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SOUTH AFRICA

- Economic growth decelerated to 0.3% in 2016 although it is expected to rebound to 1.1% in 2017 and higher in later years.
- Growth prospects will be driven by moderately stronger global growth, more favourable weather conditions, reliable electricity supply, less volatile labour relations, recovering business and consumer confidence, and stabilising commodity prices.
- The industrialisation strategy is geared towards promoting entrepreneurship, which will also help to generate employment.

Overview

Economic growth at 0.3% in 2016, is expected to rebound from 2017 onwards as several limiting factors are receding, creating an opportunity for a new growth cycle. Key structural bottlenecks are being addressed including power shortages. Eskom has moved from an electricity shortage of 3 000 MW, which precipitated a series of power outages in 2015, to a surplus of 3 000 MW in 2016. Moreover, the government remains committed to working with the private sector, labour and civil society to promote inclusive growth and economic transformation. Economic growth is expected to increase to 1.1% in 2017.

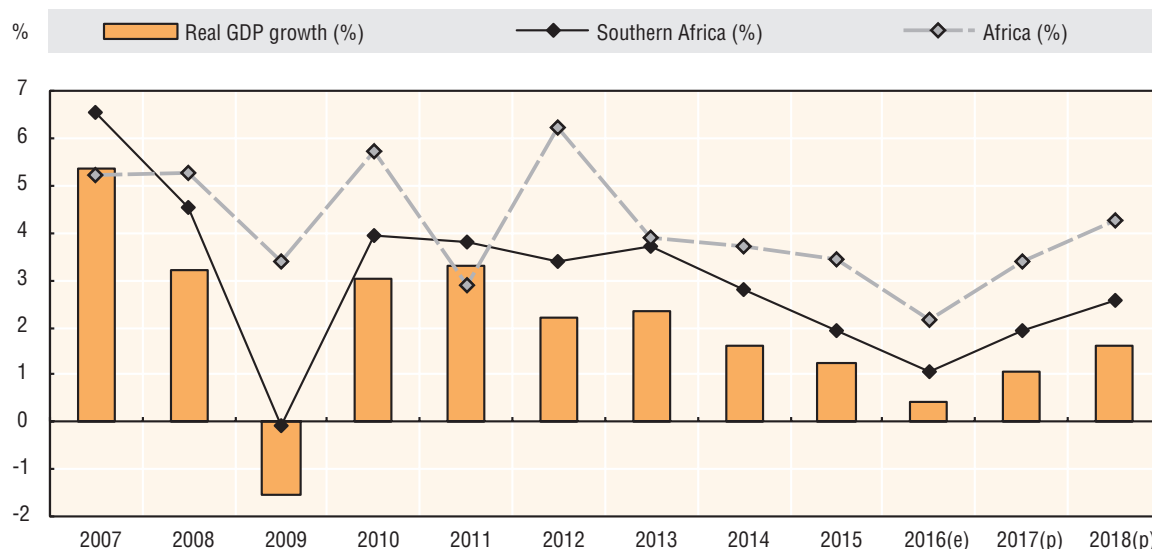
The real effective exchange rate of the rand appreciated by 23.6% between January and December 2016. Although this resulted in deterioration in the competitiveness of local producers in foreign markets, at its most recent levels the currency was still 9% below its average value of the past 15 years in real terms. Inflation breached the monetary policy target range, reaching 6.4% in 2016. Driven by higher food prices, rising world oil prices, and domestic fuel prices, headline inflation is expected to breach the policy target range again in 2017 reaching 6.1%. Monetary policy has been tightened to curtail inflation and inflationary expectations from rising amid monetary policy tightening by the US Federal Reserve. The monetary authorities increased the policy interest rate to 7% in March 2016. Due to higher interest rates and subdued investor confidence, growth in the demand for credit by the private sector fell to 5.11% in December 2016 from 10.17% in December 2015.

National government revenue increased by 11.6% in fiscal year 2015/16 reaching R1.069 trillion or 26.1% of GDP. The increase was driven by higher receipts in most major tax categories, particularly taxes on property, international trade and transactions, and non-tax revenue.

Unemployment remains a major social challenge with youth unemployment among the highest on the continent. Commendable progress was made in addressing absolute poverty in the past decade primarily through extensive social safety net programmes. Nonetheless, the government continues to face challenges to effectively deliver basic economic and social services in rural areas and the townships.

South Africa's industrialisation and employment-generation strategy aims to encourage entrepreneurship. Nonetheless, success has been limited due to inadequate technical and business management skills; lack of experienced mentoring of entrepreneurs; barriers to business entry, and lack of access to finance.

Figure 1. Real GDP growth



Source: AfDB, Statistics Department AEO. Estimates (e); projections (p).

Table 1. Macroeconomic indicators

	2015	2016(e)	2017(p)	2018(p)
Real GDP growth	1.3	0.3	1.1	1.6
Real GDP per capital growth	0.3	-0.5	0.2	0.7
CPI inflation	4.6	6.4	6.1	5.6
Budget balance % GDP	-3.7	-3.4	-3.2	-2.9
Current account % GDP	-4.3	-3.9	-3.7	-3.7

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

Recent development and prospects

Economic growth decelerated to 0.3% in 2016 from 1.3% in 2015. Real GDP grew by a mere 0.2% in the third quarter of 2016 having expanded by 3.5% in the preceding quarter. Mining and financial services were the key drivers of growth in the third quarter contributing 0.4 and 0.2 of a percentage point to growth, respectively. The manufacturing and agricultural sectors contracted by 3.2% and 0.3%, respectively, in the same period. Household final consumption expenditure grew by 2.6% contributing 1.6 percentage points to growth. Overall, the end of commodity super-cycle, the slowdown in economic activity in China, domestic policy uncertainty, infrastructure bottlenecks and low investor confidence were responsible for slow growth in the past four years.

The 2015/16 drought wrought havoc to the South African economy as well as to the entire southern and eastern African regions, forcing many countries to declare a national disaster. In South Africa, annual food inflation reached 11.7% in December 2016 due to a drop in crop production. The government took mitigating measures by instituting the National Disaster Management Centre at the Department of Co-operative Governance and Traditional Affairs to co-ordinate disaster relief efforts including investments in infrastructure, loans and capacity building to farmers, and land reform initiatives, all of which culminated in slowly reviving growth in the agriculture sector.

Growth is expected to improve significantly in 2017 and 2018 as several factors that have limited GDP growth subside, creating an opportunity for a new growth cycle. Additional sources of electricity supply are being connected to the grid. Eskom has moved from an electricity shortage of 3 000 MW which precipitated a series of power outages in 2015 to a surplus of 3 000 MW in 2016. The weaker real exchange rate of the rand has created opportunities for export growth, while reduced friction in the labour market has led to fewer days lost to industrial action. Moreover, guided by the National Development Plan and the short term 9-point plan announced in February 2015, the government is committed to working with the private sector, labour and civil society to promote inclusive growth and economic transformation. Economic growth is forecast to increase to 1.1% in 2017 reaching 1.6% in 2018.

The labour market is characterised by chronic structural unemployment which remains a major social challenge. The unemployment rate stood at 26.5% in the fourth quarter of 2016. In the fourth quarter of 2016, 5.8 million South Africans were unemployed compared to 5.2 million twelve months previously. The youth unemployment rate remains one of the highest in the continent. According to Statistics South Africa, in the fourth quarter of 2016, 50.9% of people aged 15-24 were unemployed, as were 31.9% of those aged 25-34. Between the fourth quarter of 2015 and the fourth quarter of 2016, sizeable job losses were suffered in four sectors of the economy: mining (62 000), trade (58 000) community and social services (53 000) and manufacturing (11 000). The main cause of the high unemployment remains the lack of skills. In the fourth quarter of 2016, 58.8% of unemployed persons had below matric level of education, 32.4% had matric level of education and 8.1% had tertiary level of education.

In 2016, the government announced that it was committed to better co-operation with the private sector through public private partnerships and to strengthening Micro, Small and Medium Enterprises (MSMEs) to promote sustainable industrial development. The government has initiated several programmes including the Black Industrialists Programme to incentivise black-owned businesses to enter into strategic and high value-added industrial development activities. The authorities also invested about ZAR 1 billion to implement the Youth Employment Accord 2013, which seeks to create 5 million jobs by 2020. It is however important to note that small businesses continue to have a low survival rate with 63% failing within the first 18 months of operation. Moreover, small businesses still need to be better integrated into the supply chains of larger enterprises. The one-stop shop for business registration, InvestSA, should contribute to reducing the impediments to doing business in the country.

In spite of the country's extensive social protection that covers over 16 million people, in 2015, 37.6% of South Africans (close to 18.3 million) lived below the nationally established lower bound poverty measure of R 501 per month. Good strides were noted, compared to 1994, in improving access to energy, water and sanitation and in reducing the consumption of environmentally unfriendly substances, according to the 2015 Report on the Millennium Development Goals.

In 2016, there were protests against inadequate service delivery and rising university student fees, among others. The "Fees Must Fall" protests by university students spread across the country and resulted in clashes with law enforcement, schools closure, and the vandalism of school infrastructure. The authorities responded by allocating R .6 billion in the October Medium-Term Budget Policy Statement to cover a zero fee increase in 2016, and continued emphasis on training and skills development, which contributed to easing the situation.

Table 2. GDP by sector (percentage of GDP at current prices)

	2011	2015
Agriculture, forestry, fishing and hunting	2.5	2.4
of which fishing
Mining and quarrying	9.6	8.0
of which oil
Manufacturing	13.3	13.2
Electricity, gas and water	3.2	3.7
Construction	3.8	4.0
Wholesale and retail trade; Repair of vehicles; Household goods; Restaurants and hotels	14.8	15.0
of which hotels and restaurants
Transport, storage and communication	9.4	10.3
Finance, real estate and business services	20.8	20.6
Public administration and defence	16.5	17.0
Other services	6.0	5.9
Gross domestic product at basic prices / factor cost	100.0	100.0

Source: Data from domestic authorities.

Macroeconomic policy

Fiscal policy

Fiscal policy stance has remained largely contractionary since 2013. Growth in real consolidated non-interest expenditure will fall further to 1.6% over the next three years from 2.3% at the time of the 2013 medium term budget framework. Fiscal policy is focused on containing the budget deficit and slowing the pace of debt accumulation to maintain spending programmes and promote confidence in the economy. In other words, the central fiscal policy objective is to stabilise the national debt-to-GDP ratio by closing the budget deficit.

In the 2016/17 fiscal year, the main budget revenue and expenditure were estimated at 26.2% and 29.7% of GDP respectively resulting in the main budget deficit of 3.4%. Despite revenue underperformance, the main budget primary deficit is estimated to have fallen to nearly zero by the end of 2016/17 from 0.3% of GDP in 2015/16, and to reach a surplus in 2018/19. The combination of a lower expenditure ceiling and higher taxes will narrow the consolidated budget deficit from an estimated 3.4% of GDP in 2016/17 to 2.6% by 2019/20. In the 2016/17 fiscal year, the current expenditure and capital expenditure were estimated to have accounted for 88% and 11.2% of the total expenditure respectively. In line with the priorities of the National Development Plan, in the 2016/17 fiscal year, the shares of consolidated government expenditure on education, health, agriculture and economic infrastructure will be 20%, 11.6%, 2% and 5.5%, respectively. The government anticipates investing R 865.4 billion in infrastructure over the next three years. Expenditure on economic infrastructure accounts for over 75% of total public-infrastructure investments.

The 2017 budget proposals reaffirm the government's commitment to a prudent, sustainable fiscal-policy trajectory. Over the medium term, government intends to lower the expenditure ceiling, bolster tax revenues, actively manage fiscal risks emanating from state-owned companies and sharply restrict the growth of employee-compensation budgets in a bid to achieve fiscal consolidation earlier than anticipated in the previous budget. The wage bill, as a share of total spending, is projected to remain at about 35% between 2015/16 and 2018/19. The wage bill was estimated to have reached 40% of current expenditure in 2016/17. As a result of reprioritisation, the union-government wage agreement and proposed reductions in national and provincial compensation, the consolidated wage bill is expected to grow at a nominal annual average of 7.4% over the medium term.



Table 3. Public finances (percentage of GDP at current prices)

	2008/09	2013/14	2014/15	2015/16	2016/17(e)	2017/18(p)	2018/19(p)
Total revenue and grants	28.4	27.9	28.6	30.0	30.6	30.8	30.8
Tax revenue	24.8	23.7	24.3	25.0	25.9	26.2	26.1
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending (a)	28.1	31.7	32.2	33.7	33.9	34.0	33.7
Current expenditure	26.4	27.9	28.3	29.0	29.7	29.9	29.7
Excluding interest	24.1	24.8	25.1	25.6	26.3	26.9	26.5
Wages and salaries	8.8	11.3	11.4	11.7	11.9	11.7	11.9
Interest	2.3	3.0	3.2	3.3	3.3	3.0	3.2
Capital expenditure	1.2	3.7	3.8	4.0	3.8	3.8	3.7
Primary balance	2.6	-0.7	-0.4	-0.3	0.0	-0.2	0.3
Overall balance	0.3	-3.8	-3.6	-3.7	-3.4	-3.2	-2.9

Note: a. Only major items are reported.

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

Monetary policy

A monetary policy tightening cycle has been underway since January 2014. Six policy interest-rate increases between January 2014 and March 2016 pushed the rate to 7%, but it has been on hold since March 2016. The policy decision to increase interest rates was underpinned by a risk of rising inflation, primarily caused by higher food prices and the continued depreciation of the rand, as well as by heightened inflation expectations. The successive increases in policy interest rates also reflected the need for gradual normalisation of monetary policy ahead of expected tightening in the United States. Consumer inflation breached the monetary policy target range of 3-6% reaching 6.4% in 2016 on the back of higher food prices and pass-through effects of the weaker rand.

The ZAR exchange rate has remained relatively volatile in the past three years. Nonetheless, since early 2016 the currency continued to strengthen, on average, compared to the previous year. On a trade-weighted basis the nominal exchange value of the rand increased by 21% from January to December 2016, largely due to the confirmation of South Africa's investment-grade credit rating. The ZAR, along with other high-yielding currencies, appreciated markedly in 2016. High-yielding currencies were supported primarily by the notion that major central banks could add liquidity to support markets. Driven by a stronger trade balance, relatively high domestic bond yields and a recovery in commodity prices, the real effective exchange rate of the rand appreciated by 23.6% between January and December 2016 eroding the competitiveness of South African exporters. International reserves increased to USD 47.3 billion in December from USD 45.1 billion in January 2016. The reserves covered about 5 months of imports in December 2016.

The growth in demand for credit by the private sector declined to 5.1% in December 2016 from 10.1% in December 2015. This could be attributed to subdued investor confidence, as well as higher interest rates. Likewise, growth in the broad money supply (M3) decreased from 9.6% in December 2015 to 6.5% in December 2016.

Economic co-operation, regional integration and trade

Merchandise exports decreased to ZAR 1.03 trillion (USD 74 billion) in the third quarter of 2016 from ZAR 1.11 trillion (USD 80 billion) in the preceding quarter because of weaker international demand for South African commodities. As a result, the trade balance was in deficit in the third quarter of 2016 from a surplus in the preceding quarter. Exports were also affected by the strengthening of the value of the rand that more than offset the benefit from higher international commodity prices. As a result, the current account deficit increased to 4.1% in the third quarter

of 2016 from 2.9% in the preceding quarter. The current account balance is estimated to have declined to 3.9% in 2016 and is projected to decline to 3.8% in 2018.

Inward foreign direct investment (FDI) fell to ZAR 7 billion in the third quarter of 2016 from ZAR 8.6 billion in the second quarter, in contrast to portfolio investment, which increased to ZAR 39 billion from ZAR 33 billion over the same period. As a result, total capital inflows reached ZAR 38.4 billion (3.5% of GDP) in the third quarter of 2016 from ZAR 13.8 billion (1.3% of GDP) in the preceding quarter.

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 BRICS group of emerging countries alongside China, India, Russia and Brazil. Although it has not yet come into force, South Africa is one of the six countries that have signed and ratified the 2005 SADC Protocol on the Facilitation of Movement of Persons. Its financial sector is the most developed on the African continent ranking 11th out of 138 countries in the 2016-17 World Economic Forum (WEF) *Global Competitiveness Report* and hence a key driver of regional financial integration.

In June 2016, South Africa signed the EU-SADC Economic Partnership Agreement (EPA), together with Botswana, Lesotho, Mozambique, Namibia and Swaziland. Once ratified by all six countries, the EPA will replace the current trade agreement with the European Union.

Table 4. Current account (percentage of GDP at current prices)

	2008	2013	2014	2015	2016(e)	2017(p)	2018(p)
Trade balance	-0.6	-2.1	-1.7	-0.9	-0.7	-0.4	-0.7
Exports of goods (f.o.b.)	30.8	26.3	26.5	25.8	28.1	28.5	28.5
Imports of goods (f.o.b.)	31.4	28.4	28.2	26.6	28.8	28.9	29.1
Services	-1.0	-0.3	-0.1	-0.1	-0.4	-0.4	-0.3
Factor income	-3.1	-2.6	-2.7	-2.5	-2.2	-2.1	-2.0
Current transfers	-0.8	-0.9	-0.9	-0.8	-0.5	-0.7	-0.7
Current account balance	-5.5	-5.9	-5.3	-4.3	-3.9	-3.7	-3.7

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

Debt policy

Debt sustainability remains one of the key principles of the government's approach to fiscal management. Over the medium term, the government aims to slow the pace of borrowing by reducing the budget deficit. The national government total gross debt stood at 51% of GDP (ZAR 2.15 trillion) in September 2016 from 49% of GDP (ZAR 1.9 trillion) in September 2015. Domestic debt accounts for 91% of the total national government debt. Total gross national government debt will increase to 52.3% of GDP in 2017/18. The government anticipates that the national government debt will stabilise at 48.2% in 2020/21.

South Africa's total (public and private) external debt increased to 46.2% of GDP (ZAR 1.95 trillion) in June 2016 from 41.6% of GDP (ZAR 1.73 trillion) in June 2015. The increase was driven mostly by the rise in rand denominated debt. Over 90% of the country's foreign debt is owed by the private sector. Only 10% of the total outstanding foreign debt is owed by the national government. South Africa's outstanding foreign debt reached a new record high of 140.7% of total export earnings at the end of June 2016 compared to 123% of total export earnings the same period the previous year.

Over the medium term, the government's borrowing strategy will focus on reducing the risks that will arise from the sharp increase in loan repayments beginning in 2016/17. The National Treasury has also updated the framework for reporting contingent liabilities in line with international practice. Debt-service costs are estimated to be 3.3% of GDP in 2016/17 and

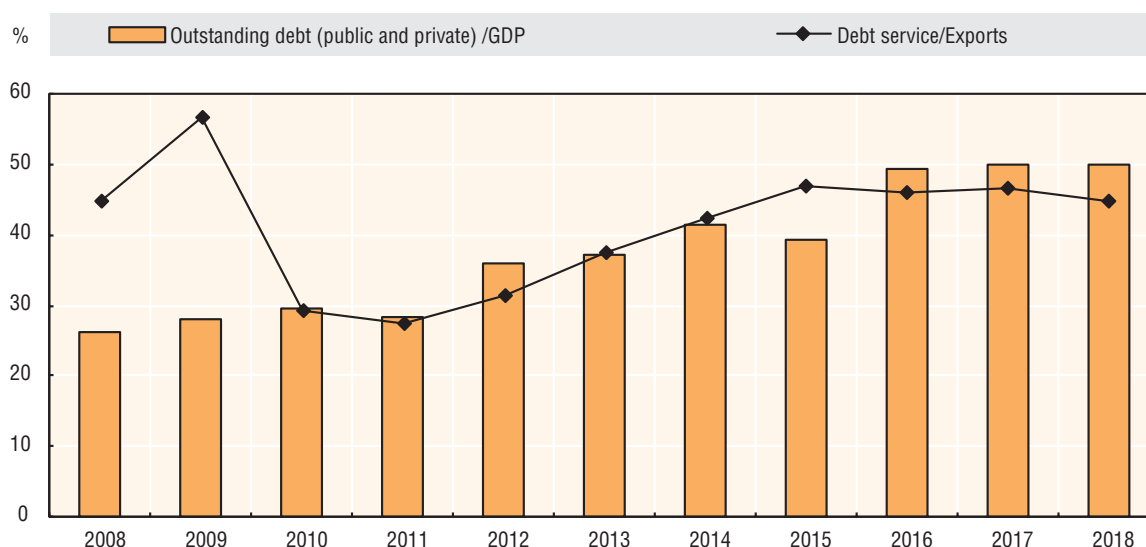


will increase to 3.6% of GDP in 2019/20. Despite volatile market conditions, debt remains within strategic risk benchmarks.

Nonetheless, several state-owned companies could pose risks to the public finances. The authorities are closely monitoring South African Airways, the South African Post Office, SANRAL and Eskom, with the aim of stabilising these entities and mitigating any risks that may materialise. South Africa avoided its sovereign ratings being downgraded by all the major ratings agencies in 2016, although Fitch and Standard and Poor's downgraded the local-currency ratings. Following a cabinet reshuffle by President Jacob Zuma in March 2017, the credit ratings agencies Standard and Poor's and Fitch downgraded South Africa's sovereign credit rating to a sub-investment grade in April 2017 while Moody's placed the sovereign credit rating on review for a possible downgrade. Fitch also downgraded South Africa's local currency ratings. A downgrade to sub-investment level by two rating agencies means that South Africa will drop out of widely used bond indexes. It could also trigger sell off from other investors. This will lead to higher borrowing costs, higher debt servicing costs and lower resources to invest in economic and social development.

South Africa's deep and liquid domestic capital markets, and its access to international borrowing, provide resources for government's financing needs. Domestic capital markets will remain the main source of borrowing. Global investors hold 32% of rand-denominated government bonds. Their investments are sensitive to any shifts in US monetary policy and South Africa's sovereign credit ratings.

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



Source: IMF (WEO & Article IV).

Economic and political governance

Private sector

South Africa's regulatory environment is relatively business-friendly. The World Bank report *Doing Business 2016* ranks the country as the 73rd easiest country in which to do business out of 189 countries surveyed. There are no minimum capital requirements and a new business can be opened in 46 days with only 6 procedures. Business exit regulations require two years and about

18% of the estate cost involved to resolve insolvency. South Africa performed better than some of its BRICS peers, such as Brazil (116th), China (84th), and India (130th) in terms of ease of doing business in the 2016 report.

Registering a business in South Africa with the Companies and Intellectual Property Commission takes 25 days. Local companies can register on line or by visiting walk-in services in Pretoria, Johannesburg, Cape Town and Durban. The government uses various transformation charters in specific economic sectors, as well as the group of policies known as Broad-Based Black Economic Empowerment (B-BBEE) updated in 2013 and 2015 to encourage the participation of the previously disadvantaged population groups in economic activities and promote inclusive growth.

One of the key structural constraints on economic growth is limited competition in the goods and services market. The South African Competition Amendment Act, 2009, seeks to address anti-competitive conduct, restrictive practices such as price fixing, predatory pricing and collusive tendering, as well as abuses by dominant firms with a market share of 35% or more. In the 2015/16 fiscal year, the Competition Commission signed memoranda of understanding with the BRICS competition authorities, the SADC competition authorities, as well as a bilateral memorandum of understanding with Namibia to deepen co-operation among competition authorities and ensure effective cross-border enforcement. The Competition Commission is conducting several market inquiries in the grocery retail sector to identify behaviours restricting competition.

In spite of the weak competition in the domestic goods and services market, South Africa has shown improvements in global competitiveness, ranking 47th out of 138 countries in the *Global Competitiveness Report 2016-17* from 56th position out of 144 countries in the 2014-15 edition. The improvement in competitiveness was driven by positive changes in technological readiness and ability to adopt existing technology to improve the productivity of its industries. The resilience of the economy to commodity-price shocks and small improvement in the quality of education have all contributed to improved overall competitiveness.

Financial sector

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 15.43% in August 2016 was well above the regulatory requirement of 10%. The tier 1 and the common equity tier 1 CARs increased marginally to 12.60% and 12.18% respectively in August 2016. The banking sector's profitability improved during the second half of 2016. The return on equity (ROE) ratio for the sector increased to 17.14% in August 2016 from 16.47% in August 2015, while the return on assets (ROA) increased to 1.23% in August 2016 from 1.19% over the same period the previous year. Net, 12-month cumulative interest income increased to ZAR 146.39 billion in August 2016 compared to ZAR 132.97 in the same period the previous year. Gross loans and advances remained the largest component of banking-sector assets, remaining at about 76% in August 2016. Impaired advances, an indicator of the banking sector's credit risk, fell to 3.17% in August 2016 from 3.27% in the same period the previous year.

The assets of pension and provident funds grew by 2.1% year-on-year during the first quarter of 2016. For the same period, the ratio of pension-fund assets to GDP, increased to 77% from 76.4% during the previous quarter. The size of the assets of the top five life insurers in the domestic economy was 47.9% of GDP in the first quarter of 2016.

According to the latest FinScope survey, levels of financial inclusion in South Africa reached 87% in 2015. The 2015 survey was based on a nationally representative sample of 5 000 adults who were 16 years or older. About 31.2 million (84%) of adults had access to formal financial services, i.e. they had a bank account and used other formal non-banking products/services in 2015. The percentage of the population using banking services increased from 75% in 2014 to 77% in 2015.



Public sector management, institutions and reforms

South Africa has an independent judiciary and respect for the rule of law is recognised in the constitution, which also guarantees the right to property ownership except in terms of law of general application (defined in Chapter 2 of the constitution, “Bill of Rights” as “for a public purpose or in the public interest”, and in any case subject to compensation) and no law may permit arbitrary deprivation of property thereby providing an effective protection to property rights in the country. 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, co-ordinates public policy. The first Five-Year Plan (Medium-Term Strategic Framework (MTSF) 2014-2019), which constitutes the first phase of the National Development Plan, is in its third year of implementation. Although access to basic economic and social services has improved over the past two decades, communities have repeatedly lamented lack of progress in service delivery to townships and rural areas.

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 reform undertaken in 2016 in public service was the adoption of the New Public Service Regulations which became effective on 1 August 2016, replacing those of 2001. The 2016 regulations include a new section on anti-corruption and ethics in public services, requiring heads of department to assess risk in these areas and to develop and implement strategies to mitigate such risk and where necessary, report such corruption to law enforcement authorities, as well as to take disciplinary steps against offenders. Freedom to access information is also guaranteed by the constitution.

Natural resource management and environment

In January 2016, the government declared that greenhouse gases were to be considered priority air pollutants. Entities using or associated with six Kyoto Protocol gases, including the synthetic gases, of which HFCs, will be required to submit a pollution-prevention plan under the National Environmental Management: Air Quality Act of 2004.

South Africa participated in COP22 talks in Marrakesh in November 2016. South Africa also played a leading role at COP21 in Paris, as the Chair of the Group of 77 and China, a group of 134 developing countries that are worst affected by climate change. The Paris Agreement on climate change, adopted at COP21 in Paris, France, in December 2015, entered into force on 4 November 2016. South Africa ratified the Paris Agreement on 2 November 2016. South Africa was keen to work with global partners in COP22 meeting to accelerate operationalising the pre-2020 implementation agenda (2016 to 2020 period); addressing the pre-2020 ambition gap; and making good progress in developing the rule book for operationalising the Paris Agreement post 2020.

A severe drought that hit southern Africa significantly reduced water levels in dams that supply water to large urban areas. Accordingly, water use has been restricted in many parts of the country. Although improved rainfall in the fourth quarter of 2016 and the first weeks of 2017 helped to raise the dam levels, restrictions on water use continued in some urban areas. The National Development Plan recognises water scarcity as a binding constraint to national development. Thus, the government is committed to investing more to protect and restore water resources.

Political context

The ruling African National Congress (ANC) suffered major setbacks in key urban areas in local government elections on 3 August 2016 for the first time since the democratic transition in 1994. The party lost three metropolitan municipalities, including Nelson Mandela Bay, Johannesburg and Tshwane, which incorporates Pretoria, the capital in the elections. The official opposition, the Democratic Alliance (DA), won a higher share of votes in these metropolitan areas and subsequently formed coalition governments with the Economic Freedom Fighters (EFF) party and other opposition parties. The DA also controls Cape Town, the second largest metropolitan area in the country. Overall nationally, however, the ANC won the local government elections with 54% of the popular vote (compared to 62% in 2011), while the DA received 27% and the EFF 8%. Observers declared the elections to be free, fair and credible. The ANC's performance was undermined primarily by the high unemployment and slow service delivery in rural areas and townships that are characterised by high levels of poverty and rampant income inequality. In recent years, community members in various parts of rural areas and townships have been protesting against the slow progress in service delivery. The ANC will hold an elective conference in December 2017 at which the next chairperson of the party will be chosen to succeed President Jacob Zuma as the party's candidate for President of the Republic in the May 2019 general election.

Social context and human development

Building human resources

Improving human resources is one of the key priorities of the National Development Plan but progress has been modest. In the health sector, the infant mortality rate grew from 27 deaths per 1 000 live births in 2012 to 28 in 2014. The under-five mortality rate was 39 deaths per 1 000 live births in 2014, while the neonatal mortality rates remained stable at 11 deaths per 1 000 live births between 2012 and 2013. The maternal mortality ratio fell from 302 per 100 000 live births in 2009 to 197 in 2011. Nonetheless, there were substantial decreases in mortality from HIV/AIDS and tuberculosis, as a result of effective health interventions in these areas.

Malnutrition remains a major challenge. The majority of young children (63%) live in households that fall below the upper poverty line (ZAR 923 per month). Therefore poverty-induced limited access to food contributes to high incidences of malnutrition among children. The percentage of South African households with inadequate or severely inadequate access to food had only marginally decreased from 23.9% in 2010 to 22.6% in 2015. Designed to alleviate poverty, improve access to education and academic performance through good nutrition, South Africa's national school nutrition programme currently feeds 9 million children. Public expenditure on health was estimated to reach about ZAR 168 (USD 12) billion or 11.5% of the total public expenditure in the 2016/17 fiscal year. It is expected to increase by 7.6% during 2016/17-2018/19. Government will allocate ZAR 606 billion on health for the next three years, i.e. 2017/18-2019/20 with ZAR 59.5 billion on the HIV/AIDS conditional grant.

In 2015, 33% 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, while some 48% attended day-care or educational facilities outside their homes in 2015. Gross primary school enrolment for those aged 7-13 was 99.7 in 2014. Gross female primary school enrolment was 97.2% while that of males was 102.1% in 2014 implying near parity participation between male and female children.

There were approximately 14 million pupils and students attending school in South Africa in 2015, 94% of them in public schools. Three-quarters (76.2%) of learners who attended public schools benefited from school feeding schemes in 2015. Higher educational institutions enrolled 710 139 in 2015. In the 2016/17 fiscal year, the government allocated ZAR 297.5 (USD 21) billion or



about 20% of total public expenditure to basic education, post-school education and training. This is expected to grow by 7.6% on average in 2016/17-2018/19. Basic and higher education will receive ZAR 857.8 billion in the next medium term budget cycle ending in 2019/20.

Poverty reduction, social protection and labour

South Africa's Medium-Term Strategic Framework 2014-2019, sets out comprehensive, responsive and sustainable social protection system objectives to combat poverty, inequality and high levels of unemployment. The social welfare system has had a major effect on poverty reduction and some effects on reducing inequality. The government allocated ZAR 167.5 (USD 12) billion for social protection in the 2016/17 budget and the allocation is expected to grow by 8.1% in the medium term, i.e. from 2016/17 to 2018/19, accounting for 12.9% of total government spending over the period. Currently, nearly 16 million South Africans benefit from social grants. By 2017/18, it is expected that 17.5 million beneficiaries will be receiving social grants, the cost for which is expected to be ZAR 180 billion. Currently, social grant expenditure remains at a stable 3% of GDP. Over the next three years, government will spend ZAR 490 billion on social grants.

According to Statistics South Africa, the percentage of individuals that benefited from social grants consistently increased from 12.7% in 2003 to 30.1% in 2015. More than one-third of black African individuals (33.5%) received a social grant, compared to 27% of coloured individuals, and 12% of Indian/Asian individuals. Only 6.3% of the white population received grants in 2015. Over 12 million children received a child-support grant in 2014. Children covered by the child-support grant account for 70% of all people covered by social-welfare transfers. The child-support grant accounts for 36% of total grant expenditure and since 2011 includes children up to the age of 18. In addition to social grants, the government also 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. A national minimum wage of ZAR 3 500 was proposed in 2016 to address lingering poverty and inequality and was signed by key stakeholders in early 2017 except the labour federation, Confederation of South African Trade Unions (COSATU).

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. The ETI progress report published on 26 August 2016 indicates that take up of the scheme has been strong, with over 32 000 employers claiming the ETI for 686 402 employees in the 2014/15 tax year. The total value of claims between 1 January 2014 and 31 March 2016 was ZAR 6.06 billion, substantially exceeding previous projections.

South Africa has not adopted an official measure of poverty. Lower, middle and upper bound poverty measures are based on monthly household income levels. Statistics South Africa indicated that the poverty head-count ratio was 7.5% while the intensity of poverty was 42.3% in 2016. The tax system cushions the poor through what is known as the tax expenditure method, where value added tax is exempted on basic food items purchased by the poor. The tax system is progressive.

Gender equality

South Africa achieved gender parity in primary school with gross female enrolment at over 97%, compared to over 102% for boys in 2014. In 2014, the gross female secondary school enrolment ratio was 103% compared to 85% for males. Good progress has also been made in tertiary institution enrolment, which reached 23.5% for girls and 16% for boys in 2013.

The unemployment level remains higher for women at 28.9% compared to 24.5% for men in the fourth quarter of 2016. According to the World Bank, the share of women in non-agricultural wage employment has, however, marginally increased in recent years from 45% in 2010 to 46% in 2013.

South Africa has made good progress in enabling women to participate in political decision making. Currently women ministers comprise 41% of the cabinet, women deputy ministers make up 47% of the total number and there is a 41% representation of women in the National Assembly. South Africa ranks 14th and 1st out of 145 countries in political empowerment of women and health and survival by women, respectively, in the WEF's 2015 Global Gender Gap Index. Only Rwanda and Cabo Verde perform better in female political representation on the African continent.

Thematic analysis: Entrepreneurship and industrialisation in South Africa

Entrepreneurship is part of South Africa's industrialisation and employment-creation strategy. Industry's share of GDP has continued to decrease from 40% in 1990 to 29% in 2015. Rising youth unemployment (reaching 54.2% in October 2016) is an abiding problem and the country has one of the highest rates of income inequality worldwide. By some measures, South Africa's rate of entrepreneurial activity is half the continental average for Africa. Specifically, Total Early-stage Entrepreneurial Activity (TEA), measuring the percentage of population aged between 18 and 64 who are in the process of starting a business, has fluctuated from 6.5% in 2001, peaking in 2013 at 10.6%, before slipping down to 9.2% in 2015.

Although 73.8% of South Africans consider entrepreneurial activity as a "good career choice" in 2015, up from 48% in 2003, the share of South Africans looking to engage in entrepreneurial activities has dropped from nearly 20% in 2010, to 10% in 2015. A weakened overall business environment, inadequate government policy support for entrepreneurs, difficult access to finance, and educational constraints contributed to decreasing the uptake of entrepreneurial activity.

Some 50-60% of entrepreneurs are between 25-44 years old. Black South Africans constituted 68% of entrepreneurs in 2015; 66% of entrepreneurs had at least a secondary school-level qualification; and 20% had at least a post-secondary qualification. More than 67% of TEA takes place in the consumer services sector, with 50% of TEA in retail trade. Low skill levels and lower barriers to entry within these sectors explain why more entrepreneurs work there.

Productive entrepreneurship faces three main binding constraints: i) a lack of human capital, in the form of inadequate numeracy and literacy as well as technical and business management skills, and a lack of effective support networks for entrepreneurs; ii) barriers to market entry; and iii) lack of financial resources for new and small businesses. The education system lacks teaching competence and fails to encourage creativity, self-sufficiency and personal initiative. It fails to provide adequate training in numeracy, economic principles or business principles. Barriers to business entry, ranging from a lack of access to capital, markets and human resources, and costly employment procedures constitute regulatory obstacles to entrepreneurship. Constraints for business operations include excessive bureaucracy, especially the time required to obtain permits and licences and for navigating government regulations. Smaller firms face difficulties of market access where large private firms dominate. Crime also constitutes a cost which disproportionately burdens MMSEs. Challenges to access to finance are compounded by young entrepreneurs' inadequate knowledge of funding sources and procedures; their inadequate overall available start-up funds; inefficient administration and lack of transparency in the use of funds by government institutions; low levels of competition among financial institutions; and collateral requirements that few start-up entrepreneurs can meet.

South Africa's National Small Business Act (1996) provides a framework to support small businesses and formalises the relationship between entrepreneurship and industrialisation. The Small Enterprise Development Agency (SEDA) was created under the Act's 2004 Amendment. Many national development strategies stress the role of entrepreneurs or SMEs. The Department of Trade and Industry (DTI) released the National Industrial Policy Framework (NIPF) in 2007, setting out the objective of Small Enterprise Support to increase financial and technical support to SMEs and co-operatives.

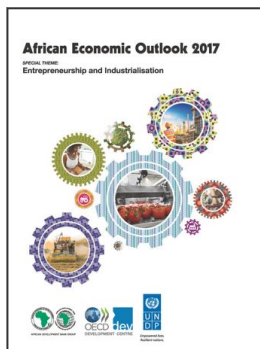


The industrialisation strategy emphasises the use of public procurement to leverage demand and develop production. The Preferential Procurement Policy Framework Act (PPPFA) is intended to support the government's ambitions of realising 70% local content in all publicly funded projects. In the automotive industry, the government's Automotive Supply Chain Competitiveness Initiative (ASCCI) seeks to capacitate local sub-component suppliers. Such programmes aim to increase local SMEs' capacity to compete with larger companies.

In 2014, the government created a Department of Small Business Development (DSBD). Since its inception, the DSBD has established several primary support schemes. One initiative is the Black Business Supplier Development Programme, providing a maximum of ZAR 1 000 000 grants to black business suppliers. This programme contributes to the industrialisation initiative by integrating small suppliers in value chains. The DSBD's Co-operatives Incentive Scheme and SEDA have supported the formation of co-operatives. The Small Enterprise Finance Agency (SEFA) caters for businesses requiring funding to a limit of ZAR 3 million (USD 215 000). SEFA's services include providing bridging finance, revolving loans and asset finance. The National Empowerment Fund provides financial and non-financial services to black-owned businesses. The National Youth Development Agency (NYDA) provides support for young South Africans between the ages of 14 and 35 years to start and finance businesses, including through mentoring and entrepreneurship-training programmes.

The government also runs two major incubator programmes. DTI finances the Incubator Support Programme (ISP) that provides grants to create commercially viable SMEs. At the end of 2013, it had committed to ZAR 817 million in investments, contributing to the creation of 19 500 jobs. The second programme is a network of incubators funded by SEDA to help technology-oriented start-ups to become commercially viable. A review has praised the programme's design, but its enlargement may pose financial risks to the agency's budget, since supporting a successful SME can cost between ZAR 240 000 and ZAR 13.4 million. Examples of South African incubators include the Allan Gray Orbis Foundation, RaizCorp, Jozihub, Cape Town Garage, Black Girls Code, Shanduka Black Umbrellas, or The Innovation Hub.

The implementation of industrial policy has strictly to adhere to B-BBEE rules. Compliance with B-BBEE rules can enable firms to earn points in public procurement bids. State-owned entities such as Transnet and SEDA, as well as parastatals, have responded to the B-BBEE frameworks by establishing business incubation services to assist entrepreneurs and SMEs in establishing firms capable of taking on government tenders. With the newest revised B-BBEE codes released in 2015, the focus is on three areas: black ownership, black skills development and black enterprise and supplier development.



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