# 2

# Economic outlook

## In brief

- The economic growth estimate for 2016 has been revised down to 0.5 per cent from 0.9 per cent.
- The National Treasury forecasts a moderate recovery over the next three years, with GDP growth reaching 2.2 per cent in 2019 as supply-side constraints become less binding, the global economy recovers, and business and consumer confidence rebound.
- The inflation forecast has been revised down to 6.4 per cent for 2016. Inflation is expected to remain close to 6 per cent annually over the medium term, with upward pressure from electricity prices.
- Household consumption expenditure growth is projected to reach 2.3 per cent in 2019.
- Investment by general government is expected to average 4.8 per cent growth over the medium term, with investment by public corporations reaching 2.3 per cent growth in 2019.
- Government has budgeted R987.4 billion for infrastructure over the next three years, with large investments continuing in energy, transport and telecommunications.
- Fiscal and monetary policy support a sustainable recovery in economic activity. Rapid progress on National Development Plan reforms can bolster confidence and promote investment.

## Economic growth and transformation

*Low growth threatens to block South Africa's economic transformation*

To achieve the goal of economic transformation and build an equitable society, South Africa requires higher growth. Without decisive action, a protracted period of low growth will set back the country's ability to realise the constitutional vision to "improve the quality of life of all citizens and free the potential of each person". The National Development Plan (NDP) recognises that faster, broad-based growth is needed to transform the economy, create jobs, and reduce poverty and inequality.

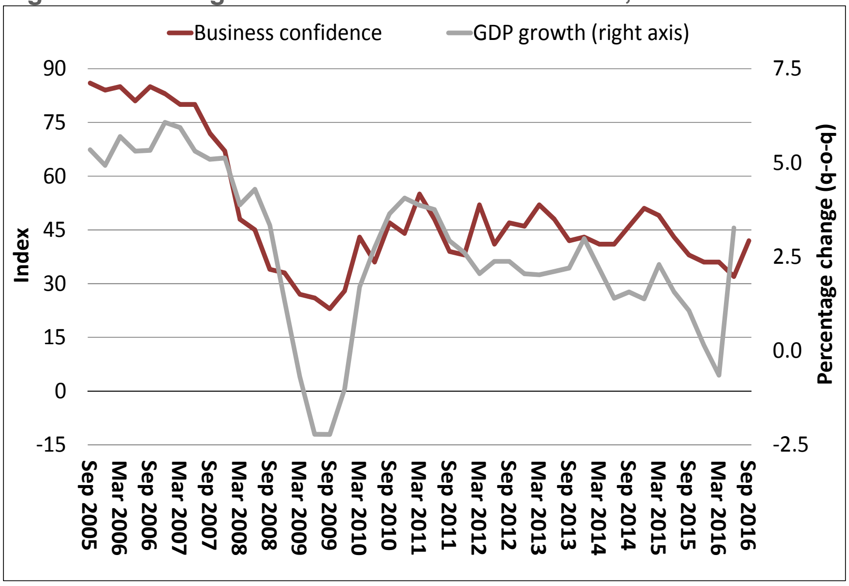
While global economic weakness plays a large role in South Africa's economic growth performance, domestic constraints stand in the way of investment, output and trade. The slow pace of finalising policy interventions in areas such as land reform, immigration, labour relations, mining and communications undermines confidence, which is a key determinant of economic activity. Government must demonstrate more rapid implementation to restore confidence and give hope to citizens.

*Fiscal framework and monetary policy stance support sustainable recovery in economy*

South Africa's strong institutions, stable macroeconomic environment, well-developed financial markets, relatively high levels of innovation capacity and strategic position in the region provide a solid platform for stronger growth. The fiscal framework and the monetary policy stance support a sustainable recovery in economic activity.

Government continues to prioritise infrastructure investment to ease bottlenecks and raise the economy's potential growth rate. Public-sector infrastructure budgets total R987.4 billion over the next three years. Continued investment in energy, transport and telecommunications will boost internal and external trade efficiency. Efforts to expand co-investment with the private sector, alongside a series of other NDP reforms discussed later in this chapter, will build confidence and encourage job creation.

**Figure 2.1 GDP growth and business confidence, 2005 – 2016**




*Source: RMB BER Business Confidence Index, Stats SA*

## Global outlook

*World economy forecast to grow by 3.4 per cent in 2017*

The global recovery from the 2008 financial crisis remains precarious, with growth forecast at 3.1 per cent in 2016 and 3.4 per cent in 2017. In developed economies, the combination of weak economic growth, low or negative interest rates, and elevated asset prices has increased the likelihood of renewed financial volatility. World trade growth forecasts for 2016 have been reduced from 3.1 per cent in April to 2.3 per cent in October. Global debt has risen to US$152 trillion – more than double the size of the world economy. About two-thirds of this amount is private-sector debt, and public-sector borrowings have also increased sharply.

*Risks to global outlook include excessive debt, weaker growth in China and political uncertainty*

Risks to the global outlook include excessive debt levels, further deterioration in Chinese growth rates, continued declines in commodity prices and political uncertainty in several major economies. Over the short term, the United Kingdom's intention to leave the European Union (EU) will remain a source of financial volatility, alongside concerns about the health of major European banks. Brexit's long-term effects, including on South Africa, depend on timing and the nature of trade and investment treaties to be negotiated with the EU.

The outlook for developing economies is mixed. GDP growth is projected to remain resilient in India and in China. A return to moderate economic growth is expected in Brazil and Russia in 2017, following two consecutive years of economic contraction.

**Table 2.1 Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2015 – 2017**

| Region / country | GDP growth[1] | | | | Average CPI[1] | | | |
|---|---|---|---|---|---|---|---|---|
| Percentage | Average 2010 – 2014 | 2015 | 2016 | 2017 | Average 2010 – 2014 | 2015 | 2016 | 2017 |
| **World** | **4.0** | **3.2** | **3.1** | **3.4** | **3.9** | **2.8** | **2.9** | **3.3** |
| **Advanced economies** | **1.8** | **2.1** | **1.6** | **1.8** | **1.8** | **0.3** | **0.8** | **1.7** |
| US | 2.1 | 2.6 | 1.6 | 2.2 | 2.0 | 0.1 | 1.2 | 2.3 |
| Euro area | 0.7 | 2.0 | 1.7 | 1.5 | 1.7 | 0.0 | 0.3 | 1.1 |
| UK | 1.9 | 2.2 | 1.8 | 1.1 | 2.9 | 0.1 | 0.7 | 2.5 |
| Japan | 1.5 | 0.5 | 0.5 | 0.6 | 0.4 | 0.8 | -0.2 | 0.5 |
| **Emerging markets and developing countries** | **5.7** | **4.0** | **4.2** | **4.6** | **5.7** | **4.7** | **4.5** | **4.4** |
| Brazil | 3.3 | -3.8 | -3.3 | 0.5 | 5.9 | 9.0 | 9.0 | 5.4 |
| Russia | 2.8 | -3.7 | -0.8 | 1.1 | 7.0 | 15.5 | 7.2 | 5.0 |
| India | 7.3 | 7.6 | 7.6 | 7.6 | 8.9 | 4.9 | 5.5 | 5.2 |
| China | 8.6 | 6.9 | 6.6 | 6.2 | 3.2 | 1.4 | 2.1 | 2.3 |
| **Sub-Saharan Africa** | **5.3** | **3.4** | **1.4** | **2.9** | **7.9** | **7.0** | **11.3** | **10.8** |
| South Africa[2] | 2.5 | 1.3 | 0.5 | 1.3 | 5.3 | 4.6 | 6.4 | 6.1 |

*1. IMF World Economic Outlook, October 2016*

*2. National Treasury forecasts*

Low interest rates prevailing in the United States, Europe and Japan have supported continued capital inflows into developing economies. This stimulus, however, has not translated into higher profitability of non-financial firms, more investment, stronger economic activity or more positive expectations about GDP growth. Productivity growth has slowed across advanced and emerging economies. Countries that are highly reliant on foreign savings, such as South Africa, will remain vulnerable to global financial volatility and rapid capital outflows.

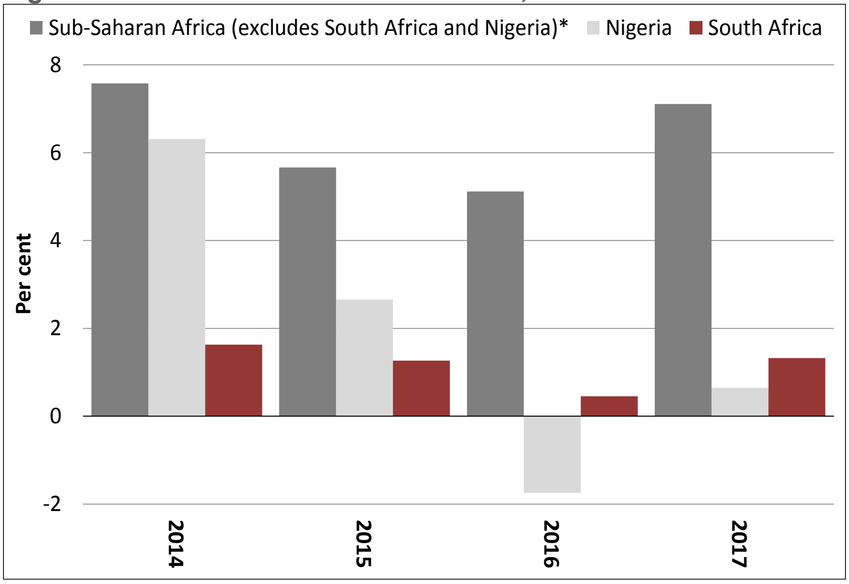
The outlook for sub-Saharan Africa is marked by low commodity prices and falling export revenues, which have led to foreign-currency shortages.

*Growth forecast for sub-Saharan Africa revised down, with large economies affected by low oil prices*

The 2016 growth forecast for the region has been revised down from 3 per cent in April to 1.4 per cent, with large economies such as Nigeria and Angola hard hit by low oil prices and disruptions in production. In contrast, Ethiopia, Kenya and Senegal are expected to record growth rates of over 5 per cent.

Slower growth in the region and global trade weakness limit South Africa's export potential. Greater economic integration with the rest of the continent would enable export-orientated South African firms to capitalise on stronger pockets of growth and increase their share of African trade.

**Figure 2.2 Growth in sub-Saharan Africa, 2014 – 2017**




**Valued at PPP-adjusted rates*

*Source: IMF World Economic Outlook, October 2016, National Treasury forecast*

The National Treasury's economic forecast incorporates the outlook for 15 major trading partners as presented in the October 2016 *World Economic Outlook*, published by the International Monetary Fund (IMF). Average growth of 4.1 per cent is forecast for these economies in 2017.

## Domestic outlook and developments

*Stable electricity supply and recovery in confidence will support improved GDP growth*

Domestic GDP growth for 2016, forecast at 0.9 per cent at the time of the 2016 Budget, has been revised down to 0.5 per cent. Growth is expected to increase to 2.2 per cent by 2019, supported by more reliable electricity supply, improved labour relations, low inflation, a recovery in business and consumer confidence, stabilising commodity prices and stronger global growth. Assumptions underpinning the forecast appear in the technical annexure.

Growth in real output remained moderate in the first six months of the year compared with the same period in 2015. Mining growth has declined and agricultural output weakened as a result of the drought. Growth in transport and telecommunications, and in electricity, gas and water, fell on weak demand. Manufacturing output strengthened following a contraction in 2015. Finance, real estate and business services remained buoyant.

### Overview of major economic sectors and employment

*Two successive seasons of severe drought have resulted in a sharp fall in agricultural output*

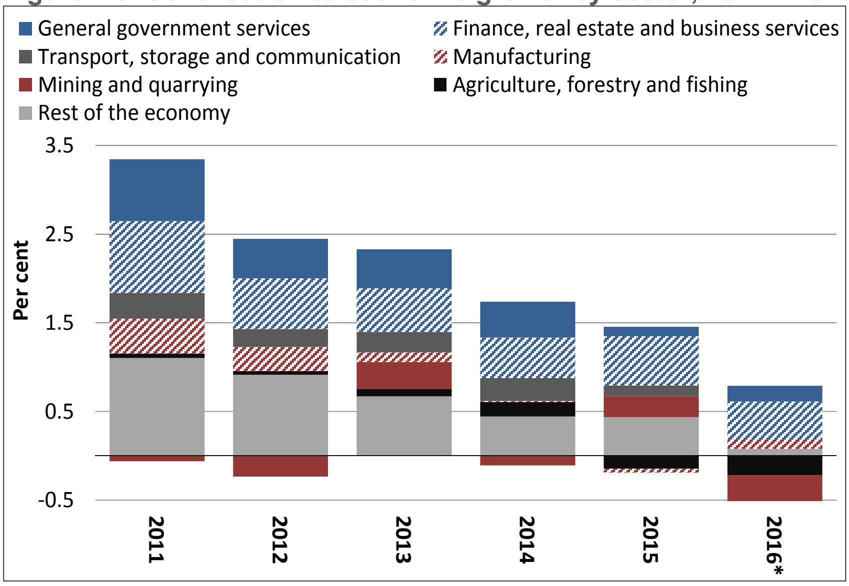
Real value added in the agriculture, forestry and fishing sector contracted by 8.3 per cent in the first half of 2016 compared with the same period in 2015. Two successive seasons of severe drought in the summer rainfall regions resulted in six consecutive quarters of falling output, following robust growth in 2014. As a result, South Africa will be a net importer of maize in 2016/17, with imports expected to exceed 2 million tons. Exports of certain fruit, nuts and beef products have remained resilient, supported by the weaker rand, global demand and market diversification. Output is expected to recover as weather conditions improve.

Mining production was down 8.3 per cent in the first half of 2016 compared with the same period in 2015. High operating costs, safety stoppages, low commodity prices and weak global demand made for a difficult operating environment. Over the medium term, improved demand and increased electricity supply should boost production. In addition, a moderate rise in commodity prices that began in 2016 is expected to continue.

*Commodity prices expected to rise moderately over medium term*

Manufacturing has contributed 0.2 per cent to gross value added in the first half of 2016, with performance varying across subsectors. Petrochemicals, wood and paper, and food and beverages posted growth rates of 6.5, 5.3 and 0.9 per cent, respectively. In contrast, metals products and motor vehicles contracted by 3.6 per cent and 0.5 per cent respectively. Overall capacity utilisation improved in the first half of 2016.

**Figure 2.3 Contribution to economic growth by sector, 2011 – 2016**




**2016 figures reflect the first six months of the year*

*Source: Stats SA and National Treasury*

A moderate recovery in household consumption growth from 2017 should support domestic demand in food and beverages, motor vehicles, furniture and appliances. Continued global demand is expected for motor vehicles, with exports of finished units set to grow by over 10 per cent this year and next.

The financial sector grew by 2.2 per cent during the first half of 2016 compared with the same period in 2015, despite low GDP growth and constrained household balance sheets. Domestic banks remain well capitalised, with a total capital adequacy ratio of 15.2 per cent in June 2016, up from 14.2 per cent in December 2015. "Tier 1" capital adequacy – the highest quality capital reserves – stood at 12.4 per cent in June 2016, well in excess of Basel III's 6 per cent requirement.

*South African banks remain well capitalised and exceed Basel III requirements*

In the 12 months to June 2016, employment fell by 112 000. In the context of an unfavourable economic and investment climate, the unemployment rate rose from 25 per cent to 26.6 per cent. According to the June 2016 Quarterly Employment Statistics, all sectors apart from construction shed jobs in the second quarter of 2016. A return to employment growth requires higher economic growth and renewed private-sector investment.

### Household consumption

*Household spending growth slowed and net wealth as share of disposable income declined*

Growth in household spending decelerated to 0.8 per cent in the first half of the year, from 1.7 per cent in the same period in 2015. Growth in real household disposable income, which reached 2.2 per cent in 2015, slowed to an annualised 0.7 per cent in the first half of the year. Household net wealth fell to 386 per cent of disposable income in the second quarter of 2016, compared with 391 per cent a year earlier. In the first seven months of 2016, the Johannesburg Stock Exchange All Share Index was 1.7 per cent lower than the corresponding period in 2015, reducing household wealth.

**Table 2.2 Macroeconomic projections, 2013 – 2019**

| Calendar year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|
| | | Actual | | Estimate | | Forecast | |
| *Percentage change unless otherwise indicated* | | | | | | | |
| Final household consumption | 2.0 | 0.7 | 1.7 | 0.6 | 1.3 | 1.9 | 2.3 |
| Final government consumption | 3.8 | 1.8 | 0.2 | 0.7 | 0.1 | 0.0 | 0.3 |
| Gross fixed capital formation | 7.0 | 1.5 | 2.5 | -2.9 | 1.1 | 2.6 | 3.1 |
| Exports | 3.6 | 3.3 | 4.1 | 0.5 | 3.0 | 4.7 | 5.2 |
| Imports | 5.0 | -0.5 | 5.3 | -2.9 | 2.7 | 4.1 | 4.7 |
| Real GDP growth | 2.3 | 1.6 | 1.3 | 0.5 | 1.3 | 2.0 | 2.2 |
| GDP inflation | 6.6 | 5.7 | 4.0 | 6.6 | 6.0 | 5.8 | 5.7 |
| **GDP at current prices (R billion)** | **3 549.2** | **3 812.6** | **4 013.6** | **4 300.0** | **4 616.9** | **4 981.1** | **5 385.3** |
| CPI inflation (Dec 2012 = 100) | 5.8 | 6.1 | 4.6 | 6.4 | 6.1 | 5.9 | 5.8 |
| Current account balance (% of GDP) | -5.9 | -5.3 | -4.3 | -3.9 | -3.9 | -3.8 | -3.8 |

*Source: Reserve Bank and National Treasury*

Consumer confidence remains low and higher inflation has reduced household purchasing power. Spending on durable goods has declined since the first quarter of 2015. Credit extended to households remains subdued, as higher interest rates and tighter lending conditions discourage borrowing. In the second quarter of 2016, applications for credit fell by 18 per cent, while the rejection rate remained relatively high, at 54.4 per cent. The ratio of household debt to disposable income has eased to 75.1 per cent of total disposable income from 77 per cent a year before, but higher interest rates have raised pressure on discretionary spending.

Household consumption expenditure is projected to rise by 0.6 per cent in 2016, gradually rising to 2.3 per cent in 2019, supported by lower inflation, wage growth and improved household balance sheets.

### Fixed investment

*Investment by public corporations fell by 2.6 per cent in first half of 2016*

Capital investment declined by 2.6 per cent in the first half of 2016, compared with a 3.6 per cent increase in the corresponding period of 2015. The contraction resulted from reduced private investment in a climate of weak business confidence. Investment by public corporations fell by 2.6 per cent in the first half of 2016, from an average growth rate of 3.7 per cent between 2012 and 2015. Over the same period, government investment growth averaged 8.6 per cent, but slowed to 5.8 per cent in the first half of 2016. The slowdown reflects general delays, declining revenue growth and deteriorating balance sheets at some state-owned enterprises.

The pattern of reduced investment is widespread. In the first half of 2016, capital formation in manufacturing contracted by 10.3 per cent, while in transport services, investment fell by 6.3 per cent. Investment continued to grow in electricity and social services as a result of capital outlays on renewable energy and public infrastructure.

*Investment required to reverse a consistent erosion of manufacturing base*

Energy and infrastructure investment provide a platform for higher growth. To increase output, however, the economy requires investment in other productive assets. Spending on machinery and equipment has declined sharply. If investment is insufficient to replace worn assets, the resulting capital erosion can weaken the economy's growth potential, with negative consequences for job creation. There has been a consistent decline in manufacturing fixed-capital stock, which fell by 11.3 per cent between 2008 and 2015, signalling an erosion of the manufacturing asset base.

*Investment is expected to contract in 2016, returning to growth next year*

Several indicators – a more competitive exchange rate, increased manufacturing capacity utilisation, strong corporate balance sheets and generally low borrowing costs – point to higher investment over the medium term. Although investment is expected to contract in 2016, it should grow in 2017. Investment by general government is expected to average 4.8 per cent growth over the next three years. Investment by public corporations is expected to reach 2.3 per cent growth in 2019.

### South Africa's competitiveness ranking improves

South Africa's position in the Global Competitiveness Index improved by six spots to 47 out of 138 in the past three years. The country is the second-most competitive in sub-Saharan Africa, after Mauritius (45th). South Africa maintains its regional leadership in financial markets, technological readiness, innovation and business sophistication, supporting competitiveness. South Africa's rankings for ease of access to loans, enhanced local competition and better use of talent in terms of how pay reflects productivity have improved significantly.

There were notable declines in several institutional categories, including public trust in politicians (down 11 spots to 109), favouritism in decisions of government officials (down 10 to 115) and reliability of police services (down 13 to 115). In addition, South Africa scores poorly in labour-employer relations (138), hiring and firing practices (135) and flexibility in wage determination (135).

## Net exports and the current account

*Exports grew, supported by performance of platinum group metals, but exports to Africa are down*

Exports grew by 3 per cent in the second quarter of 2016 compared with the same period in 2015, supported by manufacturing and mining exports, particularly platinum group metals. The first half of the year saw a two-percentage-point decline in the share of exports to African markets compared with the same period in 2015, reflecting weaker economic conditions in the region.

**Table 2.3 Distribution of South African exports by country/region**

| | 2005 | 2010 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Sub-Saharan Africa[1] | 13.2% | 24.9% | 27.8% | 29.3% | 28.0% |
| European Union | 33.3% | 20.5% | 17.7% | 19.5% | 20.7% |
| China | 2.7% | 9.0% | 12.9% | 9.8% | 9.2% |
| Japan | 10.3% | 7.0% | 5.7% | 5.4% | 5.0% |
| United States of America | 9.5% | 7.9% | 7.2% | 7.0% | 7.6% |
| Other | 31.0% | 30.8% | 28.7% | 29.0% | 29.5% |

*1. Sub-Saharan Africa includes East Africa, West Africa, Middle Africa, SACU, and SADC excluding Sudan*

*Source: Quantec data*

In recent years, despite the large and sustained depreciation in the value of the rand, South Africa has not experienced strong export growth. Since

2010, the real effective exchange rate has depreciated by 20.9 per cent. Yet the main factor in export growth is global demand, which has been moderate. A one-percentage-point increase in global demand could add as much as 0.3 percentage points to medium-term growth.

*Soft domestic demand reflected in decreased import volumes*

Soft domestic demand was reflected in the decreased volume of imports, which fell by 3.1 per cent in the first half of the year compared with the same period in 2015. Notable exceptions included vegetable products, oils and fats, where increases of between 43 and 60 per cent reflected the effects of the drought. Over the medium term, improved domestic demand should support import growth, but the weaker currency will limit the expansion of volumes. Imports are expected to contract in the current year and grow by 2.7 per cent in 2017.

*Narrowing current account deficit expected to average 3.9 per cent over medium term*

The current account deficit narrowed in the second quarter as net exports increased and the trade account recorded a surplus, despite some weakening of the terms of trade. The deficit was funded through an increase in net portfolio investment, mainly into government bonds, and a rise in net foreign direct investment. Over the next three years, the current account deficit is expected to average 3.9 per cent, down from an average of 5.2 per cent between 2013 and 2015. The forecast does not project any major gains in the terms of trade.

### Inflation

*Higher petrol and food prices pushed inflation out of target band*

Consumer price index (CPI) inflation breached the upper limit of the 3 to 6 per cent target band in the first half of 2016, mainly as a result of higher petrol and food prices. Core inflation remained relatively flat and within the target band. In response to higher inflation and rising inflation expectations, the Reserve Bank has raised the rate at which it lends to commercial banks by 0.75 percentage points since January 1.

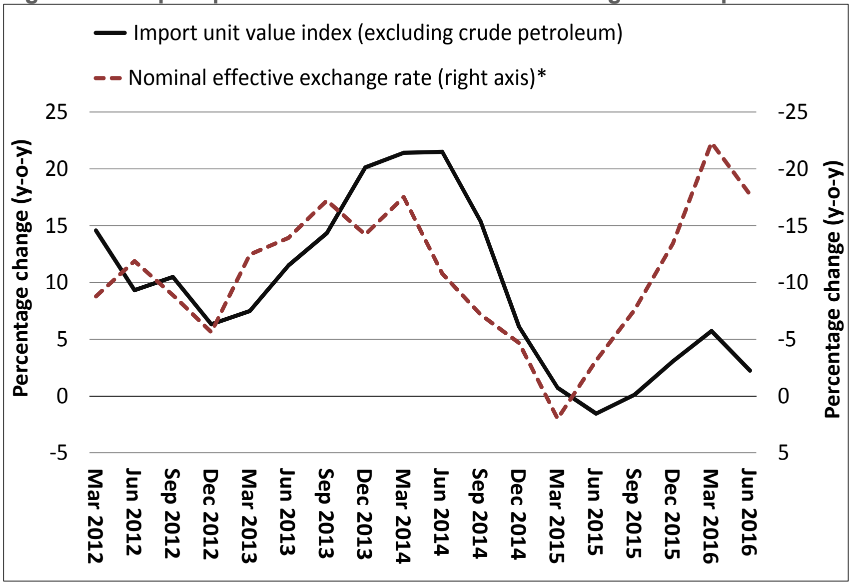
The inflation forecast has been revised down to 6.4 per cent for 2016 due to lower-than-expected electricity and import-price inflation. A further decline to 6.1 per cent is expected in 2017. Inflation is expected to stay within the target band in 2018 and 2019. Electricity price increases are forecast to average 9.1 per cent per year over the period, with food inflation stabilising at 5.4 per cent in the outer years. Rising unit labour costs, higher import-price inflation and inflation expectations are upside risks to the forecast.

*Inflation expectations hover near high end of target band, affecting wage demands and bond yields*

According to a Bureau for Economic Research survey, inflation expectations have consistently hovered around the high end of the target band over the past five years, feeding into wage demands and price increases. The Andrew Levy wage settlement survey for the first half of 2016 shows an average wage increase of 7.7 per cent, marginally lower than 7.8 per cent in the first half of 2015.

Figure 2.4 shows that import-price inflation has been significantly lower than the nominal effective exchange rate depreciation. Importers have not increased prices as much as the depreciation in the exchange rate, reducing price pressures in South Africa.

**Figure 2.4 Import-price inflation and nominal exchange rate depreciation**




**Positive values show appreciation and negative values show depreciation*

*Source: Reserve Bank, Stats SA*

## Reforms advancing economic transformation

South Africa's potential growth rate – the fastest the economy can sustain without increasing inflation – has fallen from about 4 per cent to below 2 per cent since 2012. The main obstacles to economic activity are found within the domestic economy. They include infrastructure bottlenecks, low levels of competition in certain markets, a volatile labour relations environment, regulatory constraints and red tape, inefficiencies in state-owned enterprises, and uncertainties in the policy environment. By limiting the economy's potential to grow more rapidly, these constraints effectively block economic transformation.

*South Africa's potential growth rate has fallen from about 4 per cent to below 2 per cent*

Government's economic reform programme is guided by the NDP and, over the short term, the 9-point plan announced in February 2015. These efforts aim to create a more just society and ensure that the benefits of transformation are shared as broadly as possible. The success of these efforts in boosting economic growth and employment depends on how well interventions are coordinated and put into action.

A key policy focus over the medium term is to promote urban planning reforms, supported by public and private investment, to encourage more rapid growth and innovation in South Africa's large cities.

### Improving the policy environment

Policy uncertainty in any economy undermines confidence, with consequences for investment and job creation. Accordingly, government is taking steps to strengthen policy certainty in several key areas.

*Steps to strengthen policy certainty in mining, immigration and communications*

In the **mining sector**, the Mineral and Petroleum Resources Development Amendment Bill, which was returned to Parliament due to procedural and substantive concerns, has been amended by the parliamentary portfolio committee. Concerns related to a lack of legislative consultation are being addressed. The Chamber of Mines and the Department of Mineral

Resources are negotiating an out-of-court settlement on the "once empowered, always empowered" principle in the Mining Charter. The impact on the mining sector will depend on how and when these issues are resolved, removing uncertainty from the investment equation. Under the auspices of the Presidential Business Working Group, a single application system for all licenses, including environmental authorisations for mining, is under consideration.

*Accelerating immigration reform would reduce the cost of doing business*

**Immigration reforms** to speed visa processing and boost tourism are under consideration. These include a long-term multiple entry visa that would be available to frequent travellers, business people and academics, and visas on arrival for some categories of travellers. Since January, 10-year multiple-entry business visas have been available to visitors from Brazil, Russia, India and China. Accelerating immigration reform would reduce the cost of doing business.

The August 2016 Cabinet lekgotla resolved to improve **coordination of broadband spectrum allocation policy** and rationalise state-owned companies in this area. The information and communications technology white paper is out for public comment. Combined public and private investment to upgrade telecommunications infrastructure is expected to total R26 billion in 2016. Rapid resolution of the dispute between the Independent Communications Authority of South Africa and the Ministry of Telecommunications and Postal Services on the auctioning of high-speed broadband spectrum will improve certainty in the sector.

Socioeconomic impact assessment reports have begun to **reduce legislative and regulatory duplication**, and improve policy design. Earlier this year, for example, the departments of Agriculture, Forestry and Fisheries, and Environmental Affairs proposed two overlapping bills dealing with marine affairs. The assessment process helped to ensure their combination into the Marine Spatial Planning Bill.

**Structural reforms in Mexico and India**

Both India and Mexico are implementing structural reforms to promote economic growth and development. The reforms are designed to remove supply bottlenecks, promote higher investment, make it easier to do business and improve access to finance.

Partly as a result of its reforms, Mexico is experiencing rising investment in natural gas, electricity, and telecommunications. Financial reforms have strengthened consumer protection, improved the collection of credit information, and allowed more competition in the banking sector. The IMF estimates that these reforms will support growth of 2.9 per cent over the medium term, up from 2.1 per cent in 2016.

In India, economic growth has risen from 6.6 per cent in 2013 to 7.6 per cent in 2015. The government has targeted reforms in mining, to allow competitive bidding for mining leases; in electricity, to permit debt restructuring among state electricity distribution companies; and in agriculture, amending crop insurance to benefit farmers. Reforms also facilitate more flexible labour and product markets, promote foreign investment and enhance financial inclusion. The IMF projects strong growth in India over the medium term.

### Investing in network infrastructure

Since 2009, the public sector has invested more than R1.6 trillion in infrastructure. This has alleviated pressure on network industries and expanded capacity. In line with the NDP, investment in infrastructure remains a policy priority. Public-sector infrastructure investment plans total R987.4 billion over the medium term, of which R334 billion is in transport and logistics, and R137 billion in water and sanitation. Investment in energy infrastructure totals R243 billion over the period.

Lack of adequate electricity supply has imposed severe costs on the economy. Government has worked to stabilise Eskom and increase the participation of independent power producers (IPPs), which was initially focused in renewable technologies. The IPP programme, which involves large investments by the private sector, will continue, and will expand to include private investment in coal and gas.

*IPP programme, which involves large investments by the private sector, will continue*

Further expansion of electricity generation capacity will be guided by the Integrated Resource Plan and the Integrated Energy Plan, which should be alert to the risk of over-investment. Idle electricity capacity will require higher electricity prices, with negative consequences for economic growth. In addition, integrated resource planning should take into account the falling cost of renewables and their possible use in generating baseload electricity, as discussed in the box below.

Eskom has scaled up its maintenance work. Energy availability improved from 70 per cent in October 2015 to 81 per cent in June 2016. The Medupi and Kusile plants are expected to be completed by May 2020 and September 2022 respectively. Three units of Ingula are already in commercial operation, and the fourth will come on line in the first half of 2017.

*Medupi and Kusile are expected to be fully completed by 2020 and 2022 respectively*

Over the past three years, Transnet has significantly increased its capacity through investment in new locomotives and rail infrastructure. Capacity has grown by 26.4 million tons in the general freight business, 9 million tons on the export coal line and 7.2 million tons on the export iron ore line. Transnet expects to invest a total of R30 billion in its new multi-product pipeline, which is expected to be completed in 2022/23. The pipeline will boost capacity by 3.5 billion litres per year.

### Renewable energy trends and the independent power producer programme

According to the *2016 Renewables Global Status Report*, investment in renewable generation has exceeded investment in new fossil fuel generation globally since 2014. The United Nations Environment Programme reports that developing countries accounted for 55 per cent of investment in renewable energy in 2015. Declining costs for renewable energy and the movement towards modular build options has made financing more readily available.

South Africa's independent power producer (IPP) programme has successfully introduced renewable power to the electricity grid. Of the 6 376MW of renewable power procured to date by the Department of Energy, 2 220MW has come on stream. IPPs have attracted R194 billion of investment and created just under 27 000 jobs. Since programme inception, the average price per kilowatt hour has declined by 67.4 per cent. According to the Department of Energy's IPP office, wind and solar photovoltaic generation is now cost competitive when compared with new-build options such as gas and coal.

The success of the IPP programme can be replicated in other sectors. Between 2019 and 2025, the Gas-to-Power Programme will procure 3 726MW of capacity, stimulating the gas industry and associated infrastructure development. Another 1 000MW will be added to the initial 800MW that was originally projected by industry co-generation. The Coal Baseload IPP Programme aims to procure 2 500MW of electricity from coal-fired power stations. The first bid winners, announced in October, will provide 863.3MW of capacity in the next five years.

Case studies in Australia, Denmark, Portugal and the UK have shown that it is possible for renewables to meet energy demand, including baseload power. Although wind and solar technologies generally provide power intermittently, this can be overcome by connecting geographically dispersed plants to the grid. Flexible technologies such as gas turbines can be used to fill in gaps. The Council for Scientific and Industrial Research has similar findings for South Africa.

*Development finance organisations investing in infrastructure and supporting black empowerment*

South Africa's large development finance organisations are also investing in infrastructure and economic development. The Development Bank of Southern Africa disbursed a record R17.1 billion during 2015/16, of which R8.1 billion went to municipalities. Over 250 000 households benefited from energy and water and sanitation projects. The Industrial Development Corporation approved loans of R4.9 billion and R2.9 billion for black-empowered companies and black industrialists respectively to support greater participation of black people in the economy.

### Encouraging private-sector investment

*Government working to promote greater private investment in a range of sectors*

Expanded investment by the private sector will improve productive capacity and grow the economy. Tackling corruption will discourage rent-seeking, lower transaction costs, reduce uncertainty, and prevent the wastage of both public and private resources. Initiatives that are under way include the following:

- **Easing the regulatory burden** and making it easier to invest. InvestSA has set up a one-stop shop to help investors with the procedures required to start up and run a business.
- **Reducing time spent on compliance and paperwork**. As a result of increased automation at the Companies and Intellectual Property Commission, it now takes less than a day to register a firm. Title deeds are now available within seven days at the Deeds Office. And the Department of Justice has streamlined contract enforcement, introducing court mediation to reduce legal costs.
- **Strengthening competition law**. Sections of the Competition Amendment Act that came into effect earlier this year make it a criminal offence for directors or managers of a firm to collude with their competitors to fix prices or collude in tenders. This should reduce prices and increase market access.
- **Enhancing the environment for small business**. The Department of Small Business Development is updating legislation to improve support for small businesses. Government has targeted support to small firms, and is encouraging large businesses to contract more work from small companies.

Government's approach has begun to yield greater private investment in several areas – notably in the successful IPP programme. In addition, automotive assembly firms have pledged investments of R15.4 billion, which would create an estimated 4 675 jobs. In June 2016, the Centre for High Performance Computing launched the first petascale computing system on the African continent. Construction of the 64-dish Meerkat radio telescope array in the Karoo is due to be completed by the end of 2017. And public and private investment totalling R17 billion has been targeted towards "oceans economy" initiatives over the past two years, creating about 5 000 jobs. Investments support shipbuilding and training of marine engineers and artisans.

*Support for commercial agriculture and developing farmers includes market diversification initiatives*

Complementary efforts support both commercial agriculture and emerging farmers. Efforts to diversify markets, for example, have boosted apple exports to China by 77 per cent. The recently signed Southern African Development Community – EU trade agreement improves access to European markets for sugar, ethanol and wine.

Despite a significant reduction in borrowing costs over the last 20 years, availability of funding remains an obstacle to business development. Government remains committed to working with the financial sector and development financial institutions to reduce funding constraints to business expansion and job creation.

**Improving the ease of doing business in large metros**

The Cities Support Programme is working with local governments in nine participating cities to develop action plans to improve their performance in the World Bank's 2018 *Doing Business in South Africa* survey. The country was ranked 73 out of 189 participating countries for 2016, down four places from the year before. The rankings for 2017 are to be published at the end of October 2016.

The work focuses on three business regulatory indicators – dealing with construction permits, getting electricity and registering property – for which cities have the greatest responsibility. Johannesburg, South Africa's representative in the global *Doing Business* survey, is receiving specific targeted support to improve its processes and ranking. City-level reforms complement national reforms being implemented by the Department of Trade and Industry in partnership with the National Treasury.

### Reviewing incentive programmes

Government provides a range of direct support to business. For example, the Clothing and Textiles Competitiveness Programme has helped to stabilise the sector. The Manufacturing Competitiveness Enhancement Programme has approved projects worth about R28 billion, supporting an estimated 200 000 jobs. The Automotive Production and Development Programme has contributed to increased exports.

Given increased pressures on the fiscus, these incentives, including direct transfers, tax and tariff rebates and concessional financing are being reviewed. The review is intended to assess performance, determine value for money, and analyse how the system as a whole supports the economy and job creation. The review is expected to be completed by October 2017.

### Building a platform for collective action

*Government, business, labour and civil society working to restore confidence*

To promote a faster-growing, more inclusive economy, government has strengthened its active collaboration with business, trade unions and civil society to restore confidence and reduce constraints to growth. The Presidential Business Working Group and the CEO Initiative are generating targeted support for the economy.

Initiatives include a R1.5 billion fund to support small firms with the ability to scale up and create jobs, and a private-sector programme to create 1 million internships over a three-year period, focused on improving the job-readiness of young work seekers. To complement these efforts, government will strengthen its agencies that support small business.

### Fostering better labour relations

*Employment tax incentive and learnership allowance to be extended*

Government continues talks with business and labour to reduce workplace conflict and protracted strikes. An independent panel has been established to support work on a national minimum wage. Government has proposed to extend the employment tax incentive and the learnership allowance, and will continue to monitor the impact of these incentives.

## Conclusion

The National Treasury forecasts a moderate recovery over the next three years, with GDP growth reaching 2.2 per cent in 2019 as supply-side constraints become less binding, the global economy recovers, and business and consumer confidence rebound. Decisive measures to speed implementation of NDP reforms and reduce policy uncertainty can support accelerated and broad-based economic growth.