• South Africa’s economy recorded a continued slowdown in recent years, hitting growth of 0.6% in 2016, mainly due to a decline of output growth in the industry and services sectors, reflecting falling commodity prices and lower exports. This downtrend turned around in 2017, with real GDP growth estimated at 1.3%, based on improved performance in the finance, agriculture, and mining sectors.

• The outlook for 2018 and 2019 is positive, with growth projected at 1.5% and 1.8% respectively, given increased investor confidence in the new political context, supported by improved weather conditions and higher agricultural output, better energy supply, strengthened labour relations, rising commodity prices, and an overall more favourable global growth outlook.

• The country’s infrastructure base is well developed, notably in the highly developed metropolitan areas. However, there is a substantial infrastructure gap, especially in rural areas. Public-private partnerships should be explored to finance infrastructure investments.

OVERVIEW

South Africa’s GDP growth improved from 0.6% in 2016 to 1.3% in 2017; it is expected to reach 1.5% in 2018 and 1.8% in 2019. Growth is expected to be driven by a positive global growth outlook, more favourable weather conditions resulting in higher agricultural output, more reliable electricity supply, improved labour relations, and rising commodity prices. The positive growth outlook is also anchored on the recent political developments, which boosted investor and consumer confidence. The top priorities of the new Government include the fight against corruption in both public and private institutions and enhanced partnership between the Government, the private sector, labour, and civil society to achieve inclusive growth and socio-economic transformation.

Since early 2016, South Africa’s currency, the rand (ZAR), continued to strengthen on average, compared to the previous year, appreciating by 20% between January 2016 and December 2017. The rand appreciated further by 10% against the USD after the end of 2017 as a result of the positive political climate.

Consumer price inflation fell to 5.2% in 2017 remaining within the monetary policy target range of 3-6% as a result of lower food prices and suppressed pass-through effects of the weaker rand. Monetary policy was tightened to curtail inflation and inflationary expectations from rising amid monetary policy tightening among developed economies. An overall tight monetary policy stance since 2014 ensured that inflation remained largely within the Central Bank’s monetary policy target range of 3-6%. The growth in demand for credit by the private sector declined marginally to 5.2% in December 2017 from 5.8% in January 2017, which could be attributed to subdued investor confidence, as well as higher interest rates.

Total public revenue and expenditure in FY 2017/18 were estimated at 28.8% and 33.1% of GDP respectively, resulting in an overall fiscal deficit of 4.3%, which is higher than the deficit of 3.5% registered in FY 2016/17. This was due to a revenue shortfall of about R48 billion in the current fiscal year, mainly due to deteriorating economic growth.
Despite being an upper-middle income country (MIC), South Africa suffers from high poverty, with the poverty headcount increasing to 55.5% in 2015 from 53.2% in 2011. In 2015, 25.2% of the population – 14 million out of 56.5 million South Africans – lived in extreme poverty. Moreover, unemployment remains a major social challenge, with youth unemployment among those aged 15-24 standing at 51.1% in December 2017, one of the highest in the world.

South Africa has a comparatively well-developed infrastructure base, notably in the highly developed metropolitan areas. However, infrastructure services are not sufficiently accessible, reliable, and affordable in the ‘second segment’ of the economy, which requires substantial investments in energy, transport and water and sanitation.

### RECENT DEVELOPMENTS AND PROSPECTS

Economic growth marginally rebounded to 1.3% in 2017 from 0.6% in 2016. Growth in 2017 was driven by an expansion in finance, agriculture, and the mining sectors. Household final consumption expenditure increased by 2.2% in 2017, contributing 1.4 percentage points to total growth. Government expenditure and gross fixed capital formation increased by 0.6% and 0.4% respectively, contributing 0.1 of a percentage point to growth each in 2017.

Growth is expected to improve in 2018 and 2019, reaching 1.5% and 1.8% respectively, due to a positive global growth outlook, more favourable weather conditions and higher agricultural output, more reliable electricity supply, improved labour relations, rising commodity prices and improved business and consumer confidence following the recent positive political developments. In addition, real fixed capital formation by the private sector expanded by 1.2% in 2017 after having declined by 5.3% in 2016. Moreover, reforms of State-owned enterprises (SOE) and the commitment by the new African national Congress (ANC) leadership to tackle corruption are expected to attract more foreign direct investments. Furthermore, guided by South Africa’s national development plan, Vision for 2030, the Government is committed to fostering strong partnership with the private sector, labour and civil society to promote inclusive growth and economic transformation. In particular, in the 2018 Budget, the Government vowed to finalize outstanding policy and administrative reforms, including mining sector policies that support investment and transformation; telecommunications reforms including the release of additional broadband spectrum; lowering barriers to entry by addressing anticompetitive practices; supporting labour intensive sectors such as agriculture and tourism; and increasing skill levels across the economy.

Standard and Poor’s downgraded South Africa’s long term local currency credit ratings to a sub-investment grade (i.e., BB+ from BBB-) on 24 November 2017. It also downgraded the country’s long-term foreign currency sovereign credit rating two steps below a sub-investment grade (i.e., to BB from BB+). The agency affirmed its positive outlook for both local and foreign currency credit ratings. South Africa is now fully downgraded to a sub-investment grade by two ratings agencies, S&P and Fitch. However, in March 2018 Moody’s announced its decision to maintain South Africa’s sovereign credit rating at investment grade, while the outlook was revised upward from negative to stable. Moody’s cited more transparent and predictable policies under the new President. Thus, South Africa will not be removed from the World Government Bond Index, making higher levels of capital outflows unlikely.

The country’s labour market is characterized by chronic structural unemployment. The official unemployment rate stood at 26.7% (5.9 million people out of a total workforce of 22 million) at the end of Q4 2017. Unemployment is high in townships/informal settlements and subsistence rural areas, which account

### TABLE 1. Macroeconomic indicators

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017(e)</th>
<th>2018(p)</th>
<th>2019(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td>0.6</td>
<td>1.3</td>
<td>1.5</td>
<td>1.8</td>
</tr>
<tr>
<td>Real GDP per capita growth</td>
<td>-1.0</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>CPI inflation</td>
<td>6.6</td>
<td>5.2</td>
<td>5.3</td>
<td>5.4</td>
</tr>
<tr>
<td>Budget balance (% of GDP)</td>
<td>-3.5</td>
<td>-4.3</td>
<td>-3.7</td>
<td>-3.6</td>
</tr>
<tr>
<td>Current account (% of GDP)</td>
<td>-3.3</td>
<td>-2.2</td>
<td>-2.4</td>
<td>-2.6</td>
</tr>
</tbody>
</table>

Source. Data from domestic authorities; estimates (e) and predictions (p) are based on the authors’ calculations.
for 60% of the unemployed in the country. Unemployment is below the national average in the developed metropolitan areas, such as Ethekwini/Durban (21.8%) and Cape Town (22.7%), albeit still high. On the other hand, non-metropolitan regions have the highest levels of unemployment, for example Eastern Cape (36%), Free State (35%) and Gauteng province (32%). Four provinces in South Africa are regarded largely as rural and do not have well-developed metropolitan centres. These include Northern Cape, North West, Mpumalanga, and Limpopo; average unemployment rates in these provinces are around 27%. With specific regard to youth, South Africa’s unemployment rate was among the highest in Africa at 51.1% of those aged 15-24 and 33.4% of those aged 25-34 in December 2017. The main cause of high unemployment is lack of skills arising from low levels of education. At the end of 2016, 58.8% of unemployed persons had a level of education below matriculation; 32.4% had matriculated and 8.1% had tertiary education. The economy mainly creates skilled jobs and sheds unskilled ones.

Despite being an upper MIC, South Africa suffers from high poverty, with 25.2% of the population living in extreme poverty in 2015. The country continues to face high levels of poverty in spite of the economic achievements since the end of apartheid in 1994. In 2015, 25.2% of South Africans (14 million out of 56 million people) lived in extreme poverty or below the national food poverty line of R441 per person per month, while 55.5% of the population (31.4 million) lived below the national upper bound poverty line of R992. The majority of the poor live in townships, informal settlements, and rural areas where subsistence farmers dwell. In fact, the townships and informal settlements are home to 38% of the working age population and account for 60% of those unemployed in the country.

South Africa’s economy has been facing a process of de-industrialization over a protracted period. The industry sector contributes a comparatively modest share to GDP (19% in 2016), mainly comprising manufacturing (12%) and mining (7%). Its share of value added in industry as a percentage of GDP has persistently declined, from 40% in 1980 to 19% in 2015, but remains important in terms of export earnings. The manufacturing sector faces several key challenges, notably legislative and regulatory constraints; a spatial concentration of manufacturing firms; and a lack of infrastructure and skills.

TABLE 2. GDP by sector (percentage of GDP)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2011</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, fishing and hunting</td>
<td></td>
<td></td>
</tr>
<tr>
<td>of which fishing</td>
<td>2.5</td>
<td>2.6</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>9.6</td>
<td>8.0</td>
</tr>
<tr>
<td>of which oil</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>13.3</td>
<td>13.2</td>
</tr>
<tr>
<td>Electricity, gas and water</td>
<td>3.2</td>
<td>3.7</td>
</tr>
<tr>
<td>Construction</td>
<td>3.8</td>
<td>3.9</td>
</tr>
<tr>
<td>Wholesale and retail trade; repair of vehicles; household goods; restaurants and hotels</td>
<td>14.8</td>
<td>15.0</td>
</tr>
<tr>
<td>of which restaurants and hotels</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport, storage and communication</td>
<td>9.4</td>
<td>9.9</td>
</tr>
<tr>
<td>Finance, real estate and business services</td>
<td>20.8</td>
<td>20.2</td>
</tr>
<tr>
<td>Public administration and defence, security</td>
<td>16.5</td>
<td>17.7</td>
</tr>
<tr>
<td>Other services *</td>
<td>6.0</td>
<td>5.8</td>
</tr>
<tr>
<td>Gross domestic product at basic prices / factor cost</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

* Other services include education, health and social work and other services.

Source: Data from domestic authorities.
in the world. Wealth distribution is also highly skewed. 10% of the population hold 95% of the country’s wealth. On the Millennium Development Goals (MDGs), South Africa achieved most MDGs in education, health, and empowerment of women but did not achieve those relating to extreme poverty, unemployment, infant mortality, and maternal health. South Africa ranked 99 out of 149 countries surveyed in 2016 in the SDG Index, which measures the level of achievement of the 17 UN Sustainable Development Goals.

**MACROECONOMIC POLICY**

**Fiscal policy**

The Government remains committed to a path of fiscal consolidation. It is taking steps to narrow the primary budget deficit and stabilize public debt, while protecting social spending and investments supporting economic expansion. In FY 2017/18, total public revenue and expenditure were estimated at 28.8% and 33.1% of GDP respectively, resulting in the main budget deficit of 4.3%, which is higher than the deficit of 3.5% registered in FY 2016/17. This was due to a revenue shortfall of about R48 billion in the current fiscal year mainly due to deteriorating economic growth. The budget deficit is projected to fall to 3.7% in FY 2018/19. On the revenue side, taxes are the dominant source of revenue, accounting for 89% of total revenue and 26% of GDP in FY 2016/17.

In the 2018/19 budget, the Government introduced new tax policies to bolster revenue and reduce expenditure. Tax policy measures included an increase in the value added tax (VAT) rate from 14% to 15%, and an increase in other indirect taxes, including the general fuel levy, excise duties, and environmental tax. These tax policy changes are expected to raise an additional R 36 billion (USD 3 billion) in revenue in FY 2018/19. On the expenditure side, the Government proposed additional expenditure in priority areas while overall expenditure will be reduced by R 85 billion in the medium term. The priority sectors that will receive additional allocations include higher education (R 57 billion) for fee-free higher education for the poor and the water sector (R 6 billion) for drought management.

South Africa has been ranked first, alongside New Zealand, on the 2017 Open Budget Index. The index ranks 115 countries covered by the Open Budget Survey. The survey evaluates countries on the comprehensiveness and timely availability of their budget documentation, the effectiveness of their oversight and opportunities available to the public to participate in national budget processes.
Monetary policy
A monetary policy tightening cycle ended in July 2017 when the Reserve Bank reduced the repo rate by 25 basis points to 6.75%, with a further reduction by 25 basis points to 6.5% in March 2018. The policy decision to reduce the repo rate was underpinned by a faster decline in food price inflation, lower international fuel prices, and the resilient exchange rate of the rand. Consumer inflation fell to 5.2% in 2017, thus remaining within the monetary policy target range of 3-6% on the back of lower food prices and suppressed pass-through effects of the weaker rand. Inflation is projected to remain within the monetary policy target range of 3-6% in the medium term reaching 5.3% and 5.4% in 2018 and 2019 respectively. An overall tight monetary policy stance since 2014 ensured that inflation remained largely within the Central Bank’s monetary policy target range of 3-6%.

Since early 2016 the rand continued to strengthen on average, compared to the previous year, appreciating by 20% between January 2016 and December 2017. The rand appreciated further by 10% against the USD since end of 2017 as a result of the positive political climate. The nominal rand-USD exchange rate reached R11.63/USD, a three year high in February 2018, due to positive domestic political developments since December 2017 as well as overall strength in developing country currencies. These currencies benefitted from U.S. dollar weakness, the search for higher yields by international investors, and rising global commodity prices. The real effective exchange rate of the rand (REER) decreased marginally by 0.1% from December 2016 to September 2017, implying a broadly unchanged competitive position for South African manufacturers in international markets in 2017. International reserves increased to USD 50.7 billion in December 2017 from USD 46.6 billion in January 2017, mainly reflecting proceeds from foreign debt issuance by the Government. The reserves covered about 5 months of imports in December 2017.

The growth in demand for credit by the private sector remained subdued, decreasing to 5.2% in December 2017 from 5.8% in January of the same year, which could be attributed to subdued investor confidence, as well as higher interest rates. Growth in broad money supply (M3) increased to 7.8% in December 2017 from 7.1% in January 2017.

Economic co-operation, regional integration and trade
Merchandise exports increased to R 1.17 trillion (USD 96 billion) in 2017 from R 1.12 trillion (USD 92 billion) in 2016 because of increases in international commodity prices. The value of merchandise imports also increased in 2017 but at a slower rate compared to exports. As a result, South Africa enjoyed a trade surplus of R 69 (USD 5.6) billion in 2017 compared to R 35 billion in 2016. Consequently, the current account balance deficit declined to -2.2% of GDP in 2017, compared to -3.3% in the preceding year. The current account deficit is projected to narrow further to -2.4% in 2018.

Net inward foreign direct investment (FDI) decreased to R 17.7 billion in 2017 from R 32.9 billion in 2016 due to a sale of a significant stake in a banking company by a foreign direct investor. In contrast, portfolio investment increased to R 278.8 billion in 2017 compared to R 139.9 billion in 2016 due to increased demand by non-resident investors to acquire South Africa’s debt and equity securities. Consequently, total capital inflows declined to 2.2% of GDP in 2017, from 3% of GDP in the preceding year.

South Africa is a member of three major regional economic groupings: the Southern African Development Community (SADC), the Southern African Customs Union (SACU), and the Common Monetary Area (CMA). It is also a member of the Brazil, Russia, India, China, and South Africa (BRICS) group of emerging countries. Its financial sector is well developed,

<table>
<thead>
<tr>
<th>TABLE 4. Current account (percentage of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
</tr>
<tr>
<td>---------</td>
</tr>
<tr>
<td>Trade balance</td>
</tr>
<tr>
<td>Export of goods (f.o.b)</td>
</tr>
<tr>
<td>Import of goods (f.o.b)</td>
</tr>
<tr>
<td>Services</td>
</tr>
<tr>
<td>Factor income</td>
</tr>
<tr>
<td>Current transfers</td>
</tr>
<tr>
<td>Current account balance</td>
</tr>
</tbody>
</table>

Source: Data from domestic authorities; estimates (e) and predictions (p) are based on the authors’ calculations.
globally ranking 44 out of 137 countries in the 2017-2018 World Economic Forum (WEF) Global Competitiveness Report and hence a key driver of regional financial integration.

South Africa signed the European Union (EU)-SADC Economic Partnership Agreement (EPA) in June 2016 together with Botswana, Lesotho, Namibia, and Swaziland. Mozambique signed the agreement in February 2018 making it the first regional EPA with EU in Africa.

**Debt policy**

In the 2018/19 Budget, the Government took measures to narrow the budget deficit and stabilise debt to help stimulate economic growth in the medium term. Gross public debt is estimated to have reached 53.3% of GDP in FY 2017/18 and is expected to increase further to 55.1% of GDP in FY 2018/19. Public debt is expected to stabilise at 56% of GDP in FY 2021/22. The debt servicing cost is projected to reach 3.6-3.7% of GDP in the medium term. Government adjusted its debt management strategy during FY 2017/18 to finance a large revenue shortfall. The gross borrowing requirement for FY 2017/18 reached R 246 billion. Demand for Government debt remains robust, despite sovereign credit-rating being downgraded during 2017 by Standard and Poor’s and Fitch to a sub investment grade.

Although South Africa’s total (public and private) external debt increased to R 2.2 trillion in September 2017 from R 1.9 trillion in September 2016, as a ratio of GDP it decreased to 47.8% of GDP from 49.4% of GDP in the same period. Over 90% of the country’s foreign debt is owed by the private sector. Only 10% of foreign debt is owed by the national Government. South Africa’s outstanding foreign debt marginally declined to 151.6% of total export earnings at the end of September 2017 as compared to 152.6% at the end of September 2016.

Developed and liquid domestic capital markets will remain the Government’s main source of borrowing. The debt portfolio remains well-structured with an emphasis on longer-term loans. Eskom, independent power producers and the Road Accident Fund account for the majority of the Government’s contingent liabilities.

To improve efficiency in public spending and improve planning and execution of large infrastructure projects, the Government established the Budget Facility for Infrastructure within the National Treasury. This will be the vehicle through which the Government will borrow from Development Financing Institutions (DFIs) to fund future infrastructure investments.

The Office of the Chief Procurement Officer continues to build on supply chain management reforms. In recent years, a large number of deviations from normal procurement processes has reduced the credibility of the supply chain management system. The Government has reiterated that in future, deviations will be allowed only in rare and well-justified cases.

**ECONOMIC AND POLITICAL GOVERNANCE**

**Private sector**

South Africa has a vibrant private sector, generating 75% of the country’s GDP. The overall business environment is conducive for private sector investment, but significant challenges remain, notably in terms of energy access, trading across borders and red tape. South Africa’s ranking in the Doing Business Index deteriorated to 82 in 2018 from 74 in 2017. The main reasons for the deterioration are measures introduced earlier that increased obstacles to doing business, such as the introduction of regulations making access to credit information more difficult, an increase in property transfer taxes making the registration of property more expensive, and higher vehicle taxes. In 2018, South Africa’s least favourable Doing Business indicators were ‘trading across borders’ (147 out of 190 countries), ‘starting a business’ (136), ‘enforcing contracts’ (115), and ‘getting electricity’ (112). On the positive side, the country performed well in ‘protecting minority investors’ (24) and ‘resolving insolvency’ (55). In spite of the deterioration in the Doing Business Index in recent years, South Africa performed better in 2018 than its two BRICS peers, Brazil (125) and India (100).

The country also deteriorated in the World Economic Forum’s global competitiveness ranking for 2017-2018. It was listed 61 out of 137 countries, down from 47 the previous year. South Africa remains one of the most competitive countries in Sub-Saharan Africa, and among the region’s most innovative (39). Though still relatively good in the African context, however, its institutional environment (76), financial markets (44), and goods market efficiency (54) were all rated as weaker than the previous year. One of the causes for this is a decline in the quality of auditing and reporting standards, which fell from 1 in 2016/17 to 30 in 2017/18 because several key international auditing firms were found to be involved in auditing scandals. Corruption, and crime and theft were identified as the two most problematic factors for doing business in South Africa in this year’s WEF survey. The Government will review business incentives in 2018 to improve their contribution to investment and job creation.
Financial sector
The financial sector comprises 25 registered mutual and cooperative banks, 15 local branches of foreign banks as well as other financial intermediaries. The financial sector is well developed, ranking 44 out of 137 countries in the 2017/18 Global Competitiveness Report, but is highly concentrated, since five banks control nearly 90% of total assets in the sector. South Africa signed into law the Financial Services Regulation Bill (also known as the Twin-Peaks model of financial regulation) on 21 August 2017. The Bill creates two brand new financial sector regulators: (1) the Prudential Authority; and (2) the Financial Sector Conduct Authority. The first is responsible for regulating the prudential aspects of banks and all non-bank financial institutions, and the second for regulating market conduct and fair treatment of financial consumers. The South African Reserve Bank (SARB) oversees the two regulatory bodies and provides overall financial sector regulatory oversight.

The South African banking sector remained sound, with banks holding adequate levels of capital well above the minimum regulatory requirement. The sector’s total capital adequacy ratio (CAR) of 16.22% in December 2017 was well above the regulatory requirement of 10%. The tier 1 and the common equity tier 1 CARs increased to 13.43% and 12.88% respectively in December 2017. However, the banking sector’s profitability declined in 2017. The return on equity (ROE) ratio for the sector decreased to 15.9% in December 2017 from 17.6% in December 2016, while the return on assets (ROA) remained unchanged at 1.3% in the same period. Net, 12-month cumulative interest income increased to R 158.4 billion in December 2017 compared to R 150.9 billion in the same period the previous year. Gross loans and advances remained the largest component of banking-sector assets, remaining at about 74% in December 2017. Impaired advances, an indicator of the banking sector’s credit risk, fell to 2.84% of gross loans and advances in December 2017 from 2.86% in the same period the previous year.

Despite the financial sector’s high degree of sophistication, access to finance by small, medium and micro enterprises (SMMEs) remains a key challenge and financial inclusion remains low. Only about 25% of low-income households use their accounts for transactions.

Public sector management, institutions and reforms
South Africa adopted one of the most liberal constitutions in 1996 following the democratic transition in 1994. The judiciary is independent and respect for the rule of law is recognized in the constitution. Property and contract rights are also adequately respected and enforced. The tax laws are fair, generally internationally competitive, and do not put undue burden on economic activities. The legal system is efficient.

The Policy Coordination and Advisory Services Commission, located in the Office of the President, coordinates public policy. The first Five-Year Plan (Medium-Term Strategic Framework (MTSF) 2014-2019), which constitutes the first five-year phase of the National Development Plan, is in its fourth year of implementation and will expire in mid-2019. Although access to basic economic and social services has improved over the past two decades, communities in townships and rural areas have repeatedly lamented lack of progress in service delivery.

The executive is largely accountable to strong oversight institutions. The two core branches of oversight are the Parliament and the Constitutional Institutions Supporting Democracy, which include the Auditor General, the Public Protector, the Public Service Commission, the Human Rights Commission and the Commission for Gender Equality, among others.

The key public sector reform undertaken in 2017 was the revised Preferential Procurement Regulations 2017 (PPPFA 2017), issued in terms of the Preferential Procurement Policy Framework Act, 2000. The PPPFA Regulations 2017 have repealed the 2011 PPPFA Regulations and have introduced a number of key changes aimed at using procurement to promote local industrial development, socio-economic transformation, and the empowerment of small business enterprises, cooperatives, and rural and township enterprises.

Natural resource management and the environment
South Africa is among the top 20 largest per capita emitters of greenhouse gases (GHG) globally because of its coal-based power plants that generate approximately 80% of the country’s base-load electricity capacity. Furthermore, the country is water scarce and is therefore vulnerable to the effects of drought and rainfall variability. It is estimated that drought has affected about 17.7m people in the country since 1996 (in terms of total population, the fourth highest number among African countries). More broadly, economic development, population growth, and rapid urbanization exacerbate negative environmental impacts – declining air quality, increasing waste generation, deteriorating ecosystem health, and loss of biodiversity.

South Africa ratified the Paris Agreement in 2016. The country’s Nationally Determined Contribution (NDC), focusses on both adapting to climate change and reducing greenhouse gas emissions. In recognition of the coal-dominated grid and the technical challenges of bringing renewable energy on line whilst
meeting baseload requirements, the NDC defines a ‘peak, plateau, and decline’ profile under which economy wide emissions, particularly those from energy generation, are set to increase, plateau, and later fall. Significant progress has been made in clean energy generation, mainly through wind and solar, and renewable energy generation is expected to increase to 13.25 MW by 2025. The Government has also set up a Green Fund, managed by the DBSA, to support the transition to a low carbon, resource efficient and climate resilient development path that delivers high impact economic, environmental and social benefits.

Political context
South Africa's constitution, adopted in 1996, established a society based on democratic values, social justice and fundamental human rights. The country has strong democratic systems and since the end of apartheid in 1994, it has conducted free and fair elections. The press continues to be robust and free and the opposition parties are active and enjoy full political freedom. The ruling party, the African National Congress (ANC), enjoys support from its historic coalition partners that include the Congress of South African Trade Unions (COSATU) and the South African Communist Party (SACP). The ANC conducted an election of the party leadership during its 54th national conference held on 16-20 December 2017 in Johannesburg, in which the Deputy President, Cyril Ramaphosa, was elected as the new President of the ANC. The National Executive Committee (NEC) of the ruling ANC party recalled President Jacob Zuma as a head of State, forcing his resignation in mid-February 2018. Following his resignation, the new president of the ANC was elected the President of the Republic on 15 February 2018. The election of Cyril Ramaphosa, who campaigned on the ticket of fighting corruption and weak governance in public institutions, signalled an end to political uncertainty triggered by a fiercely contested election campaign and was well received by the general public, civil society groups, and businesses. As a result, investor confidence has started to improve.

SOCIAL CONTEXT AND HUMAN DEVELOPMENT

Building human resources
Improving human resources is one of the key priorities of the Government but progress has been modest. In the health sector, the infant mortality rate grew from 28 deaths per 1,000 live births in 2014 to 34.2 in 2016. The under-five mortality rate was higher in 2016, reaching 43.3 from 39 deaths per 1,000 live births in 2014. However, the maternal mortality ratio has declined to 154 in 2016 from 165 per 100,000 live births in 2012. The mortality from HIV/AIDS and tuberculosis has declined due to effective health interventions in these areas. In particular, the TB death rate fell to 4.5% in 2016/17. South Africa has the world’s largest antiretroviral treatment programme covering 3.8 million people in March 2017.

The majority of young children (63%) live in households that fall below the upper poverty line (R 992 per month as of 2015). Poverty-induced limited access to food contributes to high incidences of malnutrition among children in South Africa. The percentage of South African households with inadequate or severely inadequate access to food decreased only marginally between 2010 (23.9%) and 2016 (22.6%). Although household access to food has improved since 2002, it has remained static since 2011. South Africa’s national school nutrition programme currently feeds over 9 million children. Public expenditure on health was estimated to reach about R 191.6 (USD 15.9) billion, or 13.9% of the total public expenditure in FY 2017/18. Government allocated R 667.7 billion on health for the next three years (FYs 2018/19-2020/21).

In 2016, 35.8% of South African children aged 0-4 years attended the early childhood development programmes at day-care centres, crèches, playgroups, nursery schools, and in pre-primary schools. Also 41.3% of these children attended day-care or educational facilities outside their homes in 2016. Gross primary school enrolment for those aged 7-13 was 99.7 in 2016. Gross female primary school enrolment was 97.3% while that of males was 102.1% in 2016, implying near parity participation between male and female children.

Approximately 14 million children were attending pre-primary, primary, and secondary schools in South Africa in 2016, 94.2% of them in public schools. About three-quarters (77.1%) of the children who attended public schools benefited from school feeding schemes in the same year. Higher educational institutions enrolled 766,812 students in 2016, implying a gross enrolment of 19.6%. In FY 2017/18, the Government allocated R 312.8 (USD 26) billion or about 23.3% of total public expenditure to basic education, post-school education and training. Basic and higher education will receive R 1.1 trillion in the FY 2018/19-2020/21 medium term budget policy period.

Poverty reduction, social protection and labour
Despite being an upper MIC, South Africa suffers from high poverty; the poverty headcount increased to 55.5% in 2015 from 53.2% in 2011. The increase was mainly due to low economic growth, rising unemployment and high household indebtedness. South Africa has not adopted an official measure of poverty, and uses the food poverty line, lower bound poverty line, and upper bound poverty line measures, which are based on monthly household income levels. In 2015, 25.2% of
South Africans (14 million) lived in extreme poverty or below the national food poverty line of R 441 per person per month, while 55.5% of the population (31.4 million) lived below the national upper bound poverty line of R 992. The majority of the poor live in townships, informal settlements, and rural areas where subsistence farmers dwell. The townships and informal settlements are home to 38% of the working age population and account for 60% of those unemployed in the country.

The Government has put in place a comprehensive social welfare system. Additionally, a national minimum monthly wage of R 3 500 or R 20 per hour was introduced in 2016, to be implemented from May 2018. Legislation will be passed in 2018 to enact the national minimum wage. Currently, nearly 17 million out of 56.5 million South Africans receive social grants. Child support grants are also provided and since 2011 include children up to the age of 18. The Government allocated R 234.8 (USD 19.5) billion for social protection in the FY 2017/18 budget and the allocation is expected to grow to R 259.4 billion in FY 2018/19, accounting for 17.7% of total Government spending over the period. Currently, social grant expenditure remains at a stable 3% of GDP. Over the next three years, the Government plans to spend R 846.8 billion on social grants. In addition, the Government provides free basic services to the households regarded as indigent. These services include free basic water, electricity, sanitation, and free school and school meals for children. The social welfare system has substantially contributed to contain the increase in poverty and hunger but it has reached a limit in the difference it can make and pockets of marginalised groups are not accessing social assistance benefits. To effectively reduce poverty, inequality and spatial disparities, South Africa’s most pressing challenge today is to generate jobs, notably for the youth and women.

The amended Basic Conditions of Employment Act 2014 protects basic labour standards in South Africa. The Employment Tax Incentive (ETI) scheme, introduced in 2014, is directed mainly at the youth and is producing positive results. Total claims for the Employment Tax Incentive amounted to R 11.2 billion for the period 1 January 2014 to 31 March 2017. The incentive was claimed by 50 977 unique employers. The number of youth who benefited is believed to have surpassed 1 million by end of 2017. In the fourth quarter of 2017, 30% of South Africa’s 10.3 million youths aged 15 to 24, were not in employment, education or training and this remains one of the major social challenges in South Africa.

**Gender equality**

South Africa achieved gender parity in primary school with gross female enrolment at 97.3%, compared to over 102% for boys in 2017. In 2017, the gross female secondary school enrolment ratio was 111% compared to 88% for males. Good progress has also been made in tertiary institution enrolment for girls, which reached 23.3% for girls and 15.7% for boys in 2017.

The unemployment level remained higher for women at 29% compared to 24.8% for men in the fourth quarter of 2017. The share of women in non-agricultural wage employment has, however, marginally increased from 45% in 2010 to 46% in 2013.

South Africa has made positive progress in women’s political empowerment. Currently women ministers comprise 41% of the cabinet, women deputy ministers make up 47% of the total number, and there is a 42% representation of women in the National Assembly. However, this is 8% below the MDG target (of 50%) and the SADC Gender Protocol. The World Economic Forum’s 2017 Global Gender Gap Index ranked South Africa 18 out of 144 countries in the category ‘political empowerment of women’ and 1 in the category ‘health and survival by women’. On the African continent, only Rwanda performed better on female political representation in 2017.

**THEMATIC ANALYSIS: INFRASTRUCTURE FINANCING**

**Overview of current infrastructure**

South Africa has a well-developed infrastructure base, notably in the highly developed metropolitan areas, commensurate with its status as an advanced upper MIC. However, infrastructure services are not readily accessible, reliable, and affordable in the ‘second segment’ of the economy, i.e., townships and poor rural areas, which requires substantial investments in energy, transport and water and sanitation.

In the energy sector, electricity supply has improved since 2016 following better maintenance, which resulted in higher plant availability capacity, additional generation by independent power producers, and commissioning of Eskom’s new projects. Eskom supplies 95% of the electricity consumed in South Africa. As of March 2017, Eskom operates 44 134 MW of nominal generation capacity for a demand of 32 985 MW. South Africa’s current energy mix includes coal (81%), nuclear (4%), gas (5%), hydro (4%) and wind/ solar (5%). The Government’s integrated energy resource plan 2010-30 aims to reduce the share of coal in the energy mix to 48% by 2030. Since 2011, the Department of Energy has procured 6 422 MW of electricity from 112 independent power producers of renewable energy. Of this, 3 052 MW of electricity generation capacity has been connected to the national grid. Renewable energy generation
is expected to increase to 13 225 MW by 2025. As regards access to energy, about 84.2% of South African households had access to electricity in 2016 (compared to 79% in India and 100% in the other BRICS). However, about 16% of households, most of which are in townships, informal settlements and rural areas, still do not have access to electricity.

The key challenges in the energy sector are: (i) aging generation plants and inadequate transmission lines; (ii) negative growth in electricity demand; (iii) financial viability and sustainability of the energy sector; (iv) funding constraints to meet required capital investments; and (v) high and rising electricity tariffs which have dampened demand by energy intensive users. The current electricity demand is lower than supply. However, if recent improvements in business confidence leads to more private sector investment in the medium term, the current generation capacity may not be sufficient. In particular, reliable supply of electricity at competitive rates to remote townships and rural areas is inadequate at present, thereby reinforcing the dual characteristics of the economy. To integrate the economic activities in townships and rural areas with the developed segment of the economy, and enable productive value added economic activity, substantial investments in the energy infrastructure are required.

The country has a well-developed transport infrastructure which includes 750 000 km of roads (of which about 25% is paved), 20 000 km of rail, 9 airports, 8 commercial ports, and 3 800 km of pipelines for petroleum products and gas. Nonetheless, the sector faces challenges due to gaps in the penetration, distribution, spread, and reliability of affordable public transport, a high road fatality rate of about 24 per 100 000 people, and substantial maintenance backlogs on lower class roads. In addition, heavy reliance on roads for freight transport increases maintenance needs. The most critical pitfall in the transport and logistics sector, however, is its inequitable penetration and distribution in townships/informal settlements and rural areas compared to developed metropolitan areas. Townships and informal settlements are located at the periphery and poorly connected to the main urban centres, which aggravates economic duality, inequality, unemployment and poverty. The unreliability and high cost of transport are major burdens for township dwellers, accounting for as much as 40% of their monthly income. Regarding logistics, South Africa’s major coal freight rail network is considered to be good but the branch rail line network is classified as poor. Freight by rail is also constrained by, among other factors, the poor condition and short supply of rolling stock, heavy haul commodity prices and demand, and lack of capacity at key points to export the country’s main mineral commodities, such as coal, iron ore and manganese. Port tariffs remain among the highest in the world for manufactured goods. South Africa is a water scarce country and is ranked as the 30th driest country in the world; water availability is 830 m³ per capita per year. In terms of access to basic services, 88.8% of the population had access to improved drinking water sources in 2016, though only 46.4% had access to water in their homes, and 80.9% had access to improved sanitation facilities. The country has experienced increasing water demand from irrigated agriculture (60% of consumption in 2013), urban areas (18%), and the mining industry (5%). The main challenge for water and sanitation is aging infrastructure, the quality and reliability of water supply, and sanitation services. In 2016, only 63% of South Africans surveyed by Statistics South Africa rated the quality of water they drank as good. The quality of water and sanitation services is even poorer in townships and informal settlements.

South Africa has a well-developed information and communication technology (ICT) sector and South Africa’s mobile phone operators have an extensive footprint across the continent. Nonetheless, mobile data costs are very high in South Africa compared to other middle-income countries in Africa, including Nigeria, Egypt, and Ghana, as well as low income countries such as Tanzania. In 2016, about 52% of South Africa’s population had access to the internet. As with the other key infrastructure components, the penetration of ICT services in townships/informal settlements and rural areas is limited. Neither public nor private broadband infrastructure is present to an adequately degree, reinforcing the digital divide and the dual nature of the economy. Investment in the ICT sector in townships/informal settlements and rural areas is critical for the industrialization of this segment of the economy. With respect to price, the Independent Communications Authority of South Africa (ICASA), which regulates the industry, is performing a difficult balancing act between setting affordable tariffs and ensuring that capital can be found to maintain and extend networks.

**Finance landscape**

The Government spent R 249.9 billion on economic and social infrastructure in FY 2016/17, about 6% of GDP, compared to R 261.2 billion in FY 2015/16. Economic infrastructure spending, mainly by SOEs, accounts for 76.2% of total public-sector infrastructure spending. Infrastructure investment is financed by national Government, provincial Government, municipal/local Government and PPP arrangements either through fiscal allocations or debt/equity financing. Development partners also provide support to infrastructure investment notably the AfDB, World Bank, European Investment Bank, China Construction Bank, and the other multilateral agencies provide loans for investment in key infrastructure sectors including energy, transport, and water.
Over the next three financial years (2018/19 to 2020/21), the Government plans to invest R 834.1 billion on infrastructure. Transport and logistics are a top priority, accounting for 34.5% of the total infrastructure budget, followed by energy (26.2%) and water and sanitation (14%). The infrastructure needs are massive and a large segment of these needs is funded through borrowing, particularly by key SOEs. In 2018, the Government will introduce regulatory reforms to facilitate greater municipal infrastructure investment.

According to the National Treasury’s 2018 budget review report, the Presidential Infrastructure Coordinating Commission has approved 18 strategic infrastructure projects to support economic development and service delivery in all provinces. The Department of Economic Development provides secretariat support to the commission. Over the next three years, the secretariat plans to spend R 32.6 million on facilitation, monitoring and reporting on ongoing projects.

Challenges
(1) Weak planning, financing difficulties, and the efficiency and quality of projects delivered. The Government has created a Budget Facility for Infrastructure to address these challenges. (2) Asset management challenges. The Government has prioritized maintaining and rehabilitating infrastructure to extend the useful life of existing assets. (3) Procurement challenges. SOEs in particular flout supply chain management rules when they procure goods and services. The Government has published standards for infrastructure procurement and delivery management to address this problem. (4) Effective use of local Government infrastructure grants. The Government is reviewing the local Government infrastructure grant to improve delivery of infrastructure projects.

South Africa has a well-developed PPP law and regulations. The Public Finance Management Act (1999) regulates national and provincial PPPs (Treasury Regulation 16). All institutions undertaking such partnerships require approval from the National Treasury in four phases (feasibility study, procurement, value for money, and final PPP agreement). All PPPs also go through regulatory tests to check compliance before they are implemented. The tests assess value for money, affordability, and risk transfer. Since PPPs was first introduced in South Africa in 1998, 33 projects have been undertaken. The total value of all projects amounts to R 89.3 billion.

Innovative solutions and policy recommendations
The Government is increasingly using PPPs to boost infrastructure spending. Infrastructure spending by PPPs is expected to increase to R 6.4 billion in 2020/21, from R 5 billion in 2017/18. Over the next three years, until 2020/21, the Government plans to spend R 834.1 billion on infrastructure, of which 2.2% (R 18.5 billion) will come from PPPs. In addition to own revenue and private funding, SOEs also issue bonds in the capital market. Given the large infrastructure gap, expanded use of PPP options should be explored.