Industrial Development Corporation

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Economic overview:

Recent developments in and outlook for the South African economy

November 2017

Department of Research and Information

Highlights

- Although conditions have recently improved to varying degrees in a number of sectors of the South African economy, such as agriculture, mining, manufacturing and retail trade, the economic environment remains generally weak.

- Confidence levels are still very low amongst South African consumers and business enterprises, with adverse implications for household spending, production levels and fixed investment.

- In contrast, South Africa's export performance has been improving markedly, contributing to the R47.1 billion surplus recorded in the balance of trade in the first 9 months of 2017. This compares with a deficit of R6.7 billion over the equivalent period in 2016.

- The improved outlook for the world economy, premised on a concurrent rise in economic activity in both advanced and emerging economies, is expected to sustain robust growth in global import volumes and to provide the basis for a solid performance by South Africa's export sector over the short- to medium-term.

- Unfortunately, the same does not apply to domestic demand conditions. Constrained household budgets and concerns over the economic climate as well as employment prospects will continue to affect the ability and willingness of South African consumers to increase spending in a meaningful manner, at least in the short-term.

- Facing weak demand conditions in local markets and surplus production capacity across many industries, the domestic business sector is likely to continue holding back on investment spending. Public corporations, in turn, have not only adjusted their capital spending plans due to lower than anticipated demand for their services, but key utilities are also facing financial constraints.

- South Africa's GDP is projected to grow by only 0.6% in 2017. In the absence of any further adverse developments, the pace of expansion is forecast at 1.2% for 2018 and to accelerate towards 2.6% by 2020, when substantially higher contributions are expected from household spending, fixed investment activity and export sales.

- However, the downside risks to this growth outlook are not only substantial but have been rising. Subsequent to the release of the Medium Term Budget Policy Statement (MTBPS) in October, concerns over the likelihood of further downgrades to the sovereign credit ratings and the economy's future performance have risen.

- The MTBPS failed to address the concerns of ratings agencies, investors and financial markets regarding South Africa's fiscal health. The challenges facing the economy, the difficulties in revenue collection and the need for action were amongst its main themes, but proposals to address such predicaments were largely lacking.

- In light of the significant downside potential to South Africa's growth outlook, the IDC's baseline projections have been supplemented by modeling an alternative *Low Road* scenario. In this instance, real GDP is projected to contract by 1.2% in 2018 and declines by a further 0.5% in 2019. All sectors of economic activity, without exception, are affected adversely, albeit to differing degrees.

- South Africa's relative ranking in the global competitiveness index compiled by the World Economic Forum fell sharply in 2017/18, with the country now ranking 61st out of 137 countries, down from 47th in 2016/17. Decisive actions are needed to stabilise the macroeconomic environment, to restore the strength and credibility of institutions, as well as to provide clear policy direction and certainty.

SA trade surplus
Jan. to Sept. 2017
(SARS):

R47.1 billion

SA unemployment
in Q3 2017
(Stats SA):

27.7%

6.2 million people

SA GDP growth
forecasts (ave. p.a.)
2017-2020:

1.3% (National Treasury)

1.6% (IDC)

SA gross government
debt by 2021/22
(National Treasury):

60.8% of GDP

SA global
competitiveness
ranking 2017-18
(WEF):

61st
out of 137 countries

Implications for South African business

- Improving conditions in global markets provide export opportunities for business enterprises in South Africa and in other African countries.

- The outlook for the global economy is generally supportive of a gradual recovery in commodity markets (both volume demand and prices), which is positive for resource-based businesses.

- The positive growth prospects for Sub-Saharan Africa are likely to bring along benefits for South African exporters, particularly those producing inputs for infrastructure development as well as consumer goods.

- The normalisation of monetary policy in specific advanced economies, particularly the United States and the European Union, may lead to capital outflows from emerging markets, including South Africa. This may contribute to ZAR weakness and potentially place upward pressure on South African inflation and interest rates.

- A relatively competitive ZAR exchange rate will be supportive of South Africa's exports. However, ZAR weakness will impact negatively on those businesses that are highly reliant on imported inputs and capital equipment.

- The cost of funding raised in international capital markets by South African entities in the public and private sectors is likely to rise. This is not only due to the anticipated upward trend in global interest rates, but also as a result of the higher risk premium associated with South African debt, which would rise considerably if further downgrades to the sovereign ratings materialise.

- Continued pressure on the fiscus, especially on the discretionary spending side, could result in lower spending on infrastructure, reducing opportunities for South African businesses intending to participate in these projects.

- The *Low Road* scenario for the South African economy outlined in this report brings to the fore some of the potential consequences if politico-economic developments result in a more unfavourable growth trajectory than that presented in the IDC's baseline forecasts. All sectors of the economy would face increased strain in such an adverse scenario. Many business enterprises would likely face serious financial difficulties, which could compromise their sustainability and employment.

Recent developments in the South African economy

Economic conditions have been improving gradually, but remain generally weak

The South African economy is showing signs of improvement.

Agricultural output has rebounded on the back of the largest maize crop on record, but concerns remain over the impact of the ongoing drought in the Western Cape on fruit, citrus, grape and wheat farming, among others.

The mining sector has recorded stronger output growth, albeit off a very low base, with higher commodity prices providing some support. However, over-supply in certain commodity markets globally, policy uncertainty in the domestic mining sector and ongoing operational challenges, may adversely impact its future performance.

Manufacturing sector's performance recovering gradually

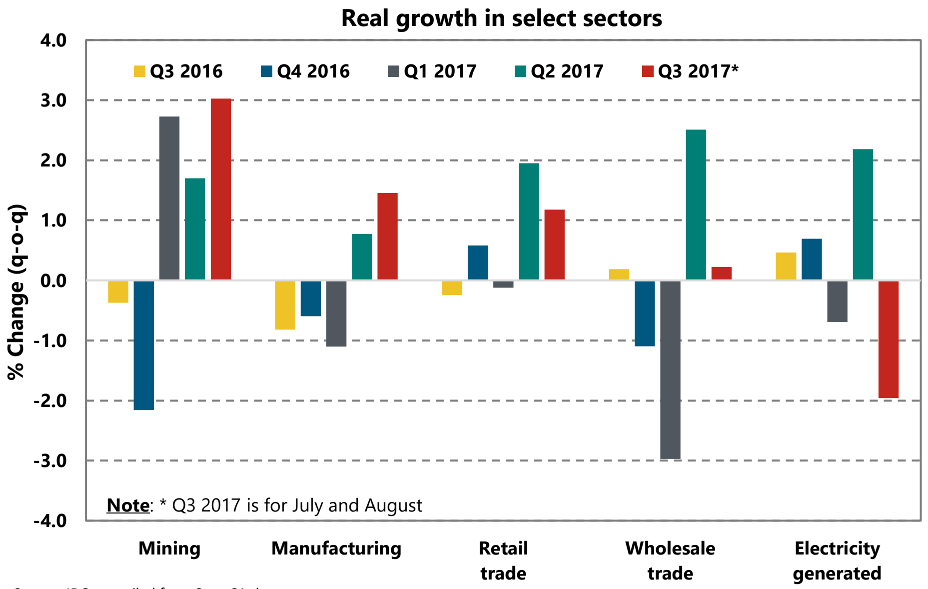
Having been in recession for quite some time, the manufacturing sector posted positive growth in the 2nd quarter of 2017 and the encouraging rebound continued in July and August. Nonetheless, the sector is still facing a challenging operating environment. Weak demand conditions, in particular, are resulting in revenue pressures and surplus production capacity across many industries. Manufacturers' expectations of business conditions over the next 12 months remain generally unsatisfactory.

The very subdued pace of economic expansion, coupled with the widespread adoption of energy savings measures by the business and household sectors, is being reflected in declining electricity generation. The construction sector, in turn, is set to benefit from the sharp increase in building plans passed.

Surprising growth in retail sales

Whereas wholesale trade sales have come under renewed pressure in recent months, retail trade sales have surprised on the upside, especially considering the difficulties faced by consumers in general.

Figure 1: Sector growth momentum likely to have remained generally positive in 3rd quarter

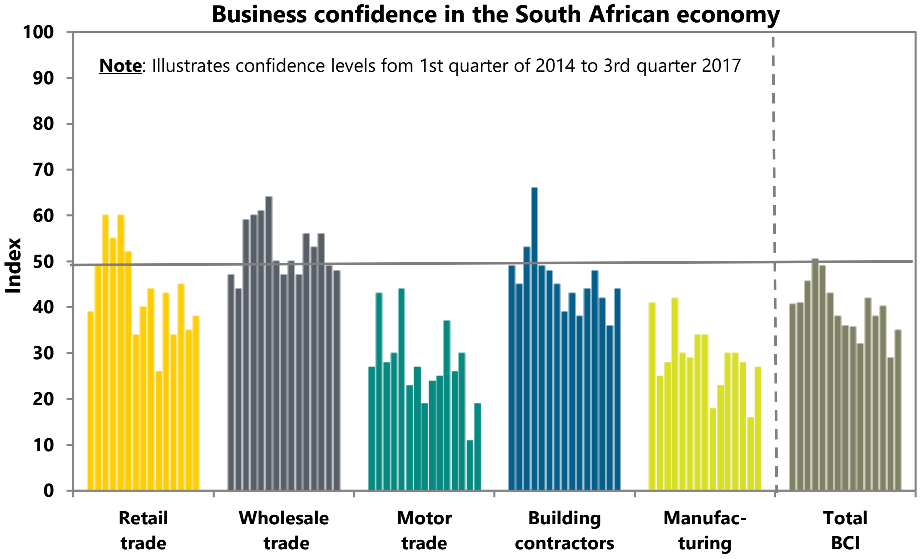


Source: IDC, compiled from Stats SA data

Consumer and business confidence have been at very low levels for a protracted period of time

Confidence levels remain at very low levels amongst consumers, businesses and investors, with adverse implications on household spending, production levels and fixed investment activity. Consumer sentiment has, on balance, been in pessimistic territory for the longest period on record, at 12 consecutive quarters. This has been impacting adversely on the retail and motor trade sectors, as reflected by the respective low confidence levels (see Figure 2).

Figure 2: Weak business confidence across all broad sectors



Source: IDC, compiled from BER data

Although business sentiment amongst manufacturers recovered slightly in the 3rd quarter of 2017, 73% of respondents were not satisfied with prevailing business conditions. The overall business confidence index (BCI) also improved somewhat, but at a reading of 35 points it is clearly low, auguring poorly for investment spending and job creation.

South Africa's economic outlook

Growth prospects are likely to remain unsatisfactory in the short-term, with some acceleration in the expansion momentum expected over the medium- to longer-term.

The rate of increase in South Africa's gross domestic product (GDP) is projected by the IDC at only 0.6% for 2017, potentially rising to a very modest 1.2% in 2018. GDP growth is projected at 2.3% per year, on average, for the period 2018 to 2022, which would be well below the National Development Plan's average annual growth target of 5.4% per annum over the period up to 2030.

Weak to modest growth expected over the outlook period

Spending by households

Even though consumer spending has been showing signs of recovery, constrained household budgets and concerns over the economic climate and employment prospects will continue to affect the ability and willingness of consumers to increase spending in a meaningful manner, at least in the short-term.

South African households are generally still highly indebted and approximately 40% of all credit active consumers have an impaired record. Hence, demand for new credit is expanding at a very modest pace, with consumers tending to focus on restoring their balance sheets and holding back on spending, especially on non-essential items.

The unemployment rate remained at 27.7% during the first three quarters of 2017, despite overall employment having increased by 358 000 in the third quarter, compared to the same period a year earlier. The largest employment gains were recorded in the formal sector of the economy, despite the difficult environment. Youth unemployment (15-34 years of age) increased to 38.6% in the 3rd quarter of 2017, compared to 35.1% a year earlier.

Unemployment remains worryingly high, especially amongst the youth

However, a gradual recovery in household expenditure is expected from 2019 onwards, based on the assumption of improving conditions in the politico-economic landscape. This would be supported by recovering consumer sentiment, rising disposable incomes, employment creation, a progressive increase in overall economic activity and a still accommodative monetary policy stance.

Government expenditure

Government spending will be constrained by fiscal challenges for several years

The Medium Term Budget Policy Statement (MTBPS) released by National Treasury on the 25th of October 2017 paints a very disconcerting picture of South Africa's fiscal position (refer to the following section). Considering the economy's weak performance, revenue collections for the current fiscal year had been expected to be well below the projections contained in the National Budget of February 2017. However, the shortfall estimated in the MTBPS is substantially worse.

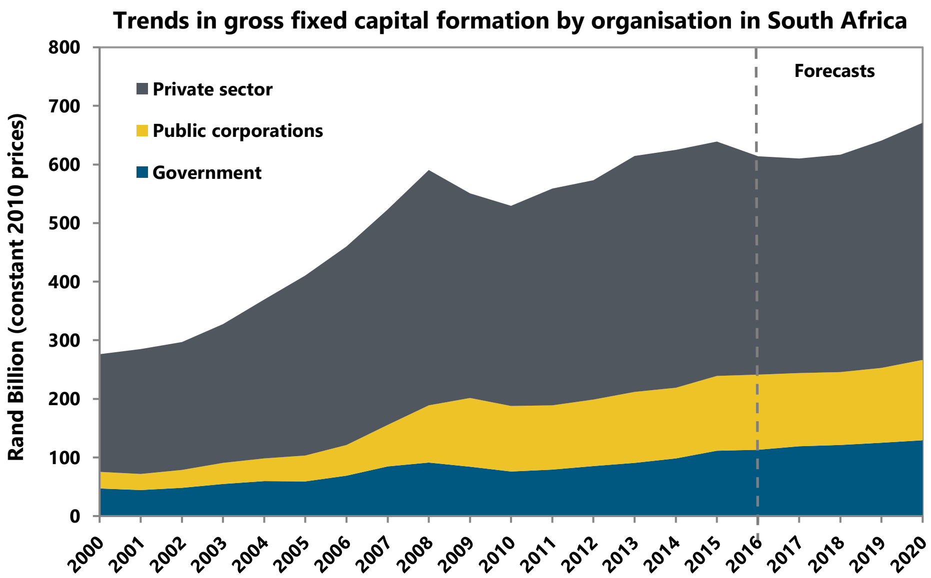
With very limited room to manoeuvre in a low-growth environment, general government will be forced to cut back on consumption spending if it is to stick to its commitments of fiscal consolidation and debt stabilisation in pursuit of financial sustainability. Accordingly, marginal growth in consumption expenditure by general government is expected in 2018, possibly increasing very modestly in the subsequent two years on the back of somewhat higher levels of activity in the economy.

Fixed investment activity

Facing weak demand conditions in local markets and, therefore, surplus production capacity across many industries, private business enterprises have been generally cutting back on investment spending in recent years. Their propensity to invest has also been adversely affected by the prevailing uncertainty on the political front, policy-related issues in key sectors of the economy, and the risk of further downgrades to the sovereign credit ratings.

The extent of the decline in capital spending by private business enterprises and public corporations intensified in the 2nd quarter of 2017 towards rates of -6.9% and -3.1% (quarter-on-quarter, annualised), respectively. Fixed investment by the private sector in the 1st half of the year was 2.3% lower in real terms than over the equivalent period in 2016.

Figure 3: Fixed investment to be under pressure over the short term



Source: IDC, compiled from SARB data; IDC forecasts

The 2nd quarter decline was particularly pronounced in the energy sector, as well as in financial and business services, but the manufacturing and transport and storage sectors also recorded lower levels of fixed capital formation.

Private business enterprises and public corporations are likely to remain cautious in their investment plans and actual spending at least over the short-term. Fixed investment spending is projected to decline by 0.7% in 2017, but could potentially record positive growth in the order of 1.2% in 2018. This would be a very modest rate of expansion from a low base.

Business enterprises are likely to remain cautious in their investment plans, at least in the short-term

Facing serious fiscal constraints and constant pressure on key items of current expenditure, such as social grant payments, spending on education and health, as well as escalating debt-servicing costs, general government may be forced to reduce spending on economic and social infrastructure over the next couple of years.

Based on current forecasting assumptions, a rebound in fixed capital formation is expected from 2019 onwards, as private business enterprises maintain, replace and potentially augment plant and equipment in an operating environment expected to present significant sales potential in export markets and improving demand domestically.

Higher growth in fixed investment spending expected from 2019 onwards

External trade

Benefitting from surpluses on the balance of trade since February 2017, the deficit on the current account of the balance of payments narrowed during the course of the year. The cumulative trade surplus for the first 9 months of 2017 amounted to R47.1 billion, compared to a deficit of R6.7 billion over the same period a year earlier.

South Africa's trade balance recorded a R47.1 billion surplus in the first 9 months of 2017

Weak economic conditions at home resulted in imports declining by 1.2%, with machinery and equipment imports falling by 6%. Higher agricultural production due to improved climatic conditions in most of the country permitted a 29% drop in imports of agriculture products. On the other hand, the value of imports of refined petroleum product imports increased by 47%.

South Africa's export performance has benefited from steadily improving demand conditions in external markets. A relatively competitive ZAR exchange rate and some recovery in commodity prices also supported overall exports, which increased by 5.4% (year-on-year) over the first 3 quarters of 2017. Whereas mining exports rose by 15%, external sales of motor vehicles declined by 8.6% despite the improving economic climate globally, including Europe.

Increasing optimism amongst global business and consumers are supporting higher levels of economic activity in advanced economies as well as in emerging markets. This underpins the International Monetary Fund's projections of 3.6% and 3.7% growth in world GDP for 2017 and 2018, respectively. This is a significant improvement on the 3.2% expansion recorded in 2016.

The world economy is growing at a faster pace, raising trade flows and supporting commodity markets

This momentum is being assisted by accommodative monetary policy made possible by relatively muted inflationary pressures, especially but not exclusively in advanced economies. Although the normalisation of monetary policy is now under way in the United States (US), the pace of increase in policy rates going forward is expected to be quite gradual. Market expectations are positioned in favour of another 25 basis points' increase in the Federal Funds rate in December 2017, but this should not destabilise global financial markets.

Since the tax cuts sougth by the Trump admnistration have yet to materialise, the associated stimulus has not been forthcoming. Nonetheless, the US economy is still expected to record growth of 2.2% and 2.3% in 2017 and 2018, respectively. This has positive implications for global trade dynamics and for South Africa's export performance, for the US accounts for around 13% of global import volumes and 7.3% of South Africa's exports.

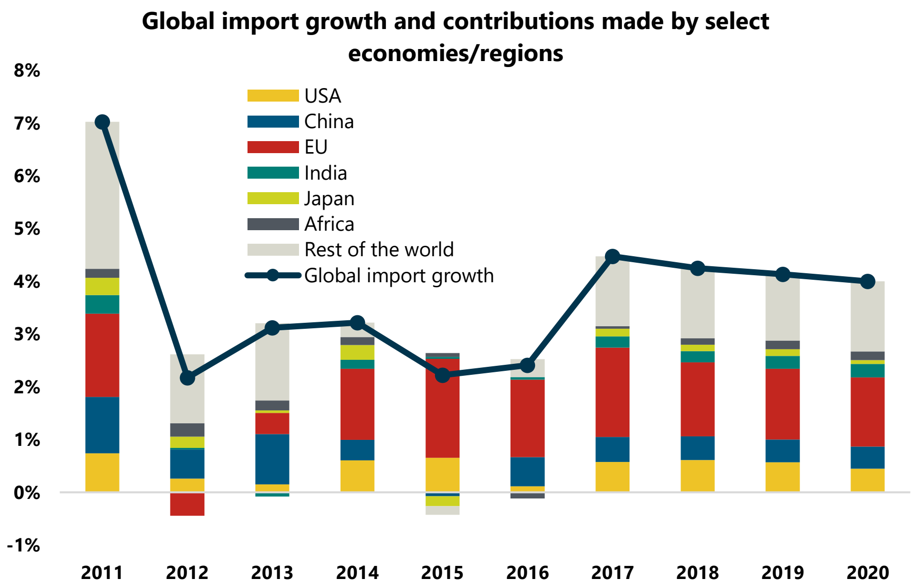
The IMF is projecting output growth in the Eurozone at 2.1% for 2017, or 0.4 of a percentage point higher than its previous estimates. This is underpinned by lower political risks and improving aggregate demand, which is also being supported by accommodative monetary policy. The European Union (EU) accounts for 34% of global import volumes and 22.6% of South Africa's export basket. However, the medium-term prognosis for the EU's economy continues to be weighed downward, to some extent, by the potentially negative implications of Brexit as well as the public and private debt overhang in its peripheral member states.

Economic growth in China has been supported by sustained domestic policy stimulus and robust public investment, which has been significantly propelled by the rapid accumulation of municipal debt. Despite the debt sustainability risks and the Chinese authorities' deleveraging efforts, economic growth is projected to come in at 6.8% for 2017, moderating to 6.5% next year. While restrictions on industrial production related to pollution control measures are expected to weigh on demand for commodities, the net effect of China's robust economic expansion is still expected to favour South Africa's trade performance.

Global import demand is on the rise, auguring well for South Africa's export performance going forward

The prognosis for growth in import demand in the world's major markets, including the United States, Eurozone and China, is thus increasingly favourable (refer to Figure 4). The rate of increase in import demand by advanced economies is projected by the IMF to accelerate from 2.7% in 2016 to an average of 3.9% over the period 2017 to 2020. Import growth in emerging markets, in turn, is forecast to rise from 2% last year to an average of 4.8% over 2017-2020. This provides a strong basis for sustained growth in global demand for South African primary commodities and manufactured exports going forward.

Figure 4: Improved global outlook expected to sustain higher growth in world import demand



Source: IDC, compiled using UNCTAD and IMF data

Improving conditions in global commodity markets bode well for Sub-Saharan Africa's economic growth performance and import demand

Improving economic sentiment globally and a still robust growth outlook for China in particular, which accounts for 50% of world demand for commodities, are expected to support global demand and the prices of industrial commodities. This should have positive implications for South Africa's terms of trade over the short- to medium-term.

Continuing challenges in some of Sub-Saharan Africa's economies, including several macroeconomic imbalances, as well as political and policy uncertainty, continue to hamper the region's growth, which is expected to register 2.6% in 2017. Nevertheless, the region's economic performance is expected to gather momentum in the years ahead. This will be on the back of more supportive domestic as well as external conditions, including increased foreign demand for and prices of key export commodities. The IMF expects the region to post 3.5% average annual growth over the period 2018 to 2020, which is well below the average of 5.6% achieved over the 15-year period to 2015. African economies accounted for 27.8% of South Africa's exports last year.

Against this background of improving conditions in global (and regional) markets, numerous South African business enterprises are likely to focus increasingly on growing export sales, especially in light of yet subdued demand domestically.

Summary of economic projections

The current downswing in South Africa's business cycle is in its 47th month - the second longest in the country's economic history, after the downswing of 1989 to1993. However, the leading business cycle indicator of the South African Reserve Bank has been edging slightly higher in recent months, possibly indicating that the worst may be behind.

Real GDP growth of 0.6% is projected by the IDC for 2017, with a contraction in fixed investment spending posing a significant drag on the economy's overall performance. In the absence of any further adverse developments, the pace of expansion is forecast at 1.2% for 2018 and to accelerate towards 2.6% by 2020, when substantially improved contributions are expected from household spending, fixed investment activity and export sales.

SA GDP forecast to expand by 1.2% in 2018, barring further adverse politico-economic developments

Table 1: SA's growth prospects remaining unfavourable

IDC forecasts of key performance indicators for the South African economy

Variable (% change or % of GDP)	2014	2015	2016	2017f	2018f	2019f	2020f
Real GDP growth and its components:							
Household consumption expenditure	0.7	1.7	0.8	1.1	1.7	2.2	2.5
Government consumption expenditure	1.1	0.5	2.0	0.2	0.4	1.1	1.4
Gross fixed capital formation (GFCF)	1.7	2.3	-3.9	-0.7	1.2	3.8	4.8
Exports	3.2	3.9	-0.1	2.7	3.8	3.6	4.0
Imports	-0.5	5.4	-3.7	3.7	4.3	4.7	4.5
GDP	**1.7**	**1.3**	**0.3**	**0.6**	**1.2**	**2.0**	**2.6**
Consumer price inflation	6.1	4.6	6.3	5.3	5.1	5.0	5.2
Current account balance (% of GDP)	-5.3	-4.4	-3.3	-2.7	-4.3	-4.4	-4.6
GFCF as % of GDP	20.6	20.4	19.5	18.5	18.0	18.1	18.1

Source: IDC, compiled using SARB data for historical figures, IDC forecasts

Risks to South Africa's economic outlook have increased

The downside risks to this growth outlook are, however, not only substantial but have been rising. Importantly, should political instability/uncertainty increase and/or the sovereign credit ratings for local currency denominated debt be downgraded to sub-investment or "junk" status by Standard & Poor's and/or Moody's Investors Service, the economy's performance could deteriorate considerably.

Subsequent to the presentation of the Medium Term Budget Policy Statement (MTBPS) by the Minister of Finance in Parliament at the end of October 2017, concerns over the likelihood of further downgrades to South Africa's sovereign credit ratings and the economy's future performance have risen.

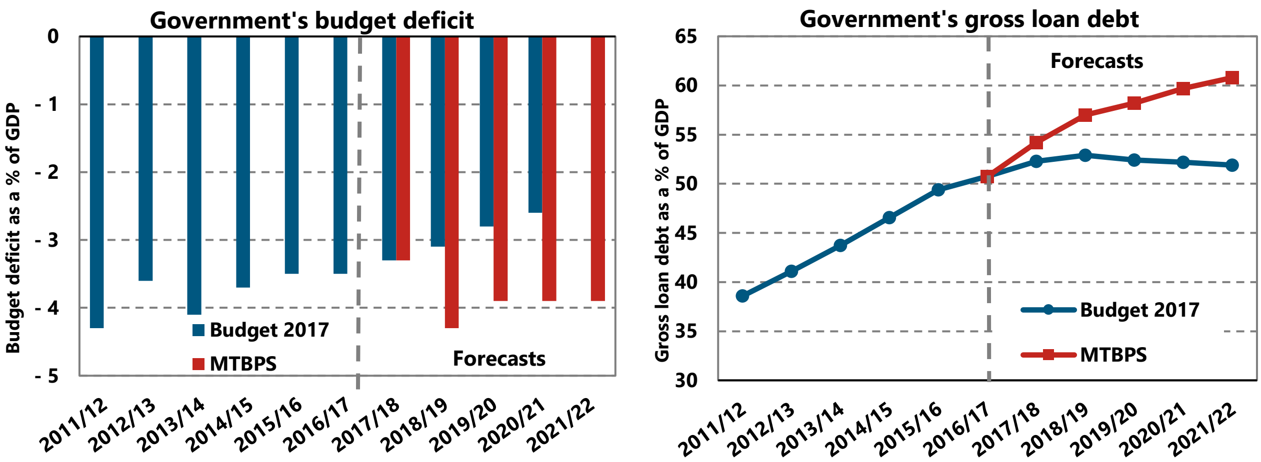
The market reaction to the MTBPS has been fairly negative. It has been perceived as not adequately addressing the concerns of ratings agencies regarding the health of public finances. The MTBPS also projected a more negative outlook for the economy over the medium-term than was generally anticipated by market players.

Weaker than anticipated economic growth in the 2017/18 fiscal year is taking a toll on revenue collections, which are estimated to be R51 billion lower than in the 2017 Budget. The MTBPS did not sketch clearly defined responses to the expected under-collection on the revenue side, nor did it provide comfort on efforts to contain public spending.

Fiscal consolidation under threat in the absence of effective corrective action and structural change

Consequently, a substantially wider budget deficit (4.3% of GDP) is projected for the 2018 fiscal year, remaining at around 3.9% over the Medium Term Expenditure Framework (MTEF) period. As illustrated in Figure 5, this results in a substantial deterioration from the fiscal balance path delineated in the National Budget in February 2017. Of major concern is the unabated upward trend in gross government debt, which is now expected to rise at a fast pace over the next couple of years, reaching 60.8% of GDP (excluding guarantees) by 2021/2022. The trajectory inclusive of guarantees (especially to Eskom and South African Airways) is markedly worse.

Figure 5: Fiscal slippage as budget deficit widens and gross debt levels rise sharply



Source: IDC, compiled from MTBPS 2017 data

Despite identifying policy uncertainty and a lack of investor confidence as key inhibitors to the economic growth in South Africa at present, the MTBPS has added to the uncertainty by failing to demonstrate that plans are in place to prevent continued fiscal slippage and stabilise gross government debt.

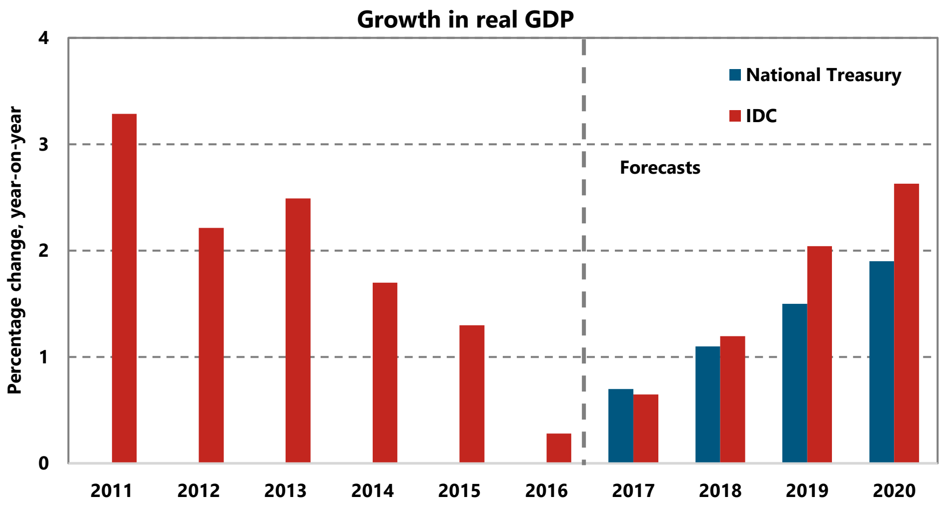
Since their introduction in 1997, medium term budget policy statements have set out the path that government expects to take with respect to revenue raising and spending plans. Although specific initiatives have not generally been outlined, the data provided has given an indication of the expected impact. The latest iteration of the MTBPS, however, does not provide much forward guidance and its projections appear to have been made on the basis of what the future would look like without the introduction of (new) corrective actions.

National Treasury's revised forecasts for key indicators surprised markets negatively

With regards to the economic outlook put forward in the MTBPS, the negative reaction by analysts, financial markets and credit rating agencies was not really related to the significantly lower growth forecasts for 2017 and 2018, for these were widely expected. National Treasury's projection for GDP growth in 2017 was revised downward from the 1.2% contained in the National Budget (February 2017) to 0.7% in the recent statement.

The element of surprise came with the growth forecasts for subsequent years, which see the rate of expansion increasing very gradually to 1.9% by 2020, as well as the projections for key fiscal metrics. These were substantially weaker than market expectations. All of these forecasts were derived under the assumption of no further downgrades being effected to the sovereign credit ratings.

Figure 6: National Treasury's growth forecasts surprisingly low from 2019 onwards



Source: IDC, compiled from MTBPS 2017 data and IDC forecasts

Macroeconomic performance under more adverse conditions

The downside risks to South Africa's economic outlook are high. It is therefore important to assess the potential repercussions of a worse performance. Accordingly, to supplement IDC's baseline growth projections (*Base Case*), as outlined in previous sections of this report, an alternative scenario (*Low Road*) has been modelled on the basis of a set of assumptions[1].

In such a scenario, the assumptions regarding global growth were lowered to some extent; South Africa's sovereign credit ratings were assumed to be downgraded to sub-investment levels across the board (including ratings for local currency denominated debt); confidence levels in the economy were assumed to decline further and to remain very low for an extended period of time, leading to a substantial further deterioration of domestic demand and investment conditions; and, due to the exclusion of South African bonds from major global indices, the ensuing large net capital outflows were assumed to lead to a sharp weakening of the ZAR, with adverse implications for inflation and interest rates.

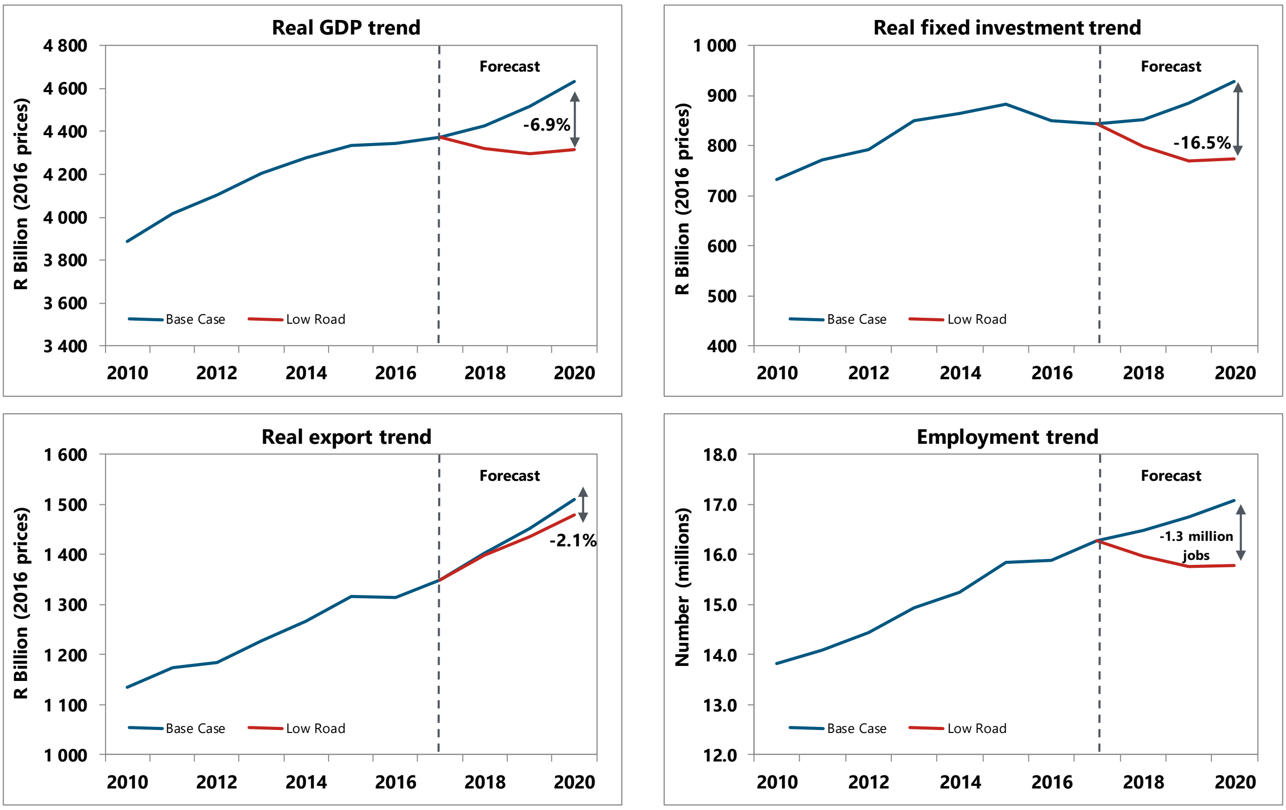
The South African economy's performance worsens significantly in the *Low Road* scenario, relative to the *Base Case*, as illustrated in Figure 7.

[1] Assumptions made in modelling the *Low Road* scenario:

- Global growth to be 0.5 percentage points weaker, on average, over the outlook period.
- South Africa's sovereign credit ratings (both local and foreign currency denominated debt) are lowered to sub-investment levels by all 3 credit rating agencies in the near-term, with further downgrades over the medium-term.
- A substantial depreciation of the Rand to an average of R16.08 by the 4th quarter of 2018, remaining at much weaker levels than in the *Base Case* over the outlook period.
- Inflation to rise sharply and average 7.1% in 2019, trending slightly lower to 6.1% in 2020.
- The repo rate is raised by 100 basis points above *Base Case* levels.
- Business and consumer confidence levels fall further and remain at very low levels for an extended period of time.
- Substantially lower fixed investment spending by both the private and public sectors.
- Household consumption expenditure to be much worse than that in the *Base Case*.

The weaker Rand triggers a surge in imported inflation, affecting adversely the outlook for domestic inflation and consequently leading the Monetary Policy Committee to raise the repo rate, with adverse implications for businesses and consumers. Government spending comes under even higher pressure than in the *Base* Case due to significantly reduced revenue collections in a much lower growth environment.

Figure 7: South Africa's economic performance under a more adverse environment



Source: IDC, compiled from SARB, Stats SA data; IDC forecasts

Although the lower global growth assumption does affect the model's outcomes with respect to South Africa's export performance, the sharp depreciation of the Rand improves the price competitiveness of exports (albeit temporarily), in the process supporting a fairly solid export performance. Even though export growth remains fairly robust, it would fall somewhat short of the performance expected under the *Base Case*.

A substantial worsening of the economic environment would impact negatively on economic activity (leading to company closures and job losses) and fixed investment spending by the public and private sectors, with adverse implications for employment levels. Under the *Low Road* scenario, overall employment in the economy reflects 1.3 million fewer jobs, compared to the *Base Case*.

Real GDP is projected to contract by 1.2% in 2018 under the *Low Road* scenario. A further decline of around 0.5% would be expected in 2019, but a marginal 0.5% recovery could follow in 2020, by which time overall GDP in real terms would be 6.8% or R225 billion lower than in the Base Case.

Sectoral performances in a Low Road scenario

A deterioration of the domestic economic environment would reflect increasing strain in the various drivers of demand in one way or another, impacting on sectoral performances.

However, in the *Low Road* scenario described above, all sectors of economic activity, without exception, would be expected to be affected adversely, albeit to differing degrees.

Figure 8: Sectoral performances under the Base Case and Low Road scenarios

For example, reduced household spending on durable goods would have a negative impact on the local motor vehicles sector, mainly passenger cars, whilst lower investment expenditure would affect the demand for commercial vehicles, both medium and heavy. In addition, weaker global demand would affect the sector's export performance. Reduced overall demand for motor vehicles would, in turn, have negative consequences for capital spending and employment levels in the sector itself.

Many supplying and supporting industries whose activities are closely linked to the motor vehicle sector would also be affected by lower production in this sector. For instance, demand for inputs such as fabricated metals, rubber, textiles, leather, electronics, glass, paint etc. would tend to fall. Hence, production in the respective supplying industries would have to be adjusted downward in line with weakening demand from the motor vehicle sector.

In a *Low Road* scenario, many firms across several sectors would face serious financial difficulties, which could compromise their sustainability and employment. Substantial job losses would possibly be recorded in labour-intensive sectors such as agriculture, forestry and fishing; textiles, clothing, leather and footwear, as well as in construction. Consequently, efforts to address the triple challenges of unemployment, poverty and inequality would suffer major setbacks in such a scenario.

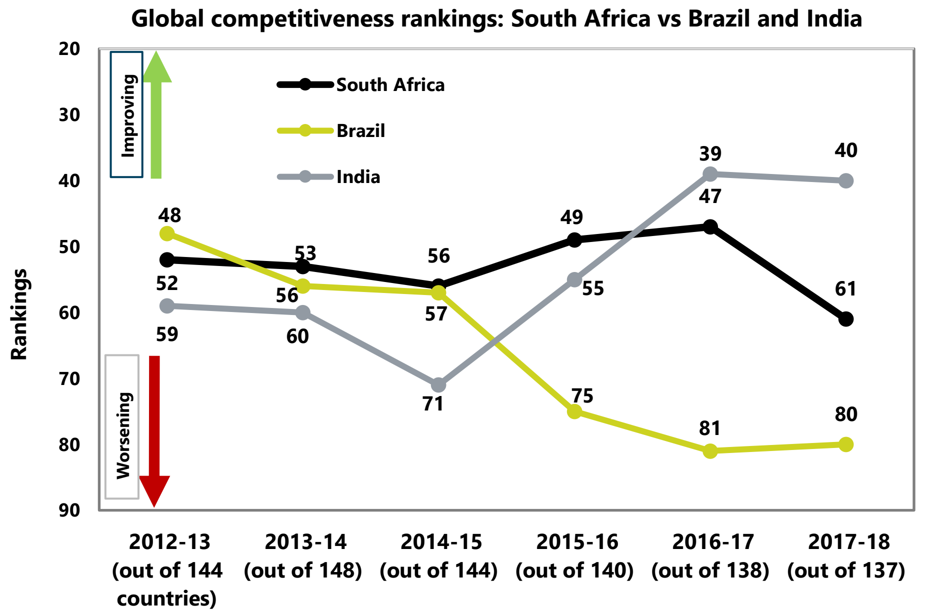
South Africa's position in the global competitiveness rankings falls sharply

South Africa's position in the global competitiveness rankings has dropped to 61 out of 137 countries

South Africa's ranking in the global competitiveness index compiled by the World Economic Forum (WEF) declined sharply in 2017/18 to 61st position out of 137 countries assessed, from 47th position (out of 138 countries) in 2016/17.

Although South Africa is still considered one of the most competitive countries in Sub-Saharan Africa, it now ranks behind Mauritius (45th place) and Rwanda (58th). It is also well below certain emerging market peers, such as China (27th), Russia (38th) and India (40th). Brazil, on the other hand, is ranked substantially lower, specifically in 80th position.

Figure 9: Institutional and macroeconomic weaknesses largely contributed to the sharp drop in SA's competitiveness



Source: IDC, compiled from the World Economic Forum's Global Competitiveness Reports

South Africa's rankings with respect to most pillars measured in the overall index declined. The exceptions were the infrastructure and labour market efficiency pillars, which improved marginally. Importantly, its rankings in the financial market development pillar, as well as in the institutions and goods markets efficiency pillars, fell sharply, contributing substantially to the drop in the overall rankings.

Considering growing concerns over the gradual erosion of the quality and independence of some of the country's institutions, as well as the economy's weak performance, some of the downward adjustments, such as in the key pillars of institutions and macroeconomic environment, were anticipated.

However, the substantial drop in the rankings of some of the indicators within the broader categories depicted in Table 2, particularly those relating to the financial market development pillar were surprising. While the continued weakness in the macroeconomic environment may have affected financial market efficiency, particularly the provision of products and services that meet the needs of business and the cost of such financial services, the worsening of other components such as regulation of securities exchanges and financing through local equity market, were unexpected.

Table 2: Select competitiveness indicators showing a significant deterioration in South Africa's rankings in 2017/18, compared to those published in 2016/17

Indicator	2017/18 (out of 137 countries)	2016/17 (out of 138 countries)
Financing through local equity market	25th	1st
Strength of auditing and reporting standards	30th	1st
Protection of minority shareholders' interest	30th	1st
Soundness of banks	37th	2nd
Regulation of securities exchanges	46th	3rd
Efficacy of corporate boards	34th	3rd
Effectiveness of anti-monopoly policy	28th	7th
Efficiency of legal framework in settling disputes	31st	9th

Source: IDC, compiled from World Economic Forum data

Notwithstanding the weak performances in most competitiveness indicators, the trend was marginally positive for the quality of electricity supply, as well as in the flexibility of wage determination and in hiring and firing practices.

It should be noted that the large deviation of the 2017/18 rankings from those of previous years is partly attributable to a structural break in the Executive Opinion Survey sample, which increased from 44 participants/respondents over past few years to 170 in 2017.

As confirmed by the challenges cited by the World Economic Forum, it is imperative that South Africa stabilises its macroeconomic environment, restores the strength and credibility of its institutions, and provides clear policy direction and certainty. These are also amongst the key concerns raised by the credit rating agencies, which will shortly announce the outcomes of their ongoing reviews of South Africa.

Department of Research and Information

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