit and strong demand for catalytic converters. The price of gold has remained volatile but has declined marginally over the past year.

Figure 2.1 Commodity prices, 2010 – 2014*



Source: International Monetary Fund and National Treasury

**Precious metals, and industrial metals and coal indices are trade weighted using South Africa's export ratios*

The world economy and South Africa

Volatility in global monetary policy and capital flows expected over medium term

Lower commodity prices, slow growth among major trading partners and volatility in global monetary policy and capital flows will directly affect South Africa over the next several years. The European monetary stimulus is expected to have a muted impact on GDP growth in Europe, and the anticipated weakness of the euro will limit South Africa's currency competitiveness. Weaker commodity demand from China in particular is expected to have a negative effect on South Africa's exports.

Continued growth in African markets is a growth channel for South African exports

The net result of these trends, however, is offset by several developments. South Africa's deepening trade links with sub-Saharan Africa, where investment has begun to diversify towards manufacturing, services and infrastructure, should continue to provide expanded export markets, though there may be negative effects from reduced Chinese demand. In the short term, lower oil prices are expected to reduce transport costs and improve the terms of trade. Disciplined government spending will reduce the economy's vulnerability to capital outflows, and create sufficient space for monetary policy to support investment and a competitive real exchange rate.

South Africa: economic outlook and trends

Projected GDP growth is revised down from 2.5 to 2 per cent in 2015, with a gradual rise to 3 per cent by 2017. Average growth over the forecast period is 0.4 percentage points lower than at the time of the 2014 *Medium Term Budget Policy Statement.*

GDP expected to reach 3 per cent by 2017

The economic forecast takes into account a wide range of factors. Global growth has been revised downwards. While there is uncertainty about the impact of key variables (see box on following page), in comparison with the pre-2008 period, a protracted period of lower global economic growth is expected. Terms of trade gains might provide temporary relief for domestic prospects, but they are likely to be offset by constraints on output growth, notably the electricity constraint. Inadequate and unreliable electricity supply has also reduced investor and consumer confidence.

Table 2.2 Macroeconomic performance and projections, 2011 – 2017

Calendar year	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Percentage change		**Actual**		**Estimate**		**Forecast**	
Final household consumption	4.9	3.4	2.9	1.2	2.0	2.6	3.0
Final government consumption	1.7	3.4	3.3	1.9	1.6	0.7	0.7
Gross fixed-capital formation	5.7	3.6	7.6	-0.6	2.2	3.4	3.8
Gross domestic expenditure	4.9	3.9	1.4	1.1	2.4	2.7	3.1
Exports	4.3	0.1	4.6	0.9	3.3	4.6	5.0
Imports	10.5	6.0	1.8	-0.3	4.6	5.3	5.5
Real GDP growth	**3.2**	**2.2**	**2.2**	**1.4**	**2.0**	**2.4**	**3.0**
GDP inflation	6.7	5.5	6.0	6.1	6.1	5.5	5.5
GDP at current prices (R billion)	**3 025.0**	**3 262.5**	**3 534.3**	**3 801.7**	**4 112.8**	**4 443.2**	**4 829.9**
CPI inflation	5.0	5.7	5.8	6.1	4.3	5.9	5.7
Current account balance (% of GDP)	-2.2	-5.0	-5.8	-5.8	-4.5	-4.9	-5.2

Source: Reserve Bank and National Treasury

Table 2.3 Macroeconomic performance and projections, 2011/12 – 2017/18

Fiscal year	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**
Percentage change		**Actual**		**Estimate**		**Forecast**	
GDP at current prices (R billion)	**3 081**	**3 328**	**3 610**	**3 880**	**4 192**	**4 539**	**4 926**
Real GDP growth	3.0	2.1	2.2	1.4	2.0	2.6	3.0
GDP inflation	5.9	5.8	6.1	6.0	5.9	5.5	5.4
CPI inflation	5.6	5.6	5.8	5.6	4.8	5.9	5.6

Source: National Treasury

Over the medium term, the electricity supply constraint will curtail output and limit expansion. Investment growth has been revised down, but private investment growth is expected to pick up as firms invest in maintenance and upgrading of equipment. Public-sector investment will remain robust, but will moderate due to lower estimates in the medium-term investment plans of Transnet and Eskom. The positive impact of low oil prices on GDP growth in 2015 is expected to recede in 2016 as oil prices are projected to increase.

Household consumption is projected to grow by only 2 per cent in 2015 as a result of subdued employment growth, lower income growth and high debt levels. Higher purchasing power and lower inflation will not fully offset these effects.

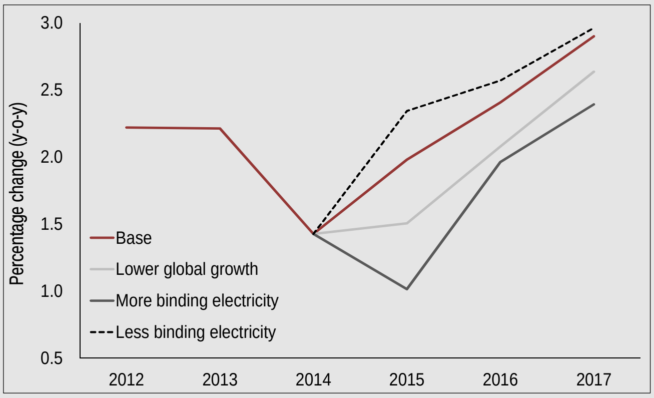
Household consumption projected to grow by 2 per cent in 2015

Economic growth scenarios

The current economic environment is characterised by high levels of uncertainty in the global outlook, the oil price and the net effect of the electricity supply constraint. Consequently, it is useful to discuss the main assumptions used by the National Treasury in compiling the GDP forecast.

Growth rate assumptions are as projected in Table 2.1. The oil price is projected to rise from current levels to US$75/barrel by 2017. Platinum prices are expected to rise from current levels of US$1 200/oz to US$1 450/oz in 2017. Coal prices are projected to increase marginally. Gold prices are likely to remain at current levels, while iron ore prices are expected to fall marginally in line with slowing growth in China. The forecast assumes electricity disruptions to output and consumption consistent with intermittent load shedding.

GDP growth scenarios to 2017



Source: National Treasury

A number of scenarios are possible depending on the outcome of these assumptions:

- Further deterioration in electricity availability in the current year, reducing growth to 1 per cent in 2015. The mining and manufacturing sectors would be most affected due to their high electricity intensity. Lower employment growth would negatively affect disposable income and household consumption.
- A decline in global growth by more than anticipated, pushing commodity prices down. A 0.5 percentage point decline in the annual growth rate for global demand, and a 10 per cent fall in export commodity prices, would lower GDP growth to 1.5 per cent in 2015 and 2.1 per cent in 2016.
- Better-than-expected availability of electricity or greater energy efficiency could boost growth in 2015 by 0.4 per cent, strengthening the benefits associated with lower oil prices and positive terms of trade.

Despite a more competitive rand, export growth has been revised down from 4.2 per cent to reflect supply-side constraints. Exports are projected to grow by 3.3 per cent in 2015 and by 5 per cent in 2017. Import growth has also been revised down in line with weaker domestic demand and reduced imports of capital equipment.

Updating the measurement of gross domestic product

All countries update their national accounts data from time to time to reflect broad changes in economic activity. South Africa has conducted these updates at a five-year frequency since 1999. In November 2014, Statistics South Africa and the Reserve Bank published two revisions of national accounts data:

- Benchmarking of data to 2010 to reflect a more current structure of the economy.
- Introducing the United Nations 2008 System of National Accounts (SNA), which will change the methodology used in measuring GDP, adjusting for aspects of the economy that have become more prominent.

Using the rebased nominal GDP numbers, the budget deficit as a percentage of GDP narrows by 0.2 percentage points in 2014/15. The level of nominal GDP in 2014 is about 4 per cent higher (about R159 billion) as a result of the exercise.

Trends in the real economy

The National Treasury's forecasts of the near and medium-term outlook are informed partly by analysis of recent trends and initiatives. During 2014, strong growth in agriculture and an improved performance by construction were offset by contractions in the mining and electricity sectors. Supply shocks and flagging demand also weighed on the performance of manufacturing, where growth was flat.

Growth in agriculture, construction in 2014 offset by contractions in mining, electricity

Table 2.4 Sector growth trends, 2012 – 2014

	2012	2013					2014			
Percentage	**Year**	**Q1**	**Q2**	**Q3**	**Q4**	**Year**	**Q1**	**Q2**	**Q3**	**Year[1]**
Agriculture, forestry and fishing	0.6	-2.9	-1.1	3.6	6.9	1.5	3.3	5.3	8.2	4.6
Mining and quarrying	-2.9	14.3	-4.5	12.3	17.2	4.0	-23.0	-3.1	1.6	-1.4
Manufacturing	1.9	-7.8	11.7	-6.6	12.3	0.7	-6.4	-4.0	-3.4	0.1
Electricity and water	-0.1	-4.8	3.0	1.9	-6.0	-0.6	0.2	-0.5	-1.1	-1.1
Construction	2.1	-0.8	5.1	0.6	3.6	2.7	3.7	2.1	2.2	2.9
Wholesale and retail trade; hotels and restaurants	3.6	0.9	2.2	0.3	1.8	1.9	1.5	-0.2	3.4	1.3
Transport and communication	2.5	2.0	1.6	2.6	1.6	2.0	1.4	3.9	2.2	2.1
Finance, real estate and business services	3.0	4.8	5.0	2.8	2.6	3.0	1.4	1.2	2.4	2.3
Personal services	2.1	1.2	2.7	1.2	1.2	1.8	1.5	1.5	1.3	1.5
General government	3.6	1.3	2.8	2.8	4.6	3.1	2.3	3.9	2.2	3.3
GDP	***2.2***	***1.4***	***3.7***	***1.2***	***5.1***	***2.2***	***-1.6***	***0.5***	***1.4***	***1.5***

1. Year-to-date growth trend
Source: Reserve Bank

Agriculture's robust performance is attributable to favourable weather conditions, high levels of production in summer field crops and animal products, and strong meat and wheat prices. Despite recent high temperatures and low rainfall that may affect certain provinces, production estimates suggest that positive growth will continue during 2015.

Real value added in the mining sector contracted by 1.4 per cent during the first three quarters of 2014. The poor performance was largely the result of a five-month strike in the platinum sector, compounded by weaker global demand, electricity constraints and long-term maintenance requirements. Underground mine production continues to fall as mines get deeper and ore grades decline. The significant reduction in platinum group metals production was offset by increased iron ore, coal and manganese output.

Strikes and weaker global demand contributed to weak mining performance

After recovering steadily since the 2009 recession, with annual growth of about 2.8 per cent and rising investment, manufacturing production contracted in each of the first three quarters in 2014. This resulted from weak domestic demand, strikes in the metals, steel and engineering sector, and refinery maintenance. Over the forecast period, manufacturing and mining, which are highly energy intensive, are expected to be seriously affected by electricity constraints.

In construction, growth is expected to improve during 2015, supported by the observed increase in the real value of building plans passed – an indication of future building activity – and continued government investment. Private-sector construction investment, however, has yet to gather pace.

Indications of positive growth in construction sector during 2015

Growth in the transport and communication sector was supported by infrastructure investment, rising passenger and freight demand, and increased competition in telecommunications. Transnet and the Passenger Rail Agency of South Africa's capital expenditure programmes, in locomotives and trains, are beginning to show results. Increased volumes on the Richards Bay coal line and the Sishen-Saldanha iron-ore line contributed to sector growth.

Measures to address South Africa's electricity supply constraint

South Africa's electricity supply constraint has worsened, largely owing to inadequate maintenance, leading to unplanned outages. Government's ministerial electricity "war room" is working to address the following:

- Short-term funding, maintenance and diesel supply concerns.
- Speeding up the completion of the Medupi and Kusile power stations.
- Procuring additional co-generation capacity of about 800 MW over the next six months.
- Increasing gas generation. Government has released a request for proposals for 3 126MW of power from natural gas, with initial power expected to be available by 2020. Steps are also under way to switch Eskom's open-cycle gas turbines from diesel to natural gas.
- Obtaining up to 2 500MW from independent power producers generating electricity from coal; this power should start being added to the grid by 2020.

Government is in talks with business and considering a wide range of options to improve energy efficiency and manage demand. Options under consideration include expanding the use of smart meters, "buying back" power from large industrial users and varying tariffs by time of use. Over time, progress towards tariffs that reflect Eskom's costs of producing electricity will encourage businesses and households to use energy more efficiently.

Over the period ahead, South Africa will procure imported hydro power (2 609 MW) and 13 more renewable power projects totalling 1100 MW from the private sector. South Africa has already contracted a total of 4 100 MW of renewable energy from 66 different private-sector projects since 2011, of which 32 are supplying 1 522 MW to the grid. A framework for investment in gas infrastructure has been released for public comment.

Government has also initiated discussions with several potential partner countries to explore nuclear power production. Like any substantial long-term investments of this magnitude, proposals would be subject to rigorous feasibility, affordability and environmental impact assessments. Final contracting would be subject to fair, transparent and competitive procurement processes within the requisite legal framework.

Frequent unplanned outages and low plant availability are expected to persist for the next three years. Reforms under way, however, will over time lead to the development of a vibrant, diversified and competitive electricity sector, which will change the supply mix, expand private participation, and ensure robust and flexible supply.

Employment and remuneration

The unemployment rate was 24.3 per cent at the end of 2014, or 34.6 per cent including discouraged job seekers. Among the unemployed, long-term joblessness is 66 per cent, underlining how lengthy exclusion from the labour market erodes skills and reduces employability. Unemployment for those between 15 and 24 years old remains extremely high at 48.8 per cent.

Worryingly, private-sector job creation remains weak

The Quarterly Labour Force Survey (of individuals) shows that in 2014, 143 000 jobs were created. Worryingly, private-sector job creation remains weak. The public sector has contributed 59 per cent of the formal non-agricultural jobs created since 2010, and 88 per cent of jobs in 2014, most of which were in public works programmes, state-owned entities and local government.

Employment in mining and manufacturing has declined. The mining sector lost 8 000 jobs year-on-year by the third quarter of 2014. Manufacturing employment has lost 18 000 jobs since the beginning of 2014, largely due to greater reliance on higher skills, technology and capital. The Quarterly

Labour Force Survey reports that the agriculture sector gained 28 000 jobs in 2014.

The labour intensity of production continues to decline. While this boosts unit labour productivity and can enhance competitiveness, total output is not growing fast enough to absorb existing job seekers or new workforce entrants. Reducing unemployment and inequality will require a large increase in job creation by the private sector.

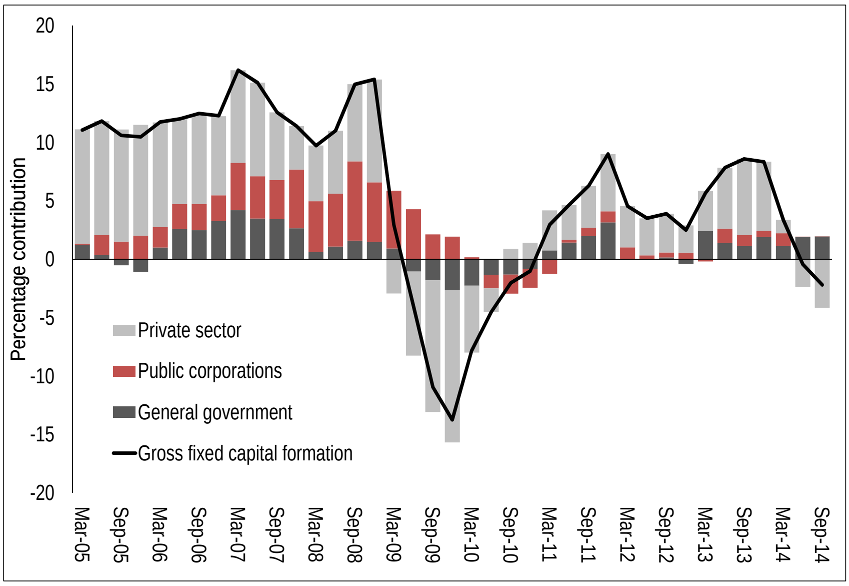
Domestic expenditure

Tighter financial conditions have reduced overall consumer debt levels to 78.3 per cent of disposable income, down from a high of 89.3 per cent in 2008, but consumer confidence remains subdued.

Overall consumer debt stands at 78 per cent, down from previous highs, but confidence is subdued

Gross fixed capital formation grew by just 0.2 per cent in the first three quarters of 2014, due mainly to a 2.8 per cent contraction in private investment. While business confidence is likely to remain subdued, continued growth in general government investment should contribute to a recovery in private investment. Economic infrastructure accounted for nearly 60 per cent of investment spending by general government in 2013.

Figure 2.2 Growth in gross fixed capital formation by sector, 2005 – 2014



Source: Reserve Bank

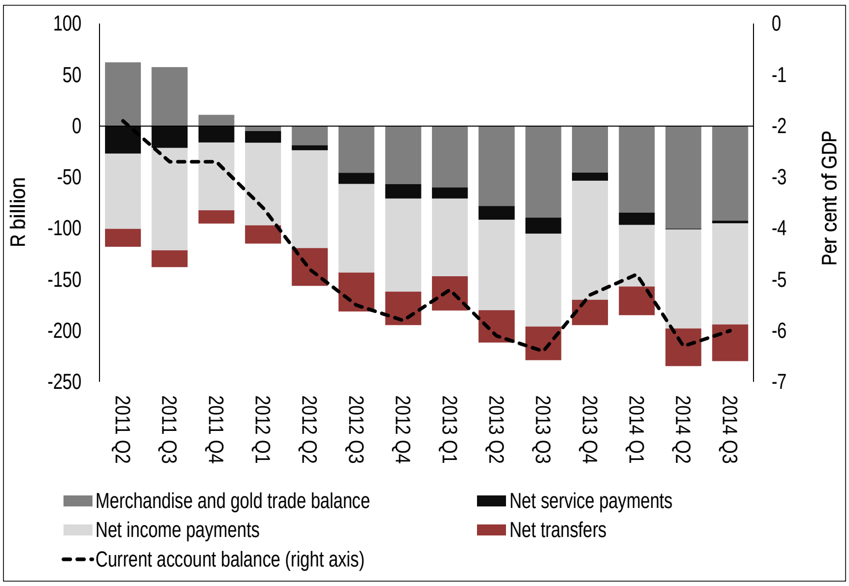
Balance of payments, exchange rates and inflation

South Africa is running an elevated current account deficit of 5.8 per cent of GDP. Negative terms of trade have worsened the trade balance since 2012, but the sharp decline in oil prices is expected to reverse this trend and narrow the current account deficit to 4.5 per cent of GDP in 2015.

The weaker rand raises import costs. Imports of machinery and equipment are expected to moderate in line with reduced investment by state-owned companies. Large infrastructure projects tend to rely on a higher proportion of imported capital equipment than general government infrastructure investments, such as roads and water pipes.

Machinery, equipment imports to moderate in line with reduced investment by state-owned companies

Figure 2.3 Components of the current account, Q2 2011 – Q3 2014



Source: Reserve Bank

Exports to China fell by 15 per cent in 2014 in response to lower commodity demand. In contrast, exports to Africa grew by 11 per cent. The continent now accounts for 19.2 per cent of the export portfolio. The share of exports to Europe has also increased, to 25.8 per cent in 2014, mainly due to strong vehicle sales. Gold exports declined significantly.

Table 2.5 Major export destinations for South African products, 2013 – 2014

	2013	2014	2013	2014	2013	2014
	% share		% growth		Contribution to export growth (price preference system)	
Africa	18.3	19.2	19.1	11.0	3.3	2.0
SADC[1]	*13.6*	*14.2*	*21.1*	*10.4*	*2.7*	*1.4*
Americas	10.6	10.8	2.6	7.6	0.3	0.8
Brazil	*0.8*	*0.8*	*-0.1*	*5.5*	*-0.0*	*0.0*
United States	*8.3*	*8.2*	*6.1*	*4.2*	*0.5*	*0.3*
Asia	36.6	35.8	17.2	3.3	6.1	1.2
China	*13.9*	*11.2*	*34.8*	*-15.0*	*4.0*	*-2.1*
India	*3.6*	*5.1*	*-6.9*	*50.3*	*-0.3*	*1.8*
Japan	*6.7*	*6.2*	*19.5*	*-2.7*	*1.2*	*-0.2*
Europe	24.8	25.8	18.2	10.0	4.3	2.5
Other[2]	1.2	1.3	6.6	17.5	0.1	0.2
Unallocated[3]	8.5	7.2	-12.6	-10.7	-1.4	-0.9
Total	**100.0**	**100.0**	**12.7**	**5.8**	**12.7**	**5.8**

1. Southern African Development Community. Data excludes trade with the Southern African Customs Union
2. Includes Oceania
3. Commodities, such as gold, sold through exchanges
Source: Quantec

Exchange rates and competitiveness

The rand depreciated by a nominal 11.0 per cent against the US dollar in 2014, following a 14.9 per cent decline in 2013. The real effective exchange rate declined by only 4 per cent due to persistently higher local inflation. The US dollar continues to strengthen against both developing and developed-market currencies on expectations of higher growth and interest rates. Further sharp depreciation of the rand is not anticipated in 2015 as investors appear to have priced in risks, and inflation expectations appear anchored. But the currency is likely to remain susceptible to bouts of volatility in response to shifts in global capital flows, commodity price fluctuations, the borrowing levels of state-owned enterprises and domestic growth constraints.

Locking in competitiveness gains requires prudent fiscal policy, moderate real wage increases and productivity gains

The gains from sustained real currency depreciation and reduced input costs flowing from lower oil prices could boost exports. However, the currencies of some important trading partners and competitors with lower inflation than South Africa are weakening in real terms against the dollar. Locking in competitiveness gains requires prudent fiscal policy, moderate real wage increases and productivity gains.

Financial account and investments

Outward FDI nearly doubled to US$5.6 billion

The financial account of the balance of payments recorded R183 billion in net foreign capital inflows in the first three quarters of 2014. Foreign direct investment (FDI) recorded a net capital outflow of R21 billion over the same period as domestic firms continued to expand abroad, particularly in Africa. South Africa is the largest recipient of FDI on the continent and is also one of the largest contributors to FDI projects in Africa. Outward FDI nearly doubled to US$5.6 billion and increased its share of greenfield investments into Africa from 3 per cent between 2003 and 2008 to 7 per cent between 2009 and 2013. Over time, dividend flows from these assets can help improve the current account balance.

Table 2.6 Investments in Africa,[1] 2002 – 2013

	2002	2007	2012	2013
Annual investments into Africa (R billion)	5.5	12.6	24.3	36.8
Dividend receipts from Africa (% of total)	2.0	11.5	12.0	14.9

1. Including Southern Africa Customs Union Region
Source: Reserve Bank and South African Revenue Services

Inflation

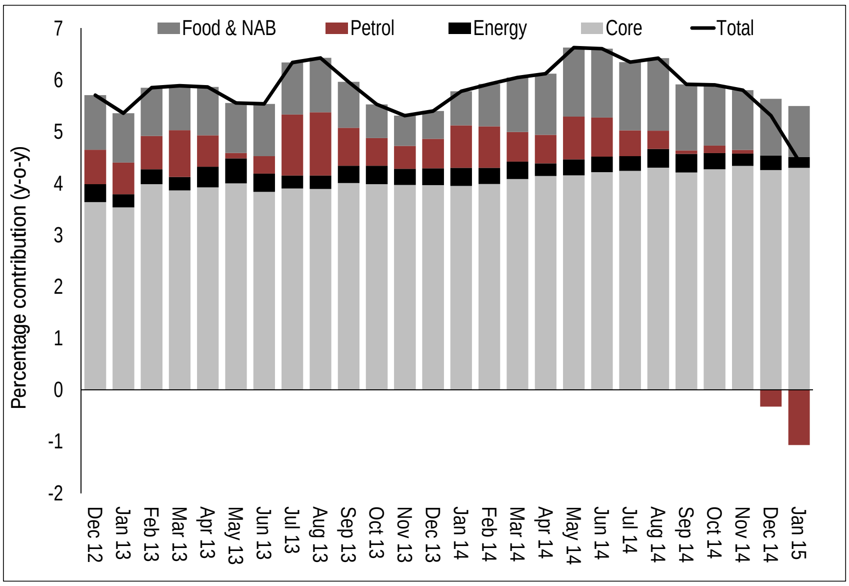
Headline inflation rose from 5.8 per cent in 2013 to a peak of 6.6 per cent in June 2014, but subsequently declined to 5.3 per cent in December 2014. A spike in maize and wheat prices combined with the effects of the weaker exchange rate led to the initial rise, but strong global and domestic harvests and the sharp fall in world oil prices eased pressures during the second half of 2014.

Inflation remains within the target band

The inflation-targeting regime is robust. The gradual increase in both headline and core inflation (which excludes more volatile items) despite a weaker currency suggests that inflation expectations remain well-anchored, albeit at the upper end of the 3-6 per cent target band.

The main risks to the inflation outlook arise from regulated prices, particularly where infrastructure costs need to be recovered (electricity, water and transport). Inflation is projected to decline to 4.3 per cent in 2015 from 6.1 per cent in 2014.

Figure 2.4 Contributions to headline CPI, 2012 – 2015



Source: Statistics South Africa

Raising growth potential

NDP envisions investment in dynamic sectors that transform ownership and economic structure

The National Development Plan points out that faster economic growth and job creation require a broad shift from consumption to investment in South Africa. This investment should be in dynamic sectors that transform ownership and economic structure, and draw in a larger proportion of the economically inactive population. As government, business and labour work toward realising the development plan's vision, the economy confronts several domestic constraints that are particularly binding over the medium term – inadequate and unreliable electricity supply, skills constraints, regulatory uncertainty, and concentrated markets that discourage new entrants.

Improving growth potential in the medium term

Government acting to lift legislative and regulatory hurdles to faster growth

Government's medium-term strategic framework (MTSF) outlines programmes to improve productivity and competitiveness across the economy. Reducing uncertainty by passing key legislation and publishing critical regulations will support the MTSF objectives. Government is also taking steps to improve the competitive landscape for business by reducing red tape, promoting investment and encouraging innovation.

In the present circumstances, government can encourage firms and sectors that are not reliant on high electricity usage to expand output and employment, benefiting from current trade patterns and the weaker rand exchange rate. Supporting opportunities in more labour-intensive sectors like agriculture and tourism, and in higher value-added manufacturing, for example, is consistent with the goal of structural transformation but less likely to be affected by electricity constraints. These sectors will also diversify exports and relieve current account pressures.

Incentives to increase employment without affecting competitiveness or labour productivity will complement these initiatives and increase economic participation. Similarly, immigration reform to attract critical skills and encourage tourism and trade would boost economic growth, because skilled migration and tourism create jobs.

Although more needs to be done to support structural change and raise growth potential, government has made progress in a range of areas.

Building critical infrastructure and raising productivity

Faster, cheaper broadband is needed to support small businesses and overall competitiveness

The public-sector infrastructure programme has begun to lift constraints to growth. Transnet's seven-year, R310 billion capital investment programme is modernising the freight logistics network, introducing more than 1 000 new locomotives and upgrading railway, ports and pipeline infrastructure. Sixty trains now run daily between Durban and Johannesburg, compared with fewer than 20 a decade ago. Telecommunications investments in the construction and upgrading of fibre-optic and mobile networks, and the introduction of municipal WiFi, will boost information technology access and affordability. Faster, cheaper and more accessible broadband is critical to support both small businesses and overall competitiveness.

Reducing energy consumption and promoting energy efficiency

Enhanced tax incentives will promote greater energy efficiency. Interventions such as the solar water heating initiative and the *energy-efficiency and demand-side management grant* to municipalities will encourage households to use energy more efficiently. The evolution towards cost-reflective electricity prices will encourage firms to reduce consumption and direct investment towards less energy-intensive sectors.

Employment creation and building skills

Tax incentive supported employment of 216 000 young workers in December 2014

Various incentives and programmes have been introduced to assist job seekers and build skills. In 2013/14, the Expanded Public Works Programme created over 1 million jobs of varying duration. To date, the Jobs Fund has created 30 701 permanent jobs and trained 75 163 work seekers. In December 2014, the employment tax incentive supported the employment of over 216 000 young workers, from a peak of 268 000 in August. Expanding education is key to developing skills required in the modern economy, and over the past three years, 92 new schools have been built as part of the accelerated school infrastructure development initiative and two new universities opened their doors last year.

Regulatory and business environment

Regulatory reforms to streamline company registrations and penalise anticompetitive behaviour

Several regulatory reforms and administrative improvements have been completed to enhance business conditions and confidence. These include the South African Revenue Service customs modernisation program; streamlined company registration processes; amendments to the Competition Amendment Act (2009) that strengthen penalties for anticompetitive behaviour; recent cuts in mobile telecommunication rates by the regulator; and government's One Environmental System, which will shorten the process of obtaining mining, environmental and water licences. Draft legislation to establish a transport economic regulator, to be tabled in 2015, should promote greater competition in the sector.

Incentives, new sectors and new business

The establishment of special economic zones, various tax incentives and grant funding for upgrading equipment and processes should help local firms become more competitive. The turnover tax and venture capital tax incentives were revised in 2014. The R&D tax incentive has approved 428 projects valued at R2.9 billion in 2013/14. Operation Phakisa (Hurry up) has established "delivery labs" to cut red tape and speed up rollout. The first two such labs focused on the oceans economy (offshore oil, marine transport and aquaculture) and health services. As a result of the first lab, Transnet National Ports Authority announced R9.65 billion in infrastructure projects at Saldanha Bay.

Structural changes under way in primary sectors

Changes in agriculture, manufacturing and mining are positioning these industries for future growth

Important structural changes are under way in agriculture, manufacturing and mining. These are expected to boost long-term growth potential.

- Since 2010, manufacturing has increased gross fixed-capital formation by a compound annual average of 10.3 per cent, with a focus on replacing or upgrading machinery and equipment. This has improved local firms' international competitiveness and boosted exports.
- In clothing, footwear and textiles, new production and clustering systems enable firms to respond flexibly, with short lead times, to local demand – changes that could substantially boost job creation.
- Mining production and investment have shifted towards newer, better-performing export sectors, such as iron ore, coal and manganese.
- Agriculture has become more export focused. Labour-intensive horticultural exports (such as grapes, citrus and tree nuts) are growing as a share of output, replacing highly mechanised grain exports such as maize. Investment growth has averaged over 10 per cent since 2010.

There are notable developments in emerging sectors such as oil and gas. The port of Saldanha has seen significant increases in rig-repair and fabrication work, with new operators and private investors. An oil-servicing zone within the Saldanha industrial development zone is planned for services and suppliers into the African industry. Government will encourage exploration for both shale and offshore gas. Recent local investments by Google and Amazon suggest the potential to expand entrepreneurial and technology-based firms, demonstrating the sophistication of the economy and possible future growth avenues.

The economy and the fiscus

Narrowing the budget deficit and consolidating debt ratio will provide a platform for structural reforms

In the period of low global growth forecast over the next several years, South Africa has begun to promote structural reforms needed for the long term. Implementing the National Development Plan and the MTSF, delivering social and economic programmes, and completing critical infrastructure projects are intended to improve growth potential. Reducing macroeconomic imbalances, including narrowing the budget deficit as a proportion of GDP and consolidating the debt ratio, will provide a sound and predictable basis for achieving these structural reforms. This is the principle underlying fiscal policy, which is discussed in Chapter 3.