SOUTH AFRICA

Table 1	2015
Population, million	54.8
GDP, current US$ billion	308.1
GDP per capita, current US$	5625
Poverty rate ($1.9/day 2011PPP terms)[a]	16.6
Poverty rate ($3.1/day 2011PPP terms)[a]	34.7
Gini Coefficient[a]	63.4
School enrollment, primary (% gross)[b]	97.6
Life Expectancy at birth, years[b]	56.1

Sources: World Bank WDI and Macro Poverty Outlook.
Notes:
(a) Most recent value (2010)
(b) Most recent WDI value (2014)

For South Africa, 2016 may mark the trough of the business cycle, and a recovery from 2017—although modest and fragile—is expected to improve the odds for reducing high levels of poverty, inequality, and unemployment. As fiscal space is exhausted, and with a possible bond-rating downgrade to 'junk' status looming, ambitious structural policies are vital to support the recovery. Policy uncertainty is arguably the biggest risk to turning the page on three years of falling per capita growth.

Recent developments

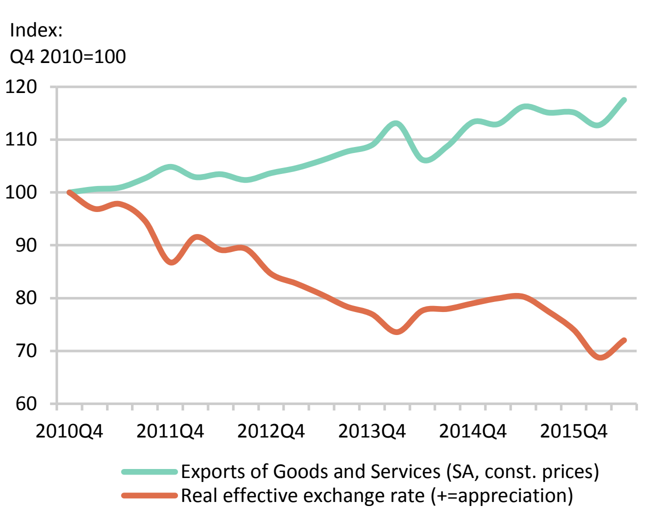
2016 may mark a turning point for South Africa's slowing economy. Following a contraction in the first quarter (Q1), a strong rebound in manufacturing, and sustained performance in commerce and finance prevented a technical recession in Q2. The decline in agricultural output is easing, as 2015 El-Niño drought-related effects begin to dissipate. And though mining has been contracting, momentum has improved in Q2. On the demand side, recovery in industry and mining was reflected in rising exports of 1.9 percent y/y in Q2, while imports contracted by 2.6 percent. Yet in spite of green shoots in the economy, growth in the first six months of 2016 remained at 0.3 percent, which points to a third year of falling GDP per capita growth, estimated to raise poverty by 0.25 percentage points compared to 2015.

Investment is declining for a third quarter, as the end of the commodity boom—but also policy uncertainty surrounding extractives-related legislation—discourages mining investment. Policy uncertainty extends into other structurally important areas, including the introduction of a national minimum wage, the auctioning of band-width spectrum to roll out broadband communications, expropriation legislation, and concern regarding opaque reshuffles of the cabinet, which all contribute to keeping investor confidence low. Better news emerges from the energy sector, where load-shedding has not occurred in a year. It is also good news that the government has strengthened dialogue with the private sector and has been carefully managing labor relations.

South Africa's foreign-currency denominated debt is rated one notch above 'junk' by S&P (with a negative outlook) as well as by Fitch. The 2016/17 budget introduced fiscal measures to stay the consolidation course. Slower upward revisions to tax brackets, an increased fuel levy, and higher tobacco and alcohol tax collections have supported revenues this fiscal year, while a new sugar 'sin tax'—currently hotly debated—is to be introduced in April 2017. In an environment of weak economic growth, demands to loosen fiscal policy are strong but the government's commitment to fiscal consolidation is credible. While some future revenue measures are yet to be identified, the budget deficit is expected to ease to 2.4 percent of GDP in FY2018/19 from 3.9 percent in FY2015/16, whereas the government expects net public debt to stabilize at 46.2 percent of GDP in 2017/18, two years earlier than previously anticipated.

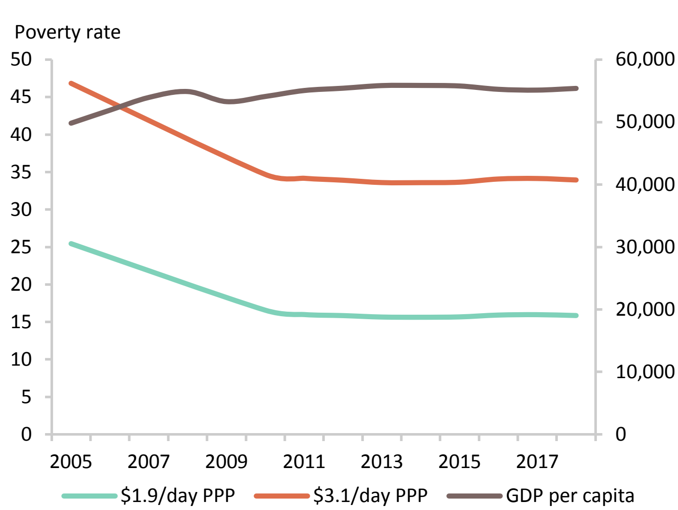
The rand has been depreciating, by a substantial 35 percent between December 2010 and January 2016. In spite of relatively rigid factor and product markets, this has resulted in some economic restructuring with exports, from vehicles to tourism, countering some of the weakening of domestic demand. Yet the rand strengthened once more over 2016, partly supported by a cumulative 75 basis-point rate increase by the South African Reserve Bank to limit exchange rate pass-through on prices, while aiming to bring inflation back below the 6 percent upper target.

FIGURE 1 South Africa / Exports of goods and services and real effective exchange rate



Sources: StatsSA, South African Reserve Bank, and World Bank staff calculations.

FIGURE 2 South Africa / Actual and projected poverty rates and GDP per capita (constant LCU)



Source: World Bank.

As exports outgrew imports, the trade deficit narrowed and swung into balance in the middle of the year. Yet other outflows through the current account, including FDI-related dividend payments, and weaker factor income from operations of South African companies continued to keep the current account deficit at 4.2 percent of GDP during the first half of 2016. The shortfall continues to be financed by volatile and unreliable capital flows.

While South Africa made progress in reducing poverty in the past decade, close to 36.9 percent of the population lived below the lower bound national poverty line of R501 per month in 2011. Extreme poverty, based on the international poverty line of $1.9 per day (PPP, 2011), was 16 percent in 2011. Given low economic growth, estimated progress in poverty reduction since 2011 is limited. South Africa's Gini coefficient of 0.634 is one the highest globally.

South Africa's high and rising unemployment remains the key challenge for poverty reduction, averaging 25.3 percent from 2000 to 2016. The unemployment rate remained near 25 percent in 2015, and increased to 26.6 percent in Q2-2016. Construction and manufacturing, both labor intensive, were hit by sluggish growth, with quarterly employment declines of 88,000 and 80,000, respectively. And the "wide" unemployment rate, which includes discouraged workers, increased to 36.3 percent, above the previous quarter's 33.8 percent.

Outlook

The recovery is expected to be slow. 2016 growth has been revised down to 0.4 percent (from 0.8 percent in the last MPO). This is consistent with heightened policy uncertainty dampening investor sentiment. Private consumption remains constrained by unemployment, high household indebtedness, and inflation. And belt -tightening by the government will provide little impetus to growth. Though the recent strengthening of the rand provides less of an impetus for exports, the significant depreciation compared to 2011 may continue to foster a restructuring of the economy. In addition, the recent stabilization of the rand has reduced imported inflationary pressures, which may serve to reduce the central bank's bias toward further tightening. This paves the way for a cautious economic rebound, to 1.1 percent in 2017 and 1.8 percent in 2018, as the economy restructures, commodity prices rise, and electricity capacity improves. Yet this will be insufficient to make a major dent in poverty and inequality: growth in consumption of the poorest 40 percent of South Africans is projected to be essentially flat, while there is some increase at the top of the income distribution.

Risks and challenges

Policy uncertainty is one of the greatest challenges for South Africa, as investment is urgently required to support the restructuring of the economy against a weaker rand, and to raise potential output growth. Municipal elections in which opposition parties captured major South African cities are seen as a testament to South Africa's strong institutions. Continued demonstration of their integrity will be crucial to bring investment. Given a tight fiscal position, structural reforms, hinging on political will, can be good value for money and should focus on the rollout of broad-band networks, improvements to the education system, strengthening the governance of State-Owned Enterprises and continued efforts to build bridges with organized labor. While the FY2016/17 budget kept fiscal consolidation on track, structural policies to foster growth are what will be needed to avert downgrade of South Africa's credit rating to sub-investment grade in the near term.

TABLE 2 South Africa / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
Real GDP growth, at constant market prices	2.3	1.6	1.3	0.4	1.1	1.8
Private Consumption	2.0	0.7	1.7	0.4	0.8	1.5
Government Consumption	-3.7	3.9	0.0	-0.2	0.8	1.1
Gross Fixed Capital Investment	13.8	0.1	2.3	-3.6	-1.9	1.0
Exports, Goods and Services	3.6	3.3	4.1	1.7	2.7	3.1
Imports, Goods and Services	5.0	-0.5	5.3	-1.8	-0.2	1.5
Real GDP growth, at constant factor prices	2.4	1.6	1.2	0.4	1.1	1.8
Agriculture	1.5	5.6	-8.4	0.0	1.0	3.1
Industry	1.8	-0.2	1.1	-0.3	0.4	1.2
Services	2.7	2.3	1.7	0.7	1.4	2.0
Inflation (Consumer Price Index)	5.4	6.4	4.6	6.3	6.0	5.8
Current Account Balance (% of GDP)	-5.9	-5.3	-4.3	-3.5	-3.3	-3.1
Fiscal Balance (% of GDP)	-3.8	-3.6	-3.9	-3.3	-3.0	-2.4
Debt (% of GDP)	43.9	46.9	50.4	50.9	51.2	50.7
Primary Balance (% of GDP)	-0.6	-0.5	-0.5	0.3	0.8	1.5
Poverty rate ($1.9/day PPP terms)[a,b,c]	15.7	15.6	15.7	15.9	16.0	15.9
Poverty rate ($3.1/day PPP terms)[a,b,c]	33.6	33.6	33.6	34.1	34.1	33.9

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: e = estimate, f = forecast.
(a) Calculations based on 2010-IES.
(b) Projection using neutral distribution (2010) with pass-through = 0.87 based on GDP per capita in constant LCU.
(c) Projections are from 2013 to 2018.