KPMG

Economic Snapshot H1, 2017

South Africa

Inflation overview – Headline inflation decreased from 6.3% y-o-y in February to 6.1% y-o-y in March. This marked the third consecutive monthly decline from a recent peak of 6.8% y-o-y recorded in December 2016. Furthermore, the average inflation reading of 6.3% during 2017Q1 was slightly below the South African Reserve Bank's (SARB) forecast of 6.4%.

Growth summary – The South African economy contracted by 0.3% q-o-q in 2016Q4, resulting in a real GDP growth rate of only 0.3% during the calendar year 2016 compared to 1.35% in 2015 and 1.7% in 2014. Worryingly, economic growth failed to keep pace with population growth last year. A local survey indicated slight growth in the local private sector activity during January, February and March this year

Economic policy – The National Development Plan (NDP) remains the main policy framework of the government. However, the State of the Nation Address (SONA) 2017 and Budget Speech 2017 both emphasised plans (no policy details have been released) for 'radical socio-economic transformation' in order to address the triple challenges of poverty, unemployment and inequality.

Trade & Investment SWOT

Strengths	Weaknesses
Clearly regulated market for incoming investors.	A reported lack of urgency on the part of some government officials to forward investment deals.
Good observance of contracts and intellectual property rights.	Potential political interference in the judiciary.
No bias against foreign companies.	Powerful unions complicate industrial relations.
Comparatively low taxes and a clearly defined taxation system.	Heavy regulation of labour market and racial quotas for employers deter investors.
Opportunities	**Threats**
Not many constraints on size or sector for foreign investor ownership.	Declining consumer confidence and limited credit growth could impact imports to a certain extent.
Inter-regional trade agreements facilitate trade flows and reduce costs.	High costs for resolving legal disputes.
Key trading partner for European and Asian countries.	Worsening corruption profile, particularly in political circles.
Tax breaks available for certain approved investments.	Land appropriation (though this can be insured against).

Source: Business Monitor International (BMI)

Mega trends

Population	2017	Total: 55.44 million; female: 28.14 million; male: 27.3 million; age 0-14: 28.78% of total; age 15 +: 71.22% of total; age 65+: 5.21% of total
Population growth rate	2015	1.65%
Life expectancy at birth	2014	Total: 57.18 years; female: 59.3 years; male: 55.17 years
HIV/AIDS	2015	Total number of people living with HIV: 7.00 million; total adult prevalence: 19.2%; HIV/AIDS orphans (age 0-17): 2.1 million
Adult literacy rate	2015	Total population: 94.6%; female: 93.43%; male: 55.17%
Urbanisation	2015	Urban population: 64.8% of total; annual urban population growth: 2.43%; rural population: 35.20% of total
Population below $1.90 per day poverty line	2011	4.90%
Unemployment rate	2017	Total: 26%; female: 28.5%; male: 24%; youth (15 - 24): 52.7%
Employment	2015	Agriculture: 4.6% of total ; industry: 23.5% of total ; services: 71.9% of total
Labour participation rate	2017	Total (ages 15+): 53.57% of total population
Business languages	n/a	English, Afrikaans, Xhosa, Zulu
Telephone & Internet users	2012	Fixed telephone subscriptions: 4.13 million; wired internet subscriptions: 3.57 million; cell phone subscriptions: 85.2 million (2015)

Sources: UNESCO Institute for Statistics, World Telecommunication/ICT indicator database, World Development Indicators, UNAIDS, International Labour Organisation

Human Development Index (HDI) 2015		Index of Economic Freedom 2016		Global Competitiveness Index (GCI) 2016		Doing Business 2017		Corruption Perceptions Index 2016	
119th	out of 188 countries	80th	out of 179 countries	47th	out of 148 countries	74th	out of 189 countries	64th	out of 177 countries

Source: Transparency International, Doing Business, World Economic Forum, UN Human Development Report, The Heritage Foundation

Sovereign Risk Ratings		
S&P Global Ratings	**Fitch Ratings**	**Moody's Investors Service**
BB+/Negative	BB+/Stable	Baa2/Negative Watch

S&P Global Ratings unexpectedly announced in April 2017 that it had downgraded its sovereign rating assessment of South Africa from investment-grade "BBB-" with a negative outlook to a non-investment-grade "BB+" also with a negative outlook. S&P commented in its downgrade report that the heightened political and institutional uncertainties in the country have led to the encompassing decision. The recent changes in executive leadership have put fiscal and growth outcomes at risk, said the agency, and internal government and party divisions could delay potential fiscal and structural reforms. Ongoing tensions and the potential for further event risk could negatively influence investor confidence and exchange rates, potentially driving increases in real interest rates. The negative outlook on the current rating reflects that political risks will remain elevated in 2017 and that policy shifts are likely, which could undermine fiscal and growth outcomes more than S&P currently projects. In the event of reduced political risks and strengthened economic growth and/or fiscal outcomes, S&P could revise the outlook to stable.

Fitch Ratings announced in April 2017 it had downgraded South Africa's rating from "BB+" (negative) to non-investment grade "BBB-" stable. The downgrade reflected recent political events in the country – in particular the Cabinet reshuffle – that was expected to weaken standards of governance and public finances. The agency believes the reshuffle will result "in a change in the direction of economic policy" and that the removal of Gordhan "is likely to undermine, if not reverse, progress in SOE governance". Furthermore, Fitch believes that under the new Cabinet, fiscal consolidation will be less of a priority given the president's focus on so-called radical socio-economic transformation. Its analysts raised concern that any renewed shortfall in fiscal revenues (for example as a result of lower-than-expected GDP growth) will likely be compensated by expenditure and revenue measures, placing upward pressure on general government debt.

Moody's Investors Services was scheduled to release a review of South Africa's sovereign rating on April 7th. However, some four days earlier, the agency announced that it had placed the country on review. This in effect means that Moody' is giving itself three months to decide on a revised rating for the country. The review will consider the risks associated with the March 30th Cabinet reshuffle and whether these changes signal a weakening in the country's institutional, economic and fiscal strength. According to a statement, Moody's believes that the reshuffle raises questions about progress on reforms previously identified as essential to sustain South Africa's fiscal and economic strength as well as the effectiveness of policymaking institutions. The organisation is also concerned about more immediate implications for economic growth and public debt.

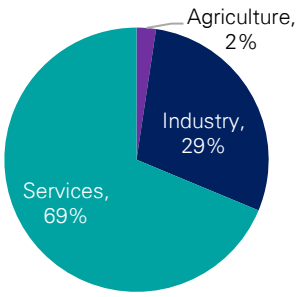
Quality of infrastructure	Economic diversity	Banking sector	Continuity of economic policy	GDP growth	Fiscal / current account balances	Foreign investment	Socio-economic development	Forex reserves
The best on the continent	Very diverse	Dominated by local banks	Lingering uncertainty	Very low	Twin deficits, although narrowing	Historically strong, recent weakness	Significant inequality	Healthy

Stock market	Listed companies	Liquidity	Market capitalisation	Largest sector	Weekly trading volume
Johannesburg Stock Exchange (JSE)	406 primary listings Source: JSE	Very high	$347 billion Source: African Alliance	Mining resources	$3.5 billion Source: African Alliance
Capital market	**Level of development**	**Liquidity**	**Maturity range**	**Municipal bonds**	**Corporate bonds**
Yes	Very advanced	Very high	91-day to 36-year	Yes	Yes

Macroeconomic overview

Economic structure - The small primary sector includes commercial farming, ocean fisheries and forestry. Farming is an import job creator in rural areas as well as a generator of foreign earnings – key exports include edible fruits and nuts. An extended drought and uncertainty over land tenure/property rights are current challenges faced by the agricultural industry. The secondary sector is made up of construction, manufacturing and mining. Factories produce goods both for the local and international market, with mining one of its key clients. Mineral extraction has been the bedrock of the South African economy for more than a century, though it is also an area of significant tension between the state, labour and private enterprise. The large tertiary sector comprises a well-developed banking sector, modern private healthcare industry, diverse tourism offerings, and an influential public administration. South Africa has the most diverse economy on the continent and is the third-largest economy in Africa after Nigeria and Egypt, based on US dollar calculations for GDP in 2016. .

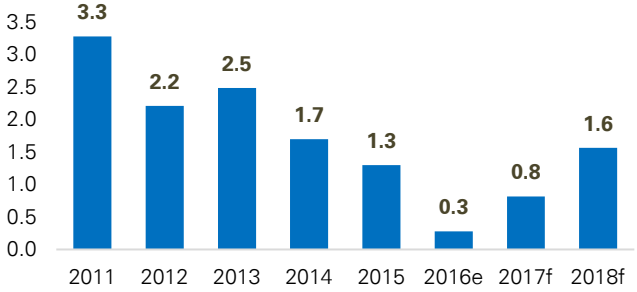
Economic structure as % of GDP 2015



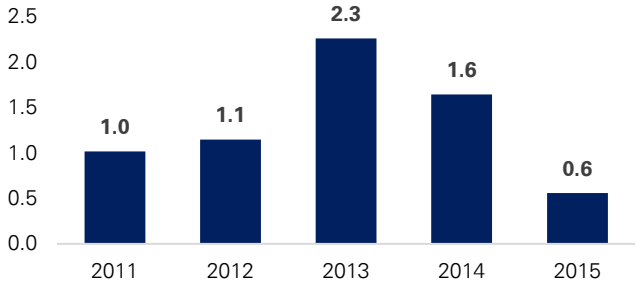
Source: World Bank: World Development Indicators

Economic growth - The South African economy contracted by 0.3% quarter-on-quarter (q-o-q) during the last quarter of 2016. This was notably weaker than a growth rate of 0.4% q-o-q seen in the preceding quarter. The negative reading is associated with a contraction in the contribution to real gross domestic product (GDP) by the mining (-0.9% q-o-q) and manufacturing (-0.4% q-o-q) sectors, as production in both industries declined. The 0.3% q-o-q contraction in real GDP resulted in the local economy being only 0.7% y-o-y larger in Q4 of 2016. The economy expanded by only 0.3% last year compared to 1.35% in 2015 and 1.7% in 2014. The latest GDP data includes revised estimates for growth during the first two quarters of 2016 which indicate that the q-o-q and y-o-y contractions in Q1 were larger than previously reported, while the bounce-back in Q2 was smaller than previously reported. As a result, economic growth failed to keep pace with population growth. Considering the first quarter of 2017, the Standard Bank South Africa Purchasing Managers' Index (PMI) – an indicator based on the surveyed views of purchasing executives in diverse private sector companies – indicated slight growth in the private sector during January, February and March this year. The International Monetary Fund (IMF) said in April expects economic growth to recover slightly in 2017 to 0.8%.

Real GDP growth (%)



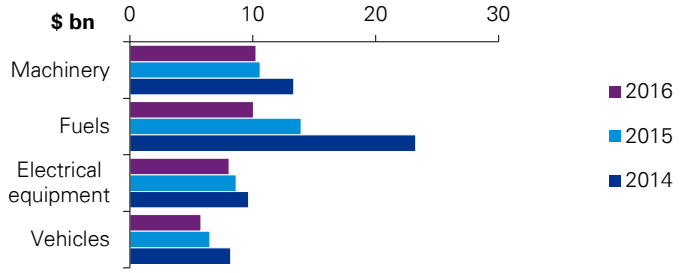
FDI inflows (% of GDP)



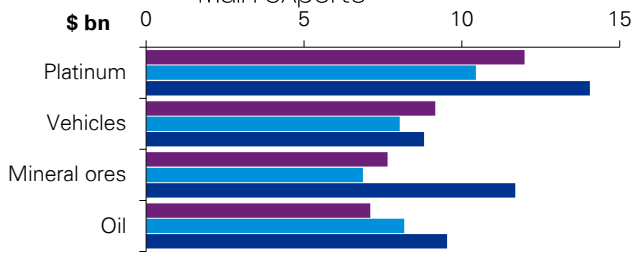
Sources: IMF, United Nations Conference on Trade and Development (UNCTAD)

Foreign investment – South Africa experienced a 38% rise in foreign direct investment (FDI) in 2016 to $2.3 billion despite a 13% decline in global FDI. Minister of Trade and Industry Rob Davies commented during April this year that the country's eight special economic zones (SEZs) were attracting billions of rands worth of investment commitments. The Musina-Makhado SEZ (in the Vhembe region of the Limpopo province) was designated as the first such area and, according to Davies, has received nearly R60 billion in investment commitments. (The zone is focussed on energy and metallurgy, agro-processing, petrochemicals, as well as trade and logistics.) However, local companies raised concern in the wake of the S&P downgrade on April 3rd that foreign investment – both portfolio and brick-and-mortar investment – into the country will suffer going forward. The accompanied deterioration in the exchange rate resulted in investors on the JSE switching their investments from banking, retail and property sectors into rand-hedge companies.

Main imports



Main exports

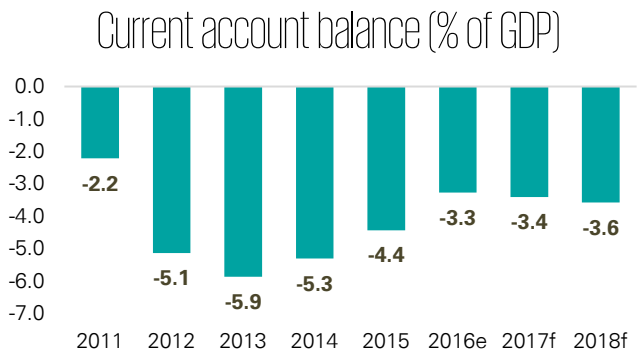


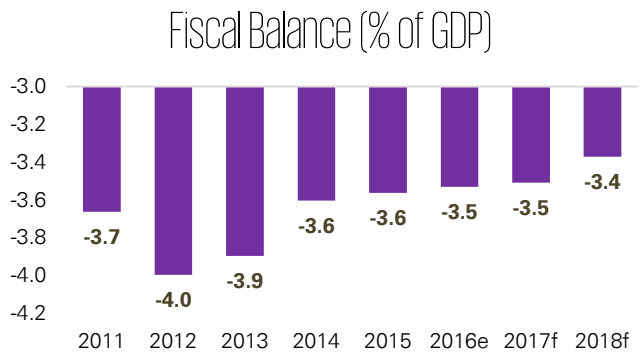
Main Imports: % share of total	2014	2015	2016
Machinery	13.3%	13.3%	13.7%
Fuels	23.3%	17.5%	13.4%
Electrical equipment	9.7%	10.9%	10.8%
Vehicles	8.2%	8.2%	7.7%

Main Exports: % share of total	2014	2015	2016
Platinum	15.5%	15.0%	16.2%
Vehicles	9.7%	11.5%	12.4%
Mineral ores	12.9%	9.9%	10.3%
Oil	10.5%	11.7%	9.6%

Source: Trade Map

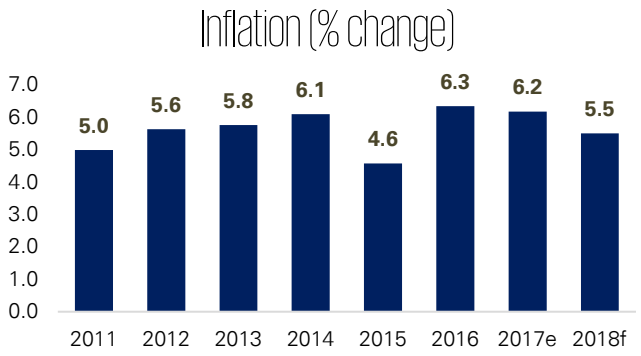
External trade – The current account deficit narrowed sharply from 3.8% of GDP in 2016Q3 to just 1.7% during the fourth quarter – the smallest shortfall in almost six years. The central bank attributed the significant change to a rebound in mining exports on the back of higher international commodity prices. The much improved current account situation supported the value of the local currency against major currencies during 2016Q4. The South African Revenue Service (SARS) reported a trade deficit of R6 billion during the first two months of 2017, registering a significant decline from a shortfall of R11.2 billion in the same period of 2016. Exports were almost 10% y-o-y higher in value at R87.8 billion while imports declined by nearly the same margin to R82.6 billion. Notably, the value of vehicles and transport equipment shipped abroad jumped by 80% y-o-y in January and February. The current account deficit is expected to narrow in 2017.





Source: International Monetary Fund (IMF)

Fiscal policy – Former Finance Minister Pravin Gordhan delivered his Budget Speech 2017 on February 22nd. Tax revenue is expected to rise by 10.5% during the 2017/18 financial year to R1.26 trillion. This includes some R28 billion in revenue raised by making adjustment to the tax system, including: 1) a new top personal income tax bracket of 45% for those with a taxable income above R1.5 million; 2) an increase in the dividend withholding tax from 15% to 20%; 3) limited bracket creep relief, resulting in the tax free threshold rising by only 1% to R75 750; 4) a 30c/litre rise in the general fuel levy and 9c/litre rise in the road accident fund levy; and 5) increases in the duties on alcohol and tobacco of between 6% and 10%. The fiscal budget allocates funding to national (47.5%), provincial (43.3%) and local (9.1%) government and redistributes money from high income areas (where most taxes are paid) to low-income communities. Rural municipalities, for example, receive allocations that are twice the value per households than metropolitan councils receive. Total expenditure of R1.56 trillion is planned for the 2017/18 fiscal year and R5.05 trillion over the next three years. The medium term spending framework has been revised due to lower-than-expected revenue collection. However, the state has reprioritised funds in order to safeguard spending on social services, education and healthcare. Medium-term planning also reflect a narrowing fiscal deficit, as forecast by the IMF.



Source: IMF

Monetary policy - Headline inflation decreased from 6.3% y-o-y in February to 6.1% y-o-y in March. This marked the third consecutive monthly decline from a recent peak of 6.8% y-o-y recorded in December 2016. Furthermore, the average inflation reading of 6.3% during 2017Q1 was slightly below the South African Reserve Bank's (SARB) forecast of 6.4%. The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) kept the repo rate on hold for the sixth consecutive time at a meeting during March. SARB Governor Lesetja Kganyago reiterated that the central bank may have reached an end in its interest rate hiking cycle. However, Governor Kganyago emphasised that before the MPC could reduce interest rates, a more sustained return of inflation to the target range of 3%-6% would be necessary.

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