SOUTH AFRICA

Economic growth is projected to rebound in 2017 and strengthen further in 2018, driven by household consumption and investment. In particular, the improvement in electricity production removes bottlenecks and should boost confidence and therefore investment, provided that political uncertainties dissipate. Rising production costs, together with the earlier rand appreciation should weigh on exports.

The macroeconomic situation is still difficult as growth is weak and inflation is above the central bank's target. Falling inflation will create scope to ease monetary policy; however, scope for easing may be limited in the short term as the persistent drought is driving up food prices. Lifting barriers to competition and favouring the development of SMEs could boost productivity, employment and living standards. Unless growth accelerates, however, unemployment and inequality will remain very high.

Fiscal policy is under pressure from the risk of a ratings downgrade. Due to the continued increase of government debt and higher borrowing rates in the context of persistent low growth, South Africa has no fiscal space. The government needs to stick to its consolidation path and improve the effectiveness of spending and investments.

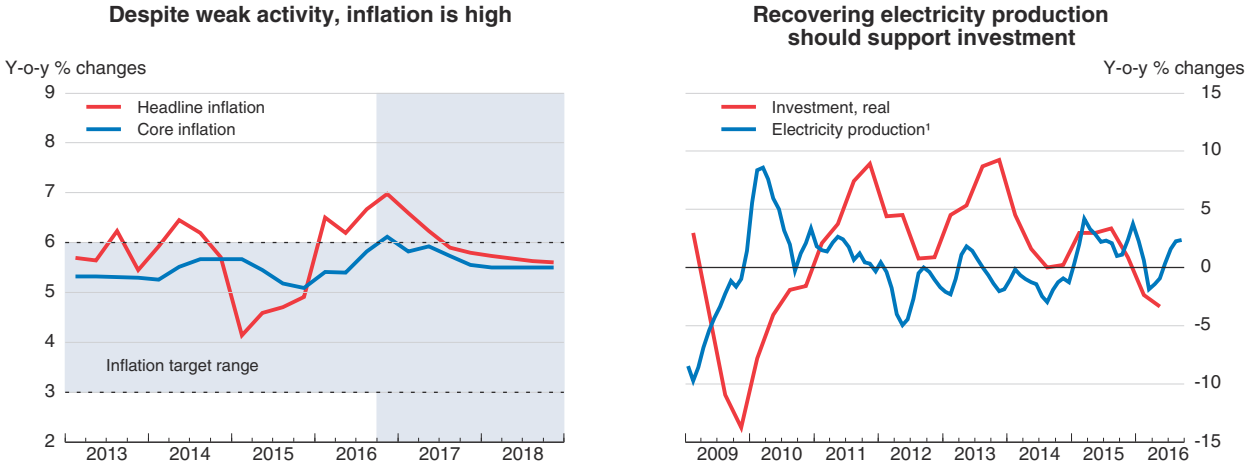
Growth is low

Falling investment and persistent drought are driving down growth. Political uncertainties have reduced confidence further. Private investment has recorded negative or zero growth for six consecutive quarters. However, in the second quarter of 2016, exports bounced back thanks to lagged effects of the rand depreciation and are lifting growth for 2016. At 27%, the unemployment rate is weighing on household consumption and driving up inequalities.

Increasing the efficiency of public spending to boost growth

Inflation will peak by the end of 2016 before declining slowly in 2017. Ongoing food price inflation, and its knock-on effects on manufactured food prices, is pushing up

South Africa



1. Three-month moving average.

Source: Statistics South Africa; and OECD Economic Outlook 100 database.

StatLink http://dx.doi.org/10.1787/888933437925

South Africa: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices ZAR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	3 539.0	1.6	1.3	0.4	1.1	1.7
Private consumption	2 144.2	0.7	1.7	0.7	1.6	1.7
Government consumption	732.5	1.8	0.2	0.8	0.5	0.3
Gross fixed capital formation	719.8	1.5	2.5	-3.3	2.6	2.7
Final domestic demand	3 596.5	1.1	1.6	-0.1	1.6	1.6
Stockbuilding[1]	27.2	-0.6	0.1	-1.0	-0.2	0.0
Total domestic demand	3 623.7	0.5	1.7	-1.1	1.3	1.6
Exports of goods and services	1 093.1	3.3	4.1	2.5	3.5	4.7
Imports of goods and services	1 177.8	-0.5	5.3	-2.4	4.3	4.4
Net exports[1]	- 84.7	1.1	-0.4	1.5	-0.2	0.1
Memorandum items						
GDP deflator	_	5.5	5.0	6.7	5.7	5.3
Consumer price index	_	6.1	4.6	6.6	6.1	5.7
Private consumption deflator	_	5.8	4.1	6.0	5.7	5.6
General government financial balance[2]	_	-4.1	-3.9	-3.7	-3.4	-3.2
Current account balance[2]	_	-5.3	-4.3	-4.0	-4.2	-4.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of GDP.
Source: OECD Economic Outlook 100 database.

StatLink http://dx.doi.org/10.1787/888933439297

inflation, despite lower than expected increases in administered prices. As inflation falls to be within the target band, it will open room for easing monetary policy while remaining vigilant on the evolution of food and oil prices. The dissipation of political uncertainties will play a key role in bringing back confidence and therefore strengthening investment and consumption.

Since 2015, the government has demonstrated its commitment to curbing spending. A strict consolidation plan is being implemented to limit the deficit and stabilise public debt. Higher-than-expected government revenues in the first half of the year and continued restrictions on spending are improving fiscal outcomes for 2016 and 2017. Fiscal policy is projected to remain restrictive in 2017-2018 to maintain credibility and reduce costs of borrowing. There is still room to increase the efficiency of spending and strengthen investment in infrastructure. Furthermore, more funds could be raised by allowing private sector participation in those state-owned enterprises which are servicing markets with a sufficient degree of competition or effective oversight by a regulator.

The high level of unemployment calls for bold structural reforms to boost the economy and job creation. Different areas of the economy are still subject to high barriers of entry or limited competition. Increasing market competition in network industries and lowering restrictions and licensing costs in service sectors could create entrepreneurial opportunities and therefore employment. Developing entrepreneurship through better training, vocational education and access to finance is key to reduce the high structural unemployment level.

Political uncertainty is the main risk

Confidence will be the key factor to restart growth. Improvements in confidence are projected to drive up investment and consumption. However, growth is projected to pick up only modestly. Improvements in electricity capacity are also expected to push up investment a little. Moreover, the recent positive trend in commodity prices and rand developments should raise exports. However, further delays on land reform and a new mining charter would weigh on confidence.

The main short-term risk is a sovereign downgrade by rating agencies. In a benign scenario, a downgrade would lead to a short-term spike in interest rates and a further weakening of the rand. In a more worrisome scenario, it could trigger a sharp reversal of capital flows and precipitate a recession. The main external risks are related to Brexit and unexpected increases in US interest rates that could have adverse effects on capital flows and the volatility of the rand. On the other hand, a normal rainy season would raise agricultural output and push down food prices. Also, if political developments stop affecting the rand, it should appreciate which would contribute to lower inflation.