SOUTH AFRICA

The outlook for 2016 and 2017 is uncertain and economic activity will likely remain subdued. Expected increases in electricity supply from investments in generating capacity should raise supply only by 2017, easing constraints that have hindered production and increasing investor confidence. Also, strengthening growth in major trade partners, such as Europe and the United States, should reinforce export growth. Inflation is hovering around the upper end of the target band, driven by the depreciation of the rand and higher electricity and food prices.

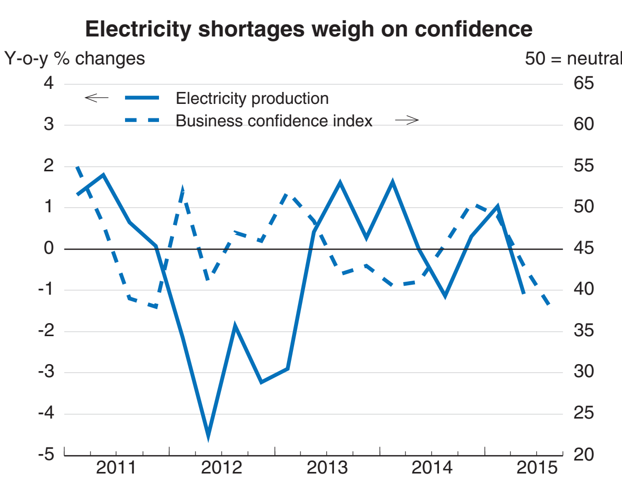
Fiscal policy has turned restrictive, constrained by a spending ceiling and the need to stabilise public debt. The combination of higher inflation and deteriorating economic activity is a dilemma for monetary policy, and any further tightening should be cautious. Structural reforms – including improving the business climate and removing bottlenecks, and liberalising energy and transport markets – are needed more than ever to boost output, jobs and living standards for the whole population, and hence to make growth more inclusive.

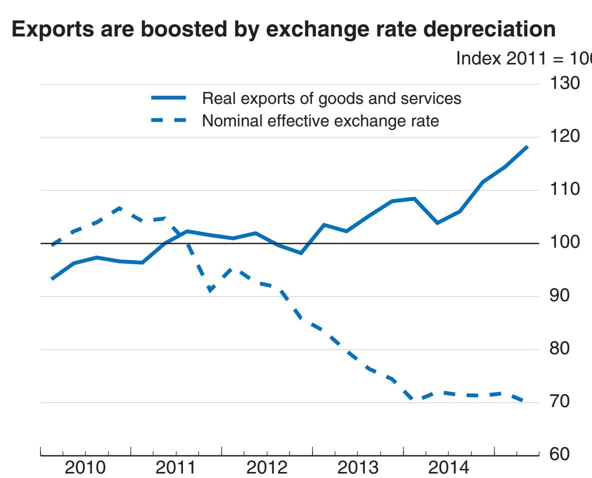
South Africa is heavily dependent on coal, and is a very energy and carbon-intensive economy. The government is committed to reducing greenhouse emissions by 42% relative to a no-change scenario by 2025. Renewable energy and the development of a nuclear power plant are part of the strategy toward a low-carbon economy. However, coal-fired power stations remain important. The planned carbon tax should be implemented and subsidies to fossil fuel consumption reduced. Incentives to increase energy efficiency should be strengthened further.

The economic outlook is uncertain

In 2015, continued electricity shortages hampered manufacturing and mining and a severe drought reduced agricultural production. The relief from new electricity generators has not yet materialised due to delays in construction and unplanned maintenance. On the

South Africa





Source: Economic Outlook 98 database; Statistics South Africa; and Bureau of Economic Research.

StatLink http://dx.doi.org/10.1787/888933296501

South Africa: **Demand, output and prices**

	2012	2013	2014	2015	2016	2017
	Current prices rand billion	Percentage changes, volume (2010 prices)				
GDP at market prices	3 262.5	2.2	1.5	1.5	1.5	2.0
Private consumption	1 974.6	2.9	1.4	1.5	1.3	2.0
Government consumption	650.9	3.3	1.9	0.2	1.1	1.6
Gross fixed capital formation	614.5	7.6	-0.4	1.2	2.2	3.4
Final domestic demand	3 240.0	3.9	1.1	1.2	1.4	2.2
Stockbuilding[1]	64.6	-2.4	-0.6	-1.1	0.0	0.0
Total domestic demand	3 304.5	1.4	0.6	0.2	1.4	2.2
Exports of goods and services	969.8	4.6	2.6	10.4	6.6	6.7
Imports of goods and services	1 011.8	1.8	-0.5	5.9	6.5	7.3
Net exports[1]	- 42.0	0.7	0.9	1.3	0.1	-0.1
Memorandum items						
GDP deflator	_	6.0	5.8	4.0	5.7	5.9
Consumer price index	_	5.8	6.1	4.9	6.3	6.2
Private consumption deflator	_	5.5	5.8	4.4	6.1	6.0
General government financial balance[2]	_	-3.3	-4.1	-4.3	-4.0	-3.8
Current account balance[2]	_	-5.8	-5.4	-4.2	-4.6	-5.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of GDP at market value.
Source: OECD Economic Outlook 98 database.

StatLink http://dx.doi.org/10.1787/888933297326

external side, demand from commodity-importing countries, such as China, and commodity prices declined. Nevertheless, exports have held up as the currency has depreciated sharply and mining exports have rebounded from strikes. The depreciation of the rand, electricity price increases and higher food prices following the drought have driven up inflation, notwithstanding the oil price decline. High inflation in the context of economic weakness poses a challenge to monetary policy. The Reserve Bank will need to exercise keen judgment to separate transitory effects boosting inflation from more fundamental factors, and carefully calibrate interest rate moves.

Implementing structural policy reforms is essential to lift up the potential of the economy

The potential for growth-enhancing structural policies is substantial. The government should accelerate the removal of barriers preventing the creation and development of SMEs, open and better regulate network industries, and encourage the entry and development of private providers in the electricity sector.

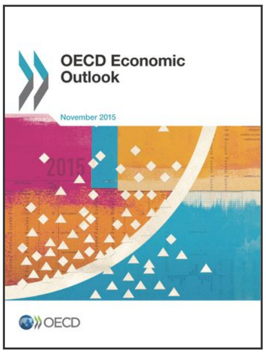
The poor labour market is a key economic weakness. The unemployment rate is chronically high, leading to large inequalities. Conflictual labour relations have depressed exports directly through strikes and indirectly by undermining investor confidence.

The government could improve the functioning of the labour market by establishing a public employment service as a one-stop shop for job seekers to lower the cost of job search and hiring costs for employers. It should also encourage the use of mediation and arbitration to make wage negotiations less confrontational. Removing entry barriers in product markets and network industries would significantly help to create more jobs.

Reviving confidence is key

Economic activity is projected to remain subdued in 2016, but then to pick up moderately in 2017. The main drivers should be a rebound in investment and household consumption provided that electricity problems are resolved and confidence returns. Inflation is expected to increase above the target band, pushed by pass-through of the exchange rate depreciation and higher electricity and food prices, but should eventually recede as these factors wear off.

New strikes in the mining sector or further delays in putting new electricity generating capacity into service would significantly cut growth. The currency is exposed to possible turbulence from the normalisation of US monetary policy, which could result in further depreciation and inflation, and possibly capital outflows. However, agreement on a new wage negotiation and industrial relations framework between business representatives and unions could create momentum for investment acceleration and growth. Moreover, higher wage growth than productivity gains, in particular in the public sector, poses a risk to inflation.



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