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Economic overview:

Recent developments in the global and South African economies

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Department of Research and Information

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Highlights

- Increased confidence in the sustainability of the global growth momentum going forward is based on the breadth and nature of contributions from the world's economies. The higher growth trajectory is likely to be supported by pro-cyclical policies, increased fixed investment activity and favourable developments in commodity markets.

- Trade has become of increased importance in sustaining economic growth and development in various parts of the world. Disruptive actions associated with protectionist tendencies could have far-reaching implications for trading activity globally, with adverse effects on economic growth and, potentially, investment levels.

- Gross debt levels have risen substantially across the world. Such a trend poses considerable risks to the global economic expansion, especially as monetary policies in major developed economies are progressively normalised by unwinding quantitative easing and raising interest rates.

- Growth prospects for the Sub-Saharan Africa region are set to improve over the next five years, with stronger global demand, more stable commodity prices and volume demand, as well as economic reforms in several countries, underpinning such expectations.

- After recording a very modest rebound in 2017, South Africa's economic growth is expected to gain further momentum in the years ahead. The principal drivers of growth are anticipated to be gradually higher household consumption expenditure in real terms, increasing private sector fixed investment, and an improved export performance on the back of sturdier demand conditions globally.

- Growth in household expenditure is anticipated to pick up momentum as consumer confidence recovers, with relatively lower interest rates, more stable inflation, rising disposable incomes and progressively improving prospects on the employment front as contributing factors. The recent hike in the VAT rate and in fuel-related levies will, however, have an adverse impact on consumer spending, which could be 0.6 of a percentage point lower over the 12 months to March 2019, compared to baseline forecasts.

- Business confidence rebounded strongly in the first quarter of 2018, reaching its best level in three years. This was mostly due to positive developments in the political arena in recent months. The outlook for fixed investment activity is thus improving, underscored by improving conditions in global markets and, gradually, in the domestic economy. As existing production capacity is increasingly utilised, the focus of capital spending is likely to shift more towards expansionary and greenfield investments.

- President Ramaphosa recently announced an ambitious investment drive aimed at raising the quantum of fixed investment in the economy by USD100 billion over the next five years. Should it succeed to a major extent, this will provide a substantial boost to overall economic growth and employment levels.

- Improving demand conditions in global markets are likely to benefit South Africa's export sector, including producers of consumer goods, intermediate products and raw materials. Manufacturers have expressed increased optimism regarding their export performance in 12 months' time. Mining exports, in turn, are expected to gain some momentum due to higher investment activity globally, which is likely to raise volume demand and impact positively on the prices of several industrial commodities.

Global GDP growth forecast over 2018 - 2022:

3.8% per annum

(IMF)

GDP growth forecast for Sub-Saharan Africa in 2018:

3.4%

(IMF)

Presidential initiative aims to elevate fixed investment activity in South Africa by:

USD 100 billion over next 5 years

SA economic growth set to gain further momentum over 2018 - 2022:

2.5% per year

(IDC)

Implications for South African businesses

- An improved outlook for the global economy bodes well for South Africa's export sector, including businesses seeking alternatives to the domestic market due to yet subdued demand conditions. Key export markets such as the Eurozone, Sub-Saharan Africa and the United States are anticipated to experience improved consumption spending and investment activity, which could potentially translate into higher import demand for consumer goods, intermediate products and raw materials.

- However, specific industries could face significant challenges in some markets. Examples include steel and aluminium producers selling to the US market due to import tariff protection, as well as exporters of platinum and catalytic converters to Eurozone markets, where diesel vehicles are losing market share at a significant pace.

- Other African economies are expected to present substantial opportunities for South African investors and exporters. These include opportunities associated with increasing infrastructure development and other types of fixed investment activity, rising consumption spending, as well as rising demand for specialised business services. However, businesses should also take special note of heightened debt sustainability concerns in Sub-Saharan Africa, for many countries have been experiencing rising public debt levels alongside constrained revenue collection abilities. About 40% of countries in the region are in debt distress or at high risk of debt distress.

- On the domestic front, the anticipated recovery in household consumption spending should benefit segments of the economy whose activities (goods' producers and/or service providers) that are closely aligned to the consumer market. Spending on durable goods, for instance, is forecast to show an improvement after some difficult years, providing market opportunities for businesses in segments such as motor vehicles, appliances and furniture, among others.

- Reviving business confidence domestically should progressively translate into higher levels of fixed investment activity by the private sector. Although this will tend to be of an asset maintenance and upgrading nature at first, which will benefit suppliers of the requisite equipment and related services, it will eventually extend to expansionary and greenfield investments.

- Public sector investment in infrastructure development is expected to remain robust in the transport and logistics, as well as the water and sanitation segments. Furthermore, efforts to enhance the impact of public sector procurement on the localisation of production, including increased scrutiny of SOC and governmental tenders, are likely to translate into tangible benefits for South Africa's industrial and services sectors, opening up opportunities for future investment activity as well as for socio-economic transformation.

- The massive fixed investment drive recently announced by President Ramaphosa should bring to the fore numerous investment opportunities.

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Global developments and outlook

Global economic growth expectations remain at 3.9% for 2018

Confidence in the sustainability of the global economic expansion has increased. In its latest review (World Economic Outlook, April 2018), the International Monetary Fund (IMF) maintained its projection for world GDP growth at 3.9% for 2018.

The advanced economies are expected to expand by 2.5% and 2.2% in 2018 and 2019, respectively, with the slower growth in the latter year being partly due to the normalisation of monetary policy, particularly in the United States (US) and the Eurozone. The emerging markets and developing economies are expected to post significantly higher rates of growth at 4.9% in 2018 and 5.1% in 2019.

The robust expansion momentum globally is being supported by pro-cyclical policies (for example, the impact of tax reductions on economic growth in the US), as well as by favourable developments in some commodity markets, which will favour resource exporters. Consequently, fixed investment activity is on the rise across the world, as are trade flows.

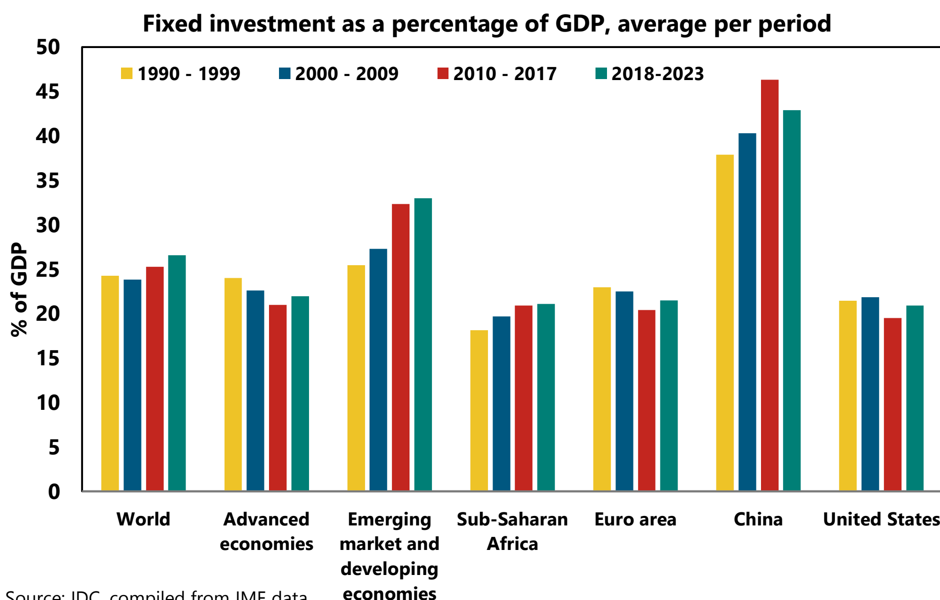
The risks to global economic growth over the medium-term are, however, tilted to the downside. Besides the risks associated with protectionist tendencies, particularly in the US, as well as with geopolitical tensions in parts of the world, some of the pro-cyclical policies currently working their way through the global economy may eventually need to be reversed. Furthermore, a number of economies are growing at their full potential or close to it, highlighting the need for structural reforms to sustain higher levels of growth.

Fixed investment activity increasing

Fixed investment activity is set to accelerate, driven mainly by the emerging markets and developing economies

Since 2010, stronger rates of fixed investment have resulted in the investment-to-GDP-ratio rising to an average of 25.3% of GDP for the world at large, which is above the long-term average ratio of 24.6%. As illustrated in Figure 1, the IMF is expecting this ratio to increase further, possibly reaching 26% in 2018 and 26.8% by 2023. This sustained higher level of investment activity will be largely driven by emerging markets and developing economies, where the investment ratio is projected to average 33% of GDP over the 5-year outlook period, compared to 32.3%, on average, since 2010. The fixed investment ratio for the advanced economies, in turn, is expected to average 22% of GDP over the forecast period, or slightly lower than the long-term average of 23%.

Figure 1: Importance of investment as a driver of growth around the globe



Source: IDC, compiled from IMF data

Global trade ties have been deepening

World merchandise trade increased significantly in 2017, recording a 4.7% growth rate. Although the World Trade Organisation (WTO) expects the pace to slow to 4.4% and 4.0% in 2018 and 2019, respectively, these remain relatively high rates of expansion. Trade openness, as reflected by the ratio of global exports plus imports to GDP, increased to 48.5% in 2017, from an average ratio of 47.3% of GDP over the period 2010 to 2017. The IMF projects this ratio to rise steadily towards 52.1% by 2023.

Global trade is increasingly important for many of the world's countries

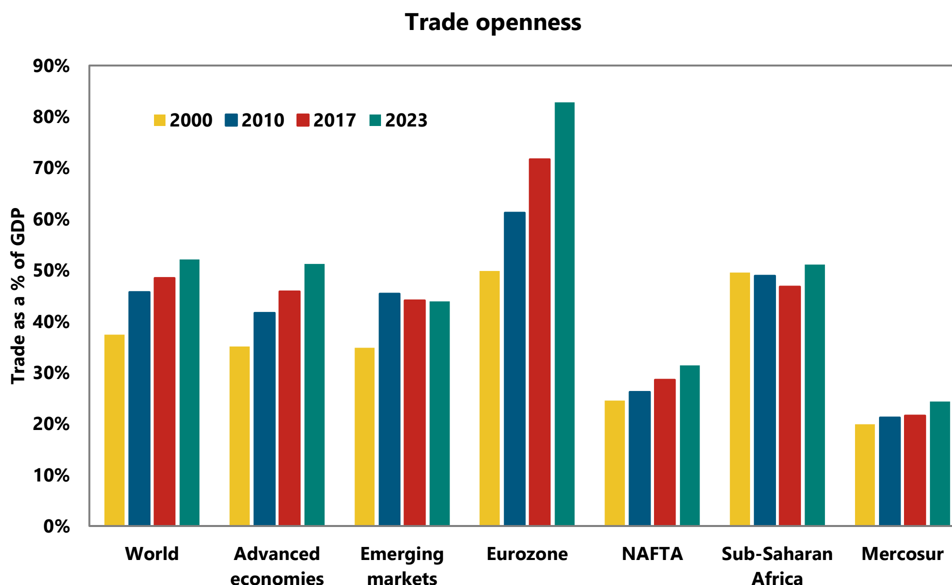
The Eurozone is the region with the highest trade openness ratio at 71.7% of GDP in 2017. This highlights the trading advantages that can be gained from a common market, for a considerable portion of its overall trade pertains to intra-regional trade amongst its member states. This is in stark contrast to the North American Free Trade Agreement (NAFTA) bloc, which recorded a trade openness of only 28.6% of GDP in 2017, which was largely due to the total external trade of the US representing 23.3% of its GDP.

The Eurozone is the world's most open regional bloc from a trading perspective

The Chinese economy is undergoing a major strategic restructuring aimed at reducing its reliance on export trade and fixed investment activity as drivers of growth, instead shifting towards a domestic consumption driven and more services-oriented economic structure. However, its trade openness indicator increased from 46.8% of GDP in 2010 to 52.4% by 2017. China's export reliance (that is, exports as a percentage of GDP) is still expected to increase from 34.7% in 2017 to 43.3% in 2023.

China will remain significantly reliant on external trade for some time

Figure 2: Trade is claiming an increasingly larger portion of economic activity worldwide



Source: IDC calculations compiled from IMF and Trademap data

Although the trade openness indicator is a useful measure of the extent of integration in the global economy, it conceals the relative proportions (and therefore imbalance) claimed by exports and imports. To illustrate, whereas the US economy's export reliance measured 10.4% in 2017, its import penetration (imports as a percentage of GDP) was higher at 12.9%. This imbalance has contributed to the Trump administration's concerns regarding the US trade performance and, accordingly, its protectionist stance.

Global debt levels have risen

Highly accommodative monetary policies, including the use of extraordinary mechanisms such as the so-called "quantitative easing" by several advanced economies, contributed significantly to the world economy's recovery since the global financial crisis (GFC) and subsequent recession in 2009. However, both public and private sector debt have escalated in the process, as illustrated in Figure 3.

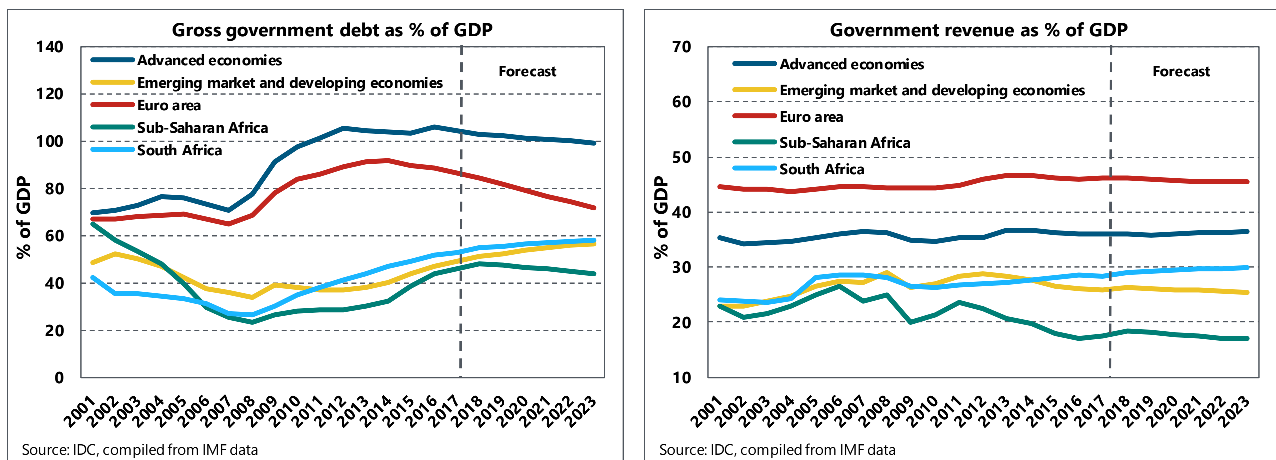
Very high debt levels pose a considerable threat to the global expansion momentum

Gross debt levels across the globe reached USD164 trillion in 2016, or 225% of global GDP, compared to the previous peak of 213% of GDP in 2009. Approximately half of this debt has been accumulated by three countries, namely the US, China and Japan, with China having seen its gross debt rise from USD1.7 trillion in 2000 to USD25.5 trillion by 2016.

Such excessively high debt levels could pose considerable risks to the sustainability of the world's economic expansion, especially as the unconventional monetary policy support continues being unwound and interest rate environments in major developed economies are progressively normalised in light of rising inflationary pressures.

The IMF has thus urged countries to undertake structural reforms and improve fiscal health, especially in the current environment of relatively low inflation and expanding economic activity.

Figure 3: Sharp rise in government debt over the past decade, revenues almost unchanged



Gross government debt in advanced economies escalated rapidly to a peak of around 106% of GDP in 2016, but is projected by the IMF to decline steadily towards 99% of GDP by 2023. To put this in context, this ratio stood at 71% of GDP at the onset of the GFC in 2007, prior to the spree in governmental deficit spending to avert economic collapse.

Government debt levels in advanced economies are expected to moderate

Stagnant growth in gross government revenues as a percentage of GDP in most major economies (refer to Figure 3) means that the fiscal space that was available prior to the GFC is no longer there to the same extent. An increased government debt load amidst constrained revenue growth has raised sovereign credit risks and reduced the capacity of several economies to absorb adverse macro-financial stresses, should these erupt again.

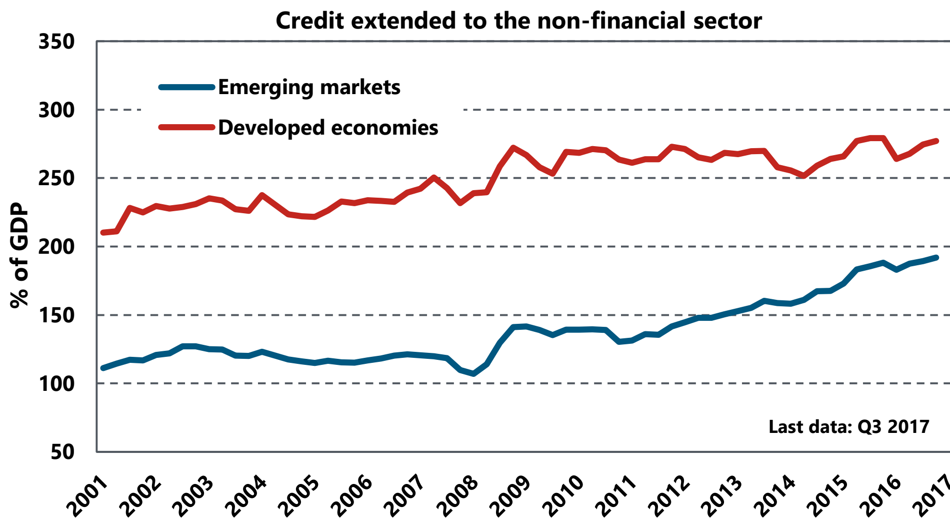
As far as emerging markets and developing economies are concerned, gross government debt increased rapidly over the past decade, from 33.9% of GDP in 2008 to 49% by 2017. While these ratios are still significantly lower than those of advanced economies, government revenue as a share of GDP fell to 26% in 2017, and is projected to fall further to 25.5% by 2023.

Governments in emerging markets and developing economies are experiencing revenue challenges

The steep rising trend in private sector debt is also of concern. Data provided by the Bank for International Settlements (BIS) shows that credit extension to the non-financial sector in emerging markets, as a percentage of GDP, increased rapidly from 107% in 2008 to 192% by the end of the 3rd quarter of 2017. Much of this growth can be attributed to credit-fuelled growth in China, which the IMF estimates accounted for 43% of the growth in the global debt load to the abovementioned record level of USD164 trillion in 2016.

Increase in private sector debt providing reason for concern, particularly in a rising interest rate environment

Figure 4: Rising trend in private sector debt is of concern



Source: IDC, compiled from BIS data

Although the recent 100 basis points cut in China's required reserve ratio (the first such action since February 2016) should boost economic activity in the near-term, it could also propel debt accumulation and increase the fragility of its financial system. This could potentially pose significant downside risks on industrial commodity prices if China was to experience financial stress, for it accounts for roughly 50% of the global consumption of industrial metals.

Similarly, elevated private sector debt in advanced economies, with credit to the non-financial sector in these economies having accounted for 277% of GDP by the third quarter of 2017, poses significant risks on the global economic system's capacity to absorb macro-financial stresses. These developments regarding global public and private sector debt add, to some extent, a degree of uncertainty to the longer-term global macroeconomic outlook.

Emerging risks to global economic growth

The decisive shift by the Trump administration to a more protectionist economic policy path has the potential to undermine somewhat the extent of the expected recovery in global economic growth. Following recent threats to impose tariffs against Chinese goods as well as sanctions against Russia, the US has withdrawn from the international nuclear deal concluded in 2015 (referred to as the Joint Comprehensive Plan of Action) and threatened to impose sanctions on European companies continuing to conduct business with Iran.

US protectionist policies to negatively impact on global growth and trade

The US sanctions against European companies would include automotive and aviation deals and could be re-imposed by August 2018, while those affecting the oil and shipping activities, as well as the insurance and energy sectors, could become effective in November 2018. These actions are anticipated to significantly disrupt world trade flows and impact adversely on globally integrated value chains and related traded product prices.

The withdrawal of the US from the Iran nuclear deal will have the direct impact of displacing Iranian oil supplies that is likely to raise oil prices going forward. Sustained higher oil prices

will induce increased cost pressures across global industrial production value chains, further threatening the pace of global economic expansion.

These developments are likely to adversely affect open economies throughout the world, both large and small, whether directly and/or indirectly. In this environment, larger trading economies such as the EU and China, among other affected economies, would tend to diversify their trading reach to other world markets and amongst themselves, displacing less competitive exporters and producers in the process.

This could induce further downside risks on South Africa's overall export performance, particularly considering that the global trading environment is becoming increasingly uncertain. Furthermore, the impending sanctions on Iran could potentially affect South Africa's trade and business relationships with that country.

More recently, trade tensions between the US and China appear to have eased to some extent following an agreement between both countries to refrain from imposing new tariffs on imports from one another. Furthermore, China agreed to substantially reduce its large trade surplus with the US and both countries have emphasised the need for more constructive cooperation regarding trade issues.

Recent developments in the Sub-Saharan Africa region

Improved growth prospects for many African economies

The growth outlook for Sub-Saharan Africa (SSA) has improved, spurred by optimistic growth in the region's largest economies. The SSA region is projected to grow by 3.4% and 3.7% in 2018 and 2019, respectively, according to the IMF. This represents a notable increase from the 2.8% growth rate estimated for 2017. These forecasts are postulated on a more supportive external environment, including stronger global growth and expectations of stable commodity prices, as well as on the premise that the authorities will generally implement reforms to address macroeconomic imbalances and boost investment.

Growth projections for the SSA region's key economies were revised upwards, in certain instances on the back of an improved outlook for oil revenues and the introduction of forex measures to ease liquidity constraints. Non-resource intensive countries, led by Côte d'Ivoire and Senegal, are also expected to post solid growth supported by infrastructure spending. However, there is significant downside risk to these forecasts, with political instability and rising debt levels as possible contributing factors.

Concerns about debt sustainability in the Sub-Saharan Africa region

There are heightened debt sustainability concerns in SSA, for many countries have been experiencing rising public debt levels alongside constrained revenue collection abilities. Furthermore, the composition of such debt has changed, as countries have shifted from the traditional concessional sources of financing towards more market-based sources. The relatively recent collapse in commodity prices, which significantly reduced government revenues, led to a sharp build-up of debt in the past few years, especially in resource-based SSA economies.

40% of countries in the SSA region are in debt distress or at a high risk of debt distress

About 40% of countries in the region are in debt distress or at high risk of debt distress. The debt sustainability outlook will remain challenging for the region, due to higher debt servicing costs as interest rates rise in some advanced economies.

Relatively weak fixed investment activity in many parts on the African continent has resulted in the investment-to-GDP ratio for Sub-Saharan Africa as a whole to be among the lowest at the broad regional level (this was illustrated in Figure 1). Nonetheless, since fixed investment activity is expected to gain some momentum in several SSA economies, this ratio

is likely to rise over the outlook period, but remaining well below the average ratio for emerging markets and developing economies.

Export reliance set to decline among resource-rich countries

The export reliance of resource-intensive countries is broadly projected to decline in the next few years, albeit remaining relatively high in countries such as Angola, Gabon and Zambia. Mozambique is an exception to this general trend, for its export reliance is expected to increase by 6 percentage points, from an annual average of 30% over the period 2012 to 2017, to an average of 36% over the outlook period. This will be largely due to the anticipated increase in liquefied natural gas (LNG) exports.

The export reliance of non-resource intensive economies, however, is projected to remain low and roughly unchanged over the outlook period to 2022. The IMF expects South Africa's export reliance to decline by 2 percentage points, from an annual average of 28% over the period 2012 to 2017, to an average of 26% over the outlook period to 2022.

Table 1: Export reliance (exports as a percentage of GDP) of select African countries

Country	Export reliance (annual averages)	
	2012 – 2017e	2018f – 2022f
Angola	45.8%	40.4%
Côte d'Ivoire	34.1%	28.5%
DRC	20.6%	18.0%
Ethiopia	4.0%	3.6%
Gabon	48.2%	48.5%
Ghana	21.0%	19.8%
Kenya	9.2%	8.8%
Malawi	22.0%	23.2%
Mali	21.4%	18.0%
Mozambique	30.0%	36.6%
Namibia	41.4%	42.9%
Nigeria	15.5%	14.8%
Senegal	20.2%	20.2%
South Africa	**28.0%**	**26.0%**
Tanzania	11.7%	11.4%
Uganda	7.5%	9.9%
Zambia	41.6%	37.6%
Zimbabwe	24.1%	22.0%

Source: IDC, compiled from IMF data

Recent developments in the South African economy

Better than anticipated economic growth in 2017 underpinned by household spending

The very modest recovery in overall GDP growth to 1.3% in 2017, from 0.6% in 2016, was underpinned by the 2.2% increase in household consumption expenditure, its best performance in five years.

Although still quite subdued, growth in private sector fixed investment measured 1.2% in 2017. This followed declines in real terms for two consecutive years (-0.5% and -5.3% in 2015 and 2016, respectively).

Despite improved global demand conditions, South Africa's merchandise exports increased by only 0.9% during the course of 2017, while overall exports of goods and services contracted by 0.1%, the worst performance in the past eight years.

Manufacturing sector taking some strain, with US protectionism potentially aggravating the situation

The 1st quarter of 2018 saw manufacturing output under renewed pressure, with modest growth of just 0.4% on an annual basis. The outlook has also worsened to some extent considering the US's stance on global trade. The recent imposition of tariffs on imported steel (+25% duty) and aluminium (+10% duty), including those from South Africa, could have a material impact on the performance of the affected domestic industries.

Approximately 17% of South Africa's exports of the affected iron and steel products (i.e. sections of the Harmonised System codes, specifically HS 72) and almost 33% of its exports of the affected articles of iron and steel (i.e. sections of HS 73) are being shipped to the US and therefore at risk. Moreover, around 24% of all of South Africa's aluminium exports of the affected products are sold in the US market.

Mining sector facing some difficulties

Mining production, largely affected by a steep drop in output during March, declined by 1.8% (year-on-year) during the first three months of 2018. This was mainly due to sharply lower output of gold, platinum group metals, copper and nickel.

Looking ahead, the principal drivers of economic growth are expected to be household spending, as consumer conditions are set to improve gradually over the next couple of years; a revival in private sector fixed investment on the back of improving sentiment and rising demand; and an improved export performance supported by higher global growth and favourable developments in commodity markets.

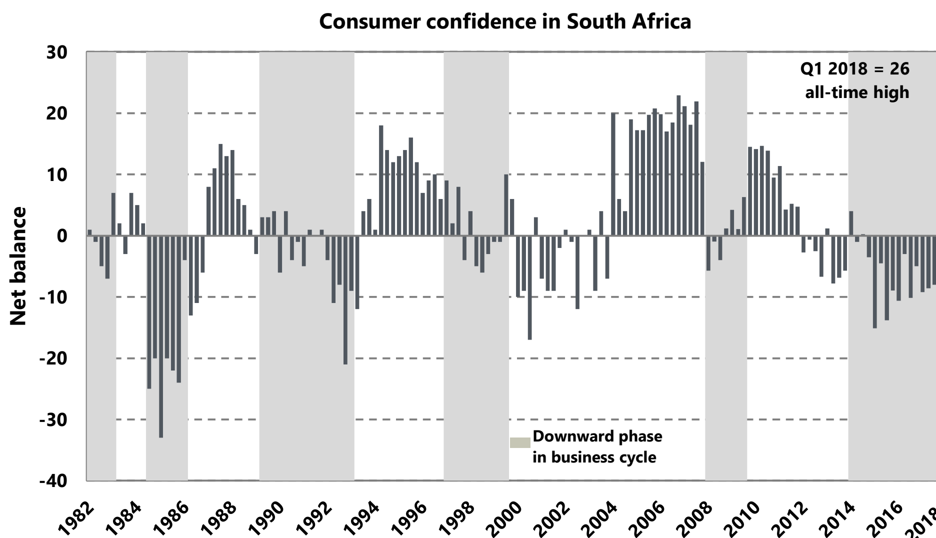
Household consumption expenditure

The consumer environment is showing signs of improvement. This should bode well for a sustained recovery in household consumption spending, albeit still very gradually. Growth in retail trade sales expanded, on average, by 4.1% (year-on-year) during the 1st quarter of the year. This was mainly due to a steep rise in spending on items such as furniture and appliances, clothing and textiles, as well as on pharmaceutical products and cosmetics.

Consumer confidence rebounded to a record high

Having been at very low levels for an extended period, consumer confidence rebounded sharply to an all-time high of 26 points in the 1st quarter of 2018. Consumers are now more upbeat about South Africa's economic outlook over the next 12 months. The assessment of their own financial position also improved quite strongly, whilst the survey also points to an improved outlook with regard to durable goods' purchases.

Figure 5: Consumer confidence rebounded strongly to a new record high



Source: IDC, compiled from BER data

These developments, along with a more favourable inflation and interest rate environment at present, the uptick in demand for new credit, and lower debt-servicing costs provide some confidence that prospects for consumer spending are indeed improving.

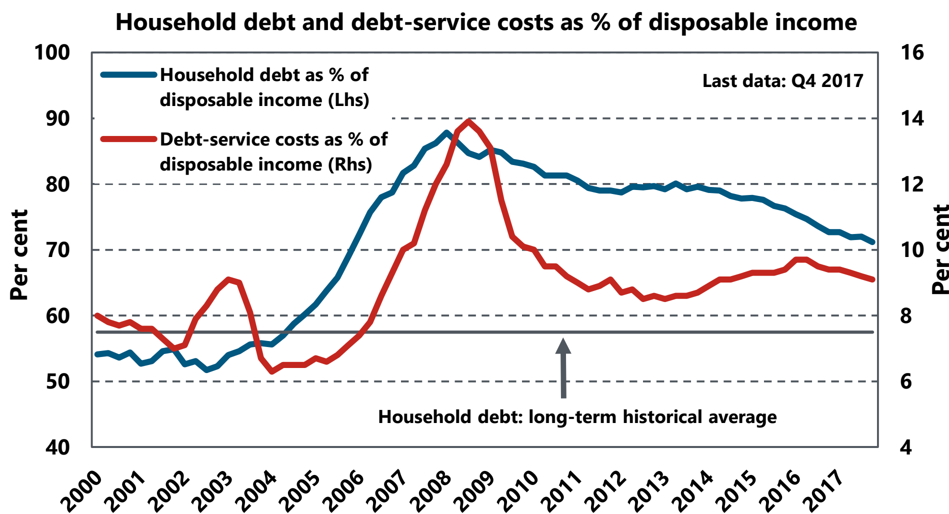
Growth in household expenditure is anticipated to pick up momentum in the years ahead. This should be underpinned by recovering consumer confidence, relatively lower interest rates, more stable inflation, rising disposable incomes and progressively improving prospects on the employment front.

The relatively high level of household indebtedness is, however, expected to continue affecting the ability and willingness of households to raise their expenditure for some time. The household debt-to-disposable income ratio has been on a steady declining trend since its all-time high of 87.8% recorded in 2008. However, at 71.2% in the 4th quarter of 2017, it is still significantly higher than the long-term average of 57.5%.

Household debt ratios have been declining, but remain very high

In line with a lower debt ratio and declining interest rates, debt-service costs have also been slightly lower, providing some relief to debt-ridden households. Of concern is the fact that roughly 40% of all credit active consumers are having an impaired record at present, as they are not able to meet their debt obligations.

Figure 6: Household debt levels on the decline



Source: IDC, compiled from SARB data

Moreover, the increase in value-added tax (VAT) from 14% to 15%, effective 1 April 2018, will also affect household spending. Table 2 (on Page 9) indicates the composition of the consumer basket per expenditure decile, with each decile capturing 1.66 million households (for example, Decile 7 covers the expenditure bracket from R94 885 to R124 227 per year).

The higher VAT rate will impact negatively on consumer spending and inflation

According to Statistics South Africa (Stats SA), 43.51% of the overall headline CPI basket is exempt from VAT. The potential impact of the higher VAT rate on consumer spending will thus differ across the various expenditure categories, as the composition of the expenditure basket varies across the deciles.

To illustrate, it is estimated that the higher VAT rate implies that 46.05% of all products falling into Decile 7 will either be exempt from VAT or zero-rated. This is the highest among all 10 expenditure groups. Thus, the one percentage-point hike in VAT means that 53.95% of this basket will be affected by higher prices.

As a result of the higher VAT rate and the concomitant increase in consumer prices in general, households will be left with less money for discretionary spending. Household spending on goods and services could be reduced by as much as R17.1 billion in 2018, with this figure potentially rising gradually to R23.7 billion by 2022.

Table 2: CPI basket according to expenditure group

Consumer Price Index (CPI) - Weights of CPI basket according to expenditute group (% share per spending item)

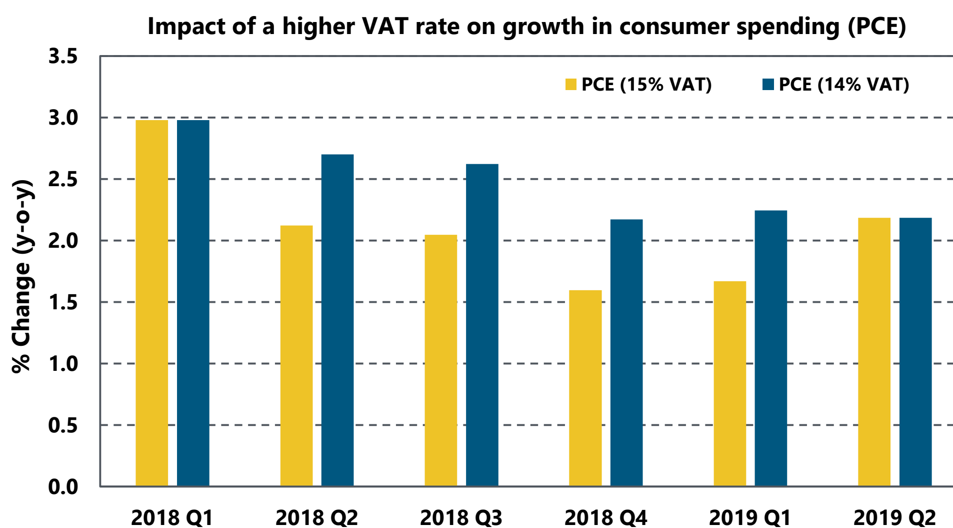
Item/ expenditure category	Decile 1: up to R17 721	Decile 2: R17 722 to R29 475	Decile 3: R29 476 to R42 582	Decile 4: R42 583 to R56 909	Decile 5: R56 910 to R73 813	Decile 6: R73 814 to R94 884	Decile 7: R94 885 to R124 227	Decile 8: R124 228 to R173 022	Decile 9: R173 023 to R269 902	Decile 10: R269 903 and more	Items zero-rated or exempt from VAT
Food & non alcoholic beverages	48.13	46.98	38.67	31.70	29.60	25.55	23.91	21.61	16.92	10.74	5.46
Alcoholic beverages & tobacco	3.86	2.96	4.16	5.76	5.05	5.94	6.09	6.29	6.89	5.58	0
Clothing & footwear	8.82	8.75	7.73	5.65	6.25	5.17	4.97	4.81	4.00	2.68	0
Housing & utilities	17.25	15.33	25.27	35.24	36.36	39.20	37.64	32.83	27.69	16.40	18.84
Household content & services	2.64	3.03	2.79	2.54	2.59	2.41	2.41	2.86	3.78	5.73	2.43
Health	0.66	0.73	0.59	0.50	0.52	0.50	0.47	0.67	0.76	1.83	0
Transport	1.18	1.95	2.50	3.43	3.63	5.77	7.40	8.92	11.65	21.11	6.33
Communication	6.95	5.70	4.67	3.41	3.09	2.72	2.54	2.60	2.65	2.38	0
Recreation & culture	1.88	2.31	2.57	3.07	3.06	3.46	3.54	4.32	4.53	6.34	0
Education	0.34	0.42	0.60	0.59	0.83	0.86	1.28	1.88	2.88	3.38	2.52
Restaurants & hotels	3.80	5.11	3.96	3.25	3.12	2.70	2.59	2.70	2.30	3.53	0
Miscellaneous goods & services	4.49	6.73	6.49	4.86	5.90	5.72	7.16	10.51	15.95	20.30	7.93
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**43.51**
VAT exempt or Zero rated	**33.15**	**33.13**	**38.27**	**43.09**	**44.19**	**45.86**	**46.05**	**44.93**	**45.10**	**42.57**	**43.51**

Source: Stats SA; IDC calculations for VAT impact per Decile

This estimated impact is illustrated in Figure 7, where the higher 15% VAT rate is shown to reduce real growth in household consumption expenditure by an average of 0.6% per quarter over the year to March 2019. From the 2nd quarter of 2019 onwards, however, real growth in household spending could again be similar to that projected under a 14% VAT rate, although the quantum of spending will be lower under the higher VAT environment.

The adverse effect on the overall growth of the South African economy will be countered to some extent by increased government consumption expenditure on the back of higher revenue collections. However, considering that around 11% of all consumption spending by general government is on interest payments, this leaves 89% of such higher revenue collection to be allocated to spending on goods and services, as well as on salaries and wages for government employees.

Figure 7: Higher VAT rate reduces growth in real consumer spending



Source: IDC, compiled from SARB data, IDC forecasts

Fixed investment activity

Subdued economic growth and insufficient demand, which resulted in surplus production capacity in many sectors of the South African economy, took a toll on private sector fixed investment in recent years. Concerns over political developments and policy-related challenges affected business confidence and, as a result, private sector investment.

Generalised weak investment activity in recent years

As far as the public sector is concerned, the stretched balance sheets of many key state-owned companies alongside intensifying fiscal constraints for general government adversely affected public sector infrastructure investment.

Gross fixed capital formation increased by only 1.5% per year, on average, over the period 2010 to 2017. Investment spending by public corporations was hardest hit, for it grew by a mere 0.5% per annum during this period, compared to an average annual expansion rate of 20.5% from 2002 to 2009.

Table 3: Growth in real gross fixed capital formation (GFCF)

Year	General government	Public corporations	Private sector	Total GFCF
2010	-9.4	-4.9	-2.3	**-3.9**
2011	4.1	-1.9	8.3	**5.5**
2012	7.3	3.8	1.2	**2.6**
2013	6.4	6.6	7.5	**7.2**
2014	5.3	-5.7	1.6	**0.7**
2015	14.4	8.3	-0.5	**3.4**
2016	-3.5	-0.7	-5.3	**-4.1**
2017	-0.7	-1.3	1.2	**0.4**
Average: 2010 -17	**3.0**	**0.5**	**1.5**	**1.5**

Source: IDC, compiled from SARB data

The investment-to-GDP ratio consequently declined from 23.5% in 2008 to 18.7% by 2017, well below the desired rate of 30% as envisaged in the National Development Plan (NDP). This poor investment performance not only affects economic growth at the present time, but also the economy's growth potential in the years ahead.

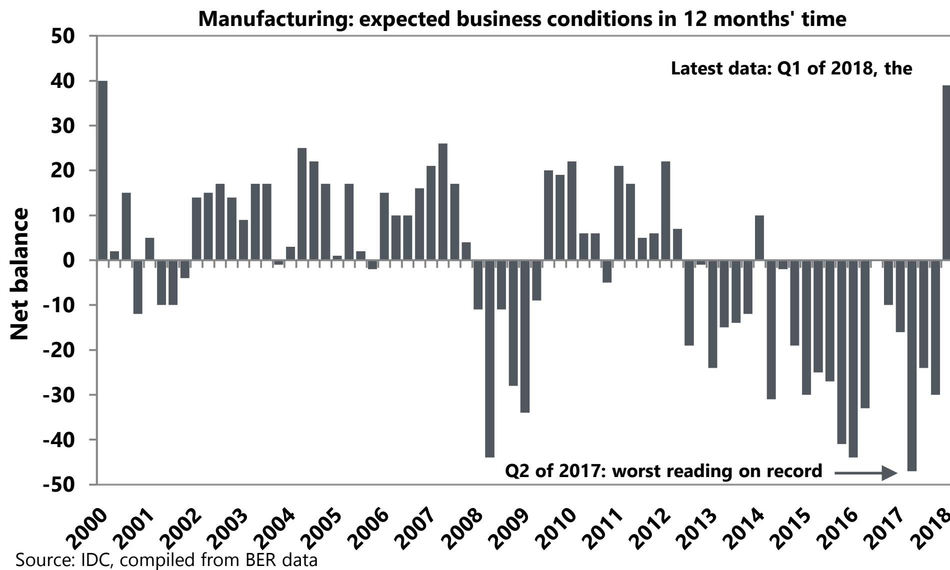
Nonetheless, the outlook for fixed investment activity appears to be improving. Business confidence rebounded strongly in the 1st quarter of 2018, reaching its best level in 3 years. This was mostly due to positive developments in the political arena in recent months. Although confidence levels among manufacturers have recovered significantly, these remain relatively low and business conditions are likely to remain challenging in the near-term. However, favourable prospects for growth in global demand should support increased manufacturing production, investment and exports going forward.

Positive developments in the political landscape underpinned the recent rebound in business confidence

Manufacturers' expectations of business conditions in 12 months' time have improved substantially, according to the Bureau for Economic Research's (BER) survey undertaken in the 1st quarter of 2018. The reading of 39 points reflects the largest rebound on record (+69 points) to its highest level in 18 years, providing encouraging signs of a welcomed recovery in the manufacturing sector (refer to Figure 8 on next page).

Although domestic demand remains a constraint, manufacturers are now more upbeat about export prospects. Furthermore, the marked improvement in expectations regarding fixed investment in machinery and equipment could lead to an eventual turnaround in actual capital outlays, in the process translating into higher levels of production.

Figure 8: Business conditions expected to improve in the manufacturing sector



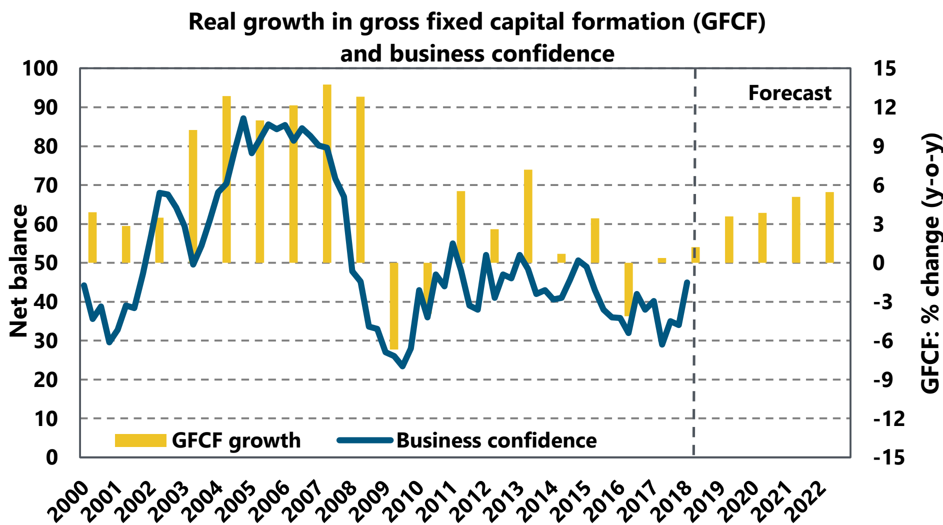
Source: IDC, compiled from BER data

Private sector fixed investment is set to gain momentum

Private sector fixed investment in general is projected to increase on the back of improving conditions in global markets and, gradually, in the domestic economy. As existing production capacity is increasingly utilised, the focus of capital spending is likely to shift more towards expansionary and greenfield investments.

Over the short-term, much of the capital spending is expected to emanate from private business enterprises, as general government and public corporations are likely to continue facing financial constraints. The situation is, however, anticipated to improve over the medium-term, with a gradual rise in infrastructure expenditure by the public sector.

Figure 9: Improving business sentiment and demand conditions to underpin higher investment



Source: IDC, compiled from SARB, BER data; IDC forecasts

Substantially lower public sector infrastructure investment is anticipated over the next three years as per the Budget 2018 data (R834 billion), which is 12% less than what was estimated in the 2017 Budget. Growth in private sector fixed investment in 2018 is forecast at 2.2% (1.2% in 2017), but is expected to gain momentum in subsequent years.

Export performance

After recording a sizeable R80.6 billion trade surplus in 2017, mainly due to a significant improvement (+23.5%) in mining and mineral exports, South Africa's balance of trade posted a R17.8 billion deficit in the 1st quarter of 2018.

Rising global demand to be reflected in higher SA exports, including that of manufactured products

Total export values fell by 17% compared to the preceding quarter, with mining exports down by R29.2 billion and manufactured exports R27.2 billion lower.

In turn, the overall value of imports fell by only 1.5%. Imports of manufactured goods were 8.3% (R21.7 billion) lower, but crude oil imports rose sharply on the back of higher international oil prices and a substantial increase in imported volumes.

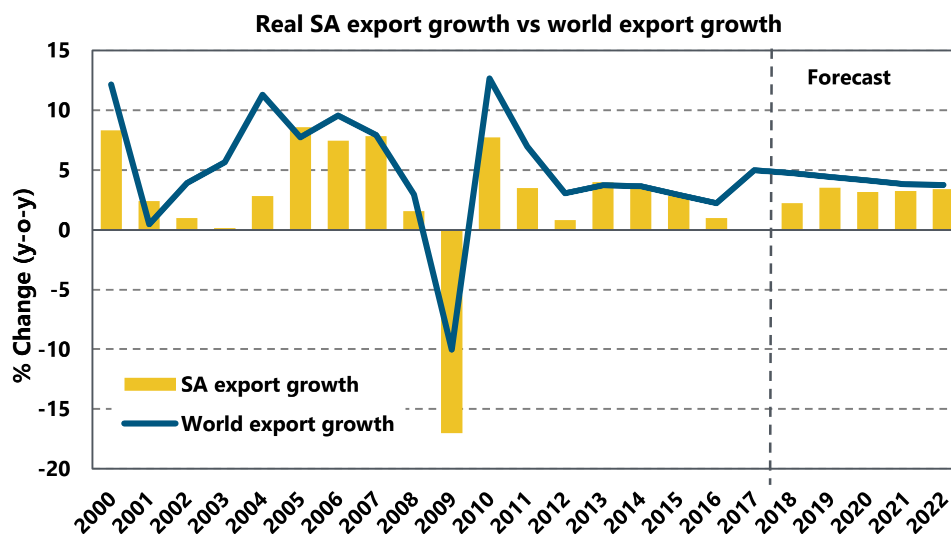
However, going forward, improving demand conditions globally should result in an improved export performance not only in some of South Africa's key external markets, such as the Eurozone, Sub-Saharan Africa and the United States, but also in market development opportunities elsewhere in the world. The improved outlook for South African exporters of consumer goods, intermediate products, as well as raw materials, has been reflected in recent business surveys. This includes manufacturers, who have expressed increased optimism regarding their export performance in 12 months' time.

However, protectionist measures in the US are posing substantial risks in this export market. South Africa's steel and aluminium industries are already facing import tariffs of 25% and 10%, respectively, in the US market, which could have detrimental implications for these respective sectors.

Mining and mineral exports are expected to gain some momentum due to higher investment activity globally, which is likely to raise volume demand and impact positively on the prices of several industrial commodities.

Although relatively modest from an historical perspective, export growth is projected to average 3.1% per year in real terms, over the period 2018 to 2022.

Figure 10: Export growth to gain a stronger momentum



Source: IDC, compiled from SARB, IMF data, IDC forecast for SA exports

Employment creation

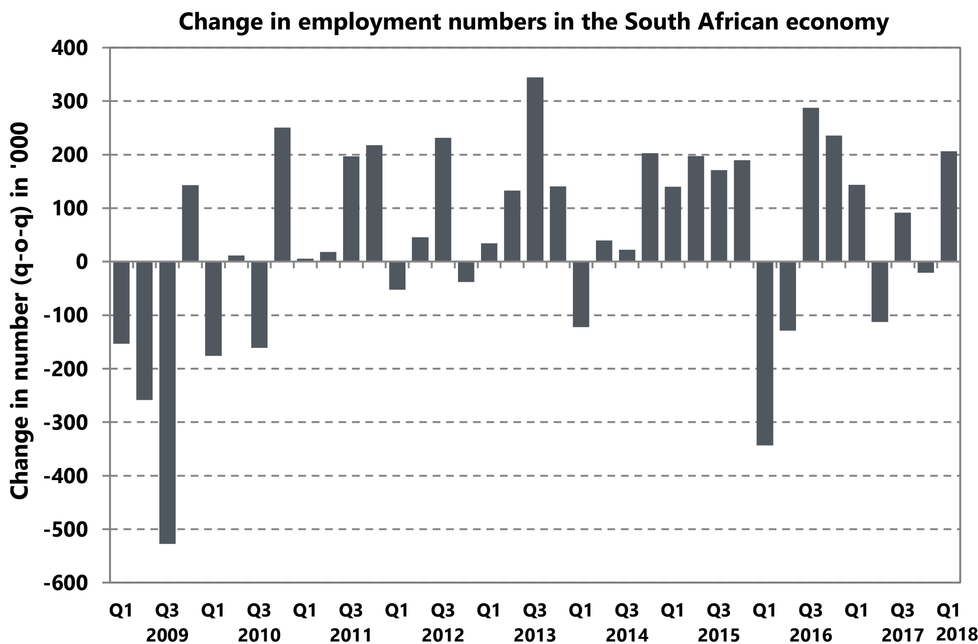
More jobs created as economic growth gains some momentum

During the 1st quarter of 2018, the South African economy managed to create just over 206 000 new employment opportunities, on a quarterly basis.

The majority of these jobs were in the formal non-agricultural sectors, with 111 000 additional jobs, mostly within the community and social services sector (+90 200), manufacturing (+68 780) and the trade sector (+40 100). In turn, substantial job losses occurred in the transport and finance sectors and to a lesser degree in construction, mining and the electricity sector.

Within the informal sector, most of the jobs were created in the construction sector (+59 420), as well as in finance (+54 200).

Figure 11: More jobs created as economic growth gathers momentum



Source: IDC, compiled from Stats SA data

The unemployment rate remains very high at 26.7%

Despite the up-tick in the employment numbers, this was not sufficient to absorb all new entrants into the labour market. Hence, the number of unemployed people rose by 100 356 relative to the final quarter of 2017, whilst the unemployment rate remained unchanged at 26.7%. Despite expectations of a gradual rise in South Africa's economic growth during the forecast period 2018 to 2022, this is not likely to make a meaningful impact on reducing unemployment levels over this period.

Growth prospects for the South African economy

South Africa's growth prospects have improved significantly

The outlook for the South African economy has improved in recent months, supported by both local and global developments, although downside risks remain.

Household spending is forecast to grow at a gradually faster pace over the next five years, propelled by recovering consumer confidence, a lower interest rate environment, reduced inflationary pressures, higher disposable incomes and improving prospects for job creation. The recent hike in the VAT rate and in fuel-related levies will, however, affect consumption expenditure to some extent, as highlighted earlier.

Encouraged by positive developments in the political arena, the economic recovery currently underway and the promise of greater policy coherence and certainty, sentiment levels have been rising in the business and investor communities.

Rising sentiment to underpin higher growth momentum

Output levels will rise as demand conditions improve, eventually justifying capital expenditure by private business enterprises on additional production activity and opening up opportunities for greenfield investments. Financial constraints should, however, continue to affect public sector fixed investment in the short- to medium-term.

South Africa's export sector is likely to benefit from stronger economic growth and rising import demand globally. A gradual weakening of the rand through the forecast period should support price competitiveness in global markets.

Real GDP growth of 1.7% is projected for 2018, rising steadily over the outlook period to 3.3% by 2022.

Table 4: Key performance indicators for the South African economy

Variable (% change or % of GDP)	2013	2014	2015	2016	2017	2018f	2019f	2020f	2021f	2022f
Real GDP growth and its components:										
Household consumption expenditure	2.0	0.8	1.8	0.7	2.2	2.2	2.3	2.6	3.0	3.1
Government consumption expenditure	3.1	1.7	-0.3	1.9	0.6	0.5	1.1	1.1	1.2	1.4
Gross fixed capital formation (GFCF)	7.2	0.7	3.4	-4.1	0.4	1.3	3.5	3.9	5.1	5.7
Exports	4.0	3.6	2.8	1.0	-0.1	2.2	3.5	3.2	3.2	3.4
Imports	5.0	-0.6	5.4	-3.8	1.9	2.0	4.0	3.6	3.7	3.6
GDP	**2.5**	**1.8**	**1.3**	**0.6**	**1.3**	**1.7**	**2.3**	**2.5**	**3.0**	**3.3**
Consumer price inflation	5.8	6.1	4.6	6.3	5.3	5.0	5.2	5.2	5.1	4.6
Current account balance (% of GDP)	-5.8	-5.1	-4.6	-2.8	-2.5	-2.9	-3.5	-4.1	-4.6	-5.3
GFCF as % of GDP	20.4	20.4	20.4	19.5	18.7	18.0	17.8	17.7	17.8	18.1

Source: IDC, compiled from SARB data, IDC forecasts

President Ramaphosa recently announced a major investment drive aimed at raising fixed investment in South Africa by USD100 billion over the next 5 years. Such a significant increase in fixed investment spending could substantially alter the country's investment trajectory and economic landscape in the years to come. This will entail attracting a considerably larger quantum of foreign direct investment (FDI) inflows, as well as leveraging much higher levels of fixed investment activity by domestic entities.

USD100 billion investment initiative to have a substantial effect on the economy's growth trajectory

Department of Research and Information

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