Contents

Highlights .................................................................................................................................................. 1
Implications for South African businesses ............................................................................................... 2

Global developments and outlook ........................................................................................................... 4
Industrial commodity markets: Lower crude oil prices weighing on the near-term outlook ....................... 6
Recent developments in and prospects for Sub-Saharan Africa ................................................................ 8
Recent developments in the South African economy ................................................................................. 10
Growth prospects for the South African economy ..................................................................................... 18
Highlights

• 2019 is likely to be a particularly challenging year for the world economy. Major factors and developments expected to affect its performance include the trade war raging between the US and China; the pace and scale of monetary policy normalisation in advanced economies, particularly in the United States (US); continued uncertainty surrounding Brexit; and potentially slower growth in several of the world’s largest economies, including China, the European Union and the US.

• The International Monetary Fund has lowered its forecasts for global growth in 2019 to 3.5%, from 3.7% previously. The advanced economies are now expected to post growth of 2%, while the emerging markets and developing economies as a group are projected to record a 4.5% rate of economic expansion.

• Increased oil price volatility at significantly lower levels has negatively impacted investor sentiment in the industrial commodities complex. The upside potential for crude oil prices is limited, considering slower global economic growth. This implies that a potential recovery in industrial commodity prices is likely to be more heavily reliant on a de-escalation of US-China trade tensions and the US dollar’s performance as the Federal Reserve’s policy rate normalisation cycle approaches its peak.

• Growth prospects for Sub-Saharan Africa (SSA) are set to improve, with real GDP growth projected to rise to 3.5% in 2019, from 2.9% last year. Solid economic expansion in several countries, particularly those that are less dependent on commodities, should contribute to the anticipated growth momentum. The downside risks to this outlook are, however, significant, considering the global macro- and geopolitical challenges, concerns over the fiscal and debt sustainability of various SSA economies, and political risks as several countries hold general elections during 2019.

• The rest of Africa has become an increasingly important market for South African exporters, accounting for 26.2% of merchandise exports to the world at large in 2017. However, South African exports to the continent are largely destined for the SADC region, principally other SACU member states. Of concern is the limited penetration of South African exports in several SSA economies with sizeable and fast-growing overall import demand.

• The South African economy exited its technical recession in the third quarter of 2018 as growth recovered to 2.2%. Real GDP over the period January to September 2018 was, however, only 0.8% higher than in the corresponding period a year earlier. The RMB/BER business confidence index remains at low levels, having declined by a further 3 index points to 31 in the final quarter of 2018. This was indicative of difficult operating conditions, policy uncertainty and poor growth prospects, especially in the short-term.

• The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) raised the repo rate by 25 basis points, at its November 2018 meeting, to anchor inflation expectations. Lower domestic petrol prices, the rand’s relative recovery vis-à-vis major currencies and the absence of demand-pull pressures on consumer inflation should contribute to the latter remaining within the SARB’s target range. The MPC is thus expected to keep the repo rate unchanged at current levels throughout the course of 2019.

• President Ramaphosa’s State of the Nation Address (SONA) placed a strong emphasis on economic matters. It highlighted several confidence-building measures aiming to revive business and investor sentiment, increase fixed investment activity, create job opportunities and accelerate economic growth of a more inclusive nature. Economic transformation, youth unemployment, education and the urgent need to address the crisis at Eskom, were also among the SONA’s key messages.
Economic overview

- Political developments in the first half of 2019 will be a key determinant of the South African economy’s performance over the remainder of the year. An investment- and growth-supportive outcome is likely to result in a gradual economic recovery. GDP growth is, therefore, forecast to rise from an estimated 0.8% in 2018 to 1.6% and 2.0% in 2019 and 2020, respectively. The expansion momentum is expected to strengthen in subsequent years, at around 3% over the period 2021 to 2023.

Implications for South African businesses

Implications of global economic developments

- Facing increasingly clear signs of a slower pace of economic expansion globally, South Africa’s export sector should follow developments in their respective external markets closely:
  - In certain instances, such as in the Eurozone, China and the US, demand for South African export products may expand at a weaker pace, but not necessarily contract;
  - Future demand in the United Kingdom, an important market for South African exports, will be highly reliant on the outcome of the Brexit process. An adverse trajectory could be export-negative in the short- to medium-term if the British economy undergoes a significant setback, but export opportunities could arise as new trading relationships are developed, especially over the medium- and longer-term;
  - External demand for South African products may increase in economies that are anticipated to post higher rates of economic growth, as is the case in several Sub-Saharan African (SSA) countries. The SSA region is a leading market for South African exports, particularly manufactured goods, and provides opportunities for the development of regional value chains.

- Ongoing negotiations between the US and China may avert a full-scale trade war between the two countries. If reasonably successful, this would possibly prevent major destabilising effects on global trade flows and overall economic growth. However, measured optimism may be in order, for the outcomes of such negotiations may be modest. It, therefore, remains crucial for South African businesses to monitor developments closely, not only to pre-empt potentially negative implications, but also to identify export market development opportunities that may arise in a rapidly changing global trading landscape.

- Infrastructure development activity is expected to accelerate in several SSA economies, with potentially positive effects on demand for South African goods and services. However, domestic business should be cognisant of the highly competitive nature of the global supply landscape when pursuing possible opportunities in regional markets.

- As highlighted in the report, several sizeable markets in SSA remain largely untapped by South Africa’s export sector, potentially indicating missed opportunities. Domestic enterprises should pursue opportunities to increase the penetration of their products in such markets, which are attractive due to their relative size as well as expected growth in import demand.

- A less hawkish monetary policy stance by the US Federal Reserve has been relatively positive for equity markets and certain emerging market currencies, including the rand. In turn, monetary policy tightening remains on hold in the Eurozone and Japan.
The rand’s significant recent appreciation reduces imported inflation and lowers the pressure on the Monetary Policy Committee of the SA Reserve Bank to raise interest rates.

**Implications of domestic economic developments**

- The private sector has welcomed President Cyril Ramaphosa’s investment-drive and efforts recently made to provide greater policy certainty, particularly in the mining sector. Confidence-building messages also dominated the President’s *State of the Nation Address* on February 7th. However, the actual deployment of investment capital may, in many instances, remain on hold until the outcomes of the May 2019 national elections provide greater clarity on the political front. An investment-supportive outcome could unleash a significant quantum of capital spending, supporting overall economic growth and employment creation.

- Assuming such a growth-supportive outcome, private sector fixed investment is projected to accelerate over the outlook period, with increasingly beneficial impacts for the utilisation of existing production capacity in the South Africa economy due to increased demand for locally-sourced goods and services, as well as the associated multiplier effects.

- Infrastructure development spending by the public sector will total R855.2 billion over the next three fiscal years. A stronger drive to maximise its impact on the South African economy through localisation is likely to be forthcoming from the three levels of government as well as state-owned-companies. Although financial and operational constraints at key SOEs may affect the roll-out of their planned capital expenditure programmes, the quantum of investment in infrastructure projects remains substantial.

- The President’s *State of the Nation Address* outlined focus areas and several initiatives. These include the focus on economic transformation and reducing the concentration of power in the economy, export sector development, increased investment activity accompanying improvements in the investment environment, the crowding-in of private sector funding for infrastructure development and, among others, the drive to maximise the localisation benefits of public sector expenditure.

- As consumer confidence improves and employment levels increase, the willingness and ability of households to raise their spending should support the recovery of domestic demand. This would be a welcome trend for enterprises that have been detrimentally affected by weak demand conditions in the local market, and progressively provide additional business development opportunities for both existing and new players.

- The resumption of load shedding by Eskom has again brought to the fore the fragility of the electricity utility, not only financially but also from an operational perspective, and, consequently, the major risks it poses for the economy at large. Such developments have been affecting businesses operations and could impact on investment decisions going forward.

- South Africa’s sovereign credit rating is expected to be left unchanged by Moody’s when the agency announces the outcome of its review on the 29th of March 2019, but the outlook might be altered from “stable” to “negative”.

Global developments and outlook

If market volatility in the opening days of 2019 provided an indication of what lies ahead, a very rocky year is almost certainly in store.

The major themes underpinning market jitters remain the trade war between the United States (US) and China, as part of the Trump administration’s broader populist protectionist policies; the pace and scale of monetary policy normalisation in advanced economies, especially in the US; continued uncertainty surrounding Brexit, despite the looming 29 March 2019 deadline; and increasing concerns over a potentially significant and relatively synchronised slowdown in the growth of several of the world’s largest economies, including China, the Eurozone, the United Kingdom and, as the year progresses, the United States.

Evidence of the negative impact of the US-China trade war on economic activity is surfacing. Relatively weak rates of expansion in China’s industrial production as well as in demand for non-oil imports are largely attributable to softer domestic demand, for exports increased by 9.9% in US dollar terms in 2018. However, China’s manufacturing PMI is indicating challenges ahead, as its sub-index for new export orders posted a reading of 46.6 in December, indicating slowing global demand for Chinese manufactured goods.

With the Chinese economy facing significant headwinds from deleveraging efforts and softer demand from global markets, particularly the US, its economic growth momentum is decelerating, albeit gradually. Amongst the Chinese authorities’ recent monetary and fiscal policy responses to stimulate economic activity are reduced financial regulatory tightening, the lowering of bank reserve requirements, and increased public sector fixed investment.

**Figure 1: Industrial production significantly weaker in China, slowing in the US**

The impact on the US economy has been modest thus far, but production costs, external trade and investment activity have started being affected by tariffs and policy-related uncertainty. The US manufacturing PMI recorded a sharp 5.2-point drop to 54.1 in December 2018, the lowest reading for the year. Furthermore, its new order sub-index reported the largest decline of 11 points, while new export orders increased marginally compared to November.

US exports increased by 9.4% in the opening 10 months of 2018, while import demand recorded marginally faster growth at 9.6%, resulting in a wider deficit on the balance of trade amounting to USD728 billion. It should be noted, however, that the higher tariffs on a wider basket of Chinese imports were only implemented as from end-September 2018. The partial shutdown of the US federal government is projected to have cost the US government is projected to have cost the US 2019 is likely to be quite a difficult year, with reasons for concern across several challenging issues

Increasing evidence of adverse impacts of US-China trade war

China’s economy is facing significant headwinds

The longest period of uninterrupted US economic expansion on record may be coming to an end
economy about USD11 billion, however, about USD8 billion of this is likely to be recovered as salaries are paid and government spending recovers, according to the US Congressional Budget Office estimates. Strengthening headwinds are, therefore, threatening to bring the longest period of US economic expansion on record to an end during the course of 2019, although recessionary conditions are not anticipated.

On the side-lines of the G20 meeting held in Argentina early in December 2018, presidents Donald Trump and Xi Jinping agreed on a 90-day truce to enable a negotiation process. Talks between both countries’ officials started at the beginning of 2019, with China having already made some concessions by lowering the import tariff on US-produced cars from 40% to 15%, while also committing to increase the volume of soya beans procured from American farmers. Although the headlines have been dominated by the tariff battles between the two countries, other critical sticking points pertain to safeguarding US intellectual property rights in China and greater access for US firms to Chinese markets.

The 90-day tariff détente expires at the end of February. The stakes are high, not only for the two countries but also for the world economy. The prospects of some sort of agreement are quite reasonable. However, if the negotiations are unsuccessful, US tariffs on USD200 billion worth of imports from China could rise, and Chinese retaliation would surely ensue. A full-scale trade war between the two countries under a worst-case scenario would be detrimental to global trade, production and investment activity, compromising the world economy’s growth momentum and potential.

Despite the US economy’s relatively strong fundamentals, healthy consumer sentiment (at the highest level since 2000), low unemployment and sturdy employment creation (312,000 jobs added in December 2018 alone), the US Federal Reserve (Fed) chair, Jerome Powell, has become somewhat dovish in his recent public pronouncements. Early in January, he stated that the Fed is sensitive to the risks highlighted by investors and will be patient with its monetary policy in 2019. Muted inflation readings also justify a more flexible approach. After having raised US interest rates four times during 2018, from 1.25% to 2.25%, the Fed is now expected to pause for a while so as to assess the impact of the rate increases. The next interest rate hike is anticipated towards the end of the first half of 2019.

**Figure 2: Policy rates still rising in the US, unchanged in the Eurozone and Japan**

![Policy rates graph](image)

Cognisant of the fragility of economic growth in the Eurozone, the European Central Bank (ECB) has also embarked on a cautious monetary policy normalisation process, specifically by unwinding the use of quantitative easing instruments, but refraining from starting an interest rate hiking cycle.

The Eurozone’s growth prospects are weakening, hence the ECB’s cautious monetary policy stance.
The composite Eurozone PMI deteriorated during 2018, reaching 51.1 in December. Developments within the monetary union itself, including slower industrial production activity in Germany, debt sustainability and other budgetary concerns in Italy, and continued weakness in consumer confidence across the regional bloc, have been contributing to the slowdown. However, external factors have also been playing a major role, particularly the impact of US protectionism on trade performance and investor sentiment, as well as the protracted uncertainty surrounding the United Kingdom’s withdrawal from the European Union (EU).

The UK will remain a member of the EU until 29 March 2019. A transitional withdrawal agreement negotiated between prime minister Theresa May’s government and EU officials was rejected by an overwhelming majority in the UK’s House of Commons. Consequently, alternative trajectories are being considered, including:

- The re-opening of negotiations with the EU, which the latter has not welcomed, in an attempt to identify a mutually acceptable arrangement for a future relationship;
- Holding a second referendum, which is an option that appears to be gaining increasing support but, due to the necessary logistical preparations, would require an extension of the 29 March deadline;
- Exiting the EU without having reached a deal, which is likely to be a very disorderly option (although a “no-deal” withdrawal is widely opposed across the UK’s political spectrum due to its highly disruptive repercussions, planning for such an eventuality has been stepped up); and
- Extending the time limit set by Article 50 of the EU’s Lisbon Treaty in order to avoid the latter outcome.

The stage is thus set for a global economic slowdown in 2019. In its World Economic Outlook Update of January 2019, the International Monetary Fund (IMF) lowered its forecasts for global growth by 0.2 of a percentage point to 3.5% in 2019, and by 0.1 of a percentage point to 3.6% in 2020. The advanced economies are projected to post growth of 2% and 1.7% in 2019 and 2020, respectively, down from an estimated 2.3% in 2018. In turn, the emerging markets and developing economies as a group may see growth drop from an estimated 4.6% in 2018 to 4.5% in 2019, although an improvement to 4.9% could ensue in 2020.

The world’s trading environment is likely to continue being affected by the major shake-up instigated by the Trump administration, with possible repercussions for investment flows and activity levels. Commodity markets will be affected in the process, with potentially adverse implications for economies that are quite dependent on resource exports.

Industrial commodity markets: Lower crude oil prices weighing on the near-term outlook

The sharp drop in crude oil prices, with dated Brent falling from a peak of around USD86/barrel in October 2018 to a low of just over USD50/barrel late in December, weighed on price levels across the industrial commodities complex. While global macro-financial developments and a slower economic growth momentum over the course of 2018 affected demand for industrial commodities, crude oil prices also played a role, for these are a key leading indicator of future commodity price expectations given their impact on the production cost structure of most industrial commodities.

The recent oil price weakness led the Organization of the Petroleum Exporting Countries (OPEC) and its partners to cut their production target by an agreed 1.2 million barrels per day (mb/d), with OPEC reducing output by 0.8mb/d and non-OPEC partner countries carrying the residual 0.4mb/d reduction in production. Such actions led to a recovery in oil prices, but these have since stalled around USD63/barrel, or 27% lower than the recent cyclical peak.
During the current period of weaker global oil demand growth, estimates by Morgan Stanley indicate that the announced joint OPEC and non-OPEC oil supply cut should effectively prevent a further build up in global crude oil inventory stockpiles that would have otherwise been observed during the first half of 2019 and which would have resulted in further downward pressure on crude oil prices.

Furthermore, although US economic sanctions on Iran did not culminate into as significant a global supply displacement as previously anticipated, they are expected to remain a structural drag on Iranian crude production at least in the short-term, further facilitating a rebalancing of the global oil market and supporting prices in the interim.

Although the recent OPEC and non-OPEC supply cut agreement has reduced the possibility of a global oil supply glut in the near-term, the upside potential for oil prices is limited over the months ahead, with prices unlikely to retest the recent peaks of close to USD90/barrel. Importantly, the supply cuts resulting from the aforementioned agreement are expected to encourage production growth from the non-OPEC countries that were not party to it. The rising trend in crude oil supplies from the US, which is now positioned as the single largest oil-producing country in the world, should remain a structural downside risk on oil prices.

Furthermore, the major crude oil market forecasting agencies, including the International Energy Agency (IEA), the US Energy Information Administration (EIA) and OPEC, now anticipate non-OPEC crude supply growth to be above 2mb/d. With global oil demand forecast to average 1.3mb/d in 2019, robust non-OPEC supply growth will be a key constraint on sustained oil price gains during the course of the new year.

Figure 3: Limited upside potential for crude oil prices

The limited upside potential for crude oil prices, amidst a slowdown in global economic growth, implies that a potential recovery in industrial commodity prices is likely to be more heavily reliant on a de-escalation in US-China trade tensions as well as the limited scope for further dollar appreciation, particularly towards the latter part of 2019 as the US Fed’s policy rate normalisation cycle approaches its peak. Industrial commodities that remain in supply deficit, particularly copper and aluminium, should benefit significantly if global trade tensions recede going forward.
Recent developments in and prospects for Sub-Saharan Africa

The IMF has lowered its projections for economic growth in the Sub-Saharan Africa region to 3.5% (previously 3.8%) for 2019, largely due to the impact of softer oil prices on the Angolan and Nigerian economies. Nonetheless, this still points to a moderate improvement in the region’s performance, considering the 2.9% annual rates of economic expansion recorded over the past two years. Continued solid growth in several countries, particularly those that are less dependent on commodities, is likely to underpin the anticipated growth momentum.

However, rising global macro- and geopolitical risks, increasing concerns over fiscal and debt sustainability in various economies within the region, as well as heightened political risks and the associated uncertainty as several countries hold general elections during 2019, will present downside risks to this positive economic outlook.

Whereas global foreign direct investment (FDI) flows fell by 19% in 2018, Africa recorded a 6% increase in inflows to USD40 billion, according to the latest estimates of the United Nations Conference on Trade and Development (UNCTAD). This was driven by substantially higher FDI flows into Egypt (+7% to USD7.4 billion) and South Africa (+446% to USD7.1 billion). North Africa and, even more so, Southern Africa, thus witnessed a significant rebound in FDI. In contrast, the West-, East- and Central African regions recorded substantial declines in FDI relative to the previous year, at -20%, -14% and -6%, respectively.

UNCTAD expects higher levels of FDI activity in Africa in 2019, with contributing factors including the stabilisation of commodity prices, greenfield projects targeting the manufacturing sector, as well as regional integration efforts supported by the African Continental Free Trade Area (AfCFTA).

The African continent is a very important market for South African exports, having accounted for 26.2% of overall merchandise exports and 38.8% of the country’s total manufactured exports in 2017.

**Figure 4: South Africa’s exports to the rest of Africa are highly concentrated on SADC**

Distribution of South Africa’s exports to select African regions and countries in 2017

South Africa’s exports to the rest of Africa in 2017:
R310.4 billion
(26.2% of SA exports to the world at large)

- SACU, 11.3%
- SADC (excl. SACU), 11.2%
- Ghana, 0.4%
- Senegal, 0.1%
- Nigeria, 0.5%
- Kenya, 0.8%
- Côte d’Ivoire, 0.1%
- Congo, 0.1%
- Ethiopia, 0.1%
- Other African countries, 1.6%

Source: IDC analysis, compiled using SARS data
However, the market penetration potential in African economies outside of the Southern African Development Community (SADC) region remains largely untapped. Collectively, African markets outside of the SADC region accounted for a mere 3.7% of South Africa’s total merchandise exports in 2017 and only 5.2% of its total exports of manufactured products.

Several Sub-Saharan African countries that are not members of the Southern African Customs Union (SACU) present relatively sizeable overall import markets and are expected to post strong average annual growth in merchandise import demand over the next few years. These include Nigeria, Kenya, Ethiopia, Ghana, Tanzania, Côte d’Ivoire, Senegal and Congo (Brazzaville). Their respective shares of South Africa’s export basket in 2017 were relatively small, as illustrated in Figure 4 (the share claimed by Tanzania, which amounted to 0.5%, is captured under SADC (excluding SACU)). Furthermore, these countries’ imports from South Africa represented negligible proportions of their overall merchandise import baskets in 2017, as shown in Figure 5.

**Figure 5: South Africa’s limited market penetration in some relatively sizeable African import markets**

Two examples illustrate these points:

- Nigeria is not only one of Africa’s largest economies (20.5% of continental GDP) but also one of its major importers. Nigeria’s merchandise imports from the world at large were estimated by UNCTAD to have totaled USD45 billion in 2017 and are forecast by the IMF to increase at an average rate of 8.9% per year over the period 2019 to 2021. Yet, imports from South Africa represented a mere 1.2% of Nigeria’s overall import basket in 2017 (refer to Figure 5), based on UNCTAD data. From a South African perspective, exports to Nigeria represented only 0.5% of South Africa’s total...
merchandise exports last year (refer to Figure 4), according to South African Revenue Services (SARS) data.

- In the case of Ethiopia, which is one of Africa’s fastest growing economies (the IMF forecasts an average annual growth in real GDP of 8.3% over the period 2019-2021), overall merchandise imports from the world at large totaled USD15.9 billion in 2017 (UNCTAD estimates). However, imports from South Africa represented only 0.8% of Ethiopia’s overall merchandise import basket in 2017, as shown in Figure 5. From South Africa’s standpoint, exports to Ethiopia represented a mere 0.1% of South Africa’s total merchandise export basket in 2017, according to SARS data.

Although it is acknowledged that many Sub-Saharan African economies may, in relative terms, be particularly challenging as potential export markets, other global producers are taking advantage of market opportunities in these economies. Furthermore, the structural reforms under way in several of these countries should significantly improve their business environments. The World Bank’s Doing Business Report 2019, which was recently released, indicates that the business environment in Sub-Saharan Africa has improved significantly, with the region scoring the highest number of reforms since 2012.

South Africa’s export sector should thus actively pursue opportunities to increase its market penetration in the rest of the continent.

Recent developments in the South African economy

In the third quarter of 2018, the South African economy emerged from the technical recession experienced in the preceding two quarters. GDP growth rebounded by 2.2% on a quarter-on-quarter basis (seasonally adjusted and annualised rate (saar)).

Although economic growth is back in positive territory, the local economy remains under considerable strain. Over the nine-month period from January to September 2018, real GDP expanded by only 0.8% on a year-on-year basis, with generalised weakness across all sectors and the various drivers of domestic demand.

*Domestic demand conditions remain largely unsatisfactory*

South African households are facing high levels of indebtedness (although the ratio of debt to disposable income is on the decline), rising costs of living, as well as uncertainty regarding employment prospects. These constraints were reflected in the sharp drop in consumer confidence in the third quarter of 2018, from an all-time high in the first semester of the year, and are collectively affecting the ability and willingness of households to raise consumption expenditure in a meaningful manner.

Limited fiscal space and financial difficulties are, respectively, constraining the ability of general government and several state-owned enterprises (SOEs) to increase spending, whether for operational or capital investment purposes.

The sharp 5.1% decline in fixed investment spending in the third quarter of 2018 was the steepest in three years. In real terms, investment outlays contracted for the third consecutive quarter, and declines were recorded in 10 out of the past 12 quarters. Consequently, the ratio of fixed investment to GDP measured only 17.7% in the third quarter of 2018, the lowest in 13 years. This is a clear reflection of a difficult operating environment and is mirrored by low levels of business confidence across the spectrum.

Fixed investment spending by the private sector fell by 4% on a quarterly basis (saar), with lower capital outlays on non-residential buildings and transport equipment. Investment expenditure by public corporations dropped 13.3% to the lowest level in almost four years.
Economic overview

General government spending, in turn, increased modestly by 1.1%, mainly on construction works and transport equipment.

However, fixed investment activity is expected to gain some momentum following recently announced initiatives by government to revive business and investor confidence, especially if some of the major bottlenecks are effectively unblocked and the domestic environment becomes more conducive for business investment.

**Figure 6: Domestic demand remains weak**

![Diagram showing growth in real GDP and its domestic expenditure components]

Source: IDC, compiled using Stats SA data

**Generalised weakness across all broad sectors**

At a sectoral level, the pace of expansion has remained uninspiring basically across the board, as illustrated in Figure 7.

**Figure 7: General weakness across sectors is indicative of difficult operating conditions**

![Diagram showing real GDP growth according to broad sector in the first 3 quarters of 2018]

Source: IDC, compiled using Stats SA data
Agricultural output rebounded strongly in the third quarter of 2018 after having declined significantly during the first half of the year. Production volumes have been quite volatile in the mining sector and the recovery momentum strengthened in the manufacturing sector.

The return to positive growth in the trade, catering and accommodation sector bears testimony to some improvement in the consumer environment, although challenges remain for the household sector. Subdued growth in the domestic economy, improved energy efficiencies and reduced business reliance on Eskom as the sole supplier of electricity were reflected in the electricity sector’s poor third quarter performance.

The construction sector, in turn, has been adversely affected by weak fixed investment activity in the economy, as both the public and private sectors are cutting back on capital expenditure in a difficult and low-growth environment.

Manufacturing activity has been under severe pressure in recent years, with output having expanded by only 0.3% per year, on average, over the period 2014 to 2018. Weak domestic demand has been a key constraining factor and rising operational costs have impacted on profitability. The political climate in general, along with policy-related concerns, have contributed to pessimistic sentiment across the manufacturing sector, thereby affecting its overall performance.

Although manufacturing output recovered by a very modest 1.2% in 2018 (refer to Figure 8), following a 0.5% contraction in 2017, formal employment losses were recorded in 8 out of its 10 broad sub-sectors. Over the first three quarters of 2018 (latest available data), formal employment in the manufacturing sector declined by 1.2% or 14 139 people. The sector’s employment intensity remains on a downward trend.

**Figure 8: Subdued growth in manufacturing output affecting employment creation**

![Growth in manufacturing output and employment in 2018](image_url)

**Notes:**
- Output is for the full year 2018.
- Employment is for the period January to September 2018.
- Bubble size indicates the relative shares of formal sector jobs in 2018.

Source: IDC analysis, compiled using Stats SA data
The outlook for the manufacturing sector remains largely unfavourable as, according to respondents to the latest BER survey, business conditions are expected to worsen in twelve months’ time. Investment in plant and equipment by manufacturing enterprises is anticipated to remain very weak. The potential for renewed “load shedding”, rising risks to the global growth outlook, low confidence levels among manufacturers, as well as weak demand conditions in the domestic economy, are likely to continue affecting production activity in this sector for some time.

A challenging operating environment, policy uncertainty (particularly the draft Mining Charter and the Mineral and Petroleum Resources Development Act amendment Bill), weaker global demand (especially from China), as well as lower commodity prices weighed on the mining sector’s performance in recent years.

Mining output declined by 1.6% in 2018, mainly due to the sharp 14.5% drop in gold production, while overall mining employment fell by 2.5% (11 673 fewer people employed) in the first semester of the year (refer to Figure 9). The gold mining sub-sector reported 13 529 job losses over this period, followed by the platinum group metals (PGMs) mining sub-sector with 6 586 job losses.

*Figure 9: Key mining sub-sectors under strain as the operating environment remains challenging*

The new Mining Charter, which was gazetted in September 2018, alongside government’s announcement that the current Mineral and Petroleum Resources Development Act remains applicable, with the amendment Bill having been withdrawn, should provide greater policy certainty to the embattled mining sector. This may result in increased fixed investment and more exploration activity. Despite its relatively small share of South Africa’s GDP, the mining sector has strong linkages along its entire supply chain, making its overall contribution to the South African economy significantly larger than the direct impact alone.
Business confidence

Business confidence levels have been low for an extended period. In the final quarter of 2018, all but one of the sub-sectors recorded confidence levels above the crucial 50-point mark (refer to Figure 10). A reading above 50 indicates a relatively optimistic view of economic conditions, with the opposite holding for readings below 50.

At a reading of only 15 points, the sub-index for new vehicle dealers was at its lowest since the 2009 recession, illustrating household reluctance to spend on durable goods.

Although confidence levels in the civil engineering sector recovered from the historical lows recorded at the start of 2018, these remain very low. Since this sector’s activities are closely aligned with the investment cycle, recent trends regarding capital expenditure are having a negative impact on demand for engineering and related services.

Of particular concern is the fact that, five years into the downturn of the business cycle (the longest downward phase on record), confidence levels not only remain very low, but have declined in some instances. This does not bode very well for a strong and speedy recovery in economic activity, with South Africa’s growth prospects indicating rather weak rates of growth over the next two years.

The run-up to the May 2019 general elections is likely to affect business and consumer sentiment due to the fair amount of uncertainty associated therewith. This will have implications for overall economic activity in the near-term.

Figure 10: Low confidence levels largely reflect unsatisfactory economic conditions

Balance of payments

South African exporters have benefitted from stronger global demand, as exports of goods and services increased by 2.8% (year-on-year) in real terms over the first three quarters of 2018. In the third quarter alone, real exports increased by 24.2% (quarter-on-quarter, saar), largely underpinned by higher export volumes of gold and PGMs. Manufacturing exports were boosted by increased external sales of motor vehicles and other transport equipment, while agricultural exports remained very strong.
Despite weak domestic demand and a rather subdued overall economic performance over the past year, demand for imports remained surprisingly robust. This is reflected in a higher import penetration ratio (i.e. real merchandise imports as a percentage of gross domestic expenditure (GDE)) at 28% for the third quarter of 2018, the highest on record.

Nonetheless, in nominal value terms, the overall balance of trade (i.e. merchandise exports minus merchandise imports) recorded a surplus of R14 billion in the third quarter of 2018, which was considerably lower than the R38 billion reported for the preceding quarter. However, the deficit on the services and income accounts remained substantial at about R191 billion, a slight improvement from the R206 billion deficit recorded in the second quarter. This has resulted in the overall deficit on the current account of the balance of payments measuring R177 billion, or 3.5% of GDP.

Considering that economic growth in some of South Africa’s key export markets, such as the Eurozone, the United States and Japan, is expected to lose some momentum during 2019, this could adversely affect the country’s export performance in the year ahead. On the other hand, the expected recovery in domestic fixed investment activity, which tends to be import-intensive, could result in demand for imports remaining fairly strong over the course of 2019 and beyond. Hence, pressure on the balance of payments is forecast to persist over the period to 2023.

**Figure 11: Substantial deficit on the balance of payments, with high import penetration**

Source: IDC, compiled using SARB data

**Interest rates and inflation**

Consumer price inflation exhibited a gradual rising trend during 2018, fuelled mainly by a steep rise in the prices of petrol and related petroleum products. By November 2018, headline consumer price inflation measured 5.2%, compared to 3.8% in March. It subsequently dropped to 4.5% in December. Core inflation (i.e. CPI excluding the cost of food, non-alcoholic beverages, fuel and energy), however, has remained relatively subdued and stable at 4.5%, slightly higher than the reading of 4.0% recorded in January 2018.

Inflationary pressures have largely emanated from the supply side of the economy, as demand-pull factors remained muted and are likely to be absent for some time given the low-growth environment and weak domestic demand conditions.
Despite inflation remaining within the target range and a marginal improvement in the inflation outlook, the Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) decided to raise the repo rate by 25 basis points (bps) to 6.75% at the meeting held on 22 November 2018. This action was taken to anchor inflation expectations and prevent second-round inflationary pressures from mounting.

The sharp drop in the domestic price of petrol both in December 2018 and January 2019 is likely to contribute to lower inflation outcomes in the months ahead. Such developments have not only provided some welcome relief for consumers and producers, but may also influence the MPC’s policy rate decisions going forward. The subdued domestic economic environment, with the consequential absence of demand-pull pressures, alongside the recent recovery of the rand vis-à-vis major currencies, should contribute to inflation remaining within the target range. The MPC is therefore expected to keep the repo rate unchanged at current levels throughout the course of 2019. Monetary policy would thus continue to be growth-supportive whilst ensuring a reasonable degree of price stability.

**Figure 12: Inflation likely to have resumed a downward trend for the time being**

![Inflation chart](image)

Source: IDC, compiled using Stats SA and SARB data

However, should Eskom be granted the requested increase in electricity tariffs, at a substantial 15% per annum over the next 3 years (about double the rates assumed in our current CPI forecasts), the inflation outcome could be 0.28 of a percentage point higher than the IDC’s baseline forecasts (refer to Table 1). This reflects only the direct impact, as the potential indirect effects of such a hike in electricity tariffs could raise inflation by an additional 0.34 of a percentage point if business enterprises are able to fully pass higher prices on to the consumer. Headline inflation could therefore be 0.62 of a percentage point higher than the baseline. This could force the MPC to raise the nominal repo rate by as much as 75 basis points so as to keep the repo rate unchanged in real terms as per the IDC’s baseline projections.

A further steep rise in electricity tariffs would not only place an undue burden on households but would also affect the competitiveness and sustainability of many business enterprises, especially energy-intensive users. This could have far-reaching implications for production activity and employment.
Sectors that are particularly vulnerable to large alterations in electricity tariffs include gold and platinum mining; ferrochrome and manganese smelting; basic chemicals; iron and steel; basic non-ferrous metals; glass and glass products; rubber products; paper and paper products; sawmilling; textiles; as well as segments of food processing (e.g. grain milling).

Developments at Eskom are not only posing major risks to the economy through financial transmission mechanisms, particularly the extraordinary tariff hikes over the years and the risks posed by its enormous financial challenges on fiscal and debt sustainability at the macro level, but also through the direct impacts of its operational challenges, which have resulted in the resumption of load-shedding and power failures. These are not only affecting economic activity on a wide scale, but also investment decisions by the private sector, both domestic and foreign players.

**Exchange rate developments**

The Rand appreciated significantly against the US dollar earlier in the year, from an average of ZAR/USD14.30 in the final quarter of 2018 to a level of around ZAR/USD13.25 by the end of January 2019. Renewed weakness ensued, with the currency trading at around ZAR/USD14.10 on 18 February, due to factors such as mounting concerns over the above-mentioned developments at Eskom, the potential impact on fiscal metrics and overall economic growth, and the sovereign ratings’ reviews by credit ratings agencies, especially Moody’s.

Looking ahead, the Rand is expected to depreciate over the coming months due to risks associated with the domestic economy and some volatility in the run-up to the May 2019 national elections. The Rand is, however, projected to regain some ground in the second half of the year, potentially averaging ZAR/USD13.84 in the fourth quarter.

**Figure 13: Emerging market (EM) currencies again under some pressure**

![Graph showing trends in select EM currencies vis-a-vis the US dollar](image)

Source: IDC, compiled using Bloomberg data

State of the Nation Address

In his State of the Nation Address (SONA) on February 7th, President Ramaphosa focused on various issues pertaining to the investment environment with the aim of reviving business and investor confidence, achieving higher rates of economic growth and more inclusive development. This includes addressing the high levels of economic concentration which are stifling enterprise growth and preventing the economy from reaching its full potential. The
important role of small businesses in enhancing economic activity and job creation, as well as in transforming the economy, was also emphasised.

Generating substantially higher levels of fixed investment activity in the economy, both by local and foreign players, was deemed critical for the expansion of economy’s productive capacity and to create employment opportunities. President Ramaphosa referred to the substantial commitments made by the private sector at the South Africa Investment Conference 2018, some of which are already being implemented. Through the Infrastructure Fund, government aims to crowd-in private sector funding for the expansion and improvement of the country’s infrastructure, which will further catalyse economic growth.

The extension of the Employment Tax Incentive for another ten years, together with the launch of the Youth Employment Service, are amongst the interventions to reduce unemployment, particularly amongst the youth.

Exports were emphasised as an important driver of economic growth. Increasing the contribution of agriculture to the national export basket; improving export sector competitiveness by lowering the costs of transportation, electricity, communications and trade; as well finding new/alternative and larger markets for export products, including the African Continental Free Trade Area, were some of the external demand-oriented areas highlighted in the SONA.

Enhanced efforts to increase the levels of local content and the share of locally produced goods and services in the public sector’s procurement will contribute to raising domestic demand, with substantial spill-over benefits throughout the economy.

The risks to the economy posed by Eskom were recognised. As an integral part of the turnaround plan for this critical SOE, the President announced that three separate entities – Generation, Transmission and Distribution – would be established under Eskom Holdings to ensure that costs and responsibilities are duly isolated and allocated. This announcement has since met with strong opposition from workers and the union movement.

Growth prospects for the South African economy

Political developments in the first half of the 2019 will be a key determinant of the economy’s performance for the remainder of the year. The outcomes of the national election will likely signal the weight which will be thrown behind structural reform, policy alignment and certainty, prudent macroeconomic management and the fight against corruption. The investment community, which is seemingly marking time, could react quite strongly and swiftly either way, depending on the results.

Assuming an investment- and growth-supportive outcome, the domestic economy’s gradual recovery could ensue. This would be, however, contingent on the world economy’s positive, albeit weakened, expansion momentum not being derailed by disruptive developments. These assumptions form the basis of our macroeconomic forecasts, as outlined in Table 1.

South Africa’s economic performance is expected to improve gradually over the forecast horizon, with real GDP growth potentially lifting to 1.6% in 2019 and to 2.0% by 2020. The growth momentum is expected to strengthen in subsequent years, at around 3% over the period 2021 to 2023. Nevertheless, at an average of 2.5% per year for the forecast period, South Africa’s economic growth rate would fall short of the momentum required to make a meaningful dent on the critical challenges of unemployment, poverty and inequality.
Table 1: South Africa’s economic growth expected to improve over the outlook period

Key performance indicators for the South African economy

<table>
<thead>
<tr>
<th>Variable (% change or % of GDP)</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018e</th>
<th>2019f</th>
<th>2020f</th>
<th>2021f</th>
<th>2022f</th>
<th>2023f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth and its components:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Household consumption expenditure</td>
<td>1.8</td>
<td>0.7</td>
<td>2.2</td>
<td>1.7</td>
<td>1.9</td>
<td>2.4</td>
<td>2.8</td>
<td>3.1</td>
<td>2.8</td>
</tr>
<tr>
<td>Government consumption expenditure</td>
<td>-0.3</td>
<td>1.9</td>
<td>0.6</td>
<td>1.4</td>
<td>1.8</td>
<td>1.3</td>
<td>1.6</td>
<td>1.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Gross fixed capital formation (GFCF)</td>
<td>3.4</td>
<td>-4.1</td>
<td>0.4</td>
<td>-0.5</td>
<td>1.3</td>
<td>3.1</td>
<td>5.5</td>
<td>5.9</td>
<td>6.5</td>
</tr>
<tr>
<td>Exports</td>
<td>2.8</td>
<td>1.0</td>
<td>-0.1</td>
<td>1.5</td>
<td>2.7</td>
<td>3.1</td>
<td>3.5</td>
<td>3.2</td>
<td>2.9</td>
</tr>
<tr>
<td>Imports</td>
<td>5.4</td>
<td>-3.8</td>
<td>1.6</td>
<td>3.4</td>
<td>3.8</td>
<td>4.1</td>
<td>4.3</td>
<td>3.7</td>
<td>4.1</td>
</tr>
<tr>
<td>GDP</td>
<td>1.3</td>
<td>0.6</td>
<td>1.3</td>
<td>0.8</td>
<td>1.6</td>
<td>2.0</td>
<td>2.8</td>
<td>3.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Consumer price inflation</td>
<td>4.6</td>
<td>6.3</td>
<td>5.3</td>
<td>4.6</td>
<td>4.7</td>
<td>5.3</td>
<td>4.9</td>
<td>4.9</td>
<td>4.8</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>-4.6</td>
<td>-2.8</td>
<td>-2.4</td>
<td>-4.0</td>
<td>-4.1</td>
<td>-3.6</td>
<td>-3.9</td>
<td>-4.0</td>
<td>-3.8</td>
</tr>
<tr>
<td>GFCF as % of GDP</td>
<td>20.4</td>
<td>19.5</td>
<td>18.7</td>
<td>17.9</td>
<td>17.8</td>
<td>18.0</td>
<td>18.3</td>
<td>18.7</td>
<td>19.3</td>
</tr>
</tbody>
</table>

Source: IDC, compiled using SARB data, IDC forecasts

Household consumption expenditure will be the main driver of overall growth considering its sizeable share of national GDP (circa 60%). Real disposable incomes are expected to rise at a modest pace and consumers may be circumspect in taking on much new debt, at least earlier in the outlook period. As such, spending on durable goods, such as motor vehicles, household furniture and appliances, could be fairly subdued in 2019, with some improvement thereafter. Household income will increase as the economic recovery strengthens and additional employment is generated, raising the ability and willingness of consumers to spend.

Although the rates of increase in household consumption spending are projected to rise to just over 3.0% by 2022, they remain lacklustre when compared to the momentum recorded before the Global Financial Crisis of 2008. The household debt-to-disposable income ratio is forecast to decline steadily from about 71% in 2018 to an estimated 67% by 2023.

Fixed investment activity could be bolstered significantly, albeit gradually, if the process of restoring business and investor confidence, which President Ramaphosa embarked upon during 2018 and emphasised during his State of the Nation Address, is strengthened post-elections. Last year’s presidential initiatives such as the Economic Recovery and Stimulus Package, the Presidential Jobs Summit and the South Africa Investor Conference 2018, could lay the foundation for higher levels of investment activity by the private sector. Alongside the expansion and improvement of critical infrastructure, which should translate into increased localisation benefits on the back of public sector investment, this could translate into the expansion of productive capacity and competitiveness improvements.

Since many sectors of the economy presently have spare production capacity, investment spending by the private sector earlier in the outlook period would tend to focus on maintenance and upgrades. Capital expenditure geared towards the expansion of production capacity, or the introduction of new capacity, should follow as demand conditions justify it.

According to the Medium-Term Budget Policy Statement, infrastructure development spending by the public sector will total R855.2 billion over the three fiscal years 2019/20 to 2021/22, of which R485 billion by general government and a further R370 billion by state-
owned companies. This expenditure will have a substantial impact on the South African economy by stimulating production activity across various supplying and supporting industries, both goods-producers and service-providers.

The public sector at large will, however, remain financially constrained, at least in the medium-term. If further downgrades to the sovereign credit ratings are to be averted, government’s commitment to fiscal consolidation and debt sustainability will have to be demonstrated in the fiscal metrics. Therefore, with revenue collections affected by the economy’s subdued growth performance over the next couple of years, measures to curb government expenditure are likely to be required.

Despite the anticipated slowdown in the world economy’s expansion momentum, external demand should be supportive of export growth. An undervalued rand should provide a degree of price competitiveness for South African products, potentially enhancing the export sector’s performance and discouraging some import competition in the domestic market. Although protectionist trends in the global trading arena pose significant risks to the export growth projections, some of the ongoing trade disputes may provide export market development opportunities for local producers.

Relatively strong rates of increase in import demand are anticipated, particularly as fixed investment activity accelerates.

Department of Research and Information
19 February 2019