Summary

A strong macroeconomic policy framework has helped to improve growth performance over the past two decades, but the 2008-09 downturn highlighted the limitations of the domestic-demand-led growth path which has characterised South Africa in recent years. Unemployment, which had remained very high, if declining, throughout the boom years, turned up again in the recession. There is now a need both to ensure a rapid recovery from the downturn and to boost trend growth and thereby create the millions of jobs required to make full use of South Africa's large supply of underutilised human resources.

The global downturn struck South Africa when it had already passed the boom, and the economy slowed sharply, experiencing its first recession in 17 years. *The decline in output was moderated by a countercyclical policy response, made possible by past fiscal prudence, and by the resilience of the banking system, which did not experience a crisis. Growth has resumed and is projected to accelerate, but macroeconomic policy stimulus should be removed only gradually, as a self-sustaining recovery, led by the private sector, takes hold.*

Evidence suggests several ways to improve South Africa's trend growth performance. *Notably, all economies experiencing successful rapid economic development in recent decades have had much higher savings and investment rates and stronger export growth than South Africa, and policy action to increase saving and strengthen export performance are therefore warranted. South Africa should do more to resist waves of real appreciation of the rand associated with surges in private capital inflows, which are largely driven by investor sentiment towards emerging markets in general, and commodity plays in particular. Tighter and more countercyclical fiscal policy, verbal and foreign exchange intervention, and liberalisation of capital outflows all have a role to play. Another key to better trend growth is reform of the regulatory environment. South Africa has low levels of competition and relatively restrictive product market regulation, which hampers more broad based innovation. OECD research suggests that lowering barriers to entrepreneurship could substantially boost South Africa's long-term growth rate.*

The macroeconomic framework is strong, but can be improved. *South Africa has a good track record of fiscal prudence, but, as in other countries, fiscal discipline was eroded in the cyclical upswing. South Africa would therefore benefit from stronger fiscal institutions to prevent unwarranted fiscal expansion when the economy is strong. The monetary policy framework is sound, but could be refined to bolster the credibility of the inflation targets and to exploit scope for limiting exchange rate fluctuations, to the extent this is compatible with achieving the primary goal of keeping inflation within the target range.*

Labour market reforms should complement improved macroeconomic policies to deliver higher employment. *A greater level of co-ordination of wage bargaining focusing on wage and price moderation as the ultimate goal, with the government providing a voice for labour market outsiders, could deliver greater wage moderation and increase the credibility of the inflation target. Limiting the legal extension of sectoral bargains would also foster wage moderation and lead to stronger job creation, particularly among smaller and medium sized firms. Other important measures to raise employment over the long term include improved basic education, reduced spatial mismatches between jobseekers and jobs, and better access to credit for small enterprises. Within an overall employment strategy, measures should be targeted at tackling youth unemployment. These could include job search assistance, training-based wage subsidies, age-differentiated minimum wages and extended probationary periods for young workers.*