

# 2

## Economic overview

### In brief

- The global economic growth outlook has weakened in recent months, led by a sharp slowdown in developing countries.
- The outlook for the South African economy has also deteriorated as a result of lower commodity prices, higher borrowing costs and diminished confidence. Currency weakness is putting upward pressure on inflation and the agriculture sector is suffering the effects of a severe drought. GDP growth is expected to improve gradually over the medium term, reaching 2.4 per cent in 2018.
- Despite these challenges, South Africa has many strengths on which to build. A strong institutional framework promotes accountability and transparency. Prudent fiscal and monetary policies anchor a sustainable approach to the public finances and keep inflation in check. The private sector is innovative and the sophisticated services sector supports growth.
- Government recognises the need to boost confidence and strengthen investment, including by promoting co-investment in capital projects, and improving policy certainty and the ease of doing business. Over the period ahead, government will strengthen its partnerships with the private sector, labour and civil society, to speed up the economic transformation envisioned in the National Development Plan.

### ■ Overview

The outlook for the world economy has deteriorated in recent months. The moderate recovery in advanced economies remains uneven, and developing economies have been experiencing broad downward revisions to growth. Expectations of higher US interest rates and concerns about the resilience of China and other large developing economies have led to greater volatility in global capital flows. Commodity prices remain low. In combination, these conditions are adversely affecting financial markets, reducing risk appetite and tolerance for further build-up of public and corporate debt, particularly in developing countries.

*Downward revisions to economic growth in developing countries*

South Africa's GDP growth forecast for 2016 has been revised down to 0.9 per cent from an estimated 1.7 per cent at the time of the *Medium Term Budget Policy Statement* (MTBPS). The weaker outlook is the result of

lower commodity prices, higher borrowing costs, diminished business and consumer confidence, and drought.

Although GDP growth is forecast to remain subdued in 2016 and 2017, improved global conditions and rising confidence are expected to result in a moderate improvement in economic growth by 2018.

*Reforms under way to encourage private investment*

Government is strengthening its collaboration with the private sector, labour and civil society, to speed up implementation of the structural reforms set out in the National Development Plan. Public-sector infrastructure spending over the medium term is expected to total R865.4 billion. Government intends to roll out major partnerships with independent power producers in gas and coal over the next several years, boosting investment and energy supply. Several regulatory reforms will encourage greater private investment and improve the ease of doing business.

*Fiscal measures over medium term to narrow budget deficit*

These and other measures are needed to enable the economy to grow more rapidly as economic conditions improve. Over the medium term, fiscal measures to narrow the budget deficit and stabilise the growth of public debt, complemented by the inflation-targeting framework, will contribute to renewed confidence and greater investment.

## Global economic outlook

*Global economic growth projection lowered to 3.4 per cent*

In January of this year the International Monetary Fund (IMF) lowered its 2016 projection for global economic growth from 3.6 per cent to 3.4 per cent, following growth of 3.1 per cent in 2015. Global trade forecasts have also been reduced. Risks remain that growth could be even lower. Developed economies, which are generally more insulated from the negative effects of commodity price shocks, continue to expand at a moderate pace, but progress is uneven.

**Table 2.1 Annual percentage change in GDP and consumer price inflation in selected regions/countries, IMF forecasts, 2014 – 2017**

Region/country	2014	2015	2016	2017	2014	2015	2016	2017
	GDP projections <sup>1</sup>				CPI projections <sup>2</sup>			
<b>World</b>	<b>3.4</b>	<b>3.1</b>	<b>3.4</b>	<b>3.6</b>	<b>3.5</b>	<b>3.3</b>	<b>3.4</b>	<b>3.6</b>
<b>Advanced economies</b>	<b>1.8</b>	<b>1.9</b>	<b>2.1</b>	<b>2.1</b>	<b>1.4</b>	<b>0.3</b>	<b>1.2</b>	<b>1.7</b>
United States	2.4	2.5	2.6	2.6	1.6	0.1	1.1	1.8
Euro area	0.9	1.5	1.7	1.7	0.4	0.2	1.0	1.3
United Kingdom	2.9	2.2	2.2	2.2	1.5	0.1	1.5	2.0
Japan	0.0	0.6	1.0	0.3	2.7	0.7	0.4	1.6
<b>Emerging markets and developing economies</b>	<b>4.6</b>	<b>4.0</b>	<b>4.3</b>	<b>4.7</b>	<b>5.1</b>	<b>5.6</b>	<b>5.1</b>	<b>4.9</b>
Brazil	0.1	-3.8	-3.5	0.0	6.3	8.9	6.3	5.2
Russia	0.6	-3.7	-1.0	1.0	7.8	15.8	8.6	7.3
India	7.3	7.3	7.5	7.5	5.9	5.4	5.5	5.4
China	7.3	6.9	6.3	6.0	2.0	1.5	1.8	2.2
<b>Sub-Saharan Africa</b>	<b>5.0</b>	<b>3.5</b>	<b>4.0</b>	<b>4.7</b>	<b>6.4</b>	<b>6.9</b>	<b>7.3</b>	<b>6.7</b>
South Africa	1.5	1.3	0.7	1.8	6.1	4.8	5.9	5.6
<i>South Africa (National Treasury forecast)</i>	<i>1.5</i>	<i>1.3</i>	<i>0.9</i>	<i>1.7</i>	<i>6.1</i>	<i>4.6</i>	<i>6.8</i>	<i>6.3</i>

1. IMF World Economic Outlook Update, January 2016

2. IMF World Economic Outlook, October 2015

Economic forecasts for some of the largest developing economies have been revised down. China's shift towards greater domestic consumption and less debt-fuelled investment has reduced headline growth in the world's second-largest economy and, as a consequence, global growth and commodity prices. Brazil and Russia are forecast to remain in recession in 2016 as low commodity prices prompt painful economic adjustments. Oil prices have fallen by 50 per cent since December 2014 and are now at levels last seen in 2004. Gold and platinum have reversed the gains made since 2010; in US dollar terms, they are now 10 per cent and 30 per cent lower respectively than a year ago.

*Oil prices now at levels last seen in 2004*

The growing importance of developing markets for the global economy has widened their impact: the World Bank estimates that a one percentage point decline in growth in the BRICS countries (Brazil, Russia, India, China and South Africa) can reduce near-term global growth by up to 0.4 percentage points.

GDP growth in sub-Saharan Africa is expected to reach 4 per cent in 2016, up from 3.5 per cent in 2015. Although it remains one of the world's fastest-growing regions, low commodity prices and higher borrowing costs have reduced growth expectations in recent months and created fiscal strains, notably in oil-exporting countries.

*Although Africa remains one of world's fastest-growing regions, growth has moderated*

Slower growth and weaker risk appetite are resulting in currency depreciation and reduced capital inflows for many developing countries. According to the Institute of International Finance, emerging market capital outflows reached about \$735 billion in 2015. Uncertainty over monetary policy in advanced economies – including the impact of negative real interest rates – will likely contribute to global volatility over the forecast period.

## ■ The South African economy

South Africa's GDP growth is expected to slow marginally from 1.5 per cent in 2014 to 1.3 per cent in 2015.

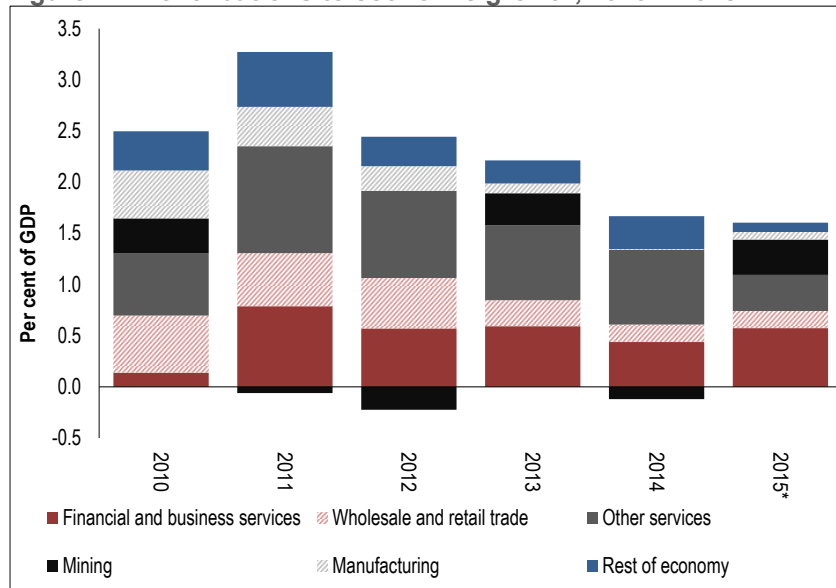
### Sector performance

During 2015 the services sector remained resilient and the mining sector recovered from protracted strikes in 2014. Their performance, however, did not fully offset difficult conditions in agriculture, manufacturing and other secondary sectors.

The services sector – financial and business services, wholesale and retail trade, hotels and restaurants, transport, communications, and community and government services – grew by 1.7 per cent in the first three quarters of 2015, down from 2.2 per cent in 2014. Financial and business services grew by 2.9 per cent over the period on the strength of banking and securities activity. Financial and business services, combined with wholesale and retail trade, increased employment by 0.7 per cent following a 2 per cent increase in 2014. Growth in transport and communications slowed due to subdued domestic demand.

*Financial and business services grew by 2.9 per cent between 2014 and 2015*

Figure 2.1 Contributions to economic growth, 2010 – 2015



\*2015 figures compare the first three quarters with the first three quarters of 2014

Source: Reserve Bank, National Treasury calculations

Moderate household consumption growth, weaker disposable income growth and high indebtedness are expected to reduce growth in services in 2016, particularly in financial and business services, and transport and communications. Tourism, boosted by rand weakness and amended visa regulations, is expected to support growth.

*Growth in steel and other basic metals fell sharply in 2015*

Manufacturing stagnated in 2015, although performance was mixed across industries. Growth was concentrated in subsectors that increased exports, such as dairy, grains and beverages, electrical machinery and motor vehicles. Output in steel and other basic metals, however, which constitute 19.6 per cent of total manufacturing production, fell sharply, reducing total sector growth by 0.6 percentage points. Manufacturing employment declined by 0.7 per cent in the first three quarters of 2015 compared with the same period in 2014. Job losses were largest in basic metals, and wood and paper products; job creation was concentrated in food and beverages.

Weak demand and limited electricity availability are expected to weigh on manufacturing performance until 2017. Steel and basic metals are expected to face difficult trading conditions, including global oversupply, lowering aggregate manufacturing growth. Although aggregate export growth is expected to remain subdued, strong export performance by autos, food and beverages is expected to continue, supported by a weaker exchange rate and growth in developed economies and Africa.

*Farmers taking advantage of rand weakness to expand into new markets*

Real value added in the agriculture, forestry and fishing sector contracted by 5.7 per cent over the first three quarters of 2015 compared to the same period in 2014, as drought reduced wheat and maize production. Although maize harvests are expected to decline in 2016, several commodities have enjoyed strong export growth as farmers take advantage of rand weakness to expand into new markets. In 2015, export volumes of tree nuts and berry crops grew by 14.6 and 20.9 per cent respectively. Rand weakness also supported double-digit growth in the export values of deciduous and citrus fruits.

Drought will contribute to a difficult operating environment for agriculture in 2016. While efforts to diversify markets are proving successful, employment prospects remain subdued.

Real value added in mining grew by 4.5 per cent during the first three quarters of 2015 compared to the same period in 2014. Output varied widely across subsectors. The recovery of platinum group metals from lengthy strikes in 2014 helped return the sector to positive growth. However, coal, gold and iron ore production declined in response to low commodity prices and rising local costs.

*Platinum sector recovered in 2015*

The weaker rand has provided a cushion for mining exporters, but low commodity prices and a high local cost base contributed to a 1.6 per cent decline in mining employment in 2015. Over the medium term, the sector is expected to face a period of consolidation.

*1.6 per cent decline in mining employment in 2015*

### Economic growth outlook

South Africa's GDP growth is forecast to decelerate from 1.3 per cent in 2015 to 0.9 per cent in 2016, improving gradually to 1.7 per cent in 2017 and 2.4 per cent in 2018. Table 2.2 sets out South Africa's macroeconomic performance and projections by calendar year. Chapter 3 presents this data by fiscal year.

**Table 2.2 Macroeconomic performance and projections, 2012 – 2018**

Calendar year	2012	2013	2014	2015	2016	2017	2018
Percentage change	Actual			Estimate	Forecast		
Final household consumption	3.4	2.9	1.4	1.4	0.7	1.6	2.2
Final government consumption	3.4	3.3	1.9	0.4	1.2	-0.2	0.2
Gross fixed capital formation	3.6	7.6	-0.4	1.1	0.3	1.4	2.7
Gross domestic expenditure	3.9	1.4	0.6	0.1	1.1	1.7	2.2
Exports	0.1	4.6	2.6	9.5	3.0	4.6	5.2
Imports	6.0	1.8	-0.5	5.3	3.7	4.5	4.9
<b>Real GDP growth</b>	<b>2.2</b>	<b>2.2</b>	<b>1.5</b>	<b>1.3</b>	<b>0.9</b>	<b>1.7</b>	<b>2.4</b>
GDP inflation	5.5	6.0	5.8	4.0	6.7	6.3	6.0
<b>GDP at current prices (R billion)</b>	<b>3 262.5</b>	<b>3 534.3</b>	<b>3 796.5</b>	<b>3 998.9</b>	<b>4 305.9</b>	<b>4 657.5</b>	<b>5 052.8</b>
CPI inflation	5.7	5.8	6.1	4.6	6.8	6.3	5.9
Current account balance (% of GDP)	-5.0	-5.8	-5.4	-4.1	-4.0	-3.9	-3.9

Source: Reserve Bank, National Treasury

The domestic economy faces a period of low commodity prices, heightened financial market volatility, and diminished consumer and business confidence. Although energy availability improved in 2015, the lack of new connections and uncertainty about future supply continues to hamper investment. While agile, competitive firms have taken advantage of currency depreciation to boost exports, the weaker rand has increased the cost of capital equipment and will have broader inflationary effects.

These factors are expected to ease over the medium term. An upturn in global trade and investment, improved policy certainty, recovering consumer and business confidence, and greater electricity availability in the outer years should support stronger growth.

*Economic growth to rise over medium term as confidence improves*

### Assumptions used in the economic forecast

In line with government’s commitment to transparent budgeting, the National Treasury published key forecast assumptions in the 2015 MTBPS. These assumptions have been updated in light of sharp commodity price declines and are published below. Global growth assumptions are similar to the IMF forecasts in Table 2.1.

#### Assumptions underpinning the economic forecast

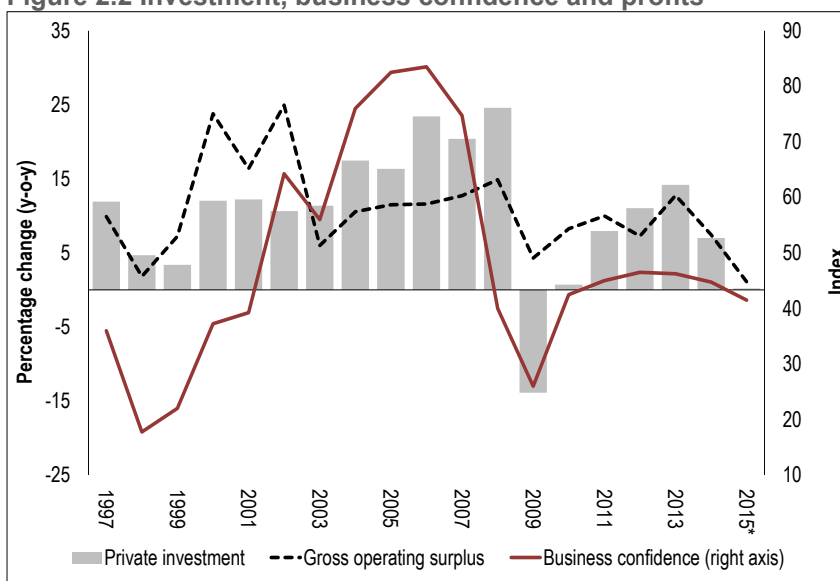
Calendar year	2014	2015	2016	2017	2018
<b>Commodity prices</b>	<b>Outcomes</b>		<b>Projections</b>		
Brent crude (US\$ per barrel)	100	54	41	48	48
Gold (US\$ per ounce)	1 266	1 161	1 075	1 081	1 081
Platinum (US\$ per ounce)	1 385	1 056	859	865	865
Iron ore (US\$ per ton)	97	55	38	36	36
Coal (US\$ per ton)	72	57	47	46	46

Source: Reserve Bank, IMF, Bloomberg, National Treasury

### Investment

Gross fixed capital formation rose by 1.2 per cent in the first three quarters of 2015 compared with 0.3 per cent over the same period in 2014, as private-sector investment increased incrementally.

Figure 2.2 Investment, business confidence and profits



\* Covers the first three quarters of the year

Source: Reserve Bank, National Treasury calculations

General government investment grew at an annual rate of 6.1 per cent in the first three quarters of 2015, as municipalities continued to invest in roads and other infrastructure. Annual growth in investment by public corporations moderated to 0.6 per cent over the same period, from 2.0 per cent in the first three quarters of 2014.

Annual growth in private investment was only 0.1 per cent for the first three quarters of 2015 due to weak demand and low levels of business confidence. Although credit to businesses grew at a robust 14 per cent in 2015, this was partly a function of operational and cash-flow requirements. Consumer price sensitivity has reduced businesses’ ability to pass on cost increases. Annual growth in gross operating surplus excluding community

and social services slowed to 1.1 per cent in the first three quarters of 2015, from an average of 7.3 per cent between 2010 and 2014.

Investment growth of 0.3 per cent is expected in 2016. Exchange rate depreciation and higher risk premiums have increased the cost of borrowing and imported capital equipment, reducing public and private investment growth more than anticipated at the time of the 2015 MTBPS.

*Investment growth of 0.3 per cent expected in 2016*

In the short term, general government will be the main driver of investment. Many businesses are likely to delay capital expansion until conditions improve. A moderate increase in global demand and easing domestic constraints should gradually support a rise in investment growth to 2.7 per cent by 2018. If current collaborative efforts by government and business successfully boost confidence, a stronger investment recovery can be expected.

### Employment

Job creation remains one of the most pressing concerns for the economy. Headline employment grew by 3.7 per cent in the first three quarters of 2015. According to Statistics South Africa, 19 000 jobs were created in the formal sector and 273 000 in the informal sector in the first three quarters of 2015. The unemployment rate stood at 25.5 per cent in the third quarter of 2015, with the number of South Africans categorised as long-term unemployed 5.7 per cent higher than in 2014.

*Unemployment rate of 25.5 per cent in the third quarter of 2015*

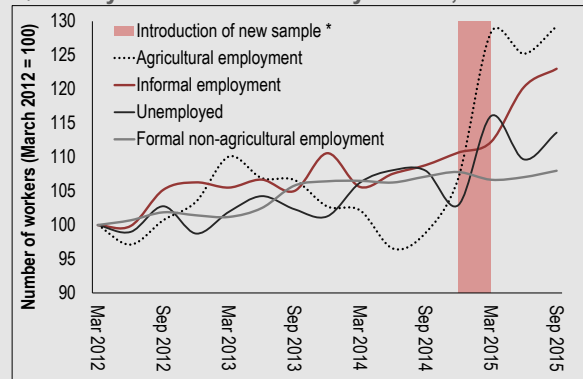
### Interpreting labour statistics

In 2015, Statistics South Africa revised its employment survey samples.

The Quarterly Labour Force Survey (QLFS), used to determine aggregate levels of employment, now reflects 2011 Census results, improving coverage of mining and metro areas. The historical series has not been revised, so recent changes in employment numbers should be treated with caution. For example, the survey shows sharp increases in the number of informal and agricultural workers in 2015.

The Quarterly Employment Survey, used to determine sector trends, now includes an additional 0.5 million workers. Historic values were revised to 2013.

Quarterly Labour Force Survey results, 2012 - 2015



\*Red bar indicates where values began to reflect Census 2011 results. Source: Statistics South Africa, QLFS

Growth in private-sector employment was concentrated in faster-growing sectors, such as financial and business services. In those industries creating jobs, the pace of remuneration growth outstripped that of employment growth. Given the large number of jobless South Africans and the increasing skills intensity of production, policy interventions to support sectors that can create jobs for low-skilled workers are critical, as are efforts to raise the quality of public education.

### Consumption

Household consumption expenditure increased by 1.6 per cent in the first three quarters of the year, up from 1.4 per cent in the corresponding period of 2014, supported by lower oil prices.

*Household consumption growth expected to moderate to 0.7 per cent in 2016*

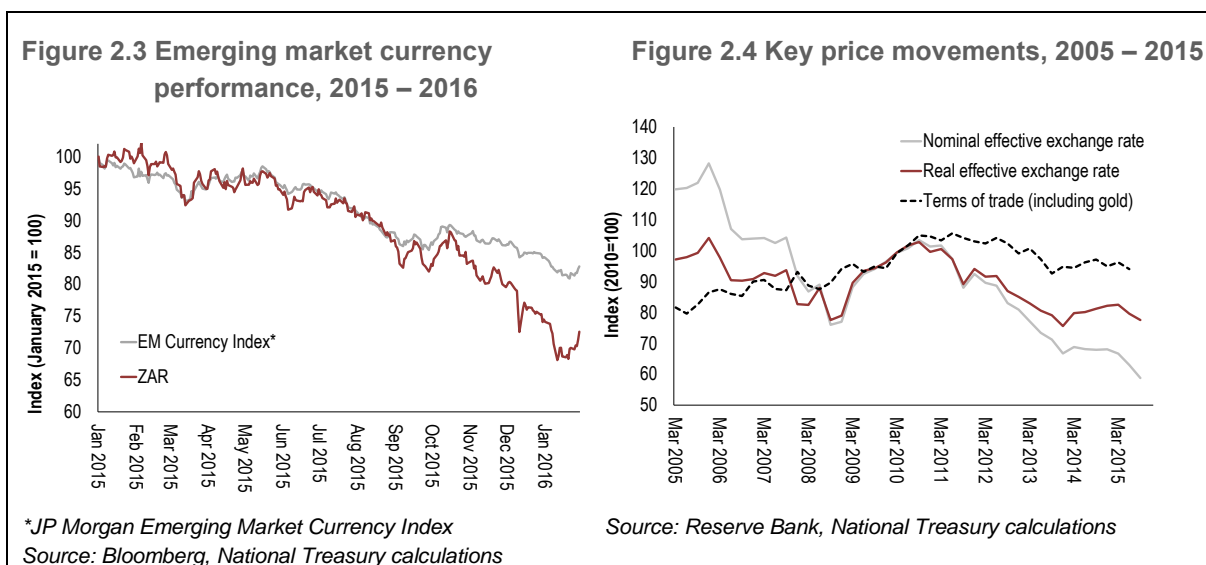
Over the same period, spending on services, food and clothing grew at a robust pace, but growth in demand for durables has fallen to just 2.2 per cent from 5.3 per cent in 2014, as households cut back on purchases of vehicles, appliances, and computers and related equipment. Higher inflation and weaker employment growth compared to the 2015 MTBPS are expected to reduce household consumption growth to 0.7 per cent in 2016. A gradual improvement alongside employment and income growth is projected in the two outer years of the forecast.

*Lower real government spending due to fiscal consolidation and inflation*

Real government consumption spending is forecast to grow by 1.2 per cent in 2016, before moderating to less than 1 per cent in 2017 and 2018. Fiscal consolidation and higher inflation have resulted in lower real government spending compared to projections made in the 2015 MTBPS.

### The rand

Over the past year the rand has depreciated by 30 per cent against the US dollar. During most of 2015, the rand's depreciation closely tracked that of other developing-country currencies, but diverged from this trend in September, as concerns mounted about South Africa's growth outlook and perceived risks to the fiscal framework. As a result, between September and December 2015, the rand fell 9 per cent against the US dollar, compared with the 2.7 per cent decline over the same period by peer currencies.



### Trade

Exchange rate depreciation can contribute to the price competitiveness of exports, provided that local inflation does not erode the benefits. Although the rand weakened by an average of 5.6 per cent against the currencies of South Africa's major trading partners in 2015, after taking inflation into account, the cost of South African goods rose by 2.0 per cent.



Despite this, physical export volumes increased by 10.6 per cent in the first three quarters of the year, as platinum-related exports recovered, and vehicles and transport equipment benefited from stronger US and European demand. Food, beverage and chemical exports to the rest of Africa also grew. More muted export growth of 3 per cent is forecast in 2016, slightly lower than projected in October 2015, owing to reduced demand in Africa and China.

*Export growth of 3 per cent projected for 2016*

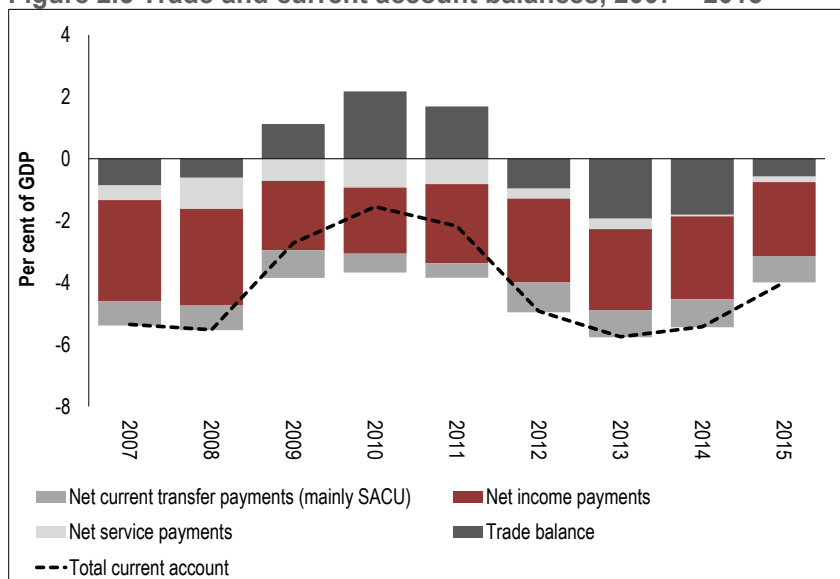
Import volumes grew by 5.6 per cent during the first three quarters of 2015. In 2016, import growth is likely to slow due to sluggish domestic demand and exchange-rate weakness, partly offset by drought-related food imports. Import growth will increase over the forecast period as export growth and local demand rise.

**Current account**

During the first three quarters of 2015, the current account deficit narrowed to 4 per cent of GDP from 5.4 per cent in 2014, largely due to an improved trade balance stemming from higher export receipts. The narrowing of the trade deficit in 2015 is expected to be maintained over the forecast period, resulting in an improvement in the current account relative to 2015 MTBPS projections. A further reduction in the current account deficit requires higher domestic savings. Over time, fiscal consolidation and structural reforms should contribute to improved savings.

*Current account deficit will continue to narrow, but further reduction requires higher savings*

**Figure 2.5 Trade and current account balances, 2007 – 2015**



Source: Reserve Bank, National Treasury calculations

The terms of trade deteriorated by 0.1 per cent over the first three quarters of 2015 compared to the same period in 2014, as falling oil prices offset declines in prices for coal, iron ore, gold and platinum. As oil prices rise gradually during 2016, the terms of trade are expected to weaken, before stabilising over the medium term.

The forecast estimates maize imports of about 5 million tons in 2016. Although the National Agricultural Marketing Council’s 2016 local production forecasts have recently improved from 4.7 million tons to

*About 5 million tons of maize imports forecast in 2016*

7.4 million tons, there is considerable uncertainty about the amount of crop that each hectare will yield given late planting arising from the drought. Maize imports could cost between R15 billion and R19 billion based on the 2016 Bureau of Food and Agricultural Policy forecast, equivalent to 0.35 to 0.45 per cent of GDP. This is a substantial increase from R2 billion of maize imports in 2015.

### *Financial account*

*Net portfolio inflows remained strong*

South Africa received capital inflows equivalent to 3.8 per cent of GDP in the first three quarters of 2015, compared with 5.9 per cent in 2014. Net portfolio inflows remained strong, particularly in equities, but other investment declined sharply. Foreign direct investment fell as parent companies sold their shareholding in domestic subsidiaries.

**Table 2.3 Components of the financial account**

R billion	2014	2014 Q1 - Q3	2015 Q1 - Q3
Net portfolio investment	49.1	67.2	66.3
Net foreign direct investment	-20.6	-25.8	-21.9
Net other investment	121.8	81.0	25.7
Financial derivatives	16.4	11.6	4.5

*Source: Reserve Bank*

*South African financial markets will continue to support portfolio inflows*

High levels of uncertainty are likely to continue to dampen capital flows to emerging markets. South Africa's deep and liquid financial markets should continue to support portfolio inflows over the forecast period; efforts to support direct investment will be critical in shifting the composition of inflows.

### *Inflation*

*To date, knock-on effect of rand weakness has been low*

Consumer inflation, which averaged 4.6 per cent in 2015, has resumed an upward trajectory in response to rising food costs and sustained increases in administered prices. To date, the knock-on effect of rand weakness has been muted. Administered price inflation excluding petrol remained elevated at 8.4 per cent in the second half of 2015, from an average of 6.5 per cent in the first half of the year. Due to the deteriorating inflation outlook, the Reserve Bank has progressively raised the repo rate to 6.75 per cent from 5.75 per cent in February 2015.

Higher food prices and exchange rate depreciation have contributed to the higher inflation forecast for 2016, as businesses are expected to pass the costs of a weaker rand on to consumers more than in the recent past.

### **Rising food prices**

In response to the drought, annual food inflation jumped to 7 per cent in January 2016 from 4.3 per cent in June 2015. Futures market prices for white maize, a staple crop, rose by 150 per cent between January 2015 and January 2016; prices for yellow maize, used mainly for animal feed, rose by about 90 per cent; and prices for wheat and soybean were up by about 25 per cent.

Although low petrol prices will have some mitigating effect on transport costs, the forecast captures an almost 10 per cent increase in food prices in 2016 due to higher maize imports and the weaker exchange rate. Inflation for meat and dairy products will also rise as feed costs increase. The culling of cattle in response to the drought is likely to lead to lower meat supplies in 2016, putting further upward pressure on prices.

Increased levels of pass through (the effect of the weaker exchange rate on domestic inflation), moderate global oil price increases and higher electricity prices are expected to keep average annual inflation above the 6 per cent target band until 2018. The forecast assumes annual average electricity price increases of about 12.7 per cent from 2016 to 2018. Revenue from administered prices must be effectively deployed by state-owned companies and municipalities if the efficiency gains of the user-pays principle are to be passed on to consumers.

### *Risks to the forecast*

Short-term risks to the forecast remain largely on the downside.

Further currency weakness could raise inflation and induce higher interest rates, leading to lower growth. Weaker-than-forecast improvements in electricity availability could further reduce growth, while higher-than-anticipated electricity prices remain a risk.

*Currency weakness could lead to higher interest rates and lower growth*

Ratings agency downgrades and a continued decline in confidence could result in higher borrowing costs, additional rand depreciation, and sharper reductions in public and private investment, with knock-on effects for employment and consumption. Weaker-than-projected global growth or sudden policy changes in major economies could increase financial market turbulence and lower capital flows to developing economies. Persistent oversupply in key commodity sectors could push prices down further, reducing export demand, income and employment.

## **■ Charting a path to higher growth**

### **Structural change and the National Development Plan**

To sharply reduce unemployment, poverty and inequality, the South African economy needs to grow faster. The National Development Plan points out that moving towards a higher-growth economy requires structural changes, including becoming less reliant on resource-intensive industries, and promoting energy-efficient, labour-absorbing sectors.

*Faster growth requires structural changes*

The rebalancing of the Chinese economy towards consumption and away from investment – and the resulting decline in commodity demand – has accelerated the pace of this adjustment, with negative consequences for growth and employment over the short term.

The World Bank estimates that if South African firms could reposition themselves to take advantage of increased Chinese demand for household goods and services, an estimated R203 billion (in real 2010 rands) could be added to GDP by 2030. But the emergence of new industries to take advantage of these shifts and replace lost jobs has been hampered by weaker global growth and domestic rigidities, such as electricity and skills shortages, high broadband costs, and low levels of competition in labour and product markets.

*Weaker global growth and rigidities hamper emergence of new industries*

The National Development Plan identifies the need to support sectors with high potential for job creation and benefits for the rest of the economy, alongside critical reforms to improve basic education and strengthen the capacity of the state. The plan guides government's current efforts to support the economy, focused on alleviating infrastructure bottlenecks,

*Government focused on alleviating infrastructure bottlenecks and improving business environment*

improving labour relations, strengthening skills, diversifying exports, and facilitating an innovation-friendly business environment.

Table 2.4 illustrates the relationship between demand, output and employment. This sector-multiplier view shows that, for example, for every R1 million of extra agricultural output, output in the entire economy expands by R1.7 million, and total employment rises by 4.9 jobs.

**Table 2.4 Sector multipliers<sup>1</sup>**

	Domestic output multiplier	Employment multiplier effect
Agriculture, forestry and fishing	1.7	4.9
Mining and quarrying	1.4	1.6
Manufacturing	1.4	2.6
Electricity, gas and water	1.6	1.4
Construction	1.9	4.9
Wholesale, retail and motor trade; catering and accommodation	1.6	5.3
Transport, storage and communication	1.6	2.9
Finance, real estate and business services	1.7	3.1
Community, social and personal services	1.5	4.1

1. Note that this does not include the effects of higher employment on consumption and therefore growth; it assumes there are no supply constraints in the economy. Subsector multipliers may vary considerably.

Source: National Treasury based on Statistics South Africa 2012 supply and use tables

### *A strong platform for growth*

South Africa has many advantages that support its transition to a more dynamic economy. The 2015/16 *Global Competitiveness Report* published by the World Economic Forum found that South Africa ranked 32 of 140 countries in both the capacity of businesses to innovate and company spending on research and development.

The country's strong institutional framework promotes accountability and transparency, guided by the values of the Constitution. The domestic financial sector is well regulated and capable of attracting global investment flows. South Africa ranked in the top 10 countries of the *Global Competitiveness Report* for soundness of banks, regulation of securities exchanges, and the ease of financing through local equity markets.

Prudent fiscal and monetary policies help stabilise inflation and keep interest rates relatively low, anchor investors' risk perceptions, ensure the continued inflow of capital to finance the savings shortfall and reduce fluctuations in production and investment. By minimising the size of boom-and-bust cycles, these policies support higher long-term growth.

Monetary policy remains committed to keeping inflation in check, both to support the competitiveness of South African businesses and to protect individual purchasing power. Left unchecked, inflation would take the greatest toll on poor households.

*South Africa's well-regulated financial sector can attract global investment*

*Monetary policy committed to keeping inflation in check*

### *Supporting private investment*

For local firms to boost output and remain competitive, the economy requires greater investment, and research and development, particularly in fast-growing and emerging sectors.

Since the beginning of 2016, government has stepped up its efforts to partner with the private sector. The Renewable Energy Independent Power Producer Programme has already begun to diversify South Africa's energy mix. To date, 6 377MW of electricity have been procured through the programme, with 2 045MW connected to the grid.

*Government focuses on partnering with private sector*

Government has invited private investors to build on the success of this programme in gas and coal. Coal projects alone will lead to investment of R45 billion. Projects to generate 2 500MW of electricity from coal are being prepared, and government is planning a gas-to-power programme that will contribute 3 126MW of electricity. The gas programme is expected to result in R64 billion of investments in port, pipeline, generation and transmission infrastructure in Richards Bay, Coega and Saldanha Bay.

Broader co-investment that leverages private-sector finance and expertise for the benefit of the country will also be encouraged. The *Presidential Review on State-owned Entities* recommends partnering with the private sector to deliver economic and social infrastructure.

Government is launching Invest SA in 2016 to promote inward investment. It will be complemented by steps to reduce regulatory burdens for local and foreign investors, enhancing South Africa's position as a hub for investment on the continent.

*New public-private partnership to boost investment*

### **Invest SA**

Invest South Africa is a public-private partnership to boost domestic and foreign investment. The initiative will include one-stop shops at national and provincial level to help investors with the procedures required to start up and run a business, and provide streamlined access to registration and authorisation processes.

The inter-ministerial committee on investment promotion will ensure the policy and regulatory environment improve the investment climate, informed by recommendations of the Presidential Business Working Group.

Several other initiatives also aim to encourage greater private investment:

- Incentives provided to the automotive industry have supported announced investments of more than R20 billion. Government will review all such incentives to assess their effects on economic growth, productivity, competitiveness and jobs.
- Operation Phakisa focuses on fast-tracking solutions to promote investment in areas such as mining, the oceans economy, health and education.
- Business and government have partnered in the Sector Innovation Funds Programme to strengthen skills, innovation, technology and competitiveness in eight priority industry sectors.

Economic transformation is supported through the Broad-Based Black Economic Empowerment Act (2003) and efforts to encourage the development of black industrialists.

### *Addressing infrastructure bottlenecks*

*Projected public-sector capital expenditure of R865.4 billion over next three years*

Public-sector infrastructure spending remains a cornerstone of government's commitment to building a more agile, competitive economy. Public-sector capital expenditure of R865.4 billion is projected over the next three years. As infrastructure constraints ease, private-sector investment is expected to increase.

*Eskom to spend R155.3 billion over the medium term*

Over the past year, electricity availability was bolstered with the completion of the first unit of the Medupi power station and the Sere wind farm. Projected capital investment by Eskom totals R155.3 billion over the medium term. This includes continuing work on the Medupi and Kusile power stations, and strengthening of transmission and distribution grids. Additional units from Ingula power station will be connected in 2017.

In addition to the US\$3.5 million feasibility study to expand and transmit Mozambique's hydro power and diversify South Africa's electricity supply, the Southern African Development Community's Project Preparation and Development Facility has allocated US\$2.1 million to investigate the feasibility of a new transmission line in Zimbabwe to benefit the regional power pool.

Transnet will spend R77 billion over the next three years. Although total investment spending has fallen, reflecting weaker growth and commodity prices, spending has been reprioritised to accelerate investment in ports.

Large urban municipalities continue to support city development projects. The first phases of bus rapid transit systems are operational in Tshwane, Johannesburg, Cape Town and George, with construction starting in eThekweni. Complementary precinct development and bulk infrastructure programmes include over 90 investment projects worth an estimated R80.5 billion. Construction to the value of R39.3 billion is currently under way.

### *Improving policy coordination, certainty and implementation*

*Government improving effectiveness of public sector*

Building a capable state requires government to improve the effectiveness of the public sector and strengthen the governance of state-owned entities. Progress in this area includes the following:

- Socioeconomic impact assessments became compulsory in September 2015. Departments are required to define the issue that a proposed policy or regulatory change is intended to address, and to assess the consequences of any such change. Impact assessments for dozens of bills, policies, plans and regulations have already been reviewed, including for the Integrated Energy Plan, the Insurance Bill and the Communal Property Associations Amendment Bill. The Department of Planning, Monitoring and Evaluation works with departments to ensure that outcomes are integrated with budgetary processes and the National Development Plan.
- Government has enacted a programme of reforms at state-owned companies (see Chapter 8). These reforms include stabilising entities that are not financially sustainable, and strengthening governance arrangements. Government looks favourably on increased private-sector participation where appropriate.

- During 2016, it is expected that Parliament will pass the Minerals and Petroleum Resources Development Amendment Bill to support greater investment and certainty in the sector.

### *Labour relations*

Government is finalising a framework with business and labour, under the auspices of the National Economic Development and Labour Council, to reduce economic disruption caused by large, protracted strikes. Social partners have reached agreement on the principle of a national minimum wage; deliberations continue on an appropriate level. Rebuilding trust between business and labour is critical for finding collaborative solutions as the economy undergoes structural change. Government continues to advance the introduction of secret ballots, the introduction of codes of good practice and reinvigorated workplace forums to improve labour relations.

*Rebuilding trust between business and labour is critical*

The Commission for Conciliation, Mediation and Arbitration continues to take an active role in settling disputes; as a result the number of arbitration proceedings has fallen by more than 75 per cent since 2003.

### *Improving the ease of doing business*

Regulatory barriers increase operating costs and place a particularly heavy burden on small business, reducing competitiveness. Government is acting to assist business through a range of measures:

*Visa regime eased to facilitate tourism and business travel*

- The visa regime has been eased to facilitate tourism and business travel.

### **Recent visa amendments**

- Biometric security checks are now being implemented at South Africa's main international airports. Travellers using these hubs will no longer require transit visas.
- In-person visa applications will not be required if travellers are using accredited agencies. A number of Chinese tour operators have been accredited, and the process of accrediting Indian and Russian tour operators is under way.
- Long-term, multiple-entry visitor visas are now available for businesspeople and academics from Africa. A 10-year visa waiver is available for business executives from BRICS countries, allowing them to remain in the republic for 30 days at a time.

- The Department of Small Business Development is working with municipalities to cut red tape and improve infrastructure for township and rural enterprises. It plans to help small businesses open bank accounts, register companies and draft business plans. The department will also help small firms set up cooperatives, and gain access to local and international markets.
- Nine of South Africa's largest municipalities are participating in a programme intended to reduce red tape for business in areas such as getting construction permits, obtaining electricity connections and registering property.

*Municipalities working to reduce red tape*

### **Turning challenges into opportunities**

South Africa remains the largest direct investment destination in Africa, but more can be done to transform current challenges into opportunities. Short-term measures can include:

*South Africa remains largest direct investment destination on continent*

- Encouraging special economic zones to roll out innovative approaches to policy to boost economic activity.
- Speeding up spectrum allocation and broadband roll out.
- Encouraging greater competition through cohesive trade, competition and regulatory policies, including those governing state-owned companies.
- Ensuring migration policy helps ease the skills constraint.
- Supporting employment-intensive services by taking advantage of global opportunities in information and communication technology, financial and other professional services. South Africa is well positioned to grow its services in an expanding African market.
- Promoting the expansion of travel and tourism. Tourism directly contributes 3 per cent to GDP and 4.5 per cent to total employment. Recent changes to the visa regime and well-targeted advertising will support sector growth.
- Regional economic integration efforts to leverage growth in Africa. Despite the commodity-related economic slowdown in many African countries, low intra-continental trade continues to suggest potential avenues to boost economic growth. Negotiations continue to create a free-trade area to bring together some 600 million consumers in the Southern African Development Community, East African Community and Common Market for Eastern and Southern Africa.

Given prevailing economic conditions, these interventions are unlikely to raise growth in 2016, but should begin to raise potential growth over the forecast period.

## Summary

Economic growth forecasts have been revised down, and risks remain to the downside. Government continues to prioritise raising investment; improving labour relations, certainty and policy coordination; and making it easier to do business so that the South African economy is better placed to grow more rapidly in future. Expanded partnerships with business, labour and civil society to realise the objectives of the National Development Plan will be a key feature over the medium term.

*Government working to position economy for rapid growth*