Industrial Development Corporation

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Economic overview:

Recent developments in the global and South African economies

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Department of Research and Information

Contents

Highlights

- The world economy is expected to post a more robust and better synchronised performance in 2018. Should the IMF's 3.9% forecast materialise, it will be the fastest rate of expansion in world GDP since 2011. The momentum is being driven by strong contributions from some of the advanced economies, as well as from several emerging markets and developing economies, particularly those of emerging Asia.

- The world economy is, however, facing significant threats. These include the pace and extent of monetary policy normalisation in advanced economies, particularly in the United States, increasing trade protectionism emanating from the Trump administration and the strong possibility of retaliatory responses from the affected trading partners, as well as geo-political tensions in parts of the world.

- Commodity prices came under renewed pressure during the first quarter of 2018 despite sustained dollar weakness over the period. Industrial commodities, including those related to the steel value chain and PGMs, recorded price declines in the first quarter of 2018, with Brent crude oil bucking this trend. The concurrent steep decline in global dry bulk commodity trade activity, as well as an increase in global investor risk aversion, forewarns of increased downside risk for commodities over the months ahead.

- Preliminary estimates point to a decline in global flows of foreign direct investment (FDI) to USD1.52 trillion in 2017, compared to USD1.81 trillion in 2016. This was largely due to a 27% drop in FDI flows to developed economies. Developing economies, in turn, reported a 2% increase in FDI inflows, although some African countries saw FDI falling quite sharply last year. In contrast, South Africa recorded a 43% rebound in FDI inflows to USD3.2 billion.

- The South African economy posted a better than expected growth performance in 2017. GDP expanded by 1.3%, up from a revised 0.6% in 2016. Considerably higher agricultural and mining output supported this faster growth, whilst most other sectors struggled to make meaningful contributions.

- Household consumption expenditure surprised on the upside, considering the challenges faced by domestic consumers. The modest recovery in overall growth in fixed investment was mainly due to higher capital spending by the private sector, with public corporations and general government having recorded lower infrastructure spending in real terms compared to 2016. Nevertheless, the economy only managed to create 102 000 additional job opportunities in 2017. Despite a modest decline to 26.7% in the fourth quarter, the unemployment rate remained uncomfortably high.

- Moody's not only maintained its rating of South Africa's local currency denominated debt at investment grade, but also revised the country's credit outlook from 'negative' to 'stable'. In so doing, it recognised positive developments in the political and economic arenas, specifically a gradual recovery in the economy's growth performance, a more business-friendly political administration that is committed to restoring trust in key public sector institutions, fiscal consolidation and debt sustainability, as well as to providing certainty and consistency in the policy and regulatory environments.

- Growth prospects for the South African economy have improved significantly, supported by positive developments in the political arena; rising confidence levels amongst businesses, investors and consumers; gradually ameliorating economic fundamentals; favourable developments in certain commodity markets; as well as by steadily improving demand conditions globally. However, considering the very open nature of the economy, developments in the world's trading environment will be particularly important.

Global GDP growth forecast for 2018:

3.9%

(IMF)

FDI flows into South Africa up 43% in 2017 to:

USD3.2 billion

(UNCTAD)

Business confidence in SA in Q1 2018 improved by:

11 points to 45 points

(BER)

Average annual GDP growth projection for SA economy over 2018 - 2022:

2.6%

(IDC)

Implications for South African business

- Faster rates of economic expansion in global markets should provide significant opportunities for South African exporters in the mining, manufacturing and agricultural sectors. Key external markets such as the Eurozone and sub-Saharan African markets 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.

- Specific South African manufactured exports are likely to face significant challenges in the US market due to import tariff protection, particularly steel and aluminium products. Businesses involved in these sectors are likely to be detrimentally affected, directly or indirectly, by the imposition of 25% and 10% tariffs, respectively, on US imports of steel and aluminium products.

- In the near-term, a stronger rand and weaker commodity prices will weigh on the mining sector. However, commodity prices are expected to trend higher over the medium-term, providing some support to the sector, although varying across the commodities' complex. Increased fixed investment activity in many parts of the world should also have a beneficial impact on demand for commodities in the years ahead.

- The rebound in business confidence in the opening quarter of 2018 should, if sustained, progressively translate into higher levels of fixed investment activity by the private sector. 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, but eventually will extend to expansionary investments.

- However, lower investment activity by public sector entities in real terms over the next three fiscal years may affect the performance of the supplier industries who are supplying goods and services to SOEs. Similarly, certain suppliers to general government are likely to be adversely affected by significantly weaker growth in fiscal spending. However, efforts to enhance the impact of public sector procurement on the localisation of production, including increased scrutiny of SOE and governmental tenders, are likely to translate into tangible benefits for South African industry.

- Enticed by positive developments in the political arena, the economic recovery currently underway and the promise of greater policy coherence and certainty, global investors may increasingly consider South Africa as an investment destination.

- South Africa's growth prospects are set to improve quite significantly. Domestic companies should position themselves to take advantage of an eventual economic recovery by investing timeously in plant and equipment. More specifically, a gradual recovery in domestic household consumption expenditure should benefit those sectors of the economy that are closely aligned to consumer spending. It is also crucial that appropriate marketing strategies be developed to exploit opportunities in both existing and new external markets.

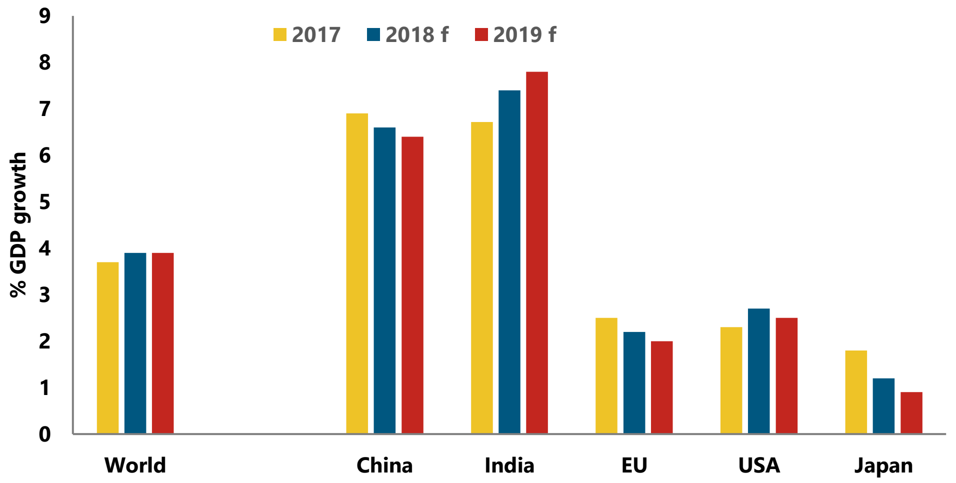
- The adverse trend in the sovereign credit ratings is likely to have been halted. The most recent review by Moody's in fact reflects a more favourable outlook in this regard, with potentially positive implication for the sourcing and pricing of funds.

Global developments and outlook

Global growth is set to improve in 2018, but major downside risks are threatening this outlook

The world economy is expected to post a faster rate of growth, at 3.9%, in 2018 (2017: 3.7%). Should this forecast of the International Monetary Fund (IMF) materialise, it will be the highest rate of expansion in global gross domestic product since 2011. The growth momentum has been driven by sturdy contributions from some of the advanced economies as well as by the solid performances of several emerging markets and developing economies, particularly those of emerging Asia. However, rising protectionism in the United States (US) is bringing forth substantial downside risks to the world's growth outlook, particularly if it escalates and retaliatory measures are taken by major trading partners.

Figure 1: World economy's expansion gaining momentum



Source: IDC, compiled from IMF and various country statistics data

Tax cuts are providing a significant stimulus to US growth, but trade protectionism is likely to have the opposite effect

Robust economic data continues to emerge out of the US, prompting the Federal Reserve (Fed) to continue on its monetary policy normalisation path. US interest rates have increased by 100 basis points (bps) since the start of 2017, with the most recent hike announced in March 2018. Sustained economic growth in the US has been supported by continued low unemployment rates, strong growth in household consumption expenditure, rising private sector fixed investment and export activity. The recently enacted tax cuts are providing significant stimulus, but are also likely to add inflationary pressures. The growth momentum supports the view of at least two more policy rate increases of 25bps each over the remainder of 2018. A more hawkish monetary policy stance, along with the effects of recent protectionist moves on external trade, which will eventually negatively affect the country's competitiveness and export performance, while also raising inflationary pressures. This is likely to temper the US economy's growth performance in the medium-term.

China's growth is expected to moderate as fixed investment slows and exporters face a tougher external environment

The Chinese economy expanded by a robust 6.9% in 2017, its first acceleration in economic growth since 2010. This occurred despite the Chinese government's efforts to contain excessive credit extension and address surplus production capacity in certain sectors of the economy, including through plant closures. However, slowing fixed investment activity, the full impact of the government's efforts to rein in credit, combined with an increasingly difficult export environment for Chinese firms, are expected to underpin lower growth prospects for 2018.

The European Union (EU) reported economic growth of 2.5% for 2017, the fastest rate since 2007. The main contribution emanated from Germany, complemented by most of the eastern European member states. It is also notable that the economies most affected by the global financial crisis have shown signs of recovery, albeit at considerably different speeds. Portugal, Italy and Greece have recently seen their sovereign credit ratings upgraded, with the first two at investment grade. A much stronger momentum in regional demand, accommodative monetary policy and a supportive global environment have underpinned regional growth. However, persistently high unemployment rates, especially amongst the youth in western European countries, will continue to limit growth in consumption demand and therefore the overall expansion momentum.

The world economy is, however, facing significant threats. These include the pace and extent of monetary policy normalisation in advanced economies, increasing protectionism on the part of the United States, both in terms of external trade and foreign direct investment, and the likely retaliatory responses from the affected trading partners. Geo-political tensions have also escalated in parts of the world.

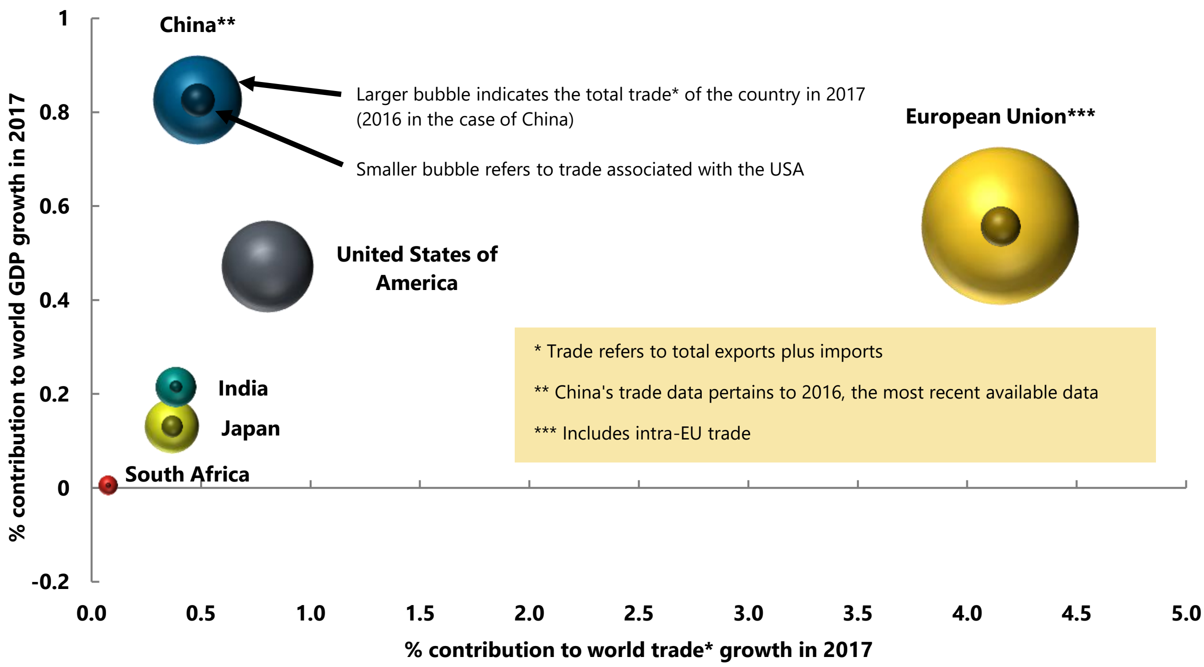
Major risks to global growth in the form of monetary policy normalisation, protectionism and geo-political tensions

The tightening of monetary policy in the US has the potential to constrain this economy's growth. Hence, the US Federal Reserve may continue opting for a cautious approach when considering future hikes in the benchmark rate. The tendency has been for assessing the resilience of economic growth to changes in policy rates before considering the subsequent move. Nonetheless, equity markets have tended to react nervously ahead of Fed meetings.

The increasingly protectionist stance of the US administration under President Donald Trump is raising tensions amongst trading partners across the world. The focus appears to be largely on China, but a very broad brush approach was adopted when tariffs were imposed on US imports of steel and aluminium products. These had been preceded by the imposition of safeguard tariffs on solar cells and modules, as well as on washing machine imports. Although most likely tactical, protectionist action by the US is threatening global trade and its rules-based governance framework, with a potentially negative impact on the world economy's pace of expansion.

Figure 2 illustrates the relative contributions made by the US, the EU and Japan, as advanced economies, as well as by the emerging economies of China, India and South Africa to growth in global trade and GDP in 2017. Furthermore, it shows the relative size of their overall trade (exports plus imports), including the portions that are pertinent to trade with the US, so as to illustrate the potential effect, in relative terms, if trade relations are adversely affected.

Figure 2: Relative contributions to global trade* and GDP of select countries/regions in 2017



Source: IDC calculations, based on ITC data and IMF estimates

More recently, the Trump administration proposed the imposition of 25% tariffs on 1 333 products imported from China. These amount to approximately USD50 billion worth of Chinese imports (around 10% of US imports from China). The items targeted are mainly advanced manufactured products such as industrial robots, high-speed trains, electric vehicles, jet engines and nuclear reactor parts. In response, China indicated that it was considering raising tariffs on 106 US products entering the country, also worth an estimated USD50 billion. This would impact on almost one-third of China's imports from the US, with a wide range of products being targeted, from soya beans, to vehicles and chemicals.

However, as shown in the case of recent changes to the new US tariff regime on steel and aluminium, a degree of flexibility can be applied, as certain countries/regions have been exempted from the tariff increases. In addition, most sides appear to prefer leaving the door open to negotiation, recognising the damage that a "trade war" can create. Should the US, however, continue on its protectionist path, its role in the global trading system could diminish over time. Large trading blocs/countries such as the EU and China, among other affected economies, would tend to diversify their trading reach to other world markets and amongst themselves, potentially displacing US exporters in the process.

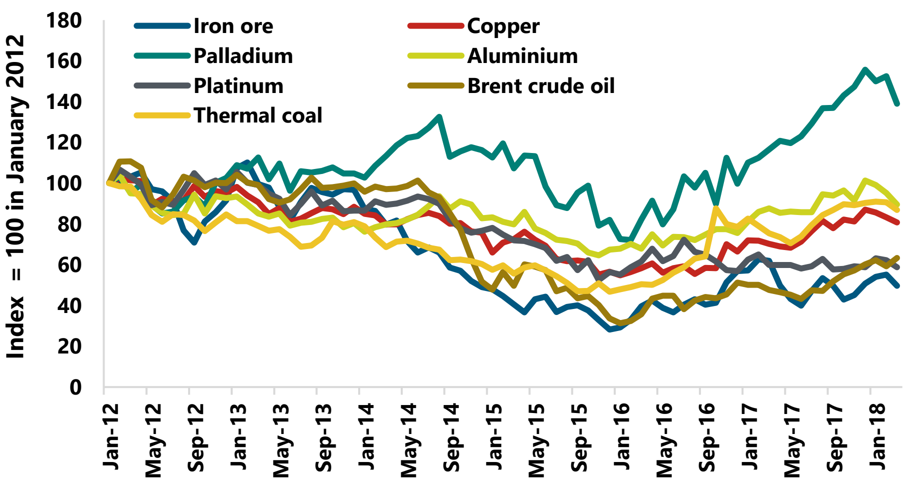
A trade war can be avoided through more conciliatory approaches to trade concerns and disputes

Global equity markets have reacted negatively to the increasing tension in the trading environment. From the 6th of March (the day before the US announcement of tariffs on steel and aluminium imports) to the market close on the 4th of April (when China announced its latest envisaged retaliatory tariffs), the S&P 500 and the Dow Jones Industrial Average indices declined by 3.1% and 2.5%, respectively; while the Shanghai Composite index fell 4.8%. South Africa's FTSE/JSE All Share index, in turn, declined by 7.8% over this period.

World equity markets have reacted negatively to rising trade-related tensions

Rising trade-related tension has not only weighed on investor sentiment, but also on commodity prices due to potential distortions in global trade flows. The negative ramifications have already been reflected in the steep 33% decline in the Baltic dry index, a measure of global dry bulk commodity trade activity, from its recent peak in November 2017. Lower global trading activity, if sustained, has adverse implications for the short- to medium-term outlook of commodity prices.

Figure 3: Relative movements in commodity prices



Source: IDC, compiled from Bloomberg data

Steel related commodities (including iron ore) and base metals endured price corrections during the opening quarter of 2018, despite sustained weakness in the US dollar. Lower global investor appetite for risk also saw the platinum group metals endure price weakness, notwithstanding a deep deficit in the palladium market. Continuing losses in market share by diesel vehicles in the European automotive market, which impact on demand for

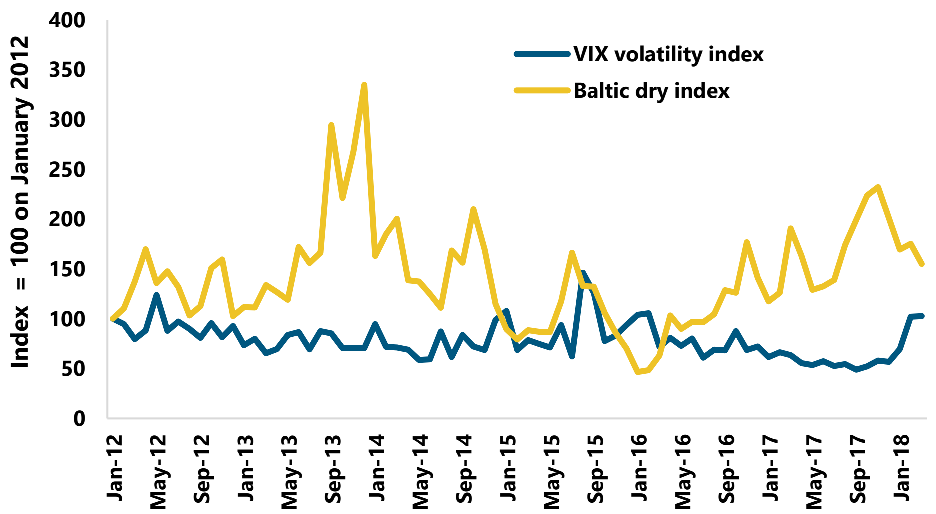
Although industrial commodity prices have been impacted adversely, crude oil prices have shown resilience platinum-based autocatalysts, have also posed a structural constraint on platinum demand, at least in the shorter term. Brent crude oil was a notable exception during the first quarter of 2018, with price stability anchored on stronger global demand, decreased OPEC production and slower than anticipated growth in US oil production.

While oil price resilience is supportive of investor sentiment in industrial commodities, China's intention to restrict growth in its property and infrastructure sectors, in line with its plans for the economy's restructuring, has adverse demand-side ramifications for iron ore and copper. The ramp-up of Vale's S11D mine, in turn, is expected to exacerbate the existing surplus in the global seaborne iron ore market, weighing on prices over the medium-term. Nevertheless, the shorter-term prognosis for iron ore remains positive, supported by robust growth in China's steel production. Furthermore, generally strong growth in the world's industrial and manufacturing production should limit the potential for sustained weakness in the prices of industrial commodities over the medium-term.

A steep decline in the Baltic dry index, coupled with increase investor risk aversion, bodes ill for commodity prices in the shorter term

Deteriorating US-China trade relations have culminated in a marked increase in global investor risk aversion, measured by the VIX volatility index, since the fourth quarter of 2017. This, in conjunction with the concurrent steep decline in global dry bulk activity, forewarns of significant downside risks for commodities and global growth in in the months ahead. China accounts for a significant share of production and consumption for several industrial commodities. Thus, the risk of imposition by the US of further trade barriers towards China, accompanied by retaliation from China itself, can significantly impact on industrial commodity market balances and prices. Lower global dry bulk activity, alongside a potential recovery of the US dollar as the US Federal Reserve normalises policy rates over the course of the year, as anticipated, could imply elevated downside risks for industrial commodities over the months ahead.

Figure 4: Baltic Dry index and VIX volatility index



Source: IDC, cmpiled from Bloomberg data

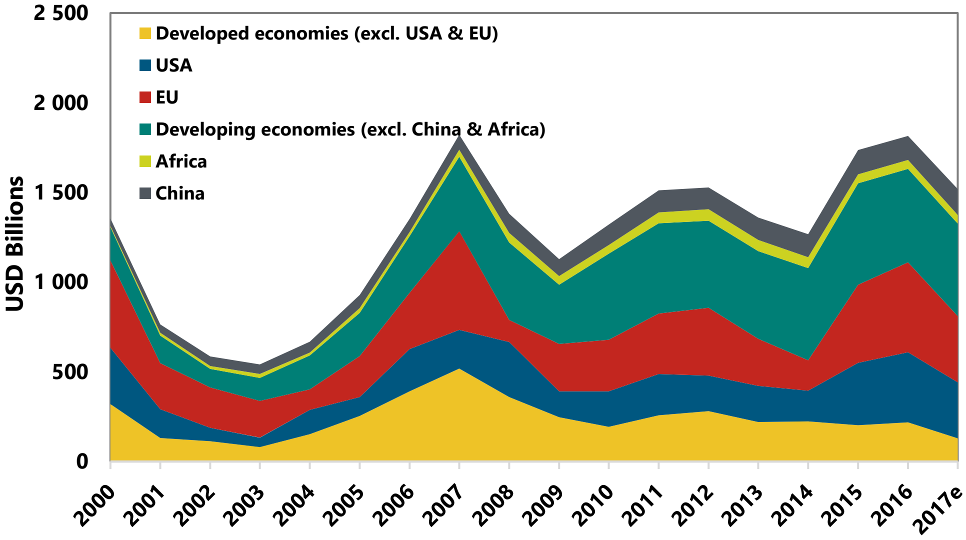
Foreign direct investment activity

Global FDI inflows down 16% to USD1.52 trillion

Despite a more robust and synchronised economic growth globally in 2017, alongside relatively higher commodity prices, worldwide FDI flows are estimated to have declined sharply during the year. The latest estimates from the United Nations Conference on Trade and Development (UNCTAD) indicate that overall FDI inflows fell by 16% to USD1.52 trillion in 2017, from USD1.81 trillion in 2016.

This was largely underpinned by a steep decline in FDI flows to developed economies, particularly into the United Kingdom and the United States. In contrast, FDI flows increased modestly into developing Asia, including China, as well as into Latin America and the Caribbean, pushing flows into the developing countries 2% higher, to an estimated USD653 billion.

Figure 5: Global FDI flows declined significantly in 2017



Source: IDC, compiled from UNCTAD data

Africa is still struggling to attract higher levels of FDI

However, FDI flows into Africa are estimated to have fallen marginally to USD49 billion in 2017, representing a 1% decline on the 2016 figures. Some African countries continued to feel the impact of adverse conditions in global commodity markets, including relatively lower prices (particularly for crude oil), on their economies. This was reflected in sharp declines in the quantum of FDI inflows recorded by Nigeria (-24%), Angola (-20%) and Egypt (-14%), among others, in 2017.

Strong rebound in FDI flows into South Africa, albeit from a relatively low base

Nevertheless, FDI flows into South Africa are estimated to have risen by 43% to USD3.2 billion in 2017, although still well below historical levels. Ethiopia, in turn, attracted its highest level of FDI inflows (USD3.7 billion), while other mineral and metal commodity-exporting countries, such as the Democratic Republic of the Congo and the Republic of the Congo, also managed to post positive growth in FDI inflows.

Rising protectionist tendencies could limit foreign investor activity globally

A recovery in global FDI inflows to about USD1.8 trillion is anticipated by UNCTAD for 2018. This should be supported by improved economic conditions globally, including favourable developments in commodity markets. However, rising geo-political risk and protectionist tendencies could hamper such an outlook for FDI. Furthermore, the reported decline in the value of announced greenfield FDI projects across the developing regions, including in Africa, does not bode well for FDI prospects.

An escalation of protectionist action would adversely affect global trade and investment activity, with adverse impacts on world growth and demand. Such developments could have far-reaching consequences for the African continent due to its generally high dependency on export markets, particularly resource-rich economies. The impact on China's economic performance is particularly important, for this Asian giant has, over the years, become a critical trading and investment partner for many African economies. Furthermore, specific economies are at risk of feeling the brunt of US import tariffs directly, as could be the case for South Africa's steel and aluminium industries should negotiations towards exemption prove unsuccessful.

Recent developments in the South African economy

Domestic economic growth gained momentum during the course of 2017

South Africa's economy expanded by a better than anticipated 1.3% in 2017, from an upwardly revised 0.6% in 2016 (previously 0.3%). Having started the year with a marginal contraction (-0.5%) in real GDP, the pace of growth gained some momentum in subsequent quarters to a rate of 3.1% by the final quarter of the year. This was the highest quarterly growth rate since the middle of 2016, and the second fastest over the past three years.

The technical recession previously reported for the period starting in the fourth quarter of 2016 and ending in the first quarter of 2017 is no more. Instead, the recent revisions to GDP data made by Statistics South Africa now indicate a marginal positive growth rate of 0.4% in the final quarter of 2016 (previously -0.3%).

Sharp rebound in agricultural output and recovery in mining sector underpinned higher economic growth

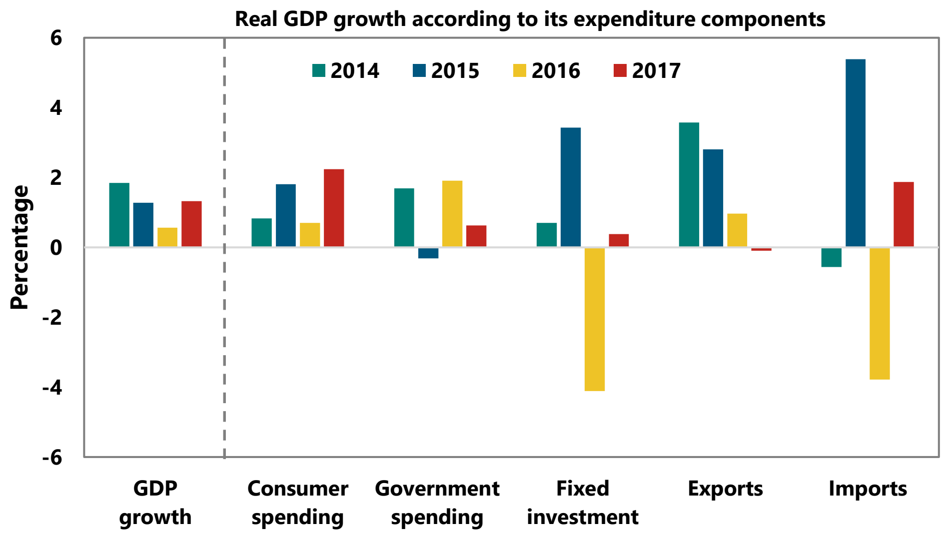
Growth in the South African economy in 2017, albeit still fairly modest, was underpinned by a sharp rebound (+17.7%) in the agricultural sector's GDP and, to a lesser extent, by the 4.6% increase in mining GDP, buoyed by stronger demand and higher commodity prices. Collectively, these two sectors contributed 0.7 of a percentage point to the 1.3% overall economic growth rate, whilst the finance and business services sector added a further 0.4 of a percentage point.

However, the manufacturing sector continued to be adversely affected by weak demand in the South African economy, rising operational costs, as well as by concerns over the political landscape and policy uncertainty. Its output consequently declined by 0.5% in 2017, despite positive developments in some of the key external markets for South Africa's manufactured exports, including Europe.

Better than anticipated growth in consumer spending a key contributor to economic growth

On the expenditure side, consumer spending increased by 2.2% in real terms in 2017, supported by lower household indebtedness, a lower inflation and interest rate environment, higher real disposable incomes and increased demand for new credit. Household spending contributed 1.4 percentage points to overall GDP growth last year, whereas the very marginal positive contributions made by general government and fixed investment, were offset by the subtraction of 0.6 of a percentage point linked to imports of goods and services.

Figure 6: Consumer spending the key driver of higher GDP growth in 2017



Source: IDC, compiled from SARB data

Despite stronger global economic growth and a gradual recovery in world demand, South Africa's exports of goods and services declined by a marginal 0.1% in 2017 as a whole, but expanded strongly (+12.3% on a quarter-on-quarter basis) in the final quarter of the year.

Real fixed investment improved substantially in the final quarter of 2017, recording 7.4% growth in real terms. This followed contractions in each of the preceding three quarters. Hence, for the year as a whole, gross fixed capital formation in the South African economy increased by 0.4%. This was underpinned by a 1.2% increase in capital outlays by the private sector, for the public sector saw its investment spending decline for the second consecutive year.

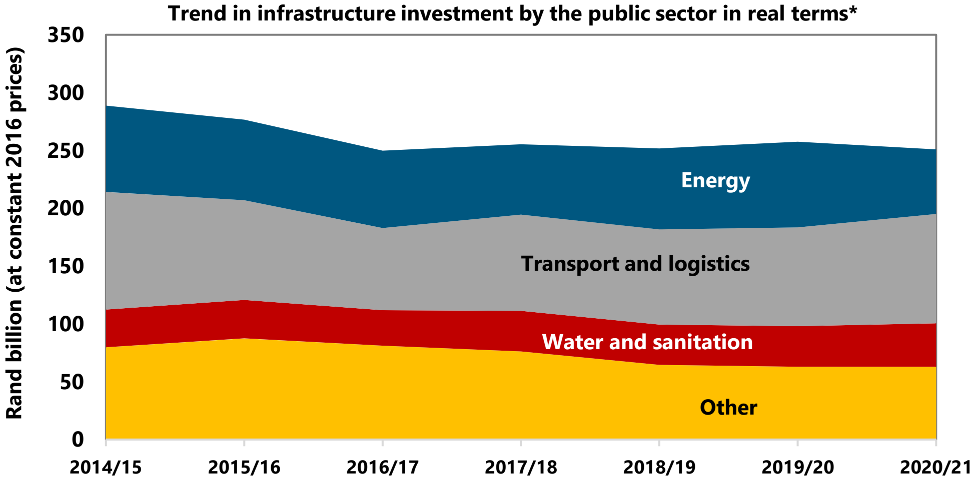
Private sector investment recovered modestly in 2017, while the public sector reduced its real capital spending

Faced by an ongoing and intensifying fiscal challenge, with an estimated R48.9 billion revenue shortfall in the 2017/18 fiscal year, general government had to reduce its overall expenditure. Not surprisingly, investment spending on economic and social infrastructure fell by 4.1% over the past two years, whilst government consumption expenditure increased at a moderate pace of 0.6% in 2017 (1.9% in 2016).

Looking ahead, public sector investment is likely to decline further. According to National Budget 2018 data, overall investment by the public sector on infrastructure development will total R834.1 billion over the next three fiscal years. This is considerably lower than the R947.2 billion projected in the 2017 Budget. Figure 7 illustrates the anticipated trend in real infrastructure investment spending by the public sector at large over the medium-term expenditure framework period.

Spending on infrastructure by the public sector is budgeted to decline in real terms

Figure 7: Lower public sector spending on infrastructure in real terms



Source: IDC, compiled from Budget 2018 data

Note: * Data at constant 2016 prices, utilising IDC's GFCF deflator

Fixed investment spending in the manufacturing sector increased by a modest 1.4% in real terms in 2017, after a sharp drop of 15.7% in 2016. With production activity still relatively subdued and significantly under-utilised production capacity in several of its sub-sectors, much of this investment was directed towards maintenance, replacement and technology upgrades, as opposed to expansionary investment.

Moreover, the manufacturing sector's capital stock declined by a further 2.8% to R564 billion in 2017. This was the 9th consecutive yearly decline, taking the capital stock to its lowest level, in real terms, in 22 years. Facing unfavourable business conditions at present, investment outlays by the manufacturing sector are likely to remain subdued, at least over the short-term. In addition, important sub-sectors such as steel and aluminium are now facing trade barriers in the US market and the threat of increased competition from foreign producers in other export markets as well as domestically.

Capital stock in the manufacturing sector at its lowest level, in real terms, since 1996

Subdued rates of economic expansion resulted in only 102 000 new jobs being created in 2017, thus frustrating efforts to meaningfully reduce high levels of unemployment, poverty and inequality. Although the unemployment rate dropped marginally to 26.7% by the final

Insufficient job creation to make a meaningful dent on unemployment quarter of 2017, from its 14-year highs of 27.7% in the preceding three quarters, approximately 5.9 million people could not find a job in 2017. If discouraged work-seekers are included, this number rises to 9.2 million individuals or 36.3% under the expanded definition of unemployment.

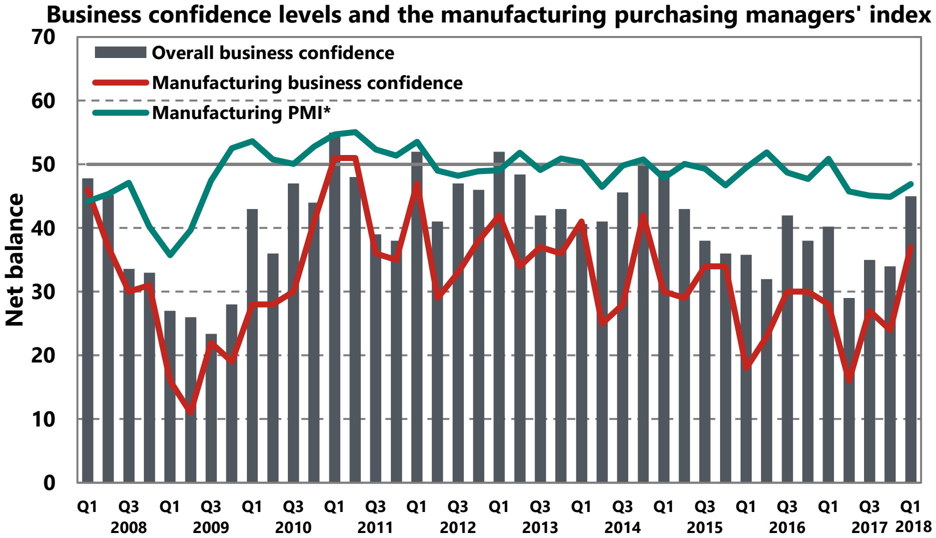
Growth prospects for the South African economy appear to be improving as indicated by the up-trend in the leading business cycle indicator, with its January 2018 reading being the highest in 60 months.

Improved business sentiment due to favourable developments in the political landscape

Business confidence rebounded by 11 points to a reading of 45 points in the first quarter of 2018, reflecting the positive reaction to recent political developments. Business sentiment improved in all of the five broad sectors surveyed, albeit at varying degrees. However, despite a 13-point surge, confidence levels remain low (at 37 points) in the manufacturing sector, as more than 60% of all survey respondents are still not satisfied with current business conditions. Furthermore, manufacturers expect business conditions to remain largely unfavourable over the remainder of 2018.

Of particular concern is the recent drop in the manufacturing purchasing managers' index (PMI), from 50.8 points in February to 46.9 points by March 2018. Sharp declines were reported for new sales orders and business activity, whilst manufacturers have indicated that exports came under renewed pressure, most likely due to the recent appreciation of the rand. The decline in the expected business conditions index (i.e. in six months' time) provides further reason for concern, as it points to a continuation of the challenging operating environment for manufacturers.

Figure 8: Steep rise in business confidence due to political developments



Source: IDC, compiled from BER, ABSA data

Note: * PMI as for end of the quarter

Moody's recent rating decision is indicative of increased confidence in South Africa's economic prospects

In its review released on 23 March 2018, Moody's maintained its rating of South Africa's local currency denominated debt at investment grade (Baa3). Importantly, it revised the country's credit outlook from 'negative' to 'stable'. In so doing, this credit rating agency has recognised positive developments in the political and economic arenas, specifically a gradual recovery in the economy's growth performance, a more business-friendly political administration that is committed to restoring trust in key public sector institutions, fiscal consolidation and debt sustainability, as well as to providing certainty and consistency in the policy and regulatory environments.

Table 1: Key factors highlighted by Moody's that have influenced their credit rating decision

Areas where improvements have been observed
Economic fundamentals, institutional strength/framework, as well as governance and/or management have shown a material improvement
Recent political changes have halted the deterioration of South Africa's institutional framework and preserved long-standing strengths. The speed with which the President has replaced leadership in key institutions is seen as a signal of intent for the resolution of the problems of the recent past
Expected reversal of the weakening of SA's institutional governance under a more transparent and predictable policy framework
Several key state institutions, including National Treasury, the South African Revenue Services (SARS) and key state-owned enterprises (SOEs) have embarked on efforts to rebuild their former institutional strength
Rebuilding of institutional strength to support a broader economic recovery and the stabilisation of fiscal strength
Technical strength and independence of SA's media, civil society and institutions such as the South African Reserve Bank and the judiciary
Improved growth performance, the changing political landscape, as well as the rebound in business and consumer confidence could transpire in improved growth prospects, with economic growth to be higher than previously forecast
An improved fiscal policy stance, with a clear commitment to containing expenditure, while simultaneously focusing on improving revenue collection (e.g. higher VAT), will assist in fiscal consolidation and debt sustainability
Government's debt burden now expected to stabilise at 55% of GDP during the period 2018 to 2020, much lower than what was presented in the MTBPS
Areas that are still of concern
Steady progress must be attained on objectives set out in the President's State of the Nation Address 2018 so as to boost business confidence, which is important for improved economic and fiscal prospects
Challenge of meeting diverse economic, social and fiscal objectives not to be underestimated
Financial constraints at key SOEs, the reduced capacity of SARS to collect sufficient revenue, as well as the lack of clear policy direction as per the October 2017 MTBPS, serve as examples of the erosion of government's balance sheet
Fragile state of many SOEs, particularly Eskom, pose material contingent liability
Sourcing of funds for increased spending on education announced under previous Presidency to prove challenging
Changing political dynamics may lead to policy uncertainty in light of an increasingly diverse political environment. Issues regarding the Mining Charter, as well as the issue of land expropriation without compensation, present challenges for society and the new administration

Source: IDC, compiled from Moody's media release

Growth prospects for the South African economy

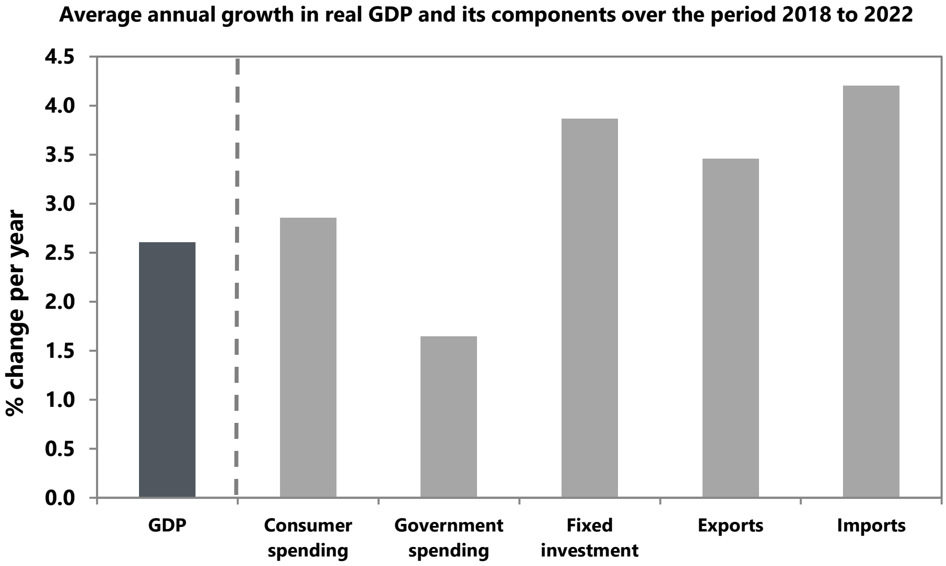
South Africa's growth prospects have improved considerably

Against the backdrop of a significantly improved political environment, which is impacting positively on consumer, business and investor sentiment, alongside a relatively benign inflation outlook, supportive monetary policy and more favourable prospects for the world economy, including higher commodity prices, the outlook for the South African economy has improved considerably.

However, the increase in the VAT rate to 15% (from 14%) effective 1 April 2018, as well as higher excise duties and the rise in the fuel levy, could curtail to some degree the anticipated up-tick in economic growth as it not only affects household consumption expenditure, but may also have implications for fixed investment spending and production activity.

Some of the challenges faced by South African households are expected to be alleviated over the medium-term, leading to a gradual recovery of consumer sentiment. Contributing factors may include rising disposable incomes, progressive employment creation as economic activity increases, as well as an accommodative monetary policy stance (the Monetary Policy Committee cut the repo rate by a further 25 basis points on 28 March 2018).

Figure 9: Gradually improving economic growth expected over the outlook period



Source: IDC, compiled from SARB data; IDC forecasts

Private sector investment activity set to increase significantly

Private sector fixed investment is projected to increase on the back of improving conditions in global markets and, gradually, in the domestic economy. However, fixed investment by the public sector is projected to decline further in real terms in 2018. Facing a revenue squeeze, general government may be forced to reduce spending on economic and social infrastructure, at least in the shorter-term.

Improving global demand conditions and higher commodity prices to support stronger exports in the manufacturing and mining sectors

Stronger demand from South Africa’s key trading partners is anticipated to result in an improved export performance over the medium-term, although a relatively strong rand may limit the benefits to some extent, at least in the short-term. Manufactured exports should benefit from increased demand in the Eurozone and sub-Saharan African markets, among others, but may face significant challenges in the US market, as exemplified by the recently imposed tariffs on US imports of steel and aluminium. Mining and mineral exports could gain some momentum due to higher investment activity globally.

Developments in the world’s trading environment will be particularly important. South Africa has a very open economy, as indicated by the sizeable shares of GDP, at 29.8% and 28.4% respectively, claimed by exports and imports in 2017. This makes the economy extremely vulnerable to global trade developments, for these can affect its performance directly and/or indirectly. The US, for instance, was the destination for 7.5% (or R88.7 billion) of South Africa’s merchandise exports in 2017, which benefitted significantly from existing trading arrangements, particularly the African Growth and Opportunity Act (AGOA). Furthermore, considering that China is South Africa’s single largest trading partner at the individual country level, disruptive impacts on its export and overall economic performances may result in reduced demand for South African exports.

Barring adverse developments globally, as outlined earlier in this report, the domestic economic recovery already underway is expected to gain further momentum, with GDP growth forecast to expand at an average rate of 2.6% per year over the period 2018 to 2022.

Department of Research and Information

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