SOUTH AFRICA

Economic growth is projected to continue to be weak in 2017 before picking up moderately in 2018, as private consumption and exports rise on the back of a recovery in commodity prices and growth in export markets. Unemployment and inequality will remain high, reflecting large skill gaps and low education quality. Inflation has been above target, due to the rand depreciation and rising food prices, but is easing.

Monetary policy has been slightly accommodative since March 2016, which is appropriate as inflation peaks were driven by temporary shocks, such as a severe drought. Continued depreciation of the rand due to ratings downgrades could have second-round impacts on inflation. The Reserve Bank may need to communicate clearly its readiness to act to ensure that inflation expectations remain anchored. A moderate fiscal consolidation to stabilise debt levels should be pursued, while social transfers should be preserved to reduce inequality and poverty. Bold structural reforms are needed to boost growth, especially more competition in network and services sectors, and to improve the education system.

Greater regional integration can boost growth by broadening access to markets and resources. South African firms can benefit from deeper integration, given their better financial resources and advanced technologies, if trade and non-trade barriers are further removed. Globalisation and financial openness have helped deepen financial markets, but have also implied high volatility of the rand and the stock market. This can be contained by further developing prudential rules for financial institutions. Workers in exporting sectors, like mining or banking, have benefited from globalisation with high wages, tending to raise inequality. The government is introducing a national minimum wage which will reduce wage inequality and poverty.

Persistent low growth

Growth in 2016 marks the lowest rate in the past 16 years, apart from the 2009 recession. Political uncertainty remains high, weighing on business and consumer

Source: OECD Economic Outlook 101 database.

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confidence. Investment will remain low in 2017. Persistent high unemployment and a high level of indebtedness will keep household consumption low. On the government side, expenditure growth will remain moderate as rising debt is still calling for consolidation. Exports will support demand, as commodity prices are picking up and growth is firming in South Africa’s main foreign markets.

The current account deficit has fallen, for the undesirable reason that slow growth of domestic incomes has reduced imports, but also for the good reason that the terms of trade have benefitted from rand appreciation in 2016 and the pick-up of international commodity prices. The current account deficit is financed by portfolio investment flows, creating high exposure to a reversal of capital flows. In 2016, South Africa experienced a high level of equity outflows partially covered by bond inflows, reflecting investor’s portfolio arbitrage and political uncertainty.

**The policy environment has deteriorated**

Political uncertainty has led to credit ratings downgrades, weighing on monetary and fiscal policies. Monetary policy is operating in a difficult environment of high inflation and low growth. The long-lasting drought, rising oil prices and the delayed exchange rate pass-through have maintained inflation high in 2016. Any further rand depreciation might keep inflation high.

Fiscal consolidation has to continue to limit the growth of debt. The main risks to debt sustainability stem from the consequences of the ratings downgrade and rising contingent liabilities in state-owned enterprises. The downgrade may trigger spikes in interest rates
with persistent effects on growth and debt. The exposure of the public sector to state-owned entities has been increasing in recent years. Pursuing consolidation in a credible way will help limit increases in sovereign premiums. The structure of government spending is skewed by a large wage bill and household transfers (accounting together for 50% of government spending in 2016). This limits space for the public investment needed to meet physical and social infrastructure requirements and unlock growth. Further efforts could be made to limit annual wage increases in the government sector and increase the effectiveness of government spending.

The proposed national minimum wage will potentially affect 6 million workers, which is almost half (47%) of all wage earners. It should substantially reduce poverty amongst low-skilled workers.

**Growth remains dependent on political uncertainty**

Another moderate increase in GDP is projected in 2017 as investment will remain subdued and household consumption growth stays moderate. A growth pick-up in 2018 will come mainly from exports supported by higher commodity prices.

The level of confidence in the economy is fragile given the unstable political environment. A rise in political tensions could further restrain private investment. The rand also remains highly responsive to US interest rates, and hence exposed to their increases. In addition, as the United Kingdom is South Africa’s largest European trading partner, uncertainty about the impact of Brexit may affect imports and financial flows. Finally, the outlook could be better if international commodity prices keep on increasing or growth accelerates in the main trading partners, such as the United States and China. Also, the agriculture sector is growing again and could through price effects boost domestic demand. Indeed, the current crop estimates are large and the harvest seems to be good. If food prices come down significantly, it would ease the pressure on households and increase their purchasing power.