Economic overview:

Recent developments in the global and South African economies

February 2020

Department of Research and Information
Contents

Highlights .................................................................................................................................................. ii
Implications for South African businesses .............................................................................................. iii

The global economy’s recovery may be delayed ...................................................................................... 1
Industrial commodities - relative stability in prices, risks abound ............................................................ 4
A positive economic outlook for Sub-Saharan Africa .............................................................................. 5
South Africa’s economic performance .................................................................................................. 7
Growth prospects for the South African economy ................................................................................... 14
Economic overview

Highlights

- The new year has heralded signs of an improved economic performance for the world economy. Global growth is set to recover some momentum in 2020, projected at 3.3% by the International Monetary Fund (IMF), up from an estimated 2.9% in 2019.

- Market sentiment has improved on the back of emerging signs that the downturn in global trade and manufacturing production is bottoming out, continued monetary policy accommodation in major economies, the de-escalation of trade tensions between the US and China, and reduced fears of a no-deal Brexit.

- The emerging and developing economies as a group are expected to be key contributors to global growth, despite a further slowing of Chinese economy in line with its structural transformation strategy. The pace of expansion in advanced economies is anticipated to return to more normalised levels. While a slower rate of growth is projected for the United States (US), the Eurozone economy is expected to achieve a slightly better growth outcome in 2020.

- The outbreak of the coronavirus may, however, delay the global economic recovery. Its potential impact on economic activity in China and globally will depend on how swiftly the outbreak is arrested.

- Following the signing of the “phase one” agreement on trade between the US and China, a renewed bullish prognosis emerged for industrial commodities coming into 2020. The coronavirus outbreak has, however, impacted negatively on industrial commodity supply chains due to the mandatory shutdowns of productive operations in various parts of China in efforts to contain its transmission. At this stage, the epidemic’s impact on global supply chains is expected to be transitory, with increased prospects for a recovery in industrial commodity prices after the first quarter of 2020.

- Sub-Saharan Africa is expected to post a moderate acceleration of GDP growth to 3.5% both in 2020 and 2021, from an estimated 3.3% in 2019. Economic conditions will vary widely across the region, with countries that are less reliant on resources generally likely to record robust rates of expansion, whereas several commodity-exporting countries may continue facing significant constraints to growth.

- The South African economy finds itself amidst the longest economic downturn on record. Real GDP growth in 2019 is estimated at a mere 0.3%. In the face of weak demand conditions, economic activity was lacklustre across all broad sectors of the economy. In a very low growth environment, the economy could not sustain employment levels. Approximately 108 000 jobs were lost over the year to the final quarter of 2019.

- Public finances have worsened substantially in the 2019/20 financial year, with the budget deficit estimated at 6.7% of GDP and overall gross loan debt of government projected to rise sharply to a ratio of 61.8% of GDP (IDC projections). Measures to contain government expenditure are critical, as revenue raising efforts may not contribute meaningfully towards restoring fiscal sustainability.

- Eskom recently announced that South Africans must brace themselves for prolonged periods of load-shedding over the next 18 months, so that the utility can embark on “philosophy maintenance” to fix its power stations. Although consistent and effective maintenance is critical, the negative implications for economic growth are considerable. Government has announced efforts to address the financial plight at Eskom, whilst numerous measures are being contemplated to restore its financial situation.
Economic overview

- The lead Moody’s analyst for South Africa was recently quoted as saying that it is too early to assess progress on undertaking structural reforms that could assist in improving the economy’s growth prospects and arrest the deterioration in public sector finances. This has been interpreted as suggesting that Moody’s might not downgrade South Africa’s rating to sub-investment shortly after the release of the 2020 Budget on 26 February.

- In his State of the Nation Address, President Ramaphosa emphasized the need to “fix the fundamentals” and executing strategic plans, while acknowledging that there needs to be a social compact as government cannot do it alone. The President elaborated on action plans regarding the energy, water, telecommunications and specific industrial sectors, and emphasised the imperative of addressing youth unemployment as well as restoring fiscal sustainability.

- In the shorter term, South Africa’s economic performance is likely to continue being adversely affected by weak domestic demand, electricity supply constraints, a degree of policy uncertainty and, among other factors, a challenging global trading environment. Real GDP is projected to expand by 1.2% in 2020 and, on average, by 1.7% per annum over the five-year outlook period 2020 to 2024.

Implications for South African businesses

Potential implications of global economic developments

- Although gradually higher growth is forecast for the world economy over the next couple of years, the expansion momentum for some of South Africa’s key trading partners is projected to decelerate, including China, the United States and Japan.
  - Businesses targeting these markets may encounter some challenges, with commodity-based exporters potentially affected by weaker demand emanating from China. South Africa’s export basket to the world’s second largest economy is overweight in mining and mineral products, with iron ore, chrome and manganese as the key export products.
  - The United States, in turn, is in the process of altering a key exemption of its trade law, with implications for South Africa. This move could have adverse implications for the domestic motor vehicle and parts industry, considering the preferential access it presently has to the US market. Other product categories at risk of losing preferential market access include ferroalloys, industrial chemicals, citrus and nuts, among others.
  - The de-escalation of trade tensions between the US and China may alleviate, albeit to a limited extent, the scramble for alternative global markets by Chinese and American producers, which risked the displacement of South African exports or increased import penetration in the local market.

- The anticipated gradual, but nevertheless marginal, improvement in Eurozone growth should be welcomed by business enterprises focusing on its markets. The bloc’s increased emphasis on green investments, including through considerable fiscal support, could bring about export opportunities but also threats, such as substantially reduced demand for thermal coal.

- The growth momentum anticipated for Sub-Saharan Africa should provide trade and investment opportunities for South African business enterprises wishing to expand their global reach.
- Some of South Africa’s key export markets in the region are expected to post significantly higher growth over the next couple of years, such as Botswana and Mozambique, thus enhancing export potential.

- Regional market development efforts should also target sizable African economies with limited penetration of South African products and services.

- The coronavirus outbreak is currently denting economic growth in China and affecting other economies in the process, including South Africa.

- Factory closures in major Chinese industrial centres are affecting exports and disrupting global supply chains - from parts and components for electrical and electronic goods, to vehicle parts and accessories, machinery and equipment, etc. South African businesses that are reliant on such supplies may experience significant delays in their shipment.

- The disruptions to global supply chains are prompting companies around the globe to consider diversifying sources of supply to reduce their reliance on China. This could potentially enhance manufacturing investment activity in African economies, including South Africa.

- The negative effects of mandatory shutdowns of industrial operations in areas affected by the coronavirus is affecting import demand in China, including demand for industrial commodities generally imported from South Africa or other African economies. Cancellations or delays in import shipment orders will affect the respective suppliers.

- Financial and currency markets are likely to experience volatility from time to time, with heightened risk aversion towards emerging markets not to be ruled out. This was evident at the start of 2020, although mostly linked to concerns over the implications of a potential spread of the coronavirus in China and elsewhere in the world.

**Potential implications of domestic economic developments**

- Fixed investment activity is likely to remain subdued in the short-term, particularly in certain segments of the mining sector, as well as in manufacturing sub-sectors that have considerable spare production capacity due to weak demand.

- Businesses that rely on public sector procurement, whether of a capital- or consumption spending nature, are likely to encounter reduced demand due to financial constraints facing government in general and several SOEs.

- Prolonged periods of load-shedding over the next 18 months will affect the operations of business enterprises basically across the board. However, based on recent experience, the release of relatively reliable load-shedding schedules will improve predictability, enabling firms to plan their production runs.

- Various opportunities for investment and business activity may be inferred from President Ramaphosa’s State of the Nation Address (SONA), including:
  - The expanding potential for energy generation by independent power producers (IPPs) through the implementation of the IRP 2019 and, among others, by permitting municipalities in good financial standing to procure directly from IPPs. Importantly, limits to embedded generation will be removed and prescribed application processing times adhered to.
  - The broadband roll-out, considering that the licensing process by means of auction will be concluded before year-end.
- Co-financing opportunities in the pipeline of projects associated with the Infrastructure Fund.

- Industrial development opportunities associated with the green economy will be opened up through the finalisation of the Climate Change Bill, which aims for a just transition to a low-carbon economic growth trajectory.

- The implementation of various master plans. The automotive, CTFL, poultry, sugar and steel master plans were specifically mentioned.

- A strong focus on SMME development, including the planned designation of 1 000 products for local procurement from this enterprise segment.

- The release of 700 000 hectares of state-owned land for agricultural production.

- The launch of a tourism equity fund in 2020 to stimulate the sector’s transformation.

- The substantial worsening of the fiscal metrics is of major concern as it enhances the probability of a sovereign credit rating downgrade by Moody’s. This agency may, however, opt for waiting a while longer (that is, beyond the scheduled review date of 27 March 2020), as it assesses South Africa’s progress on undertaking structural reforms.

- As the South African economy is forecast to experience subdued rates of growth over the next five years, this will require careful planning and strategising by businesses to withstand the challenging environment, but also to be on the lookout for emerging opportunities in local as well as global markets.
The global economy’s recovery may be delayed

2019 turned out to be a difficult year for the world economy, and 2020 is off to a challenging start.

Global growth is estimated by the International Monetary Fund (IMF) to have slowed to 2.9% in 2019, the weakest pace of economic expansion since the 2009 recession. Growth rates moderated in most of the world’s larger economies, both advanced and emerging. Adverse developments in the global trading and investment arenas, especially the trade war between the United States (US) and China, were the principal contributing factors. The trade spat reached its peak in September 2019 when the cumulative trade between the US and China subject to increased tariffs amounted to USD550 billion.

In January 2020, the US and China signed “phase one” of a trade deal, which placed on hold further escalations in tariffs previously threatened. Under the agreement, the US and China will, by mid-February, halve the tariffs imposed on each other’s exports in September 2019. Furthermore, China has committed to USD200 billion worth of additional imports from the US over the next three years.

The two countries also committed to continue negotiations surrounding the outstanding sources of conflict, including US allegations of inadequate intellectual property protection, forced technology transfers and competitive currency devaluation by China, as well as the opening-up of its market to foreign financial service providers. Such positive developments have eased uncertainty globally to a significant extent.

Figure 1: A mixed picture in the anticipated performance of the economy in 2020

Source: IDC, compiled using IMF data
In contrast to the gloom that characterised 2019, the new year has heralded signs of an improved economic performance. The IMF projects world growth to accelerate to 3.3% in 2020 and 3.4% in 2021. This outlook is supported by more positive market sentiment on the back of "tentative signs that manufacturing and global trade are bottoming out, a broad-based shift toward accommodative monetary policy, intermittent news on US-China trade negotiations, and diminished fears of a no-deal Brexit..." (IMF, World Economic Outlook Update, 20 January 2020)

The emerging and developing economies as a group are expected to be the main drivers of growth. India, Brazil, Mexico, Russia and Turkey, among others, should be key contributors, while Sub-Saharan Africa is also projected to post a higher growth momentum. The outlook for the advanced economies is somewhat diverse but generally not as promising, ranging from marginally higher rates of expansion in the Eurozone, the United Kingdom (UK) and Canada, to slower growth in the US and Japan.

The moderation in US economic growth is likely to continue, with rates of 2.0% and 1.7%, projected for 2020 and 2021, respectively. This is based on expectations that fiscal policy will be neutral (i.e. the previous sizeable tax reductions having worked through the economy) as well as lower growth support from further loosening of financial conditions. The slowing economic momentum should encourage the US Federal Reserve to maintain its accommodative monetary stance.

The Eurozone is anticipated to experience marginally higher growth as its export sector's performance improves in a relatively more normalised global trading environment, as well as due to potential fiscal stimulus, or at the very least an end to fiscal austerity. With the Brexit focus shifting to the future trading relationship between the UK and the EU, some uncertainty will remain, although at a lower level compared to 2019.

However, the trade tensions between the US and the European Union (EU) remain unresolved, while continued weakness in Germany’s manufacturing sector provides reason for concern. The US imposed higher tariffs on USD7.5 billion worth of EU goods due to the World Trade Organisation (WTO) ruling against the EU regarding state support to Airbus. The US continues to threaten to impose increased tariffs on European cars and vehicle parts due to the sustained trade deficit with the EU. The strong push by European countries to introduce digital taxes is also raising the spectre of retaliatory tariffs from the US.

The Chinese economy’s ongoing structural transformation underpinned the IMF’s forecasts of 6.0% and 5.8% for GDP growth in 2020 and 2021, respectively. The conclusion of “phase one” of the agreement on trade with the US is expected to cushion the slowdown to some extent, but the unresolved disputes with the US will still weigh on economic activity.

Furthermore, the measures being taken by the Chinese authorities to contain the outbreak of the coronavirus, alongside the accompanying reactions of households and business enterprises, are having a considerable impact on the economy’s performance, at least in the first quarter of 2020 (refer to the following sub-section). Stimulatory measures are, and will continue, being rolled out by the Chinese authorities to support the economy, but these are unlikely to prevent a downward revision to its growth projections.

Economic growth in India is forecast by the IMF to improve to 5.8% in 2020, from an estimated 4.8% last year, boosted by anticipated monetary and fiscal stimuli as well as relatively low oil prices. However, the risk to the growth outlook is significant due to the disappointing budget announced early in February, which did not introduce the reforms required to stimulate economic activity as assumed by the IMF.

The Brazilian economy is anticipated to benefit from the passage of pension reforms, as well as from increased mining activity. This should result in growth recovering to 2.2% in 2020, from a subdued 1.2% recorded in 2019. Similarly, the Russian economy is expected to report improved, albeit modest, growth supported by consumer spending and investment activity.
The coronavirus may delay the global economic recovery

The improved outlook for the world economy has been underscored by relatively positive developments in the trading arena, continued monetary policy support and anticipated fiscal stimulus, particularly in larger economies. However, the outbreak of the coronavirus may delay, if not outright threaten the global economic recovery.

The Chinese authorities have implemented strict measures to try and contain the spread of the virus, which has thus far infected over 60,000 people, mostly in China, and claimed more than 1,300 lives (only 2 outside of China). Such measures have included extending the Lunar New Year holiday, restricting travel and implementing quarantine rules in certain areas, especially in Hubei province, the outbreak’s epicentre.

The scale of disruption to economic activity in China has been massive, affecting manufacturing activity across a broad spectrum of industries due to forced shutdowns; retail and catering services as consumers stay home; transportation services due to travel restrictions; and domestic as well as international tourism, both inbound and outbound.

The ramifications are rippling through the world economy. Factory closures in major Chinese industrial centres, especially Wuhan, are affecting exports and disrupting global supply chains - from parts and components for electrical and electronic goods, to vehicle parts and accessories, machinery and equipment, and so on. Moreover, bearing in mind that China is the world’s second-largest importer of goods, after the US, and that it accounts for about half of global demand for industrial commodities, cancellations or delays in import shipment orders are affecting the respective supply markets.

The disruptions to global supply chains are prompting many companies around the globe to consider diversifying their sources of supply to reduce their reliance on China. This will reinforce the ongoing gradual shift in manufacturing production out of China, towards regional producers and further afield, including Africa.

Figure 2: China plays a key role in global supply chains

The Chinese authorities, along with their counterparts in an increasing number of countries, are expected to continue taking measures to contain the spread of the virus. Hence, the potential impact on economic activity in China and globally will depend on how swiftly the outbreak is arrested. Should it be successfully contained within a relatively short timeframe, the impact will be transitory, albeit still meaningful. Should efforts, however, extend over a protracted time period, the impact could be considerable. Initial indications are that the resumption of production activity in China will be gradual and orderly, as well as region-dependent. Importantly, the Chinese government has been front-loading, via public spending, portions of the fiscal stimulus budgeted in support of growth.
Industrial commodities - relative stability in prices, risks abound

The deterioration in trade relations between the US and China was the dominant driver of industrial commodity markets’ performance throughout 2019, weighing on dry bulk commodity trading activity and prices. The negative effects propagated into industrial value chains, hampering manufacturing production and import demand in China, which accounts for approximately 50% of world consumption of industrial commodities. Such developments had a sustained negative impact on investor sentiment across the industrial commodities complex, except for markets that experienced major supply-side disruptions (e.g. iron ore).

Figure 3: Prices of key minerals exported by South Africa appear to be finding increasing support

The implementation of various growth-supportive policies in China, including the easing of industry-specific pollution controls, liquidity stimulus measures and the approval of various infrastructure-related projects, contributed to the rebound in the manufacturing PMI index later in 2019 (refer to Figure 3 above), providing a basis for an improved outlook for commodity demand in 2020. This was reinforced by the eventual de-escalation of the US-China trade war through the “phase one” agreement.

However, the outbreak of the coronavirus has impacted negatively on industrial commodity supply chains due to the mandatory shutdowns of productive operations in various parts of China in efforts to contain its transmission. Since these measures have been enforced at the beginning of the seasonal industrial restocking period – generally running from December to May - they will delay the recovery in China’s commodity demand. This has negative implications for industrial commodity prices, at least in the first quarter of 2020, as investor sentiment is weighed downward by uncertainty regarding both the persistence and global economic impact of the coronavirus outbreak.

Nevertheless, the restocking of commodities as the disruption eases and economic activity gradually normalises in China is expected to provide support for industrial commodity prices. Furthermore, China’s ban on the imports of scrap materials of various base metals will have a beneficial impact on seaborne demand for these metals.

Source: IDC, compiled using data from Bloomberg and South African Revenue Service

China accounts for around 50% of global demand for industrial commodities

China’s growth-supportive policies provided the basis for an improved outlook for commodity prices, but the coronavirus outbreak poses significant risks

Commodity restocking in China should support prices while uncertainty prevails regarding the impact of the coronavirus outbreak
Following steep price corrections throughout 2019 due to global market surpluses, which progressively removed high-cost production capacity, the prices of both manganese and thermal coal could be supported by the resumption of restocking demand in China as economic activity ramps up in the weeks/months ahead. The recovery of margins in China’s steel industry, together with the relaxation in environmental restrictions, should support steel production, with a beneficial impact on demand for manganese.

Robust demand for thermal coal in south-east Asian economies, along with the reported curtailment in China’s hydropower generation and rebound in thermal coal fired electricity generation, could boost seaborne demand for thermal coal and investor sentiment.

Crude oil prices are expected to hold above USD50/barrel, with a bias towards this psychological support level as a plethora of macro risks weigh on oil market sentiment. The International Energy Agency (IEA) estimates that China accounted for around 75% of the growth in global oil demand in Q3 2019 (latest available data). Consequently, continued uncertainty regarding the economic impact of the coronavirus outbreak should continue to weigh on oil prices for some time.

**A positive economic outlook for Sub-Saharan Africa**

Economic growth in the Sub-Saharan Africa (SSA) region is expected to gain some momentum in 2020 and 2021, specifically to 3.5% (from 3.3% in 2019). This is despite the rather subdued performances anticipated from the Nigerian and South African economies. Economic conditions will vary widely across the region, with countries that are less reliant on resources generally likely to record robust rates of expansion, while several commodity-exporting countries may continue facing significant constraints to growth.

Notwithstanding this positive outlook for regional growth, relatively high debt levels, weather-related shocks, continued vulnerability to developments in commodity markets and in the global trading arena in general, among other risks, could weigh on domestic spending levels, export performances and investment activity, including foreign direct investment.

**Developments in key regional markets for South African exports**

Positive economic prospects for several African countries should bode well for South African exporters. In 2019, South Africa’s exports to the rest of the African continent totalled R345.7 billion at current prices. Although this represented a 4.8% increase in nominal terms compared to the previous year, exports in fact declined by an estimated 0.7% in real terms.

**Figure 4: South Africa maintains a positive balance of trade with the rest of Africa**
The top five African markets for South Africa’s exports in 2019 were Botswana, Mozambique, Namibia, Zambia and Zimbabwe. Collectively they claimed a 17% share of South Africa’s merchandise export basket and 24.1% of total manufactured exports. As indicated in Table 1, these countries are expected to post faster rates of economic growth in 2020, except for Zambia.

Table 1: SA exports likely to benefit from better economic performances in key African markets

<table>
<thead>
<tr>
<th>Region</th>
<th>Recent growth performance and forecasts for South Africa’s five largest export trading partners in Sub-Saharan Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Economic growth (% change in GDP)</td>
</tr>
<tr>
<td>Botswana</td>
<td>3.5 4.3 5.9</td>
</tr>
<tr>
<td>Mozambique</td>
<td>1.8 6.0 4.0</td>
</tr>
<tr>
<td>Namibia</td>
<td>-0.2 1.6 2.4</td>
</tr>
<tr>
<td>Zambia</td>
<td>2.0 1.7 1.7</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>-7.1 2.7 2.5</td>
</tr>
</tbody>
</table>

Source: IDC, compiled using IMF WEO October 2019 and SARS data

Botswana: Improved economic conditions in key markets for Botswana’s exports, good prospects for agricultural sector performance and an accommodative monetary policy stance should support growth in 2020 and 2021. A pick-up in demand for diamonds and the anticipated start of copper production on a commercial scale should contribute to higher mining sector output from 2021 onwards. However, the pace of expansion, particularly in the diamond segment, will remain vulnerable to developments in major external markets, especially the US, China and India.

Mozambique: Following the economic slowdown to an estimated 1.8% in 2019, largely due to the devastating impacts of tropical cyclones on the country’s infrastructure (including ports) and farmlands, the outlook for the medium-term is expected to improve significantly. GDP growth is anticipated to reach 6% in 2020, albeit from a low base, as reconstruction activity intensifies and investment in the gas sector commences.

Namibia: After three years of recession, a return to positive growth is anticipated in 2020. However, subdued growth in the mining sector, particularly due to a collapse in diamond output, along with the impact of fiscal austerity on government consumption following the 2019 elections, are likely to constrain economic growth to 1.6% in 2020.

Zambia: Government’s constrained fiscal space and declining mining sector activity, largely due to an increasingly uncertain environment for mining companies, are likely to result in weak economic growth in 2020 and 2021. Continued public sector investment in infrastructure, election-related spending and improving copper prices should, however, provide some support.

Zimbabwe: Marginal improvements on the economic front are anticipated in 2020 on the back of better weather conditions, which should result in increased agricultural production, higher water levels for electricity generation and, by implication, a slight pick-up in mining and industrial activity. However, the ongoing liquidity and hard currency challenges, erratic supply of inputs, shortages of basic goods and a challenging business environment are expected to continue weighing on growth in the medium-term. Furthermore, indications are that the risks to the economic outlook are tilted to the downside, with any rebound in growth being largely dependent on external financial support.
South Africa’s economic performance

The South African economy has been experiencing the longest downturn in the business cycle on record, which started in December 2013. Low consumer, business and investor confidence persist, largely due to depressed domestic demand, policy uncertainty, infrastructure-related challenges, a worsening of South Africa’s fiscal position and a more challenging global trading and investment environment.

Figure 5: Low business confidence amidst the longest economic downturn on record

![Business confidence in South Africa](chart)

Source: IDC, compiled using Bureau for Economic Research data

Longest downward phase in the business cycle on record, with low levels of business and consumer confidence

In the face of weak demand conditions, economic activity was lacklustre across all broad sectors of the economy in 2019. Output levels in the mining and manufacturing sectors were affected by weak demand, rising input costs and operational challenges, while prolonged interruptions in energy supply at the start of 2019, as well as towards the end of the year, impacted adversely on these sectors’ performances. The impact of load-shedding was felt across all segments of the economy, with wide-ranging implications for production, trading and investment activity. Corporate profits are under strain and the number of company liquidations increased by 10.7% in 2019, the first increase since the 2009 recession. Real GDP is estimated to have expanded by only 0.3% in 2019 as a whole and the leading business cycle indicator of the South African Reserve Bank is pointing to continued economic weakness in the months ahead. This does not bode well for a swift and sustained recovery, whilst challenging global conditions are adding to the woes of the South African economy, at least over the short-term.

Manufacturing sector in recession

Manufacturing output decreased by 0.9% in 2019, but there were tentative signs of improvement gauging from trends observed over the course of the year. The rate of decline in sectoral output softened to -1.2% (q-o-q) in the final quarter, from -4.5% in Q3 2019.

Despite the sharp downturn in the transport equipment sub-sector (see Figure 6), some recovery was evident in the second half of 2019 (on a q-o-q, seasonally adjusted and annualised basis). Output in the basic iron and steel, as well as in the chemical products sectors also rebounded in the final quarter of the year. In contrast, the clothing, textiles, leather and footwear sub-sector (CTFL), which had shown some recovery in the middle of the year, reported a steep drop in output in the final quarter, with a similar trend also observed for motor vehicles, parts and accessories. Although food processing was the best performing sub-sector for the year as a whole, its output fell marginally in the final quarter.
Economic overview

Figure 6: Manufacturing output declined as operating conditions deteriorated

Manufacturers remain unsatisfied with prevailing business conditions, as indicated by confidence levels remaining continuously below the crucial 50-point mark for an extended period. Insufficient demand has been highlighted as a key constraining factor in doing business in the manufacturing surveys of the Bureau for Economic Research (BER), with the reading of 74 points in Q4 2019 being the highest in 10 years.

Manufacturers expect the operating environment to remain challenging in 2020, according to the BER survey of Q4 2019 (refer to Figure 7). However, despite the challenging global trading environment, domestic manufacturers indicated that they anticipate a modest improvement in their export performance in 12 months’ time.

Figure 7: The outlook for the manufacturing sector remains unsatisfactory

Mining production recovering, but the sector is still facing challenges

Operational challenges, rising costs and weakening demand are among the key factors affecting the mining sector. Output fell by 1.3% in 2019, with the sharp decline in the gold mining sub-sector having been the main contributor. Excluding gold, mining output growth would have been flat (0%) in 2019.
However, the mining sector contributed positively to overall GDP growth in the final quarter of the year. Its output expanded by 1.1% (q-o-q, seasonally adjusted and annualised basis), following the 6.4% contraction recorded in Q3 2019. This improved performance was underpinned by strong rebounds in the output levels of sub-sectors such as platinum group metals (+14.4%, q-o-q), iron ore (+32.7%), chromium (+22.5%) and other metallic minerals (+46.9%).

*Figure 8: Mining production has improved more recently, but the sector is still taking strain*

Growth in mining output by sub-sector in 2019

---

### Retail sales reflecting a difficult consumer environment

Household consumption spending remained subdued during the course of last year, affected by moderate growth in real disposable incomes, yet high levels of indebtedness and poor employment creation. In real terms, retail trade sales rose by 1.2% - the slowest rate of increase in a decade.

This reflected low confidence levels amongst consumers, which fell sharply during 2019. However, a lower interest rate and inflation environment should provide some relief to the households going forward.

*Figure 9: Household spending mirroring low confidence levels*

---

As consumer sentiment plummeted, growth in retail trade slowed to a decade low.
Employment losses in a weak economic environment

In a very low growth environment, the economy could not sustain employment levels. Approximately 108 000 jobs were lost over the year to the final quarter of 2019.

Reduced employment across a number of key labour-intensive sectors is a matter of concern. The construction sector, which employs roughly 1.35 million people (or 8.2% of overall formal and informal sector employment) and has been facing extremely difficult operating conditions for quite some time, recorded 131 000 job losses in the year to Q4 2019. The manufacturing sector shed 46 000 jobs over this period, as a challenging operating environment resulted in a contraction in output volumes across various of its sub-sectors and companies faced a squeeze on profit margins amidst rising costs to do business.

Figure 10: Employment losses across most broad sectors in 2019

Changes in sectoral employment: Q4 2019 vs Q4 2018

The economy’s inability to provide jobs for all new entrants into the labour market has resulted in a substantial rise in the number of unemployed people. By Q4 2019, more than 6.7 million people were jobless, an increase of 587 000 compared to a year earlier.

The unemployment rate measured 29.1% in Q4 2019, unchanged from the all-time high recorded in the previous quarter. Of all the unemployed, 63% were younger than 35 years, and 73.3% (or 4.9 million unemployed people) had been without a job for more than 12 months in the final quarter of 2019.

Government finances deteriorated

South Africa’s fiscal position has worsened substantially. Weak economic growth has been affecting revenue collection, while government spending has continued to increase rapidly.

For the first nine months of the 2020 fiscal year, government revenue increased by a modest 4.8% year-on-year, whereas overall government expenditure rose by 12%. The steep spending increase is of particular concern in light of repeated promises by government to put measures in place to contain spending as part of its efforts to ensure fiscal consolidation and debt sustainability.

Widening budgetary shortfalls along with higher funding requirements by key state-owned enterprises (SOEs) have resulted in a steep rise in overall government debt, to a level of roughly R3.1 trillion by September 2019. As a ratio of GDP, this stood at 61.5%, an all-time high and contrasting starkly with the record low of 26% in September 2008.
The fiscal deficit widened considerably over the nine months to December 2019 (see Figure 11). Estimates for the 2020 fiscal year as a whole point to a considerably higher budget deficit than that estimated in the Medium-Term Budget Policy Statement (MTBPS) in October 2019. According to the MTBPS, the deficit-to-GDP ratio was estimated at 6.2% (or R324.3 billion) for the 2020 fiscal year, whereas it is now projected (IDC forecast) to reach 6.7% of GDP, or approximately R350 billion.

**Figure 11: Budget deficit to be substantially larger than expected**

Government will struggle to raise additional revenue in the current economic environment. South Africa’s tax base is already over-burdened, considering that tax revenue represents approximately 26% of GDP, a ratio that is comparable to those of advanced economies.

An attempt to raise value-added tax (VAT) would be met with considerable public resistance. Government might be tempted to raise personal income tax for higher income earners (wealth tax), but the associated additional tax collections could prove to be limited. Considering business conditions at present and efforts to stimulate investment activity, it is unlikely that any attempt will be made to raise the corporate tax rate.

As usual, the so-called sin taxes will again be raised, including excise duties on alcohol and tobacco. The fuel and road accident fund levies are also likely to be increased. Consideration may also be given to raising the sugar tax, but the resultant additional revenue would be fairly limited and, furthermore, such a move would aggravate the plight of the domestic sugar industry.

Additional means of raising revenue could include the sale of specific state assets, such as unutilised properties, as well as a clampdown by the South African Revenue Service on base erosion and profit-shifting.

Bold actions will be required to bring government expenditure downward to more sustainable levels, otherwise the continued deterioration of South Africa’s fiscal metrics is not likely to be arrested. Key in this regard is the ballooning public sector wage bill, which absorbs roughly 46% of all tax revenue.

Considering the salary and wage increases projected over the next few years, which are well above inflation, government will have to be decisive in its wage negotiations going forward. At the very least it should negotiate annual increases in line with inflation. This could, on its own, make a major contribution towards lowering overall expenditure. Further downsizing of governmental employment may also prove inevitable. This may be achieved through
continued natural attrition, the offer of voluntary/early retirement packages and/or by scrapping vacant positions altogether.

Critically, government cannot bail out SOEs indefinitely, making it imperative that effective solutions be found for their ongoing financial and operating challenges, with a view towards long-term sustainability. A credible plan for dealing with Eskom’s rising debt burden is essential in this regard.

**Eskom – the single largest risk in the South African economy**

Bailouts to key state-owned companies have escalated over the years, placing an undue burden on government finances. By March 2019, government guarantees to SOEs totalled R683.3 billion, compared to R670 billion a year earlier, with the largest facility being the R350 billion guarantee underpinning Eskom’s debt. By March 2019, some R372.4 billion of such guarantees had been used. Eskom accounted for R294.7 billion or 55.7% of this figure.

Considering that Eskom is buckling under a R450 billion debt burden, this entity is clearly the single largest risk facing public finances, as well as the South African economy. National Treasury has indicated that it will not provide additional debt relief to Eskom until proven progress has been made with its unbundling process.

COSATU recently put forward a proposal for Eskom to tap onto R250 billion in funding from the Public Investment Corporation (i.e. state employee pension funds) and state-owned development finance institutions.

Eskom will have to find ways of curbing its expenditure (e.g. reducing its over-sized staff complement, reviewing its coal purchase agreements); addressing operational challenges (e.g. improving productivity, implementing proper maintenance to its aging power-generating fleet to increase its energy availability factor); recovering outstanding debt; and rolling out the proposed operating structure, unbundling into three separate entities - power generation, transmission and distribution.

Eskom has also been putting the case for much steeper electricity tariff hikes before the National Energy Regulator of South Africa (Nersa), so as to complement its efforts to return to financial viability over time. This has not met with Nersa’s blessing, for the adverse economic and social impacts would be far-reaching. Electricity prices as included in the consumer price index (CPI) increased by 301% from 2008 to 2019, well in excess of the 97.7% in overall CPI over the entire period. In response to rising electricity costs and uncertain supply, the economy has become less energy-intensive over time, as illustrated in Figure 12.

**Figure 12: Energy-intensity of the economy has been reduced**

![Graph showing energy intensity of the South African economy](Image12.png)
Eskom recently announced that South Africans must prepare themselves for prolonged periods of load-shedding over the next 18 months, so that the utility can embark on “philosophy maintenance” to fix its power stations. Although consistent and effective maintenance is critical, especially for an ageing fleet of power stations, the negative implications for economic growth are considerable. Nonetheless, should these power outages be communicated properly and also taking into account that businesses and the public at large are aware of what to expect in the months ahead, this could soften the adverse impact on the economy to some extent.

Going forward, the playing field in terms of electricity supply could also change radically, considering the pronouncement recently made by the Minister of Mineral Resources and Energy on creating an enabling environment for self-generation. Mining companies have expressed a keen interest in generating their own electricity. The roll-out of such a plan, along with the possibility of selling surplus energy back into the grid, would go a long way in addressing the energy supply shortfall which is constraining the economy at large, diversifying the energy basket and introducing competition in this monopolistic arena.

**Moody’s assessing South Africa’s progress on structural reform**

Ratings agency Moody’s has kept South Africa’s sovereign rating (foreign currency) at investment grade, although it changed its outlook from “stable” to “negative” in November 2019. A negative outlook generally has a 12- to 18-month horizon, although a ratings’ action may of course be taken in the interim.

The agency is expected to make an announcement of its ratings review on 27 March 2020. Late in January, Lucie Villa, the lead Moody’s analyst for South Africa, was quoted as saying that it is too early to assess South Africa’s progress on undertaking structural reforms that could assist in improving the economy’s growth prospects and arrest the deterioration in public sector finances.

This has been interpreted as suggesting that Moody’s might not downgrade South Africa’s rating to sub-investment shortly after the release of the 2020 Budget on 26 February, even if the agency is not quite satisfied with government plans to restore its finances back onto a sustainable path. In addition, it was indicated that the scheduled date for the ratings review, 27 March 2020, could ultimately be waived or delayed.

Nevertheless, the ratings agency will be keeping a close eye on developments in the fiscal space, state-owned enterprises, economic growth and the much-awaited structural reforms.

**The State of the Nation Address**

In his State of the Nation Address (SONA) on 13 February 2020, President Ramaphosa focused on various issues aimed at fostering inclusive growth as well as addressing structural constraints on investment and economic growth. The President emphasised the imperative of social compacts, for “government cannot solve our economic challenges alone”. Among the salient aspects of the SONA are:

- The resolution of South Africa’s energy challenges by altering the trajectory of energy generation going forward. This includes restoring Eskom’s operational capabilities and expanding generation capacity outside of the utility’s domain. Aspects pertaining to the effective implementation of the Integrated Resource Plan 2019 were elaborated upon. Importantly, no limit will, henceforth, be imposed on the generation of electricity for own use and applications will be processed within the prescribed 120 days.

- Further investment opportunities will be unlocked through the release of high-demand spectrum by auction before the end of 2020.

- The finalisation and implementation of various industry master plans.
Economic overview

- Improving the business environment by cutting red-tape and enhancing the efficiency of key economic infrastructure.
- A strong focus on vocational training and the development of advanced skills in science and innovation.
- Enhancing the functioning of the criminal justice system, visible policing, and the introduction of specialised units to combat crimes of economic disruption (i.e. extortion, corruption etc.) and to support tourism development.
- The rolling out of public infrastructure projects with private funding support, including independent water and electricity production.
- Addressing the challenge of youth unemployment through various initiatives, including the allocation of 1% of the national budget for this purpose.
- Restoring fiscal sustainability and the rationalisation of SOEs.
- The establishment of a sovereign wealth fund.
- The establishment of a state bank to extend access to financial services to all South Africans.

A blow from the US on South Africa’s preferential access to its markets

The US is in the process of altering a key exemption of its trade law, which will make it easier to penalise a number of its trading partners, including South Africa.

This move could have far-reaching implications for South Africa, considering that the US was the country’s third largest trading partner in 2019, with exports valued at R89.5 billion or almost 7% of the overall merchandise export basket. The top export categories to the US in 2019 were platinum group metals (31.6% of South Africa’s export basket to the US); motor vehicles, parts and accessories (11.1%); chemicals and chemical products (10.3%); basic iron and steel (8.3%); and non-ferrous metal products (7.2%).

South Africa’s motor vehicle exports, in particular, could be adversely affected considering the preferential market access the sector receives at present. Other product categories at risk of losing market access include ferroalloys, industrial chemicals, citrus and nuts, among others.

There is also concern regarding South Africa’s draft Copyright Amendment and Performers’ Protection Bills, with the US having expressed dissatisfaction with the protection of copyrights, seeing it as violating the Generalised System of Preferences.

Growth prospects for the South African economy

In the shorter term, South Africa’s economic performance is likely to continue being adversely affected by weak domestic demand, electricity supply constraints, a degree of policy uncertainty and, among other factors, a challenging global trading environment.

Real GDP is projected to expand by 1.2% in 2020 and, on average, by 1.7% per annum over the five-year outlook period 2020 to 2024. Although growth is likely to remain quite subdued earlier in the period, it should garner momentum towards the latter part of the forecast horizon. The anticipated progressive recovery in household consumption spending and in private sector fixed investment, alongside stronger export growth, should underpin the gradually faster pace of economic expansion.

Household spending is likely to remain constrained in the short- to medium-term due to modest increases in disposable incomes, yet high household debt levels and an uncertain
employment outlook. However, its rate of increase may gain some momentum towards the latter part of the outlook period. Business and investor confidence should improve gradually on the back of structural reforms and initiatives led by government, including major reforms at key SOEs. As business confidence improves, fixed investment spending by the private sector is expected to increase at a faster pace. However, financial constraints will limit capital spending by general government and key state-owned enterprises for most of the forecast horizon.

South Africa’s export performance is anticipated to improve to some extent, particularly on the back of market development opportunities in the Sub-Saharan Africa region and supported by a relatively competitive exchange rate for the Rand.

**Table 2: Key assumptions underpinning IDC’s macroeconomic forecasts**

<table>
<thead>
<tr>
<th>Global economy</th>
<th>South African economy</th>
</tr>
</thead>
<tbody>
<tr>
<td>- World growth as per IMF projections (average of 3.5% per year over the period 2020 to 2024).</td>
<td>- Low confidence levels in the short-term, recovering progressively.</td>
</tr>
<tr>
<td>- Trade disputes between US and China as well as the EU remain largely unresolved in the shorter term.</td>
<td>- Gradual pace of structural reforms, increased policy certainty in certain areas.</td>
</tr>
<tr>
<td>- Highly accommodative monetary policy in advanced economies for some time, on the back of muted inflationary pressures.</td>
<td>- Relatively undervalued Rand, accommodative monetary policy on the back of an improved outlook for inflation.</td>
</tr>
<tr>
<td>- Low confidence levels in the short-term, recovering progressively.</td>
<td>- Fiscal metrics worsen over the short-term.</td>
</tr>
<tr>
<td>- Gradual pace of structural reforms, increased policy certainty in certain areas.</td>
<td>- South Africa’s sovereign rating (foreign currency) is not downgraded by Moody’s to a sub-investment level.</td>
</tr>
</tbody>
</table>

**Table 3: Outlook for the South African economy set to improve gradually**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real GDP growth and its components:</strong></td>
<td></td>
<td></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>0.8</td>
<td>1.9</td>
<td>0.6</td>
<td>2.1</td>
<td>1.8</td>
<td>1.0</td>
<td>1.2</td>
<td>1.4</td>
<td>2.0</td>
<td>2.2</td>
<td>2.5</td>
</tr>
<tr>
<td>Government consumption expenditure</td>
<td>0.2</td>
<td>-0.8</td>
<td>2.2</td>
<td>0.2</td>
<td>1.9</td>
<td>1.5</td>
<td>0.4</td>
<td>0.6</td>
<td>0.9</td>
<td>1.2</td>
<td>1.4</td>
</tr>
<tr>
<td>Gross fixed capital formation (GFCF)</td>
<td>0.7</td>
<td>2.5</td>
<td>-3.5</td>
<td>1.0</td>
<td>-1.4</td>
<td>-0.1</td>
<td>0.5</td>
<td>1.7</td>
<td>2.4</td>
<td>3.0</td>
<td>3.4</td>
</tr>
<tr>
<td>Exports</td>
<td>3.6</td>
<td>0.2</td>
<td>3.3</td>
<td>0.4</td>
<td>-0.7</td>
<td>2.6</td>
<td>-2.5</td>
<td>1.8</td>
<td>2.3</td>
<td>2.5</td>
<td>2.8</td>
</tr>
<tr>
<td>Imports</td>
<td>-0.6</td>
<td>5.4</td>
<td>-3.0</td>
<td>1.0</td>
<td>3.3</td>
<td>0.4</td>
<td>1.4</td>
<td>2.4</td>
<td>3.0</td>
<td>3.6</td>
<td>3.4</td>
</tr>
<tr>
<td><strong>GDP</strong></td>
<td>1.8</td>
<td>1.2</td>
<td>0.4</td>
<td>1.4</td>
<td>0.8</td>
<td>0.3</td>
<td>1.2</td>
<td>1.4</td>
<td>1.7</td>
<td>2.0</td>
<td>2.1</td>
</tr>
<tr>
<td><strong>Consumer price inflation</strong></td>
<td>6.1</td>
<td>4.6</td>
<td>6.3</td>
<td>5.3</td>
<td>4.6</td>
<td>4.1</td>
<td>4.7</td>
<td>4.6</td>
<td>4.5</td>
<td>4.4</td>
<td>4.3</td>
</tr>
<tr>
<td><strong>Current account balance (% of GDP)</strong></td>
<td>-5.1</td>
<td>-4.6</td>
<td>-2.9</td>
<td>-2.5</td>
<td>-3.5</td>
<td>-3.7</td>
<td>-3.8</td>
<td>-3.3</td>
<td>-3.2</td>
<td>-3.2</td>
<td>-3.4</td>
</tr>
<tr>
<td><strong>GFCF as % of GDP</strong></td>
<td>20.4</td>
<td>20.3</td>
<td>19.4</td>
<td>18.8</td>
<td>18.2</td>
<td>18.0</td>
<td>17.4</td>
<td>17.5</td>
<td>17.6</td>
<td>17.8</td>
<td>18.0</td>
</tr>
</tbody>
</table>

Sources: SA Reserve Bank for historical data, IDC forecasts

Although South Africa’s economic growth performance is expected to improve gradually over the outlook period, the downside risks are significant:

- On the domestic front, persistently low confidence levels among businesses and consumers, policy uncertainty and structural impediments (especially electricity supply constraints), a deteriorating fiscal situation and the possibility of a downgrade by Moody’s of South Africa’s sovereign rating (foreign currency) to sub-investment, among other factors, could stifle the economy’s fragile performance and prospects.
• Globally, economic and geopolitical risks could weaken the expansion momentum of the world economy, including key external markets for South African exports and sources of foreign direct investment. Moreover, heightened concerns over the spread of the coronavirus and its impact on global value chains, China’s economy and several others, add to the risks facing the South African economy.

Department of Research and Information

14 February 2020