SOUTH AFRICA

Table 1	2016
Population, million	55.7
GDP, current US$ billion	289.4
GDP per capita, current US$	5195
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]	98.5
Life Expectancy at birth, years[b]	56.7

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

The South African economy remained stuck in low gear during 2016, with GDP growing just 0.3 percent. The outlook is particularly uncertain following the recent downgrade of sovereign debt to sub-investment grade by S&P and Fitch. In the baseline forecast, growth is weaker compared with the previously anticipated recovery of the economy, which renders the challenge of tackling high unemployment, and reducing poverty and inequality even more pressing. Accelerating the implementation of South Africa's National Development Plan while enhancing fiscal sustainability will be critical to reestablish a stronger path for growth.

Recent developments

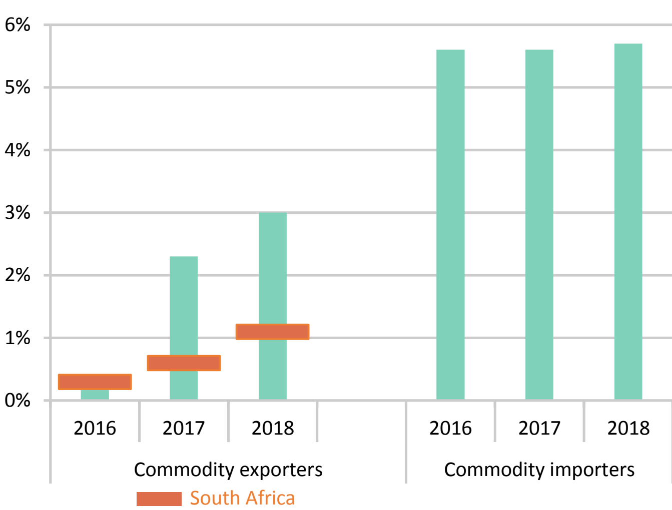
GDP growth registered just 0.3 percent in 2016, marking a fifth consecutive year of slowing momentum. Investment contracted by 3.9 percent, the main contributor to weak actual and potential growth, as structural constraints and policy uncertainties diminished investor confidence. South Africa is lagging its emerging market peers with weak FDI and portfolio inflows. Rising unemployment and falling real earnings contributed to weaken private consumption, easing from gains of 1.7 percent in 2015 to 0.8 percent in 2016. Government consumption, while limited by fiscal consolidation, improved from growth of 0.5 percent to 2.0 percent in 2016. And a sluggish global recovery adversely affected trade, as export and imports contracted for the first time since 2009, at -0.1 and -3.7 percent, respectively.

On the supply side, services continued to be the main driver for growth. Agricultural production showed signs of strengthening in the fourth quarter of 2016, the first year-on-year gain since the onset of the El-Nino drought in the first quarter of 2015. The industrial sectors also contracted in 2016, mainly due to a fall in mining output. Weaker output lowered demand for electricity. This combined with new capacity helped avert the chronic electricity shortages that have plagued the economy since 2007.

With a third consecutive year of falling GDP per capita, South Africa's 'triple challenge' of high unemployment, poverty and inequality remains stubborn. The number of unemployed workers increased by 11 percent in 2016, elevating the unemployment rate to 26.5 percent of the economically active population. Employment declines were reflected in mining, trade, community and social services as well as manufacturing. Youth (aged 15 to 34) remain vulnerable with an unemployment rate of 37.1 percent. Against this background, poverty rates measured at the international poverty lines of $1.9-and $3.1 a day are estimated at 16.0 and 34.1 percent respectively in 2016, up from 15.7 and 33.7 percent in 2015. The Gini coefficient is estimated to have remained unchanged at 63.4, making South Africa the most unequal country in the world. To tackle high levels of poverty and inequality the government announced a national minimum wage of ZAR20 per hour, to be phased in by May 2018. Inflation, especially escalation of food prices to double-digit gains, put pressure on the poor through 2016. A decelerating trend, as drought effects dissipate, promises relief for consumers, especially the poor. Although still above the South African Reserve Bank's target band (3-6 percent), the expected easing of inflation allowed the Monetary Policy Committee to keep interest rates unchanged during their latest meeting in March 2017, following hikes of a cumulative 75 basis points during 2016.

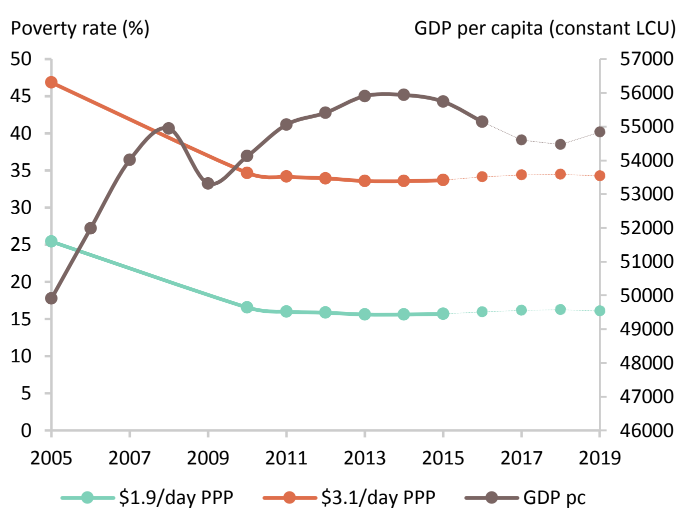
The 2017 Budget, tabled in February, announced new revenue measures in the face of projections for sluggish growth and declining tax buoyancy. These included tried and tested measures like fiscal drag (raising tax brackets by less than inflation), increasing the fuel levy, and sin taxes (alcohol and

FIGURE 1 South Africa / GDP growth forecasts: commodity exporters and importers



Sources: Global Economic Prospects and World Bank staff estimates.

FIGURE 2 South Africa / Actual and projected poverty rates and GDP per capita



Sources: World Bank (see notes to table 2).

tobacco, increases of 6 to 8 percent, with a 'sugar tax' likely to be implemented later in the year). The top personal income tax rate is to be raised from 41-to 45 percent; and the dividend withholding tax rate is to be increased from 15-to 20 percent.

On March 30, 2017, a cabinet reshuffle changed the political leadership at the National Treasury, which was interpreted by markets and rating agencies as undermining governance and the quality of institutions. Overnight, 10-year Treasury bond yields rose by 40 basis points and the rand lost 5 percent, as capital fled the country. Standard and Poor's downgraded South Africa on April 3, 2017 to sub-investment grade--and Fitch followed suit on April 7. It is yet to be seen how this will affect execution of the 2017 Budget. However, slower growth would require additional fiscal effort beyond the consolidation foreseen in the 2017 Budget, and this could jeopardize the government's, objective of stabilizing public debt-to-GDP over the next 3 years as laid out in its October 2017 Medium Term Policy Statement.

Outlook

Prospects for the economy are unusually uncertain given the recent nature of the ratings downgrades and lack of clarity concerning its long-term impact. While a more favorable external environment and better agricultural performance favor growth in 2017, higher borrowing costs and increased uncertainty will work to mute growth. In the baseline forecast GDP is projected to grow around 0.6 percent in 2017. Higher borrowing costs—and likely weaker consumer and business confidence—would weigh on both investment and private consumption, and effects from the markdown are likely to persist through the projection period. Growth for 2018 is now anticipated at 1.1 percent, with 2019 growth to register 2.0 percent. If realized, such an outturn would imply falling per capita incomes in 2017 and further raise poverty. Partly as a result, South Africa is expected to lag recovery in other commodity exporters, where growth should gain momentum from modestly rising commodity prices (figure 1). Overall, the slow growth is expected to stymie poverty reduction, with poverty rates projected to remain roughly constant between 2015 and 2019 (15.7 percent at $1.9/day PPP and 33.7 percent $3.1 day PPP by 2019, figure 2). Against this background, it will remain vital for the country to make progress on the implementation of the National Development Plan in order to achieve South Africa's Vision 2030: to eliminate poverty and reduce inequality. Safeguarding fiscal sustainability, and eventually regaining a solid credit position, will continue to be key.

Risks and challenges

Outturns could prove weaker or stronger than in the baseline forecast, depending on the longer-term impacts of the downgrade and policy reactions to it. Policy uncertainty and political instability remain arguably the largest risks to growth in South Africa, dampening both investor and consumer confidence. The depreciation of the rand will contribute to higher prices — including food prices —constituting bad news for the poor, for whom food is an important expenditure. Higher inflation is also likely to keep monetary policy tighter than had been anticipated. Continuing global challenges include policy uncertainty in advanced economies, potential trade frictions and the risk of financial market disruption.

To address the challenges of low growth and weak confidence the most pressing reforms include: (i) accelerated implementation of ongoing public and private infrastructure projects; (ii) investing in basic and tertiary education; (iii) promoting competition and SME growth, and (iv) increasing the flexibility and efficiency of factor markets.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	1.7	1.3	0.3	0.6	1.1	2.0
Private Consumption	0.7	1.7	0.8	1.0	0.8	2.0
Government Consumption	1.1	0.5	2.0	0.9	1.1	1.0
Gross Fixed Capital Investment	1.7	2.3	-3.9	-3.0	0.5	0.9
Exports, Goods and Services	3.2	3.9	-0.1	2.0	2.8	3.2
Imports, Goods and Services	-0.5	5.4	-3.7	0.8	1.8	2.0
Real GDP growth, at constant factor prices	1.8	1.3	0.4	0.6	1.1	2.0
Agriculture	6.9	-6.1	-7.8	1.8	2.1	2.4
Industry	0.1	1.1	-1.3	0.5	1.4	1.6
Services	2.3	1.6	1.3	0.5	0.9	2.1
Inflation (Consumer Price Index)	6.4	4.6	6.3	6.2	5.8	5.6
Current Account Balance (% of GDP)	-5.3	-4.4	-3.3	-3.3	-3.1	-2.9
Financial and Capital Account (% of GDP)	6.5	5.1	3.6	3.3	3.1	2.9
Net Foreign Direct Investment (% of GDP)	-0.5	-1.3	-0.4	-1.5	-0.5	-0.1
Fiscal Balance (% of GDP)	-3.6	-3.7	-3.5	-3.5	-3.2	-2.9
Debt (% of GDP)	46.6	49.5	50.5	53.3	54.4	54.5
Primary Balance (% of GDP)	-0.4	-0.4	0.0	0.4	0.9	1.1
Poverty rate ($1.9/day PPP terms)[a,b,c]	15.6	15.7	16.0	16.0	15.9	15.7
Poverty rate ($3.1/day PPP terms)[a,b,c]	33.6	33.7	34.1	34.2	34.1	33.7

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) Nowcast: 2014 - 2016. Forecast are from 2017 to 2019.