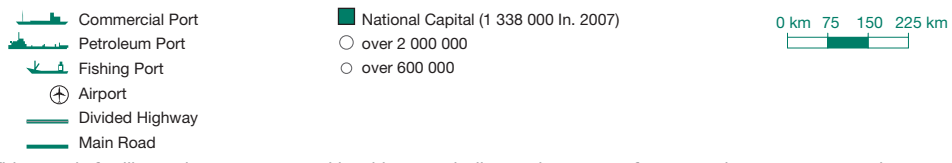
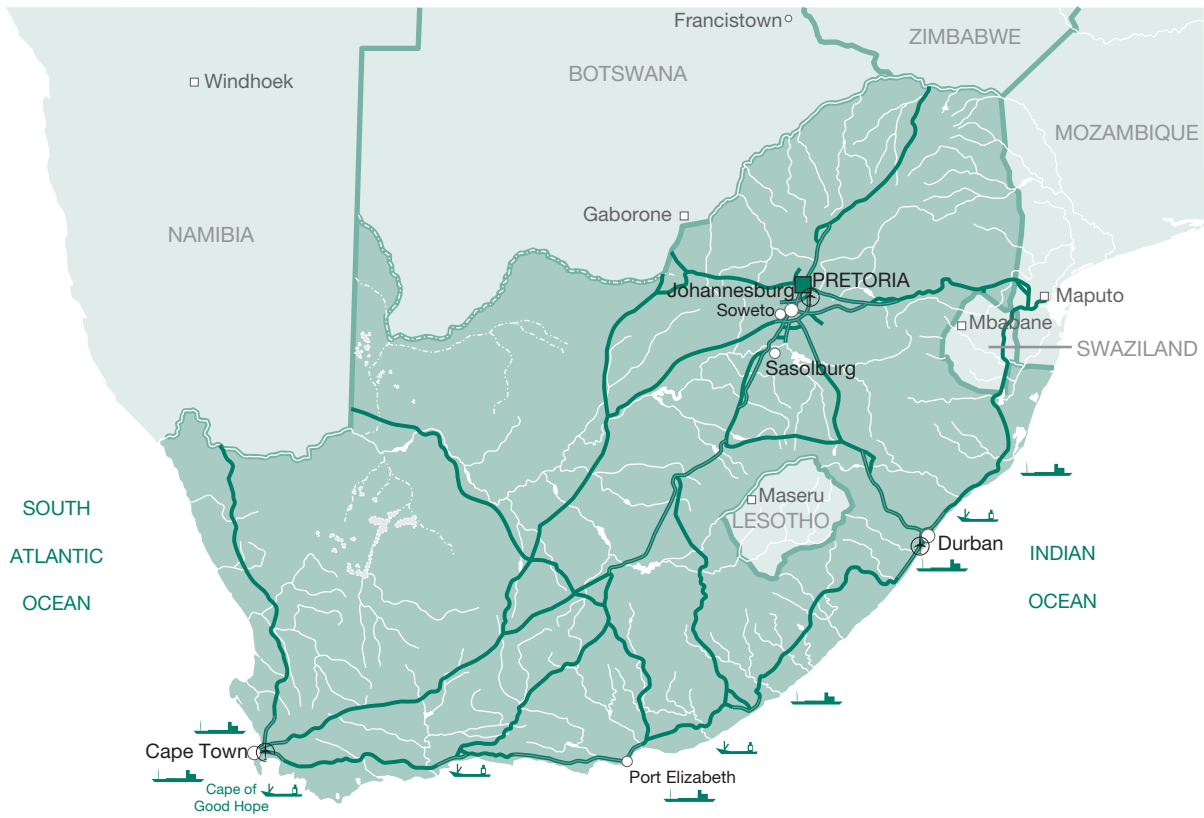


South Africa

2011



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South Africa

Overview

Real GDP has recovered from -1.7% in 2009 to 2.8% in 2010; this rate of GDP growth remained clearly below potential, estimated around 4% per annum for South Africa. GDP is expected to grow at a rate of 3.6% in 2011 and 4.3% in 2012. GDP growth for 2010 was driven primarily by a steady recovery in consumer spending, partially attributed to the FIFA World Cup. Inflation fell to 3.5% by the end of 2010, averaged 4.3% in 2010, and is expected to reach 5.3% in 2011.

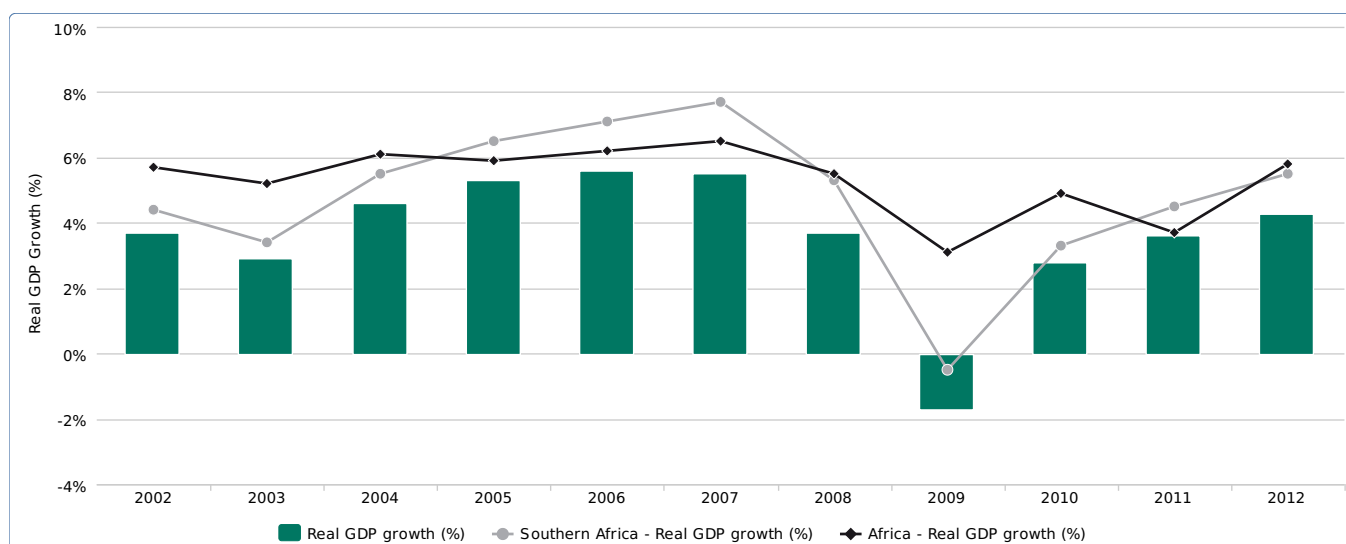
The consolidated government deficit rose to 6.9% of GDP in fiscal year 2009/10, and the central bank's policy rate declined by 6.5 percentage points since the end of 2008. Fiscal policy is now taking a less expansionary turn, with the consolidated government deficit slowing to an estimated 5.4% in fiscal year 2010/11 and projected to decline further to 5.0% in fiscal year 2011/12. Likely increases in the wage bill pose a downward risk to the fiscal balance outlook as do the possible introduction of a new public health insurance system and youth employment subsidy. The repo rate, the price at which the South African Reserve Bank lends cash to the banking system, is expected to remain close to 5.5% throughout 2011 and to start rising moderately only towards the end of the year.

China has become the top destination for South Africa's exports since mid-2009 and is also South Africa's leading source of imports. China is the dominant investment partner among emerging partners with its foreign direct investment (FDI) ranked fifth in terms of value in early 2010, at 33 billion South African rand (ZAR). Many emerging partners use South Africa as a gateway to other African countries. In December 2010, South Africa became an official member of the BRICS (Brazil-Russia-India-China-South Africa) group. The challenge for the government is to show that it has a purposeful plan to engage with BRIC countries, to prioritise its productive capacity, and to maximise its contribution to the national economy. Another challenge is to avoid neglecting traditional partners while nurturing its strategically important emerging partnerships. Indeed, the EU is still South Africa's topmost regional export destination. The year 2011 will also see the launch of the South African Development Agency (SADPA) to inform and direct the country's development assistance.

In the political arena, 2010 was characterised by a clearer elaboration of the Zuma administration's goals, and progress in achieving some of them. The administration has shown strong commitment to fighting crime. Significant progress has been made, for example, in crime prevention. Corruption, however, remains a major challenge, and both unemployment and inequality are on the rise. South Africa has achieved the 1st Millennium Development Goal (MDG) - reducing the proportion of the population living on less than 1 USD a day by half - but the government still needs to tackle issues such as providing adequate public health services, improving the quality of education, and reducing unemployment, especially for the youth. HIV/AIDS remains a critical issue: South Africa has the world's largest population of people living with HIV: 5.6 million. In April 2010, the Zuma administration launched a campaign to test 15 million people for HIV by end-2011; 5 million people have been tested since the launch began.

Structural challenges such as infrastructure bottlenecks hampered recovery in private investment in 2010. Unemployment remained very high in 2010 even though it declined marginally in the fourth quarter of 2010 to 24% from 25.3% in the previous quarter. The government outlined a number of measures to address these challenges in the New Growth Path framework (November 2010), including more investment in infrastructure, skills enhancement, public service and regional economic ties.

Figure 1: Real GDP growth (S)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink <http://dx.doi.org/10.1787/888932404560>

Table 1: Macroeconomic indicators

	2009	2010	2011	2012
Real GDP growth	-1.7	2.8	3.6	4.3
CPI inflation	7.1	4.3	5.3	5.6
Budget balance % GDP	-6.9	-5.4	-5	-4.5
Current account % GDP	-4.1	-2.8	-3.4	-4.3

Source: National authorities' data; estimates and projections based on authors' calculations.

Figures for budget balance refer to fiscal years; thus 2009 corresponds to FY 2009/10, running from April 2009 to March 2010, for instance.

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink <http://dx.doi.org/10.1787/888932406916>

Recent Economic Developments and Prospects

Table 2: GDP by sector (in percentage)

	2005	2010
Agriculture, forestry, fishing & hunting	2.7	2.5
Agriculture, livestock, fishery, forestry and logging	-	-
of which agriculture	-	-
of which food crops	-	-
Mining and quarrying	7.6	9.6
Mining, manufacturing and utilities	-	-
of which oil	-	-
Manufacturing	18.5	14.6
of which hydrocarbon	-	-
Electricity, gas and water	2.4	2.8
Electricity, water and sewerage	-	-
Construction	2.8	3.8
Wholesale and retail trade, hotels and restaurants	13.9	13.9
of which hotels and restaurants	-	-
Transport, storage and communication	10	9.1
Transport and storage, information and communication	-	-
Finance, real estate and business services	21.1	21.2
Financial intermediation, real estate services, business and other service activities	-	-
General government services	14.9	16.1
Public administration & defence; social security, education, health & social work	-	-
Public administration, education, health	-	-
Public administration, education, health & other social & personal services	-	-
Public administration, education, health & social work, community, social & personal services	-	-
Public administration, education, health & social work, community, social services	-	-
Other community, social & personal service activities	-	-
Other services	6.3	6.3
Gross domestic product at basic prices / factor cost	100	100

Source: AfDB Statistics Department, based on data from Statistics South Africa.

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink  <http://dx.doi.org/10.1787/888932407885>

Real GDP grew year-on-year by 2.8% in 2010, recovering from the low base of a 1.7% contraction in 2009.

GDP growth was primarily driven by steady recovery in consumer spending. Real GDP growth is expected to increase to 3.6% by 2011, still held back by sluggish domestic investment and tighter fiscal spending. In 2012, real GDP growth is expected to increase to 4.3%. The main risk to the outlook for 2011 and 2012 is the outlook for the global economy.

The mining sector's real value-added recovered in 2010, registering a 4.2% increase. However, output recovery was uneven across sectors owing to diminishing gold reserves, infrastructure constraints and an uneven recovery in global demand. Furthermore, strikes by the National Union of Metalworkers and mine workers in September 2010 affected production in coal and platinum mines. Overall, high commodity prices drove growth in mining revenues in 2010, in spite of revenues being negatively affected by an appreciation of the Rand. The mining and quarrying sector expanded by 17% during the fourth quarter of 2010 contributing significantly to the improvement in GDP growth.

Real value added grew by 5.1% in the manufacturing sector in 2010, recovering from a 10.4% contraction in 2009. This was due to recovering industry confidence and strong demand for iron and steel, non-ferrous metals, machinery, and electrical equipment – much of it driven by the FIFA World Cup. However, the recovery was not as strong as expected due in part to liquidations and to the prolonged industrial action in the automotive industry. Export-oriented manufacturing was negatively affected by the Rand's appreciation against major currencies. The 2011 outlook for growth in manufacturing output remains modest because of structural constraints.

The agricultural sector rebounded and increased by 0.9% in real value added in 2010 primarily as a result of a bumper harvest in maize. The maize harvest, the biggest in nearly three decades, was due to unexpectedly good rains, an increase in maize plantings, and greater use of genetically modified seed. This reduced food price inflation to 1.2% in 2010. Consumer price inflation also slowed to reach a 3-year low of 4.3%.

On the expenditure side, real private consumption was up by an estimated 4% in 2010, after a 2.0% contraction in 2009. Growth was attributed to FIFA World Cup related consumption, increased household real disposable incomes, and lower interest rates that encouraged household borrowing. Real disposable income, for example, increased by an estimated 4.6%. Private consumption thus became a driver of recovery in the South African economy in 2010. Continued, though modest, recovery is expected in 2011 with a projected 3.4% growth in private consumption.

Households deleveraged less than expected during the crisis, and indebtedness remained high at 78.5% of disposable income in 2010. Household borrowing gained momentum driven in part by mortgage borrowing which had recovered by October 2010 to a year-on-year growth rate of 4.7% as interest rates and the lending criteria of banks eased. Household insolvency is on a downward trend; however, the number of households with an impaired credit record remains high, at 46%. In addition, the rebound in consumer confidence and consumption were observed primarily in the high income consumer group, and less so in the low income groups. These factors, coupled with the high unemployment rate, will continue to weigh on consumer spending, projected at 1.2% and 1.9% in 2011 and 2012, respectively.

Private investment did not recover to the expected levels, growing only at 0.5% in 2010. Robust growth in private investment is not expected before 2012, with its growth rate projected to pick up to 7.5% and 10.5% in 2011 and 2012. In some sub-sectors, the observed trend is explained in part by a return to trend growth. The contraction in the construction industry, for example, came after years of double digit growth prior to the economic recession. It was mostly fuelled by excess demand on the local market, but also got a boost from the FIFA World Cup. The moderation in housing prices in 2010, despite improvements in mortgage borrowing, is a sign of increased supply.

Other key determinants of private investments in 2010 were firm liquidations, which remained high. Total loan advances to companies started off at a year-on-year growth rate of *minus* 5.7% in January 2010 and only recovered to positive growth of 1.4% in September 2010. Industrial imports did not recover until the third quarter of 2010. Private investment is expected to pick up – from 0.5% in 2010 to 7.5% in 2011 and 10.5% in 2012 – as capital flows to emerging markets begin to accelerate and as the recovery begins to take hold in OECD countries.

Gross fixed capital formation was positive overall at 4.0% in 2010 with public investment continuing to grow in 2010 at a 8.5% rate, reflecting both the government's expansionary fiscal policy, and adherence to ongoing infrastructure expansion programmes. Public spending fell off following the completion of projects undertaken for the football tournament and generally lower capital outlays by all levels of government in the recovery period. Over ZAR 800 billion has been budgeted for fixed investments towards infrastructure development between 2011 and 2013, reflecting a 40% increase in annual infrastructure expenditures in this period relative to 2008.

Infrastructure bottlenecks and labour market constraints are likely to prevent a return to the pre-crisis growth rates of 2011 and 2012. However, growth in the medium term (post-2012) is expected to be stronger as the massive infrastructure development projects being undertaken by state-owned enterprises, such as Eskom and Transnet, start to bear fruit. South Africa's close economic ties to the global economy also imply that growth will be affected by the evolution of the EU, US and Chinese economies, and the trend of capital flows to emerging markets.

Table 3: Demand composition

	Percentage of GDP (current price)		Percentage changes, volume			Contribution to real GDP growth		
	2002	2009	2010	2011	2012	2010	2011	2012
Gross capital formation	15.9	19.6	4	5.4	7.7	0.8	1.2	1.7
Public	3.8	8.6	8.5	2	3	0.7	0.2	0.2
Private	12.1	11	0.5	7.5	10.5	0.1	1	1.5
Consumption	80.3	81.3	2.6	3.1	4.1	3.4	2.6	3.4
Public	18.8	21.1	4.7	2.5	2.9	1	0.5	0.6
Private	61.5	60.2	4	3.4	4.5	2.4	2.1	2.8
External sector	3.8	-0.9	-	-	-	-1.3	-0.2	-0.8
Exports	32.9	27.4	4.3	3.3	3.5	1.2	0.9	0.9
Imports	-29.1	-28.3	8.9	3.3	5.4	-2.5	-1.1	-1.8
Real GDP growth rate	-	-	-	-	-	2.8	3.6	4.3

Source: Data from Statistics South Africa (Stats SA); estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink  <http://dx.doi.org/10.1787/888932408854>

Macroeconomic Policy

The government employed expansionary fiscal and monetary policies in 2010 to counter the effects of the economic crisis. These fiscal measures led to a 10% expansion in government expenditure for the 2009/10 fiscal year. The stimulus on the monetary side brought interest rates to a 30-year low as the repo rate was cut by 650 basis points between 2008 and November 2010. In theory, some policy space exists for further stimulus. However, in practice, not much of the remaining space, if any, is likely to be exploited in 2011 as the economy rebounds to trend growth.

Looking ahead, a fiscal deficit of 5.0% of GDP is expected for fiscal year 2011/12 with a more moderate 4.5% of GDP for fiscal year 2012/13 – that is relative to a deficit of 5.4% in fiscal year 2010/11. These projections will have to be revised if the wage bill rises substantially again or in case of the introduction of a new public health insurance system or youth employment subsidy. Likewise, a tightening of monetary policy is possible early in 2012. The South African Reserve Bank (SARB) has been communicating to the market that the repurchase rate has bottomed out and that it is not planning to cut rates further in 2011 and 2012.

Fiscal Policy

The government responded to the global crisis by expanding public spending on social assistance. Consolidated government gross capital spending rose by 1.5% in 2010, much more slowly than current payments and transfers. Government borrowing remained high in 2010 even though spending decreased and tax revenue increased somewhat: the consolidated government's fiscal position went from a deficit of 6.9% of GDP in fiscal year 2009/10 to a deficit of 5.4% of GDP in fiscal year 2010/11. Government spending supported the economy throughout the recession. According to the Treasury, the structural fiscal deficit widened from 2.25% to 4.1% of GDP between fiscal year 2008/09 and fiscal year 2010/11, mainly due to lending to state-owned enterprises Eskom, Transnet and SANRAL, an increase in public sector salary, and increased coverage of social transfer programmes.

Corporate taxes decreased in 2010 due to lower profitability ratios, and VAT decreased due to decline in consumer spending. International trade contracted dramatically due to the slump in global demand. This manifested in a 25% underperformance in collections of customs duties than projected in the budget. Import VAT was also impacted by the slump in global demand. Tax compliance appears to have deteriorated during the recession. The pro-cyclicality of tax collection in South Africa leads to expectations that revenues will bounce back if growth rebounds back to trend. To encourage taxpayers to make payments early, a voluntary disclosure programme was instituted in late 2010. Over the next three years, the South African Revenue Services will also modernise its systems, improve enforcement and strengthen audit capacity.

The fiscal policy outlook is less expansionary. The government foresees a cyclical upswing which will enable them to hold expenditure increases below GDP growth. Indeed, total expenditure and net lending is expected to decrease from 30.4% of GDP in 2010/11 to 29.2% in 2011/12 and further to 28.7% in 2012/13. Treasury estimates that the debt stock will stabilise at about 40% of GDP in fiscal year 2015/16. This is a cautious projection in case of faster GDP growth or smaller deficits than projected by the government. If the expenditure trajectory proposed in the 2010 budget is maintained, the improvement in revenue prospects of about ZAR 80 billion over initial budget for fiscal year 2010/11 will assist a faster reduction of the deficits. The government also plans to curb real non-interest spending from the circa 9% growth rate of the past three years to 2-3% over the three-year period beginning in fiscal year 2011/12. The downside risk to this scenario is that Treasury's expected increase in wage bill is rather low, and the projections do not take into account the possible approval of some of the different social programmes being debated. In addition, if aspects of the New Growth Path become policies, the expenditure landscape could change substantially. The proposed expenditure framework for 2011 budget gives priority to education, health, infrastructure and job creation.

Table 4: Public finances (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Total revenue and grants	23.2	27	26.3	23.7	25	24.2	24.3
Tax revenue	22.8	26.4	25.8	23.4	24.6	23.8	23.9
Oil revenue	0	0	0	0	0	0	0
Grants	0	0	0	0	0	0	0
Other revenues	0.4	0.6	0.6	0.3	0.4	0.4	0.4
Total expenditure and net lending (a)	25	26	27.5	30.6	30.4	29.2	28.7
Current expenditure	25.6	26.1	26.1	28.8	28.7	27.7	26.7
Excluding interest	21.6	23.5	23.7	26.5	26.2	25.2	24.7
Wages and salaries	9.2	8.5	9.1	9.9	9.8	9.2	9
Goods and services	3.3	3.7	4.2	5.7	5.7	5.5	5.4
Interest	3.9	2.5	2.4	2.3	2.5	2.5	1.9
Capital expenditure	1.1	1.3	1.8	2.4	2.4	2.3	2.3
Primary balance	2.2	3.5	1.2	-4.5	-2.9	-2.4	-2.5
Overall balance	-1.8	0.9	-1.2	-6.9	-5.4	-5	-4.5

a. Only major items are reported.

Source: Data from Statistics South Africa (Stats SA); estimates (e) and projections (p) based on authors' calculations. Fiscal year July (n-1)/June (n).

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink  <http://dx.doi.org/10.1787/888932409823>

Monetary Policy

The Reserve Bank cut interest rates in 2010, bringing the repurchase rate to its lowest level in 30 years at 5.5%. This was consistent with the inflation targeting framework for monetary policy, since inflation, helped by the appreciation of the Rand, approached the lower bound of the target band (3-6%) at 3.5% by the end of 2010. The monetary stimulus measure was intended to encourage private borrowing. However, both household and corporate borrowing did not respond in 2010, reflecting constraints from the high levels of indebtedness, high unemployment, uneven recovery in consumer and producer confidence, and incomplete pass-through of lower repurchase interest rates to new borrowers.

The average Consumer Price Index (CPI) inflation for 2010 was 4.3%, down from 7.1% in 2009, due to a decline in the price of imported manufactured goods (a result of the strong local currency) and very low inflation in food and petrol prices. The inflation projections depend on what happens with administered prices, i.e. prices set by the government, and also with wages, commodity prices, oil and food items in particular, and with the exchange rate. Inflation is expected to increase to 5.3% in 2011 on the back of rising commodity prices. A weakening Rand is expected to contribute to rising prices. CPI inflation is expected to reach 5.6% in 2012.

Additional downward adjustment of the repurchase rate is not expected in 2011. No structural changes to the monetary policy stance, or the range of currency stabilisation instruments, are foreseen so far. SARB has been accumulating foreign currency reserves to moderate the exchange rate. However, these exchange rate stabilisation measures were in the past associated with high sterilisation costs and are therefore not favoured by the Bank. Although the New Growth Path being championed by the Ministry of Economic Development does call for looser monetary policy, its current focus is on restructuring the economy, particularly its composition of growth drivers and labour absorption capacity, as the key growth stimulus.

External Position

In 2010, the current account deficit shrank to 2.8% of GDP from 4.1% in 2009. The deficit is forecast at 3.4% of GDP in 2011 and 4.3% in 2012. The trade deficit decreased as imports contracted by more than exports in value terms, despite the continued appreciation of the Rand. Some observers have concluded that the export recovery was sustained because of an improvement in manufacturing production while the sluggish recovery of consumer spending kept a lid on import demand. In fact, the rebound in import volumes has been considerably greater than that of export volumes but the price of exports has increased a lot relative to the price of imports.

Export growth was particularly significant in the intermediate goods and raw materials classifications, driven by activity in emerging economies and by the strong recovery in commodity prices. Exports of mining products increased in 2010 while the agriculture, forestry and fishing sector recorded a contraction in exports, with cereal exports particularly hard hit. The recovery led total imports of goods and services to increase, mainly driven by consumer goods and by intermediate goods. Although imports of capital goods recovered, imports of raw materials came under pressure as a reflection of relatively weak levels of domestic production and investment. However, the imports of televisions, radio and communication equipment expanded, reflecting improved economic activity and consumer demand. This contrasts with the decline in local production, indicating that manufacturers may have been struggling to compete with international producers. Indeed, the recovery has not taken production back to pre-crisis levels. The contraction in imports of machinery and equipment are evidence of cutbacks or delays in investment.

In terms of the regional distribution of trade, export demand from emerging economies, particularly in Asia, gained further ground. Asia again claimed the largest share of exports in the first semester of 2010, with China the leading destination. The leading product categories to Asia included iron ores, platinum, coal and Ferroalloys. South Africa's trade balance with the rest of the African continent continued in surplus territory. The value of exports to the rest of Africa declined in 2010. Yet, the rest of the African continent increased its share of imports from South Africa. Imports from the rest of Southern African Development Community (SADC) have been recovering gradually. Subsequent to the implementation of the SADC Free Trade Agreement (FTA) in 2008, delays in laying the groundwork for a customs union have prevented such a union from coming into effect by 2010, as envisaged. As part of ongoing efforts towards the harmonisation and rationalisation of regional economic communities (RECs), the implementation of the SADC/COMESA/EAC Tripartite Summit Decisions to accelerate economic integration between SADC and the Common Market for East and Southern Africa (COMESA), as well as the East African Community (EAC), is a key focus area going forward. The proposed tripartite arrangement would entail a tariff-, quota- and exemption-free FTA encompassing the existing members of the three organisations.

The financial account of the balance of payments kept on recording sizable surpluses into the third quarter of 2010 as portfolio inflows, notably into the bond market, were recorded. In 2011, there have been net outflows in the bond market and renewed foreign interest in the South African equity markets. Moderate reserve accumulation by the SARB has continued. The total value of the stock of foreign direct investment (FDI) in South Africa was ZAR 867 billion at the onset of 2010. FDI flows into South Africa declined by 78% in 2010. Total FDI in 2010 was a mere USD 1.3 billion. Approximately a third of the stock of FDI is in mining and quarrying, and a little less than a third in manufacturing and also nearly another third in finance, insurance, real estate and business services. In 2010, the largest acquisitions were made by traditional partners, specifically Japan, with Nippon Telegraph and Telephone (NTT) acquiring 100% of Dimension Data, the IT services firm.

Net capital inflows to South Africa reached 5.5% of GDP in 2010. The UK remains by far the dominant country of origin for FDI, with more than half of the FDI stock in the country at the end of 2009, totalling ZAR 468 billion. Smaller but important players are the Netherlands (10.5%), Germany (6.7%), the United States (6.5%) and China (3.8%). The Chinese stock of FDI has expanded most impressively from less than ZAR 500 million at the end of 2007 to nearly ZAR 34 billion at the end of 2009 with the 20% acquisition of Standard Bank by the Industrial Commercial Bank of China (ICBC). However, the inflows of FDI from the UK and the Netherlands still amounted to a multiple of Chinese inflows – 3.7 and 1.7 times, respectively, in 2009 alone.

Inward portfolio investment increased from ZAR 28.4 billion in the second quarter of 2010 to ZAR 45.8 billion in the third quarter. Non-resident investors showed enhanced interest for domestic debt securities and continued to acquire securities and to dominate portfolio inflows. Indeed, acquisition of domestic debt securities by non-resident investors more than doubled and amounted to ZAR 41.2 billion as the bond market continued to offer attractive yields, given the extremely low level of interest rates in developed countries.

Total outstanding foreign debt receded from USD 81.1 billion at the end of the first quarter of 2010 to USD 79.9 billion at the end of the second quarter, largely due to a decline in foreign-currency denominated debt. Rand-denominated debt, however, increased by USD 6.1 billion in the twelve months to June 2010, driven by the appreciation of the rand against the USD and by significant increases in holdings of rand-denominated bonds. As a result of the appreciation of the rand and domestic economic growth, the ratio of

foreign debt to GDP declined to 24.1% in 2010.

Table 5: Current account (percentage of GDP)

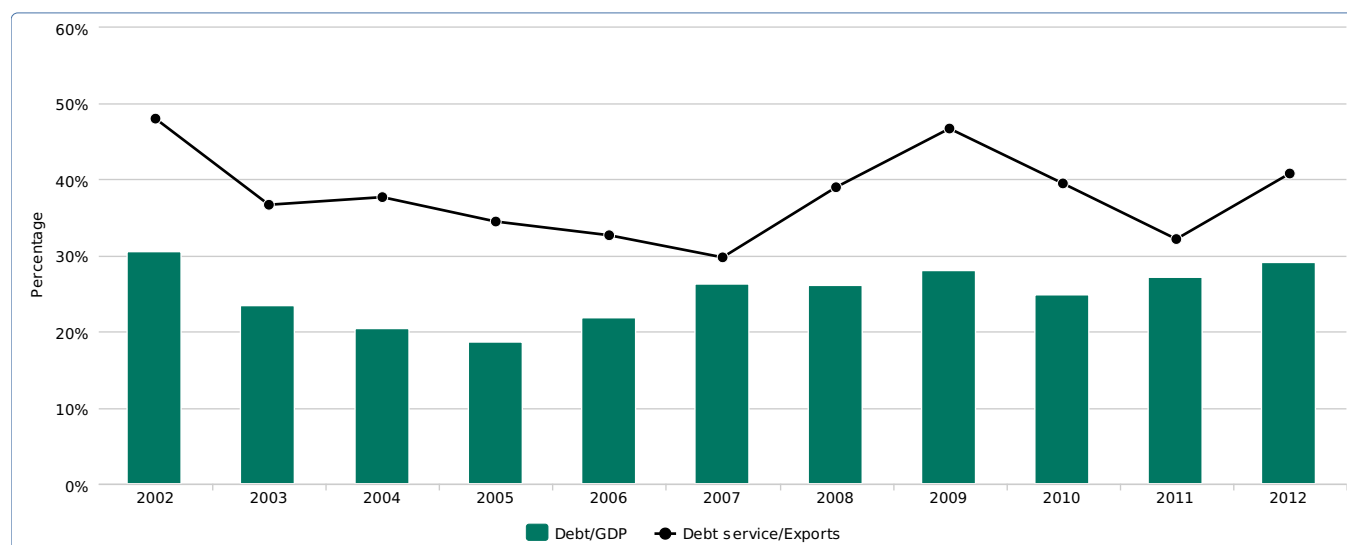
	2002	2007	2008	2009	2010	2011	2012
Trade balance	4.3	-2	-1.6	0.1	0.8	0.8	0.1
Exports of goods (f.o.b.)	28.5	26.5	31	23.2	23.3	24.3	23.7
Imports of goods (f.o.b.)	24.2	28.5	32.5	23.1	22.6	23.5	23.6
Services	-0.5	-0.9	-1.5	-1	-1.1	-1.4	-1.3
Factor income	-2.5	-3.4	-3.2	-2.2	-1.7	-2.1	-2.3
Current transfers	-0.5	-0.8	-0.8	-0.9	-0.8	-0.8	-0.8
Current account balance	0.8	-7.2	-7.1	-4.1	-2.8	-3.4	-4.3

Source: Data from local authorities' data; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink  <http://dx.doi.org/10.1787/888932410792>

Figure 2: Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink  <http://dx.doi.org/10.1787/888932404560>

Structural Issues

Private Sector Development

Despite having experienced one of the deepest recessions on the continent in 2009, the South African economy benefited from having key economic institutions intact to sustain activity during the recession and in the recovery period; in particular, solid capital markets, development funding support and sound financial market regulation. Financial market regulation was strengthened by the adoption of the Basel II international banking standards in January 2008. The quality of consumer credit had also improved with the creation of the National Credit Regulator (NCR) of 2007, which helped curb excessive lending. At the time of the NCR's creation consumer credit had reached half of GDP, and the quality of credit had substantially deteriorated. By mid-2009, the amount of credit granted per quarter had more than halved and growth of loan balances had slowed significantly. These developments proved timely in their effect on the economy's capacity to better weather the crisis.

Solid institutions also played a role in supporting strong growth of South African firms in the pre-crisis period. A survey undertaken by Business Leadership South Africa in 2010 showed that a number of large firms have gone on to increase their presence on African markets and beyond. On the local market, however, the private sector faces challenges to become competitive and diversified enough to support sustained growth and tackle unemployment. Although highly competitive on the African continent, South Africa's private sector does not fare so well in competitiveness against producers from other emerging markets. The competitiveness of the economy has declined as measured by the global competitiveness index (GCI), with ranks of 54 in 2010 relative to 45 in 2009, and continues to lag behind China (27) and India (51). According to the GCI, infrastructure and labour market inefficiencies (after basic health and education) are the major constraints to competitiveness.

The low response of private investment to lower interest rates in 2010 is explained to an extent by the presence of infrastructure bottlenecks. Infrastructural constraints are also held partially responsible for the lethargic growth in the mining sector in the past ten years, despite extensive fiscal support and a commodity price boom. Inadequate electric power and rail and port inefficiencies in particular are considered to have held back expansion of mining production and its contribution to the economy. There are also mounting problems with the country's polluted water sources: poor management of dams, sewerage works and treatment plants threaten the water supply.

However in infrastructure, the government is making headways, through major investments to address energy, transport and water deficiencies. These developments are likely to entail higher service charges across the board, in line with the government's new thinking on cost basis pricing of services. Electricity tariffs, for example, are seen as an integral element of the financing plan for Eskom's expansion programme. In 2010, tariffs increased by 24.8%, and further increases of at least 25% annually have already been approved by the electricity regulator for 2011 and 2012. This will nullify some of the competitiveness gains to the private sector from improved infrastructure services, although the very low base from which these rates have risen provides some room for upward adjustment. More financing and efficiency gains could also come from increased competition in infrastructure service provision.

In 2010, the ongoing debate about labour market regulation was heightened by the strikes in light of their substantial effects on productivity in selected key sectors, and the large wage settlements, estimated by Treasury at a nominal 8.3%. In fact, job losses in 2010 reached higher than expected levels with many of these losses due to firms using the pretext of the business cycle to lay off unwanted workers in an otherwise rigid labour regulation environment. With regards to centralised bargaining, the 'insider-outsider' conundrum created by the high entry-level wages became more evident in 2010. Indeed the GCI records deterioration in labour market efficiency in 2010 relative to 2009. When it comes to contracting flexibility, wage determination and labour-employer relations, South Africa now ranks in the bottom ten. Productivity and adequacy of skills also remain key challenges.

The relevance of the current framework for the conduct of monetary policy by the South African Reserve Bank (SARB) under the leadership of the Treasury has been questioned in 2010, and all the more so in light of the appreciating Rand. The perceived overvaluation and excessive volatility of the currency are issues that affect not only the external sector but also the planning of private investment and domestic prices. While importers and, among others, segments of the wholesale and retail sector are content with a strong Rand, the consensus is that the currency's volatility is too high. There are few instruments to address either currency valuation or volatility aside from SARB's foreign currency accumulation programme, and changes to private foreign currency investment allowances implemented in 2010. Proposals being debated include the creation of stabilisation funds such as a sovereign wealth fund with foreign dominated assets, introducing a Tobin tax on short-term capital flows, and looser monetary policy to allow higher inflation rates and currency devaluation. None seem to be currently gaining momentum as the country's dependency on foreign capital inflows remains a dominant issue.

Indeed, easing of exchange controls by the end of 2010, including the increase in the life time limit of capital remittance of ZAR 4 million to the same amount per year, is believed to have contributed to the recent weakening of the Rand.

Other Recent Developments

The more pronounced impact of the economic downturn in the South African economy compared to other African countries and to other emerging economies and the fact that it was accompanied by rising unemployment and poverty resuscitated the debate on the structural dynamism of the economy. Opinion leaders from the public and the private sector are highlighting again the economy's reliance on consumption – rather than production-led growth, capital and skills intensive industry, slow growth of the formal small- and medium-sized enterprises (SME) sector, infrastructure bottlenecks and low public service capacity.

The government's position on how to address some of these challenges is detailed in the New Growth Path. This framework, which sets a target of creating 5.5 million jobs over the next decade, was unveiled in November 2010. The framework addresses five key job drivers: *i*) substantial public investment in infrastructure; *ii*) targeting more labour-absorbing activities across the main economic sectors; *iii*) taking advantage of new opportunities in the knowledge and green economies; *iv*) leveraging social capital in the social economy and public service; *v*) fostering rural development and regional integration. To create these jobs, the government plans to implement both macroeconomic and microeconomic packages. The macroeconomic package essentially calls for somewhat looser monetary policy. The microeconomic package includes reforms that touch industrial activity, rural development, competitiveness, labour, technology, developmental trade and African development policy, as well as the Broad-based Black Economic Empowerment Programme. The government also plans to actively support education and skills and enterprise development.

At the January 2011 ANC meeting, President Zuma made it clear that there needs to be a concrete action plan to achieve the New Growth Path. There is an ongoing debate about the realism of the government's goal of creating 5 million jobs. However, acknowledgement of inequality and unemployment as a vital problem by the architects of the New Growth Path is considered a major step forward by some political analysts.

Emerging Economic Partnerships

China became the topmost destination for South Africa's exports in mid-2009 and is also South Africa's leading source of imports. India currently ranks eighth as a source of imports. As a destination for exports, India ranked sixth in 2010. China, and to a lesser extent India, have become dominant trading partners not only compared to other emerging partners but also compared to traditional partners as well. China's 14% share of imports in the first three quarters of 2010 overshadows Germany's 11.6% and the US's 7%. Similarly, China's 9.3% share of South Africa's exports surpasses the 8.8% and 8.1% claimed by the US and Japan, respectively.

This contrasts sharply with the situation at the turn of the century, when China took 11th position as a destination for South Africa's exports and was the eighth largest source of the country's imports. Back in 1992 China was even less important as a trading partner, ranking 20th as an export destination (accounting for a mere 0.8% of South Africa's exports) and 15th as a source of imports (claiming only 1.2% of South Africa's import basket). By 2010 (that is, the first three quarters of the year), 9.3% of South Africa's exports were destined for China, which in turn accounted for 14% of South Africa's imports.

South Africa exports a narrow range of mineral and resource-intensive products to China: metals, minerals and other commodities. By contrast, South Africa imports a widening range of higher value-added products from China, including clothing, data processing machines, printing machinery, bulldozers and motor vehicles. Indian exports to South Africa are dominated by petroleum products (other than crude), electrical and electronic equipment, as well as pharmaceutical products. Its imports from South Africa consist largely of inorganic chemicals, coal and coal products.

China is the dominant investment partner amongst emerging partners having reached rank five in terms of the value of its stock of FDI in early 2010, with ZAR 33 billion. The figure is considered to understate reality. This status was reached notably fast since China's stock of FDI back at the beginning of 2008 was only R480 million. The subsequent acquisition of a 20% stake in Standard Bank by the Industrial Commercial Bank of China (ICBC) was central to this rise. Yet, South Africa also ranks second (behind the Democratic Republic of Congo) in China's mining investment in Africa with five projects in total, mainly focused on chrome. Other investments have been in metals (around R3.8 billion), followed by chemicals, food and tobacco, consumer electronics, automobiles and communications. In late 2010, a USD 877 million Chinese investment from Jinchuan and the China-Africa Development Fund into the Johannesburg Stock Exchange (JSE)-listed junior platinum firm Wesizwe Platinum was announced.

There are a few emerging partners whose absolute trade and investment standing in South Africa, while still low, are progressing very fast and can be expected to reach prominence in a few years time if current trends stay in place. For example, in terms of South African exports, the United Arab Emirates were the 20th largest destination market in the first three quarters of 2010, claiming 1% of exports, up from 49th in 1992, when it was the recipient of a negligible 0.1% of South Africa's exports. Malaysia, which did not even feature amongst the top 50 destinations for South Africa's exports in 1992, captured 31st position at the turn of the century and ranked 22nd in the first three quarters of 2010. Brazil's ranking has also improved over this period, from 30th in 1992 to 23rd in the first nine months of 2010, when the South American economy absorbed 0.9% of South Africa's exports. The relative performance is slightly better on the import front, in the sense that Brazilian products have represented between 0.9% and 1.7% of South Africa's import basket in these periods (ranking between 17th and 21st). Interestingly, Turkey has seen its relative importance as a trading partner for South Africa drop since 1992, both on the export and import fronts, with the downward trend being also quite pronounced in the case of Chinese Taipei.

Many emerging partners use South Africa as a gateway to other African countries, and vice versa – countries in the region use South Africa as a gateway to emerging markets. Investors enjoy the high property rights, protection standards and relatively good infrastructure of South Africa as a base for trading with and investing in other African countries. Other African countries are becoming increasingly important as trading partners accounting for 8.4% of South Africa's imports and 14.4% of its exports in the first three quarters of 2010. Imports from the rest of the continent have risen dramatically over the past decade, from a 2.3% share in 2000. In terms of exports, the share has stabilised since 2000, when Africa accounted for 14.9% of South African exports (9% in 1992). About half of South Africa's investments are targeted toward companies within the continent. However, in the last two years, the top ten investments made by South Africa have been mostly targeted towards emerging countries on other continents with the exception of the investment made in Unki Mine, Zimbabwe.

South Africa has put a lot of political effort into engaging diplomatically both industrial and fellow southern countries since the country's democratic transformation. The year 2011 will see the launch of the South African Development Agency (SADPA) to inform and direct the country's development assistance. Almost all

development assistance has been directed at the African continent so far, with a strong focus on member countries of the Southern African Development Community (SADC). This focus is not expected to change. The government argues that the SADPA will boost the country's status as an emerging economic power and champion of the African continent, and improve accountability about the way funds are being disbursed.

The diplomatic weight of South Africa is more than proportional to its economic and demographic size. This has been underlined by the invitation to join the BRIC summit in April 2011 in Beijing. The hope is to gain substantial trade and investment benefits, through potential preferential trade pacts and economic co-operation. Reputational gains in joining this largely symbolic 'club' are argued to increase investors' interests. South Africa is very different from the BRIC countries, however, particularly with respect to its size and growth rate. It remains to be seen whether investors will react to a political gathering. The government argues that membership is aimed at promoting South Africa as an important player and that it complements its role in various other organisations, including the United Nations, the India-Brazil-South Africa (IBSA) initiative, and the G77.

One challenge for the government is to show that it has a purposeful plan to engage with the BRICs and to prioritise productive capacity and local beneficiation. The South Africa-China Partnership for Growth and Development (PGD) has not delivered concrete results so far. Yet, South Africa could seek to actively understand and implement the "China developmental model". Another challenge is to avoid neglecting traditional partners while nurturing its strategically important emerging partnerships. Indeed, the EU is still South Africa's topmost regional export destination.

Political Context

The year 2010 saw the Zuma administration more clearly articulate its priorities, which paid more attention to social issues. Progress has been made in crime prevention: national crime statistics for 2009/10 show that street robberies declined by 10.4%, bank robberies by 8.8%, and truck and car hijackings by 6.8 %. Violent crime also declined, with murder down by 8.6%. Reliability of police services also marginally improved in 2010 relative to 2009, according to the GCI. Improvements are also due to the tightening of security during the FIFA World Cup.

According to Transparency International, the Corruption Perceptions Index (CPI) has deteriorated further, from 4.7 in 2009 to 4.5 in 2010. The Broad-based Black Economic Empowerment Programme is also perceived as being vulnerable to political influence, as is the issuing of mining rights. The Directorate for Priority Crime Investigation (also known as the Hawks) established in mid-2009 to fight corruption, organised crime, and economic crime had made several thousand arrests against organised crime and commercial crime by mid-2010, with conviction rates of 15% and 60% respectively. Despite a large number of incidents of corruption being investigated, fewer convictions were made.

Public trust in politicians, judicial independence, and decisions of government officials also deteriorated in 2010, according to the GCI. While the political environment remains stable, slow delivery on key social goals – youth unemployment and inequality in particular – remains a major risk.

Social Context and Human Resource Development

South Africa has achieved the Millennium Development Goal (MDG) of eradicating extreme poverty and hunger, by reducing the proportion of the population living on less than 1 USD a day by half. Despite this progress, the country faces many challenges. In January 2010, the Cabinet adopted 12 outcomes against which performance will be assessed with priority given to health, education and job creation.

Lack of adequate public health services remains one of the notable issues. Public expenditure on health grew at an average annual rate of 17.6% between fiscal years 2006/07 and 2009/10, from ZAR 11.3 to ZAR 18.4 billion. The incremental support was towards HIV/AIDS programmes and hospital revitalisation grants.

South Africa has the world's largest population of people living with HIV – 5.6 million – representing nearly 1/6th of the global disease burden. Of the total population, approximately 18% of adults are infected with the virus. The Zuma administration launched an HIV campaign in April 2010, which aims to test 15 million people by the end of 2011, up from 2.5 million in 2009, a six-fold increase in just two years. Five million people have been tested since the launch, and over 900 000 were found to be HIV positive. To further provide anti-retroviral drugs (ARVs) to its citizens, in December 2010, South Africa successfully negotiated a 53.1% reduction in the cost of total tender with its ten suppliers, including Aspen Pharmacar owning 40.6% share. At least twice as many patients can be treated as a result of this reduction in price.

Further effort to improve child mortality and maternal health is needed to achieve the MDGs. While the mortality rate for children under 5 was 64 per thousand back in 1990, it has only decreased to 62.1 per thousand in 2007. South Africa is unlikely to meet the goal of decreasing maternal mortality ratio (MMR) by 75%, as the MMR effectively doubled between 1990 and 2008. The significant cause of maternal deaths in South Africa is non-pregnancy related, mainly HIV-related infections.

In September 2010, the ruling African National Congress (ANC) released its current proposals for the National Health Insurance (NHI), which aims to provide health coverage for all South Africans. This would cost an expected ZAR 11 billion in additional health budget for 2012. NHI would improve access to healthcare; however, some Treasury officials have expressed scepticism about its financial feasibility.

South Africa has near-universal primary and secondary enrolment, owing to the National School Nutrition Programme (NSNP) and the fee-free schools programme. However, deficiencies are evident in the quality and functionality of the public school system. Although the school-leaving exam pass rate has increased from 60.6% in 2009 to 68.7% in 2010, this outcome is much lower than the 73.3% pass rate in 2003. The drop-out rate is very high with more than 50% of the students leaving before completing matriculation. This implies that barely 1/4th of pupils entering school eventually pass matriculation. A recently commissioned study showed that the number of working hours spent by teachers on teaching is only four hours in South Africa compared with seven hours in the southern Africa region. The education system's poor outcomes impact far more heavily the poor, rural and township schools – they are also predominantly black – and 80% of these schools remain dysfunctional. The Department of Basic Education is finalising a comprehensive turnaround plan for teaching in schools called “Action Plan 2014”, with the objective to improve the basic education standards.

The country scores well on the targeted gender ratios in education and the share of women in formal employment. South Africa is third in the world in terms of female political representation, with 44.5% of the National Assembly made up of women. This puts the country well on track to achieve the SADC target of 50% female representation by 2015. However, more effort to improve gender equality is needed in areas such as the legal system, traditional succession and religious laws.

From the peak to trough of the labour market in terms of employed workers, i.e. from the fourth quarter of 2008 to the third quarter of 2010, just over a million jobs were lost. Losses were concentrated in the manufacturing, trade and construction sectors. Of the unemployed, youth are hardest hit as there are not enough jobs to absorb the number of new entrants to the labour market. In the 1st quarter of 2010, 40% of youth aged 16 to 30 were unemployed, compared with 16% for those aged 30 to 65. Although total employment increased by 56 000 over 2010 and unemployment had declined marginally to 24% by the fourth quarter, the labour market remains very weak – the share of employed to the population decreased from 41.1% in the first quarter to 40.8% in the fourth quarter of 2010.

The New Growth Path, released in November 2010, sets a target of creating 5.5 million jobs over the next decade. If government succeeds in achieving this goal, the unemployment rate would drop by 10 percentage points from 25.3% to around 15%. Besides the macroeconomic package mentioned in the monetary section above, the government plans to reform rural development policy and to promote educational and skills development. For example, the government will re-prioritise the co-ops that enable small producers to enter formal value chains. To enhance education and skills development, the government plans to provide targeted

programmes to increase the number of individuals with skills that are vital and/or scarce by 2014. It calls for 30 000 engineers and 50 000 artisans with skills in construction, mining, manufacturing and new industries such as in the green economy.