Deloitte.

Competitiveness: Catching the next wave
Africa

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Contents

1. Executive summary

Sub-Saharan Africa is primed for an era of sustainable growth. As other markets across Latin America and Asia face short-term challenges and many advanced economies decelerate, the outlook remains encouraging for sub-Saharan Africa to gather speed and create greater opportunities for its rapidly growing population.

The region already boasts a strong base in mining, agriculture, and oil production. A growing pool of young and well-educated people is poised to enter the workforce. Investments in infrastructure and the wider adoption of new technologies—such as mobile telephony and Internet services—have the potential to accelerate the growth of a consumer- and service-led economy, as well as cutting-edge industry.

The pace of growth in sub-Saharan Africa could easily surpass most regions of the world

To be sure, the region faces significant challenges. Even as democracy spreads across the region, logistical bottlenecks, poor governance, the threats of increased terrorism and social unrest from rising urban unemployment, and vulnerability to commodity price shocks (with knock-on impacts to macroeconomic stability) and economic downturns in key trading partners indicate the risks to the region's rapid and ongoing transformation. The 2015 Social Progress Index disclosed that the region still scored lower than any other in guaranteeing human well-being.[1]

As the region moves beyond its colonial past and its traditional reliance on agriculture and extractive industries to integrate deeper into the global economy, key industries will drive a wave of growth in Africa. By increasing the full range of manufacturing activities from low- to high-tech, expanding the penetration of financial services, and focusing on growth sectors like tourism, information technology, and communications, longer-term growth can be realized.

Strong government policies and effective implementation, robust business and infrastructure environment, and a focus on ensuring citizens' basic human needs, conditions for opportunity, and human rights, would drive further stability and growth.

This report will examine the industries with the potential to fuel growth and development over the next two decades for three of the region's most important economies and regional hubs: South Africa, Nigeria, and Kenya. While some countries in the subcontinent may actually experience stronger long-term growth, these three key economies together depict the nascent opportunities emerging across much of Africa. In addition, the transitions taking place in Nigeria and Kenya serve as an intriguing counterpoint to those facing South Africa. This report will also examine the public policy considerations and challenges the region's governments must address in order for the region to fully realize its sustainable growth potential.

2. Introduction and regional economic outlook

Beneath recent headlines highlighting sectarian violence, tribal politics, and regional threats of terrorism, a number of promising signs across sub-Saharan Africa are visible. A peaceful and democratic transition in Nigeria suggests that a campaign to root out corruption and more fully share economic gains enjoys wide public—as well as investor—support. Agricultural innovations, a move to higher-value exports, major infrastructure projects, and the increasing use of mobile technologies to boost trade and commerce, are helping to improve the outlook in Kenya, as is the potential for major oil and gas development. In South Africa, the government has clearly acknowledged a need for greater and more coordinated investments in infrastructure, education, and electricity to help strengthen its role as a major trading partner and investor in intra-African trade. Moreover, the "re-basing" and better management of the national accounts of Nigeria and Kenya make their economies far more significant than outsiders might previously have understood.

A diversified economic base offers the region more resilience and less vulnerability to the volatile swings of commodity prices. The rise of a consuming middle class is already boosting the rapid development of its key urban centers. Cities such as Lagos and Johannesburg have become regional hubs for financial services, tourism, and intra-African trade. As incomes rise and new technologies generate new opportunities, a technology-savvy, brand-aware, and sophisticated middle class will attract foreign direct investment (FDI) in sectors ranging from financial services to telecommunications to construction.[2]

Moreover, rising flows of FDI can help place those institutional forces that promote social progress on a firmer footing. By expanding beyond mere economic priorities to ensure that its citizens have the preconditions for fuller economic participation—improved health, safety, nutrition, and education, as well as personal rights and freedoms—the region can also more rapidly improve the lives of its people.

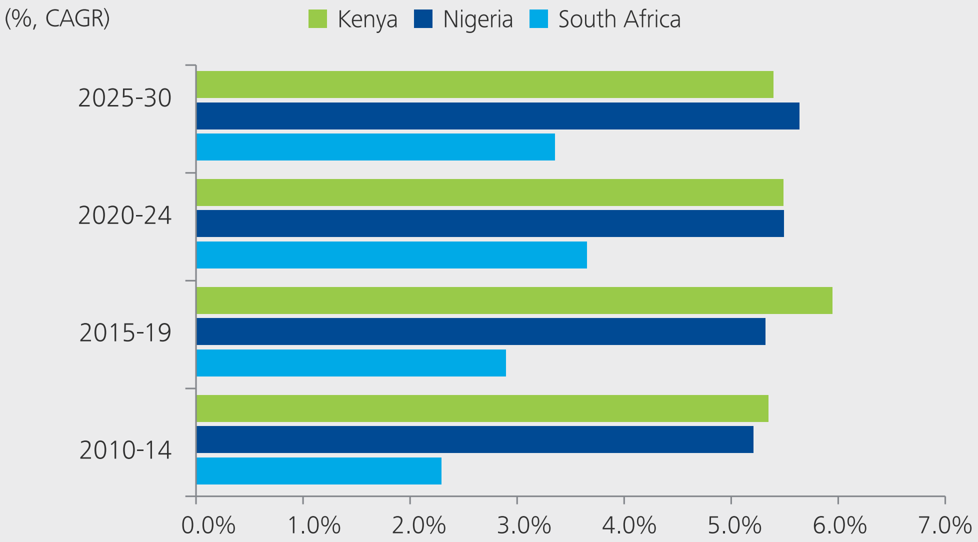
Since the turn of the new century, the People's Republic of China has taken very intensive steps to strengthen its trade and economic relationships across the subcontinent. One comprehensive survey found some $75 billion in unrecorded development projects between 2000 and 2011—in addition to an estimated $6.3 billion in aid flows each year. The money ranges from direct grants funding projects from dams and railroads to deals to finance and support natural resource exploration.[3] Many of these investments come from state-owned Chinese enterprises, who can use subsidized credit to out-bid potential competitors, whether other foreign investors or domestic African firms.

While some critics have suggested Chinese firms invest only to exploit natural resources and cement political connections, many Africa leaders welcome the opportunity for these investments to create more jobs and economic opportunities for their people. Indeed, the rising presence of Chinese investment in Africa helped encourage the Obama administration to announce in 2014 some $33 billion in new commitments to invest in Africa on the part of U.S. private sector firms like General Electric and Coca-Cola.

The economic output of the sub-Saharan region is projected to grow at a 5 percent compound annual growth rate (CAGR) over the next two decades.[4] As Figure 1 illustrates, while South Africa—the region's most mature economy—will expand by almost 3 percent per year over the next five years, Kenya and Nigeria will grow at rates exceeding 5 percent. Indeed, growth across sub-Saharan Africa over the next two decades could surpass most regions of the world.

Fig 1: Projected GDP growth of key African markets

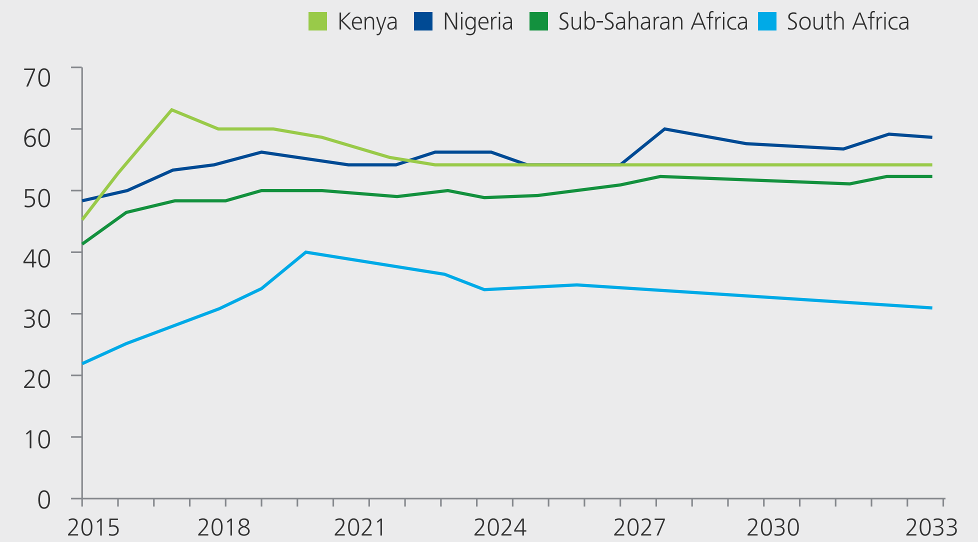
GDP Growth



Source: Oxford Economics

Fig. 2: Africa's projected growth over the next 20 years

% of GDP



Source: Oxford Economics

3. South Africa: The continent's special case

Since the end of colonialism and the demise of apartheid in 1994, South Africa has taken enormous strides toward developing into a region of promise. After two full decades of democracy, the living standards of the average South African have risen substantially, with growth exceeding 1.5 percent per year. While the nation's inequality levels remain high, and access to basic nutrition and health must still improve, South Africa has developed more opportunities to create an inclusive society and vastly expanded political choices for its people—all important metrics of social progress.[5]

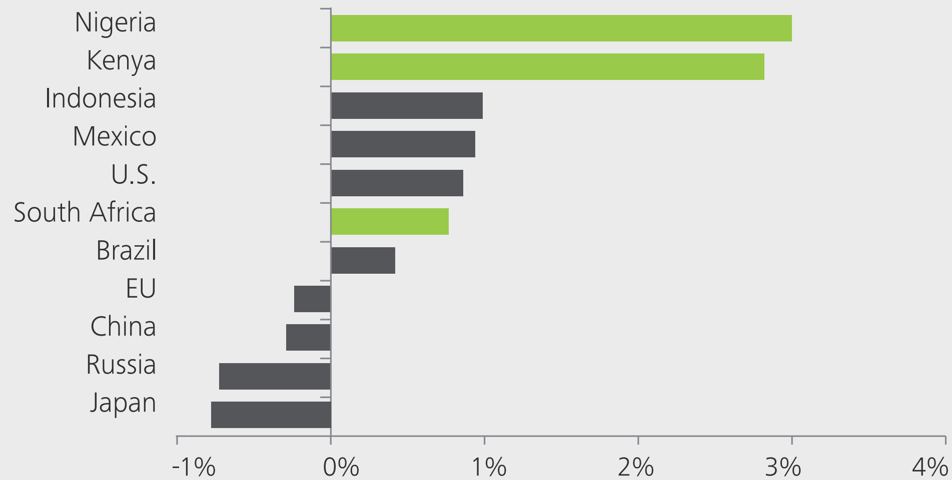
> "Too few South Africans work, the quality of school education for the majority is of poor quality, and our state lacks capacity in critical areas."

– Trevor Manuel, Chairman of South Africa's National Planning Commission

The nation's competitive advantages have also made it a major destination for foreign direct investment (FDI), and its well-developed logistics and financial services sectors have made South Africa a relatively easy country with which to do business.[6] For many foreign firms, it remains the "jumping off" point for developing a comprehensive portfolio of business investments across the African continent and a fulcrum for pan-African trade. Boosting such intra-African trade will be crucial for future prosperity, even as it is likely to face new competition from nations like Kenya and Nigeria.

Fig. 3: Global changes in working-age population

% CAGR, 2015-34



Source: Oxford Economics

Yet, stubbornly, South Africa has also failed to grow as robustly as many of its African neighbors. Unemployment, a high level of inequality and continuing labor strife have diminished growth. Infrastructure bottlenecks, especially around electricity generation, have reduced opportunities and diminished productivity. Moreover, the country today faces fiscal and current account deficits that cast a shadow over its economic potential and its ability to withstand future shocks. As the chairman of South Africa's National Planning Commission, Trevor A. Manuel, has written: "Too few South Africans work, the quality of school education for the majority is of poor quality, and our state lacks capacity in critical areas. Despite significant progress, our country remains divided, with opportunities still shaped by the legacy of apartheid."[7]

Indeed, the long period of racial separation and international sanctions helps explain some of the unique circumstances that distinguish South Africa's long-term outlook from those of Nigeria and Kenya. For example:

- While the African continent is relatively young and ready to reap a significant "demographic dividend" as young workers enter the labor force, South Africa is relatively more mature—and thus its birthrate is slowing. South Africa's working age population is forecast to grow at just 0.8 percent over the next two decades, a significant slowdown from the 2 percent annual growth recorded over the past quarter century.
- Most other economies in sub-Saharan Africa are deeply involved in agriculture, but food production accounts for just 2.5 percent of South Africa's total GDP, while services account for almost 70 percent of total output.
- South Africa's GDP, now estimated at roughly USD$6,500 per person, makes it appear, from a standpoint of economic development, to be more on par with a rapidly industrializing China than the other, less developed economies of the subcontinent like Kenya or Nigeria, whose vast populations are still transitioning from farm to factory and creating new cities.

Viewed from this distinct structural perspective, the productivity challenges the South African economy confronts today more resemble those faced by an aging Italy or Spain than those encountered by Nigeria or Kenya, where the industrial transformation is ongoing.

In the short term, the South African economy faces significant economic challenges. Growth will be less vigorous than in other parts of the region, falling to only 1.5 percent in 2015, because of relatively high unemployment, labor unrest, and debilitating brownouts and power shortages that deter manufacturing. In a continent beset by poverty and strife, recent xenophobic attacks in South Africa against immigrant populations could deter additional foreign investment and dampen one of the country's chief avenues for potential growth opportunities—its ability to manage foreign involvement in the rest of the subcontinent and inter-regional trade.

From a medium (five-year) and longer (20-year) horizon, however, South Africa's prospects are far more favorable. GDP growth is forecast to rise to 4 percent by 2020 and average 3.4 percent for the next 15 years. The country stands to gain from the strong growth expected in the rest of sub-Saharan Africa, where it remains a key investor and intermediary. If it addresses critical infrastructure, the well-being and opportunity of its citizens and other needs, it can become an important player in the medium- and high-value supply chains that will grow up across the region as the rest of the continent industrializes. As regional economies grow, South Africa should attract more tourists and business services.

Unquestionably measures to reduce inequality, expand national infrastructure in a phased and comprehensive fashion, and boost employment will depend on the government's success at implementing the vast majority of structural reforms outlined in the National Development Plan (NDP). The government has estimated that the economy could grow by as much as 5.4 percent per year if it is able to successfully implement the program. While this may be somewhat optimistic, it clearly suggests the sort of opportunities available to South Africa if it can fully carry out its ambitious reforms.

South Africa—The legacy of apartheid

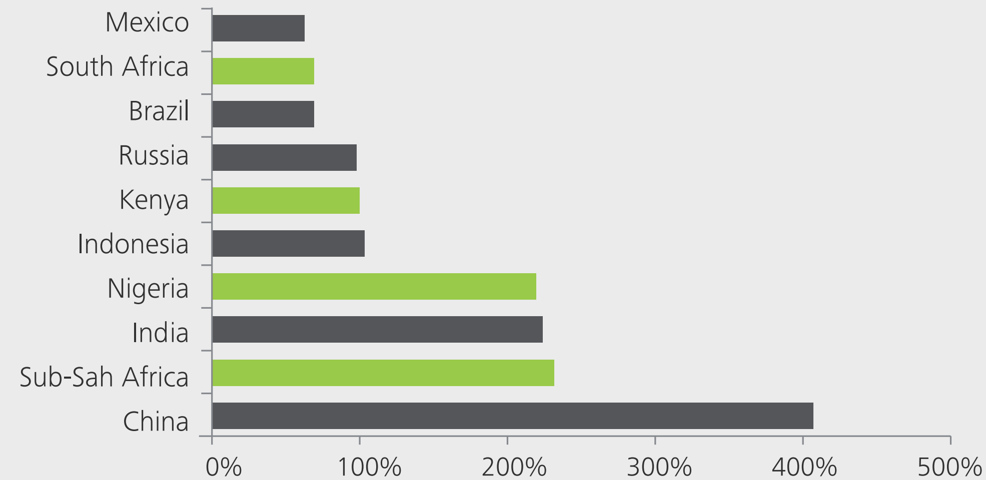
South Africa today is still wrestling with the consequences of a rigid system that created two nations, separate and unequal, and which remained standing for nearly 50 years. The apartheid regime thwarted democratic rule, enforced racial segregation and kept millions from gaining equal opportunities. The injustice and cruelty of the apartheid system did not go unnoticed by governments of the world, which instituted economic sanctions against the South Africans in hopes of spurring reform. The legacy of apartheid still informs the social issues South Africa faces today, as does the economic impact of the sanctions.

Apartheid's demise in 1994 left a newly democratic South Africa to grapple with an enormous set of challenges. White rule had created an advanced Western state—but for only 5 percent of the nation's population. The black townships lacked basic modern infrastructure after years of underinvestment. Segregation in education, health, welfare, transport, and employment left deep scars of inequality, limited social progress, and economic inefficiency, while across the landscape of commerce and industry, very large conglomerates dominated by whites controlled major portions of the domestic economy. Employment segregation concentrated advanced skills in white hands. Small- and medium-sized enterprises were underdeveloped, while highly protected large industries underinvested in research, development, and training.

As a result, an entire system of governance and a host of national institutions had to be overhauled, even as the world economy in the 1990s was undergoing dramatic changes resulting from rapid globalization, export-led growth, and the creation of global supply chains, many centered in Asia. The pressing need to empower the newly freed black majority also had to be reconciled with the existing structures of the economy, which was primarily owned and directed by the white minority.

In the 20 years since the demise of apartheid, South Africa has struggled to achieve the strong and consistent growth required to create sufficient jobs, despite its enormous potential, and address—and overcome—the long history of social and economic inequality.

Fig. 4: GDP growth across select developing economies
1996-2014 (% growth)



Source: Oxford Economics

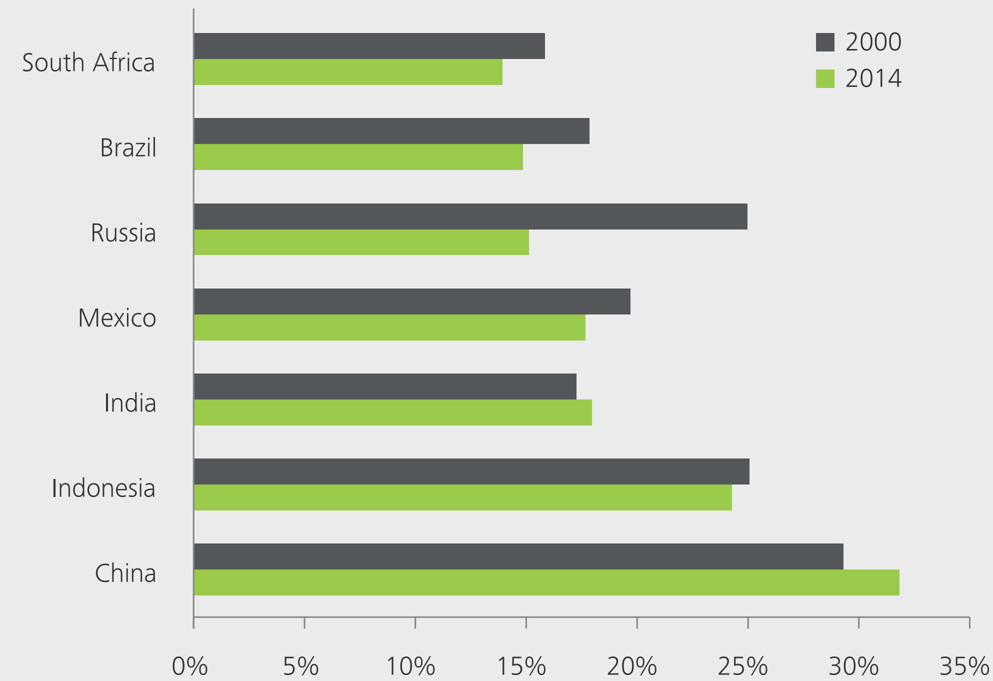
Indeed, since 1996, economic growth in South Africa has significantly lagged sub-Saharan Africa as a whole. While the subcontinent’s output has expanded by more than 230 percent between 1996 and 2004, South Africa’s total output has grown by just 69 percent in that period. By contrast, Nigeria’s total growth has been only slightly lower than that of the region as a whole, while Kenya’s output has doubled and China’s output rose 400 percent.

The imbalances left behind by the long period of apartheid contributed to this underperformance. During apartheid, strict racial policies led to insufficient investment in physical and human capital and heavy government spending in protected industries. While a “typical” developing economy might have chosen the path of industrialization followed by Asian countries like Taiwan, South Korea, and then China—shedding rural labor, developing industries as a means of building a larger middle-class consumer society, and gaining a greater presence in the global economy—South Africa’s path was systematically diverted. The governing powers were reluctant to help create a black middle class during a period of enforced segregation, and trade sanctions limited the nation’s ability to seize upon export-led industrial growth as a development strategy.

Thus, instead of leading a transition from mining and agriculture into industry, South Africa’s output during the 1970s and ’80s shifted primarily to the service sector. As a result, South Africa is today the continent’s most developed economy, even though manufacturing accounts for less than 14 percent of GDP, compared with almost 18 percent in Mexico and India, and more than 30 percent in China.

But, services-sector jobs offer far lower levels of productivity than manufacturing industries and boosting the productivity of service sector jobs is notoriously difficult. As a result, economy-wide labor productivity in South Africa has consistently lagged that of industrializing Asian countries at similar stages of development. Today, the services sector accounts for nearly 70 percent of national GDP. Because its economy is so much more heavily focused on services, it has been difficult for South Africa to match the productivity gains of other, more-industrialized economies.

Fig. 5: Manufacturing share of GDP across developing markets
% of GDP



Source: Oxford Economics

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South Africa's economic productivity has risen only 1.4 percent per year since 1990, compared with 3.1 percent per year in Indonesia and an outstanding 9.2 percent per year in China.

Likewise, the legacy of apartheid generated serious inequality, which the nation has struggled to overcome. Today the official unemployment rate is around 25 percent (and some private estimates put it even higher), and more than two-thirds of the jobless have been unemployed for one year or more. This has left a large share of South Africa's potential labor force mired in poverty. High rates of joblessness and the perception that foreigners are taking jobs from native South Africans helped trigger the recent xenophobic attacks against immigrants centered around Durban. The statistics agency[8] estimates that more than 20 percent of the population lives in extreme poverty (defined as an income level below which individuals are unable to purchase enough food to provide them with an adequate diet). By a broader measure, which includes essential nonfood items, 45 percent of the South African population lives in poverty. Compared to their economic peers, South Africans also have lower levels of basic health care and live in communities with reduced levels of personal safety.[9] Moreover, South African society remains starkly unequal; the country's Gini coefficient is 0.65, compared to 0.37 in China and 0.41 in the United States—on a scale where zero means wealth is distributed evenly and one means that all of the country's wealth is held by one individual.[10]

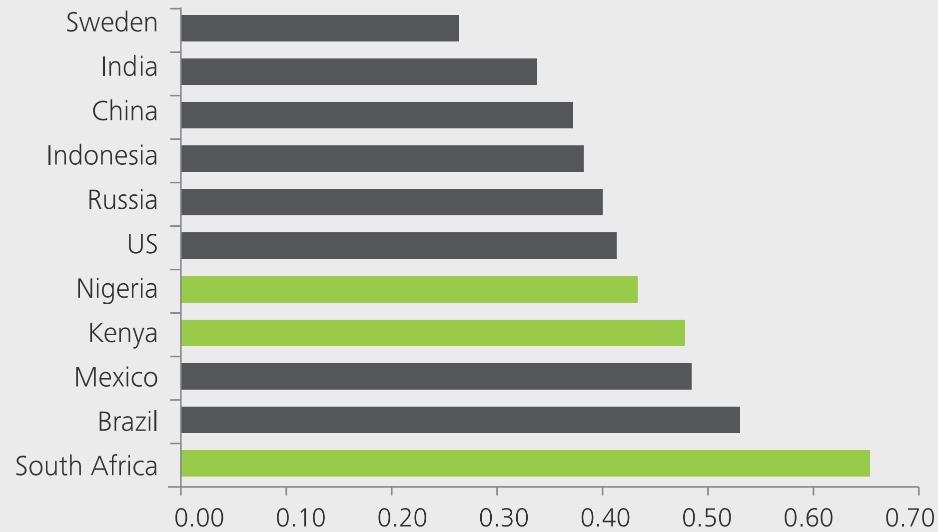
> The difficulty of settling intractable disputes with trade unions often translates into pay raises that don't reflect actual productivity.

The 20-year forecast for South Africa contains many optimistic components. But the country also faces a series of more immediate challenges, many of them structural, which it must squarely and resolutely address if it is to bring greater prosperity to more of its people.

Fig. 6: Economic inequality

GINI Index

0=perfect equality, 1=perfect inequality

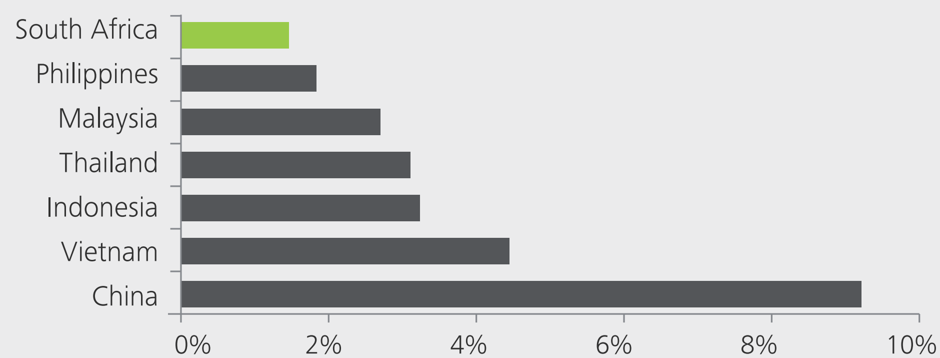


Source: World Bank

Fig. 7: South Africa's productivity performance

Labor productivity

% CAGR, 1990-2014



Source: Oxford Economics

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South Africa—Growth challenges

Today, mining and automotive manufacturing represent two key export sectors. Yet a series of intractable labor disputes have damaged national prospects and impeded growth. The strong trade union movement in South Africa represents another legacy of the opposition to apartheid. Strikes by platinum miners in 2014 lasted for five months, the longest and most expensive walkouts in the nation's history. Walkouts like these serve as a major drag on overall growth, and strikes by workers in the steel and engineering sectors in 2014 disrupted production in key manufacturing sectors for almost a month.

The difficulty of settling such disputes often translates into pay raises that don't reflect actual productivity. So even though millions of its people are poor across many industrial sectors, South Africa is not as globally competitive. According to scores compiled by the World Economic Forum, South Africa ranks 136 globally (out of 144) on the relationship between pay and productivity. Tense labor relations—and the political calculus of the ruling party—will likely make it difficult to address the underlying issues in the short term. New manufacturing jobs, as a result, are much more likely to be created in less expensive parts of the region.

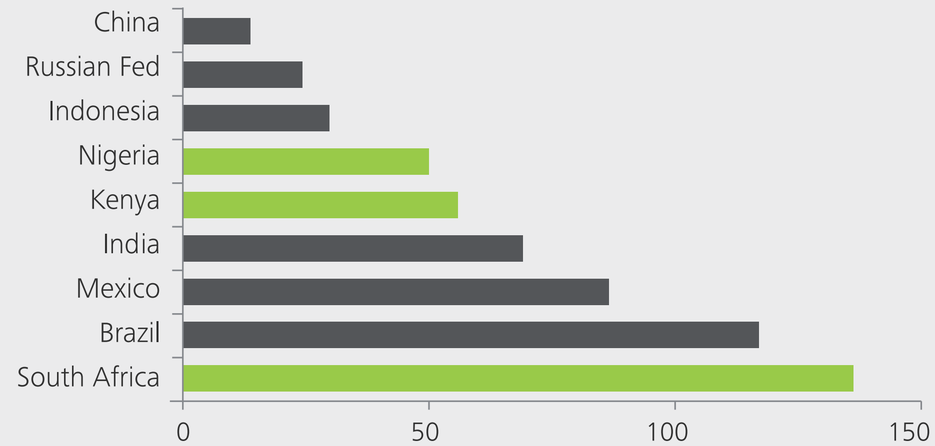
The continuing crisis in electrical supply also inhibits the nation's growth. The country regularly experiences rolling blackouts and suffers from substandard power generation. Although new power plants are currently under construction, the supply/demand mismatch in South Africa is about 3,600 mw, and according to World Economic Forum rankings, South Africa ranks 99th globally in the reliability of its electricity supply. A reliable power supply is critical for propelling workers down into mines, operating smelters, or running automobile assembly plants. The lack of a stable energy supply also deters investors from considering new investments in manufacturing plants.

Issues related to crime and safety also represent major concerns to business in South Africa. Globally, South Africa ranks 133rd on the World Economic Forum's ranking of the cost of crime and violence on business.[11]

Fig. 8: Global rankings after factoring in pay levels

Pay and productivity

Global rank



Source: World Economic Forum

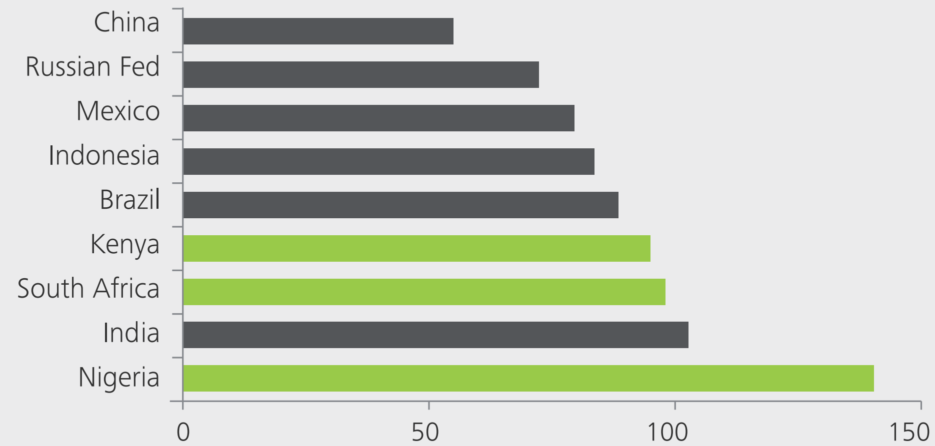
For businesses seeking to engage in international trade, the historic volatility of the South African currency, the rand, has also contributed to business uncertainty, as it makes cost and revenue projections more complex to calculate and deters foreign investors. In examining the monthly standard deviation of the U.S. dollar exchange rate since 2000, the rand appears to be the most volatile of a number of currencies.

For businesses seeking to engage in international trade, the historic volatility of the South African rand makes cost and revenue projections more complex and deters foreign investment.

Mindful of these challenges, the South African government has crafted a comprehensive National Development Plan (NDP) with the aim of reducing poverty and inequality by 2030. Among the policies it outlines are programs that create more-flexible labor practices and give firms incentives to hire young workers; increased investments in health, nutrition, and education quality and access; strengthened welfare services; and a higher level of investment in the economy. The plan calls on the government to spend 10 percent of GDP to upgrade infrastructure in such diverse sectors as public transport, mining, electricity, and telecommunications and broadband. President Jacob Zuma reaffirmed the government's commitment to the NDP following elections in May 2014, but many fear that certain reforms may be weakened in the implementation process if they clash with the interests of powerful political constituencies.

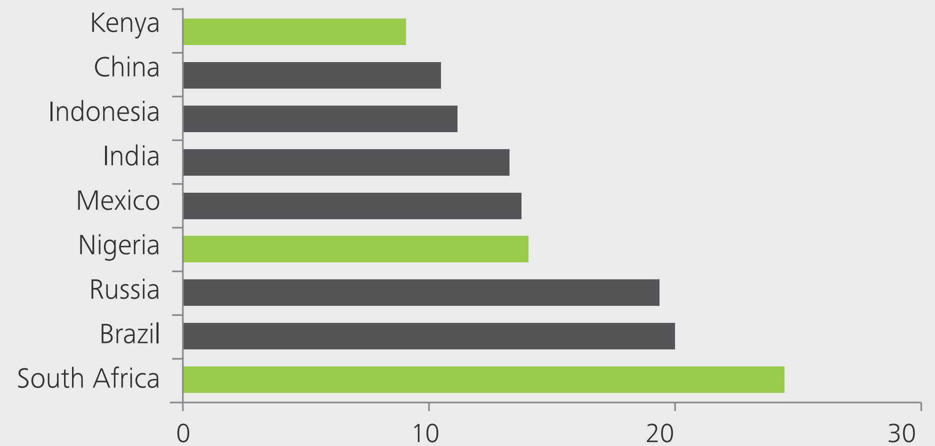
As a result of these facts, GDP is forecast to grow just 2.1 percent in 2015 and 2.4 percent in 2016.[12] The recent fall in oil prices should result in lower inflation, but rises in electricity rates and the weak currency will limit its benefit to households. Moreover, South Africa's bloated fiscal and current-account deficits leave it vulnerable to shifts in investor sentiment, while lower commodity prices could further weaken the currency. On the other hand, a weaker currency may boost the competitiveness of manufactured exports.

Fig. 9: Power generation rankings
Electricity supply
Global rank



Source: World Economic Forum

Fig. 10: Currency concerns
Exchange rate volatility
Standard deviation since 2000



Source: Oxford Economics

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South Africa—Catching the next wave: industry outlook and opportunity

Despite current uncertainties, South Africa's growth prospects over the next two decades appear more favorable, especially if it can overcome the unrest of recent months and develop constructive, long-term relationships that can build intra-regional trade and expand the service-oriented economy. The sectors likely to drive South Africa's growth and boost its longer-term economic performance are precisely those that will link the country more closely to the robust expansion expected in other parts of the sub-continent, as well as to markets in the developed world. These include trade, high-value manufacturing, business services, and tourism.

a. Intra-African trade

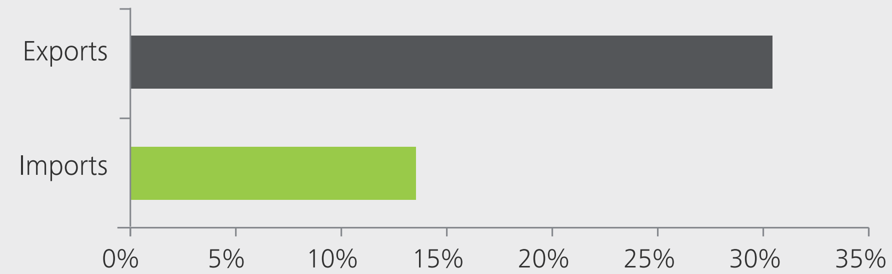
South Africa today is the major trading hub for Africa, and the nation stands to gain from the strong growth expected in the rest of sub-Saharan Africa over the next few decades. Today, more than 30 percent of South Africa's total exports of goods are sent to other African countries, and it receives 13 percent of its imports from the region. As the region industrializes, there is a major opportunity for South Africa to deepen its roots in medium- and higher-value supply chains to service others. For example, MTN, the largest Pan-African mobile network operator and ICT services provider, is headquartered in South Africa, and is the largest mobile network operator (MNO) in the burgeoning mobile phone market in Nigeria. Moreover, as incomes grow across sub-Saharan Africa, South Africa should attract more tourists and visitors from the rest of the continent, offsetting the slowing demand expected from Europe.

b. Trade with the European Union and U.S.

Both Europe and the United States have developed trade preferences to encourage employment and trade growth with sub-Saharan Africa. In the U.S., the African Growth and Opportunity Act (AGOA), first signed into law in 2000, is designed to promote U.S.-African trade and investment relations through duty-free and largely quota-free access to U.S. markets.

Fig. 11: South African regional trade

% of merchandise trade in 2014

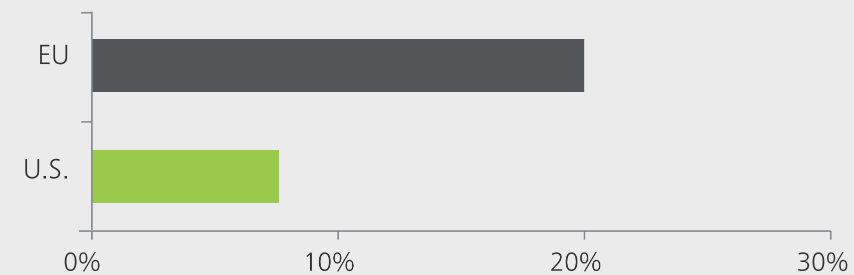


Source: Oxford Economics

Fig 12: South African exports, 2014

Exports by destination

% of merchandise exports



Source: Oxford Economics

Exports under AGOA increased from $7.6 billion to $24.8 billion between 2001 and 2013 but declined over 50 percent in 2014 to $11.6 billion, mainly due to reduced petroleum exports to the U.S.[13]

While petroleum products have represented a significant portion of overall African exports, the share of textiles and manufactured goods being exported from the region is also growing. South African exports to the U.S. totaled $8.5 billion in 2013, according to U.S. government data, and included cars and machinery, in addition to precious stones and steel.[14]

The EU has been more far more successful at catalyzing exports from the subcontinent to help boost employment and economic opportunities. Today the region exports 10 times as much to Europe as it does to the U.S. The equivalent European trade pact—the Everything but Arms initiative—is estimated to have generated almost twice as many exports than AGOA. The European Union of Economic Partnership Agreements, with a number of countries in sub-Saharan Africa, is also providing enhanced market access. As Figure 12 illustrates, some 20% of South African exports currently head to the EU, versus just 7% to the U.S.

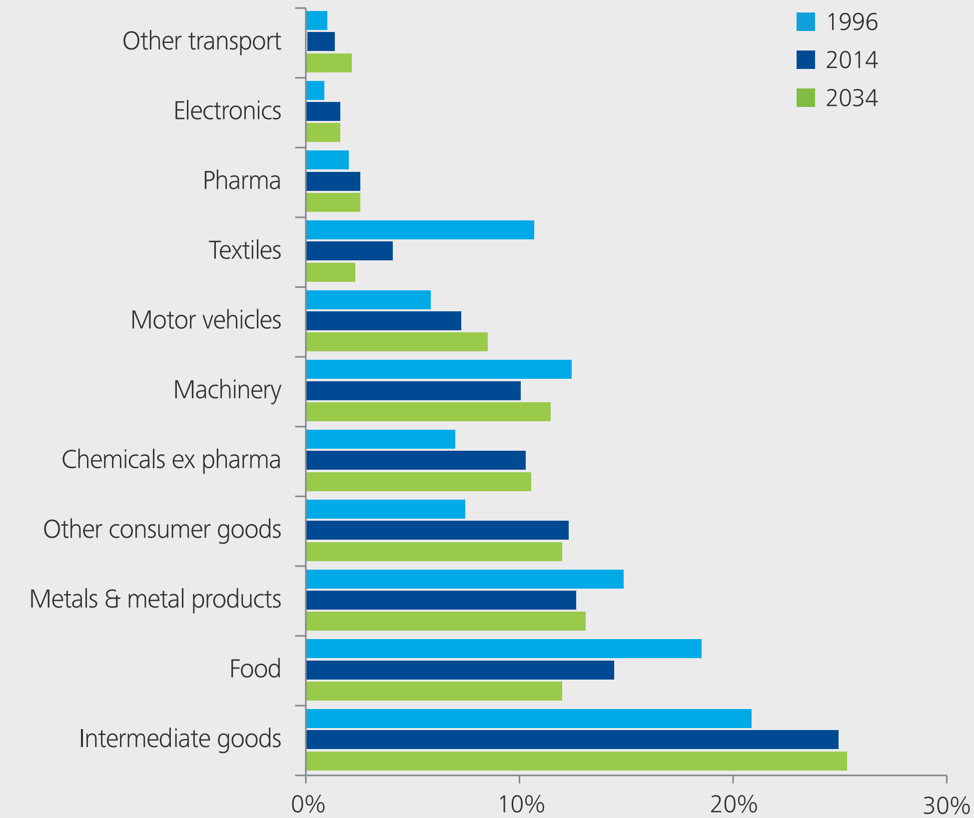
c. Manufacturing

The South African manufacturing industry is a significant contributor to the economy. It contributes some 14 percent of national GDP and employs some 1.7 million people. Manufacturing output growth is forecast to be higher than overall GDP growth over the next decade, with a 3.4 percent CAGR projected.[15] Moreover, every rand invested into manufacturing yields R 1.13 of value to the economy—through value addition, revenue generation, export earnings, and the knock-on effect to other related industries.

That being said, South Africa's manufacturing sector does face challenges. Relatively inflexible labor markets, unreliable supplies of electric power, and the low productivity of the workforce relative to their pay makes it unlikely that South Africa will become a regionally completive player in labor-intensive manufacturing industries in the medium- or long-term unless reforms are implemented.

Fig. 13: South Africa manufacturing composition

(% of manufacturing)



Source: Oxford Economics

Furthermore, the relatively high costs of production in South Africa have created an opportunity for lower-cost imports from China to gain market share. A study conducted by the Southern Africa Labor and Development Research Unit[16] argues that the rapid growth in Chinese imports has reduced domestic employment and production in manufacturing and has displaced imports from other countries. High labor costs, coupled with mostly stagnant or deteriorating labor productivity, are also expected to generate higher levels of automation and demands for higher skill intensity among industrial workers, according to the Manufacturing Circle of South Africa.[17]

As the rest of the sub-continent experiences more rapid growth and industrialization, South Africa has the potential to become a regional hub for medium- to high-value manufactured goods.

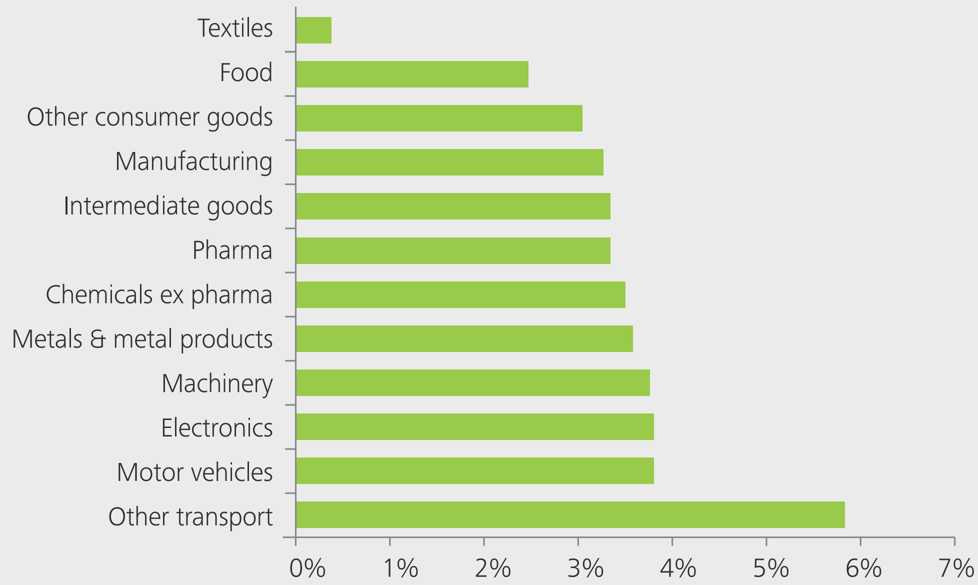
Manufacturing companies globally are entering an era of profound change, however. The future is unfolding in an environment of evolving customer needs, digital connectivity, and increasing complexity and risk. Vastly improved technologies and advances in materials are accelerating the pace of innovation. This paradigm shift in manufacturing is creating new ecosystems that challenge companies to alter the traditional business model boundaries and rethink their strategies for growth.

Therefore, it is crucial for South Africa to adapt and become agile in order to be a competitive force in manufacturing globally. Technology enhancements, such as 3D printing and predictive production modelling, along with big data, are creating large cost reductions and can leverage skills that already exist in South Africa to the benefit of the rest of Africa.

As the rest of the sub-continent is forecast to experience more rapid growth and industrialization, South Africa is positioned to become a regional hub for medium- to high-value manufactured goods such as

Fig. 14: Composition of projected manufacturing growth in South Africa

(CAGR 2015-34, %)



Source: Oxford Economics

motor vehicles, aviation and aerospace equipment, industrial products, and electronics. For these higher-value investment goods, growth could equal almost 4 percent per year, while in the "other transport" sector (primarily aerospace), growth of nearly 6 percent can be expected.

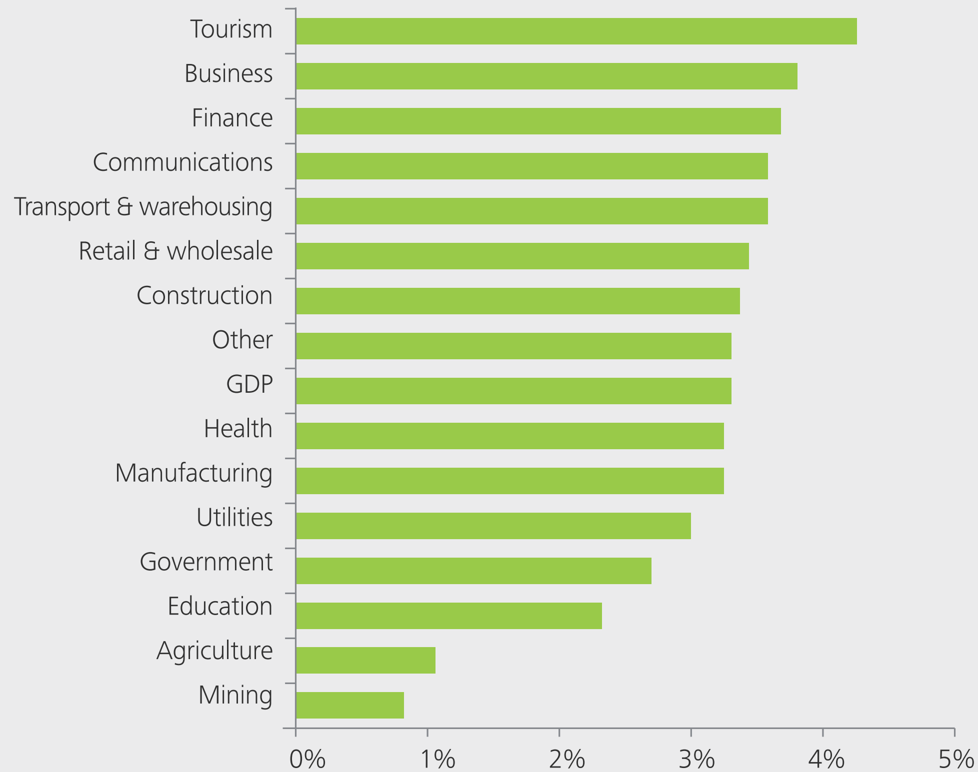
Motor vehicles

A number of multinationals today use South Africa to source components and assemble vehicles. Companies like Ford, Daimler, Volkswagen, Nissan, and Toyota have production facilities operating in the country, employing roughly 30,000 workers. Moreover, supportive government policies suggest that motor vehicles will be a key growth sector. Toyota is expected to invest US$33.2 million in a parts distribution warehouse and a new assembly line,[18] which will be located in Durban, while BMW is adding a third shift at its plant. At the same time, Beijing Automotive Works is expected to invest US$17.9 million in a plant with the aim of servicing the whole of sub-Saharan Africa.[19] In addition, the country's Automotive Production and Development Program (APDP) will create incentives for domestic vehicle production by imposing import duties on vehicles and partial reimbursements on investments in production. With Friedrich Boysen, a German manufacturer of automotive exhaust technology, investing US$16.4 million in a new plant, recent news reports are now suggesting South Africa could become a key supplier of components to Nigeria.[20]

Aerospace

Prospects in this sector appear quite solid. In 2013, Airbus Military awarded a components contract for its A400M military transport aircraft to South Africa's Aerosud, while Denel, a state-owned defense manufacturer, signed a R157 million, eight-year contract to build tail components for the same aircraft. Denel Aerostructures has also invested heavily in composite materials, a sector the government considers as having significant potential.[21] More recently, a collective agreement between Denel and Aerosud will allow the two South African producers to bid for contracts related to Airbus's commercial airlines segment, aiding the development of the domestic aerospace industry.[22] Aerospace is expected to expand by nearly 8 percent CAGR over the next five years.[23]

Fig. 15: South Africa sector growth over the next 20 years
CAGR 2015-34 by industry (%)



Source: Oxford Economics

Industrial products

South Africa's large, well-developed metals industry, with vast natural resources and a supportive infrastructure, represents roughly a third of all South Africa's manufacturing. The sector includes basic iron ore and steel manufacturing, from smelting to semi-finishes as well as basic nonferrous metals and mining. South Africa is also the continent's largest steel producer, accounting for approximately 45 percent of Africa's total crude steel production in 2013.[24]

South Africa is also the world's eighth largest producer of aluminum, though it relies on feedstock from other African nations for its raw material. Other nonferrous metal industries include production of copper, brass, lead, zinc, and tin. The metal products sector is projected to grow at a 3.9 percent CAGR over the next five years.[25] Moreover, as infrastructure spending and construction ratchets upward across the sub-continent, South African firms may find significant potential to expand their sales reach.

Electronics

As the most developed economy in the region, electronics production is projected to expand at a healthy pace, especially in smartphones. The creation of a Special Economic Zone led Samsung to invest US$20 million to build a television manufacturing plant in Durban.[26] Likewise, CK Electronics is already producing smartphones in the country by assembling imported parts to undercut competitors who must pay import duties for fully manufactured units.[27] A similar duty-free zone is being created in Dube, offering manufacturing incentives, world-class logistics, and office space to attract FDI. While the initial investments are expected to be focused on consumer white goods, like refrigerators, a move into higher-valued electronics is expected later.

Naturally the growth projections for high-valued manufacturing could fall below expectations if improvements in the reliability of electricity supply and a more tranquil labor environment cannot be achieved. The motor vehicle sector was already damaged by walkouts in the first half of 2014, and the decision by Nissan to produce new models in India and export them to South Africa could represent a worrisome trend.

Beyond manufacturing other components of South Africa's long term growth include the following sectors:

d. Tourism

Strong growth in the rest of sub-Saharan Africa should be a boon to the tourism economy. By 2024, total visitor arrivals from the region are forecast to account for 53 percent of the total, up from 48 percent in 2014. Moreover, stronger economic activity in Europe should provide a further source of growth over the next few years, helped by a weak rand in the near term, although European arrivals are expected to lose market share over the coming decade. A growing middle class in China will provide an additional source of inbound tourism.

South Africa has much to offer tourists, including natural beauty, wildlife reserves, wineries, city culture in Johannesburg and Cape Town, history, and stunning beach resorts. In addition, South Africa actively promotes a number of measures to encourage responsible tourism, offering guidelines for visitors to limit their environmental footprint. These measures aim to avoid waste and overconsumption, be sensitive to local cultures, involve local community in planning, and assess the environmental impact on any new measures undertaken. One early initiative includes offsetting the carbon emissions generated by airplane flights by planting fruit and indigenous trees in schools, clinics, and impoverished areas.

Although South Africa may not be as inexpensive for foreign tourists as some other markets in sub-Saharan Africa, it offers a significant number of other advantages. For one, it has the air and road infrastructure to handle a large influx of tourists. O.R. Tambo International Airport in Johannesburg is the busiest in Africa, handling 18.8 million passengers in 2013, and Cape Town International Airport is the continent's third busiest. South Africa has also created the necessary tourism infrastructure, including many luxury hotels and resorts.

Nonetheless, new, more restrictive rules could pose a risk to the sector's growth. Beginning in June 2015, new regulations for traveling with children under 18 take effect. These rules are intended to stop child trafficking, but are more restrictive than similar rules elsewhere. Also from June, visitors applying for a tourist visa will need to apply in person at an embassy or consulate in their home country. This could be particularly harmful to visitors from countries such as China and India (as well as parts of Africa), where this may involve flying to another city to get a visa.[28] If imposed, this could significantly reduce growth and create job losses in one of the nation's most vibrant sectors.

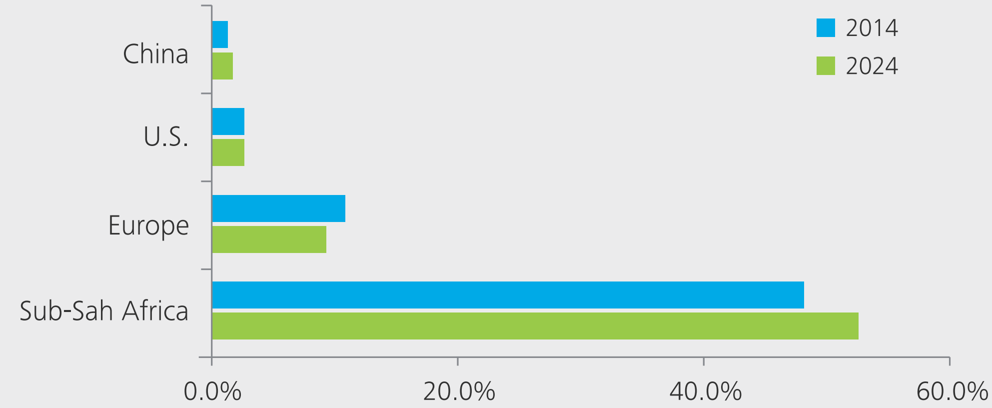
e. Electricity generation

The continuing brownouts across South Africa have dramatically demonstrated the need for more sustained investment and better management of the nation's electrical infrastructure. In March 2015, S&P downgraded Eskom, the nation's major electricity supplier, to "junk" status because of the utility's cash situation. In order to address the cash issue, Eskom announced plans to interrupt the electricity supply to municipalities with unpaid bills in order to strengthen its financial position. Eskom has also applied for a 25 percent increase in tariff to recover diesel fuel costs not catered for in the electricity tariff. There is a push to get the utility to cost-reflective tariffs. The South African government is taking measures to bring on board more baseload and renewable IPPs to help address some of the challenges. The Department of Energy has run a very successful renewable energy IPP program with more than 1,500 mw already commissioned and a further 2,000 mw planned.

Fig. 16: South Africa foreign tourists

Tourist arrivals by origin

(% of total arrivals)



Source: Oxford Economics

The NDP stresses that 40,000 mw of new electricity capacity will need to be put online by 2030, including at least 20,000 mw coming from renewable energy. Already under construction are two new major power plants, Medupi and Kusile. The first unit was completed at Medupi in March 2015, with five more units expected to be added in the coming years, for a total output of 4,764 mw of electricity at this plant. The Kusile power station will be the fourth-largest coal-fired power station in the world once it is completed. It will be composed of six units of 800 mw each, for a total of 4,800 mw of capacity.

While the utilities sector will not contribute on its own to a large amount of long-term employment, building additional generating capacity will help produce additional investments and engender greater productivity across a variety of key sectors, ranging from manufacturing to mining and transport. Construction jobs will also grow. Over the medium term, however, sustained investments in the electrical infrastructure should boost employment.

f. Transportation and logistics

The nation's physical infrastructure received a significant shot in the arm when South Africa hosted the 2010 World Cup and several important new projects to improve the infrastructure within the trade and transport sector are now being launched. These include improving the Durban-Gauteng freight corridor, constructing a series of natural gas pipelines, and expanding capacity at the port of Durban, the nation's largest. Nearly a third of the country's GDP is concentrated in Gauteng, where Johannesburg is located, which lies 1,400 above sea level and more than 500 km from the nearest local port at Durban. Likewise, expansion of the Durban harbor can have positive effects on trade, and the first phase of the expansion is projected for completion in 2019.

g. Communications

South Africa's telecommunications network is the continent's most advanced in terms of technology deployed and services provided. Mobile phone penetration is high, but Internet and broadband services stagnated for years because one firm dominated fixed-line and international bandwidth. With a new licensing regime, hundreds of companies have been licensed to offer Internet services. Indeed, mobile subscriptions in Africa are expected to grow by 46 percent from 2014 to 2019, to a number approaching 930 million.[29] Companies like MTN are also claiming a major stake in a number of markets across the subcontinent, including Zambia, Botswana, Nigeria, and Kenya.

Nevertheless, the World Economic Forum in its 2015 Network Readiness Index, which measures the ability of nations to use IT and connectivity to boost competitiveness, ranked South Africa at 75 out of 143 economies. The Forum found South Africa weak on affordability and the willingness of businesses and government to use digital communication to improve and accelerate business. The government has proposed establishing national, regional, and municipal fiber-optic networks to improve access to high-speed broadband, and further deregulation could boost employment and business prospects. Access to quality information is crucial for economic development and poverty reduction, and globally, the ICT sector is one of the fastest-growing sectors.

h. Finance, real estate, and business services

Though South Africa faces significant challenges centered on inequality and unemployment, it consistently rates highly across the subcontinent for the "rule of law," its "business environment," and the capacity of its finance sector, according to indexes from the World Economic Forum and World Bank. Indeed, the country ranks in the top 10 globally in areas covering its legal framework, accounting system, corporate governance and its financial sector, which is attractive to investors.[30] South Africa already boasts a reasonably mature business and financial services sector—these sectors account for more than 20 percent of South Africa's GDP—and a number of multinationals already operate in the country.

Further, financial inclusion in South Africa has been steadily rising, with about 63 percent of adults using the formal banking sector in 2010 (up from about 50 percent in 2003)[31]. As the rest of Africa matures, demand for business and financial services will increase, and South Africa's first-mover advantage means that it is well placed to benefit. South Africa can also be expected to become a leader in taking investment positions in businesses being created in the faster-growing economies of the subcontinent.

South Africa consistently rates highly for its respect for the "rule of law," its business environment in general, and the capacity of its finance sector.

Even Chinese investors have moved from mining into the real estate and the wine growing business recently. In late 2014, Shanghai Zendai Property, a Hong Kong-listed firm, purchased more than 3,900 acres of land near Johannesburg for a reported US$28 million to develop a mixed-use project, including residential, commercial, light industrial and retail components.[32]

Finance and business services are expected by grow by 3.8 percent per year over the next two decades, and this dynamic and stable legal sector has attracted a number of international legal firms to set up shop in South Africa.

The financial sector, which accounts for about half the output in the professional services sector, is well developed not just by African standards, but by global standards as well. Multinational banks, including the Bank of China, Bank of Taiwan, Citibank, Deutsche Bank, and HSBC, use Johannesburg as the main base of operation for the rest of sub-Saharan Africa. In addition, South African bank Standard, which operates as Standard Bank or Stanbic in 18 African countries, is Africa's largest company. Retail banking is dominated by the "Big Five" banks (Standard Bank, Barclays Africa, FNB, Nedbank, and newer entrant Capitec), and use of formal banking services is relatively high by regional standards.

Fig. 17: Globally competitive financial services

Areas in which South Africa ranks in the top 10 globally

Indicator	Global rank
Strength of auditing and reporting standards	1
Regulation of securities exchanges	1
Protection of minority shareholders' interests	2
Accountability	2
Efficacy of corporate boards	3
Financing through local equity market	3
Availability of financial services	6
Soundness of banks	6
Trustworthiness and confidence	7
Financial market development	7
Efficiency of legal framework in challenging regs	9
Strength of investor protection	10

Source: World Economic Forum

Although some 63 percent of adults use the formal banking sector, plenty of room for growth exists, with mobile banking services and payment systems seen as significant drivers of future opportunities. A survey conducted by Mastercard in 2013, for example, found that just 43 percent of the value of transactions in South Africa were cashless, comparable to Brazil, for example, but considerably lower than the 80 percent level in the United States and 89 percent in the United Kingdom. [33] This suggests the "cashless economy" has significant room to grow.

It seems clear, however, that the biggest opportunities for growth in South Africa's business and financial services lies in developing closer linkages to the wider world. As the subcontinent expands, Johannesburg should also grow in importance as the main regional center of financial and business services, not unlike London, New York, Hong Kong, and Singapore. Already, investment by South African companies in the rest of Africa is significant. According to the United Nations Conference on Trade and Development, South Africa accounts for the fifth-largest stock of FDI in Africa, after France, the United States, the United Kingdom, and Malaysia.[34] As investment into the rest of Africa grows—and not just investment by South African firms—the supporting services for financial, business, and legal services will continue to be conducted in South Africa, given its key advantages in the sector.

i. Health care and pharmaceuticals

South Africa has the largest health care and pharmaceuticals market on the African continent. These joint industries are valued at approximately R 300 billion (US$26 billion) and R 34 billion (US$2.9 billion) respectively. GDP spend on health care was measured at 8.9 percent in 2013,[35] with the split between the private and public sectors almost evenly matched at 51.6 percent and 48.4 percent, respectively.[36]

Despite the near-equal spending in value terms, there are huge disparities between the quality and efficiency of health care between the two sectors. This disparity is driven by the proportions of the population utilizing each sector. It is estimated that only 17 percent of the population accesses the private health care sector through medical aid or insurance, but this number increases to up to 38 percent if out-of-pocket expenditure is taken into account.[37] This means the majority of the population has to utilize the public health care system, which is characterized by a lack of financial and human capital resources and, thus, poorer outcomes.

South Africa's diverse economy also extends into the pharmaceutical industry, health care providers, and health care insurer sectors.

In the pharmaceuticals sector, global generics companies have emerged, most notably Aspen Pharmacare, which has been ranked as the 5th largest worldwide unbranded generic drug sales company, with a market share of 4 percent in 2013.[38]

There are also a number of South African-headquartered health care providers that have proceeded to build an international presence; the most well-known of these being Mediclinic International, Netcare Health care Holdings Limited, and Life Health care Group. Dozens of smaller private providers are also emerging.

The South African health insurance sector is also highly developed in line with the country's financial services sector. Private health care schemes are thought to account for approximately 40 percent of South Africa's health care spend. These schemes are classed either open or restricted, the former being ones openly accessible to the public. One particularly successful company in this area is Discovery Limited, which has the highest number of beneficiaries at more than 2 million. It has also internationalized its services to the United Kingdom as Pruhealth.

South Africa—Policy focus

a. Anti-corruption

The NDP has recognized that high levels of corruption hinder society's ability to operate fairly and efficiently and compromise the state's ability to deliver on its development mandate. According to Transparency International's global corruption survey, corruption levels actually increased between 2001 and 2010.[39] Corruption often involves both public- and private-sector participants. In order to fight the scourge, the South African government has a clear program in place, which is headed up by the Anti-Corruption Inter-Ministerial Committee. The government has put in place seven anti-corruption institutions and 17 pieces of legislation intended to combat corruption.

In the 2013-14 financial year, 52 people were convicted in corruption cases involving more than R5 million. Thirty-one public servants were convicted in the first quarter of 2014-15, with orders freezing accounts valued at R430 million.[40] Tighter enforcement of existing rules that prohibit public servants from doing business with the state will be needed if this trend is to continue.

b. Women empowerment

Bringing more women into the economic mainstream is an important objective. In 2014, President Zuma established a new Department of Women, reaffirming the country's commitment to upgrading the rights of females. The department is attempting to right the wrongs experienced by women in South Africa by putting into place an institutional mechanism to promote women's human rights, dignity, empowerment, and equality.

Other government initiatives are also targeting women enterprises, with the goal of developing sustainable enterprises that contribute to the country's employment, while giving women equal access to and control over economic resources. These programs aim to reverse previous imbalances and create an enabling environment for women enterprises.

c. Black Economic Empowerment

Since the end of apartheid the government has possessed a clear mandate to redress the inequalities of the past in every sphere: political, social, and economic. As a result, the government has embarked on a comprehensive program to enhance the economic participation of black people in the South African economy, known as the Broad-Based Black Economic Empowerment Act (B-BBEE).

Black Economic Empowerment is an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa. It aims to bring about significant increases in the numbers of black people that manage, own, and control the country's economic resources and significantly reduce income inequality.

Various initiatives have been undertaken to implement B-BBEE, including the establishment of B-BBEE Codes of Good Practice; the development of sector charters in forestry, tourism, construction and transport; accreditation of B-BBEE Verification Agencies; and establishment of the B-BBEE Advisory Council.

Some of the outcomes the B-BBEE aims to achieve include:

- A substantial increase in the number of black people who have ownership and control of existing and new enterprises.
- A significant increase in the number of black people in executive and senior management of enterprises, an increasing proportion of the ownership and management of economic activities vested in community and broad-based enterprises (such as trade unions, employee trusts, and other collective enterprises), and cooperatives.
- Increased ownership of land and other productive assets, improved access to infrastructure, increased acquisition of skills, and increased participation in productive economic activities in underdeveloped areas including the 13 nodal areas identified in the Urban Renewal Program and the Integrated Sustainable Rural Development Program.
- Increased income levels of black persons and a reduction of income inequalities between and within race groups.

4. Regional hubs: Nigeria and Kenya

South Africa offers important lessons for Nigeria and Kenya, two economies that are only now engaging in the fundamental industrial and structural transformations that can significantly lift their future growth trajectories.

Just as South Africa is a major center for business and financial services that encompass much of the subcontinent, West and East Africa have trading and commercial hubs as well. Nigeria and its mega-city, Lagos, and Kenya's premier city, Nairobi, represent the potential for vast urban centers to become magnets for commercial services, trade, and cultural growth, as well as concentrated centers of educated workers.

Rapid urbanization is a major part of the growth story in these sprawling centers of commerce as foreign investment has poured in during the past five years to quicken growth and intensify development. To be sure, one significant factor behind the robust recent growth in both Nigeria and Kenya is that each is starting from a much lower base than South Africa, and each society has far higher levels of mass poverty. Unlike South Africa, where population growth is modest, Nigeria and Kenya could see their future prosperity balanced on a knife's edge: They must meet the challenge of educating and finding work for the millions of young workers who will enter the labor force in the next decade or face the consequences of millions of jobless and alienated citizens, making them susceptible to violence and disorder. Both nations will need to sustain strong growth, along with social progress, to create needed jobs, reduce their high levels of unemployment, and ensure stability.

Industrialization, consumer spending, tourism, and business services—along with more innovative and productive agriculture—can be keys to spurring sustainable development in both countries. But, questions will persist about governance, the ability of the respective governments to improve infrastructure and reduce corruption, and whether terrorism and Islamist insurgencies can be kept at bay. And, while Nigeria is a giant nation with a major dependency on oil production, Kenya is much smaller and more diverse, having gained more traction in manufacturing and agro-processing. Figure 18 describes the economic opportunities and challenges these two countries face.

Fig. 18: Regional comparison by industry sector
CAGR 2015-34

	South Africa	Nigeria	Kenya
Agriculture	1.0%	4.8%	4.4%
Mining	0.8%	1.4%	6.8%
Manufacturing	3.3%	6.1%	5.6%
Utilities	3.0%	6.4%	6.0%
Construction	3.4%	6.7%	6.6%
Retail & wholesale	3.5%	5.7%	6.4%
Accommodation and food services	4.3%	8.2%	6.1%
Transport and warehousing	3.6%	4.5%	6.6%
Information and communications	3.6%	6.7%	7.7%
Financial services	3.8%	4.1%	5.8%
Business services	3.7%	6.2%	5.6%
Public administration	2.7%	2.9%	3.7%
Education	2.3%	6.5%	5.8%
Health & social services	3.3%	5.9%	4.5%
Other services	3.3%	8.0%	5.6%
GDP	3.3%	5.5%	5.6%

Source: Oxford Economics

5. Nigeria

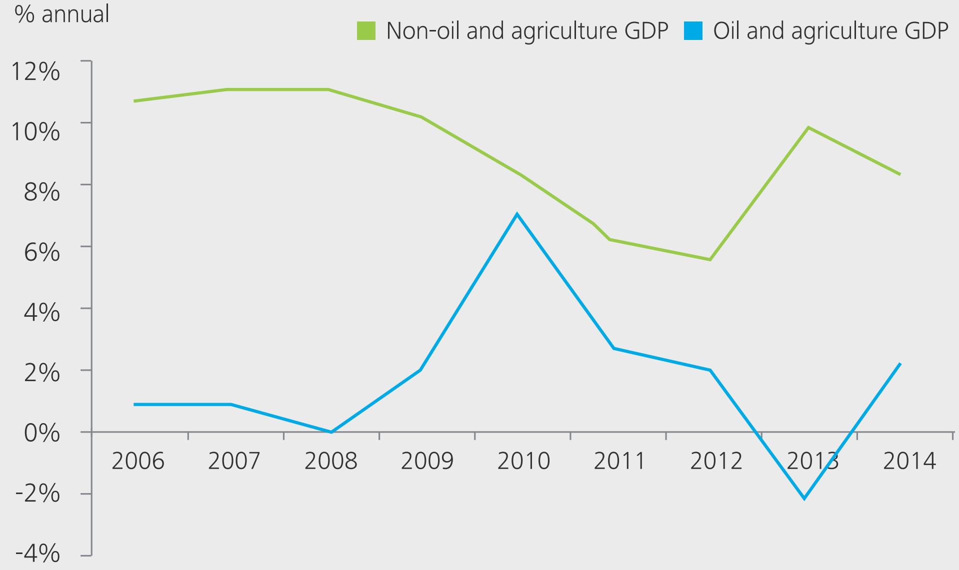
The most populous nation on the African continent and its biggest oil producer, Nigeria was also declared the continent's biggest economy in 2014—vaulting ahead of South Africa—when "rebasing" of the national economic data concluded that its economy produced nearly US$510 billion per year[41], on par with Taiwan and Belgium, and just behind Poland. This revaluation better reflects the current structure of the country's economy and shows how rapidly the sectors not involved in oil or energy production have grown up, as Figure 19 highlights.

The rebasing only confirmed what many local observers already knew—that besides its traditional base in oil and agriculture, a dynamic new Nigeria was coming into focus with investments in banking, mobile communications, and the film industry underlying the country's potential. Lagos is quickly becoming one of the continent's super cities, with a population expected to exceed 25 million by 2030. The democratic transfer of power to a new president, Muhammadu Buhari, who unseated the ruling party after 16 years in office, in a peaceful and clean electoral process, has also generated significant optimism.

The new government inherits some long-standing challenges, however. Chronic power shortages constrain the growth of manufacturing—the World Economic Forum ranks Nigeria as among the world's least reliable suppliers of power.[42] Clogged roads and ports hinder exports, and education and health systems are continuously strained as the nation's population rises. Endemic corruption feeds Nigeria's serious economic inequalities, while the continuing threat of terrorist kidnapping and attacks from Boko Haram raises questions about safety and governance. As big as the headline number may now be, per capita GDP in Nigeria is only about half the level of South Africa[43]. Moreover, wealth generated by energy production has yet to lead to great advances in social progress. On scales related to meeting basic needs, education, and basic liberties, Nigeria still trails many of its African peers.[44]

Fig. 19: Oil and non-oil growth in Nigeria

Industrial growth



Source: Oxford Economics

Further, with a population of more than 170 million that is growing at greater than 2 percent per year, Nigeria is in a race with itself: it must either grow sufficiently to reap the rewards of this "demographic dividend" or confront rising numbers of unemployed youths who could turn to Islamist extremism in the country's north. To reduce widespread poverty, the fruits of growth in Nigeria must be more equally distributed. Despite growth, ordinary citizens still face poor levels of water and sanitation, personal safety, and personal rights and freedoms, compared with citizens of countries with similar economic performance.[45]

Nigeria—Short-term outlook

The global collapse of oil prices in the past year dampens Nigeria's short-term outlook, as GDP expansion is likely to decelerate. While economic growth averaged a hearty 6.3 percent in 2014, growth this year is likely to fall below 5 percent, as lower oil prices and supply constraints, namely from theft and sabotage at energy production facilities, are expected to continue. Weaker energy prices will also contribute to slower growth in the services economy, as energy accounts for about 70 percent of government revenues and 95 percent of foreign earnings. The declining outlook for oil will also tend to weaken the Nigerian currency, the naira, which has depreciated by some 20 percent in the six months, from 155 to the U.S. dollar in October to 196 in April. In a country heavily dependent on imports of food and manufactured goods, the stumbling currency will likely push inflation higher.

This combination of falling oil revenues and higher prices for imported goods will also erode the external accounts—the current account is likely to slip into deficit this year. Meanwhile, lower government revenue will dampen growth in the non-oil sector as well; the revised 2015 budget includes sharp spending cuts to compensate.

A pledge to battle insurgency in the country's northeast and to end corruption fuelled Mr. Buhari's decisive election victory on 28 March 2015. His new administration confronts a significant set of challenges, however, including a need to tackle mismanagement in the army. Despite a large budget deficit, embezzlement by generals has left the army undersupplied to combat the threat from Boko Haram. The new administration must also end no-bid contracts signed by the state-owned oil giant Nigerian National Petroleum Corporation (NNPC), a key source of political embezzlement (a former central bank governor alleged in late 2013 that some US$20 billion in oil revenues slated for state coffers had vanished). At the same time, the government needs to keep peace in the oil-producing Niger Delta. The generals enriched under the regime of former president Goodluck Jonathan, as well as poor and disaffected youth, could stoke violence if they feel aggrieved.

Nigeria—Growth challenges

Despite the existence of enormous oil and gas reserves, poverty levels in Nigeria remain extremely high—nearly half the population lives in absolute poverty, defined as the level of income needed to afford basic standards of food, clothing, and shelter. While inequality is not as extreme as in South Africa, Nigeria's Gini coefficient, the index of inequality, is extremely high, measuring at around 0.43. The new government must make committed efforts to improve the collection of non-oil revenue, phase out fuel subsidies, and increase financial inclusion. Today, only about one-third of the adult population has a deposit at any financial institution, and the ability to conduct banking transactions by mobile phone suggests a significant potential opportunity.

In addition, Nigeria could boost its competitiveness by privatizing key sectors such as the power sector, which should feed through to lower prices and raise infrastructure investment. The country's National Infrastructure Investment Plan (NIIP) has identified infrastructure needs of about US$30 billion to US$50 billion a year, across sectors covering power, transport, and communications. In addition, the US$2.5 billion privatization of the power-generation sector—splitting the national

Power Holding Company of Nigeria into six generating companies and 11 distribution firms—should accelerate much-needed investment in the sector. However, building out extensive new generation capacity that relies on using Nigeria's abundant national gas reserves should also receive additional attention.

While there is great potential in the nation's consumer sector, enormous roadblocks must also be overcome. Land is expensive, disputes over title are commonplace, and registering property is cumbersome. As a result, it is difficult to amass the large tracts needed to build factories, warehouses, or shopping malls. Moreover, building costs are significantly higher than in South Africa, in part because imports of cement are banned to protect the local industry. As a result, Lagos, a city of more than 20 million people, has relatively few modern shopping malls.

Moreover, the slow progress of industrialization has allowed cheap Chinese-made goods to enter the country, making it more difficult for domestic industries to take hold. As Figure 21 indicates, fully 26% of Nigeria imports today come from China, up from just 10% in 2005.

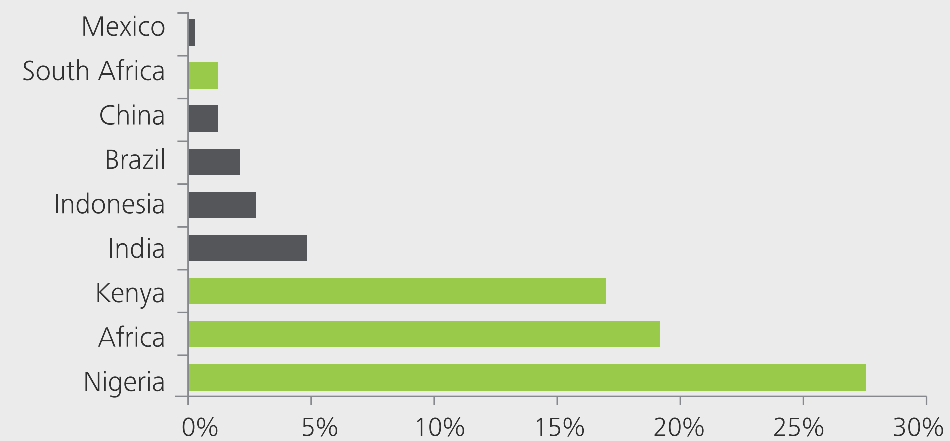
Likewise, there is a major opportunity for Lagos to become a major financial hub for the region, especially if ambitious infrastructure projects already on the books can be completed. World Bank loans are helping to finance a light rail project to help ease congestion in Lagos; however, the project remains incomplete seven years after construction started. There has been a similar level of attention paid to the potential for public-private partnerships (PPPs) to facilitate sorely-needed expansions of the country's ports and roads, but the much-anticipated construction of the Second Niger Bridge remains unfinished.

A growing working age population offers the potential for more rapid industrialization, if education and training can be significantly improved, giving young Nigerians 21st-century skills. Efforts are underway to generate more jobs, including through vocational training schemes and grants to foster entrepreneurship. However, one challenge is that many Nigerians are graduating high school without essential skills, leaving high-skilled occupations in the country facing serious worker shortages.[46]

Fig. 20: Comparative poverty in Nigeria

Population on less than $1.25/day

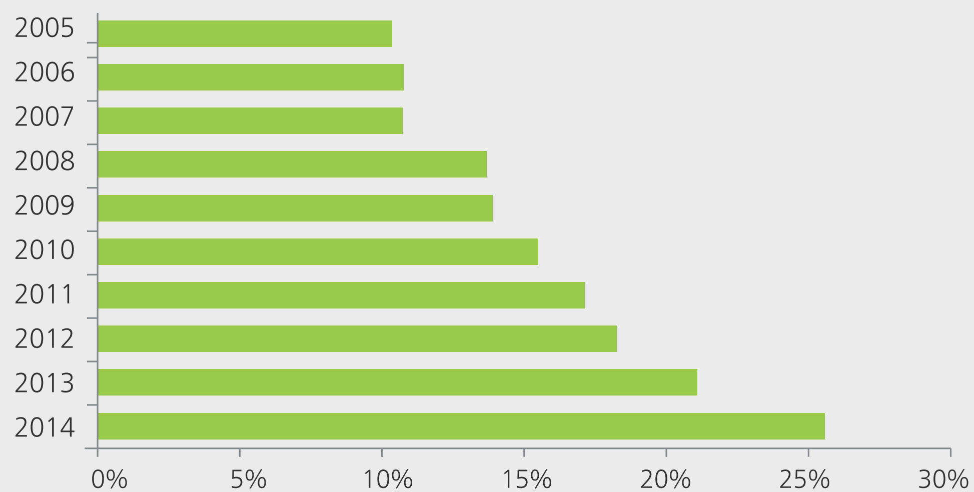
% of population at PPP



Source: World Bank

Fig. 21: Nigerian imports from China

Trade share of imports



Source: World Bank

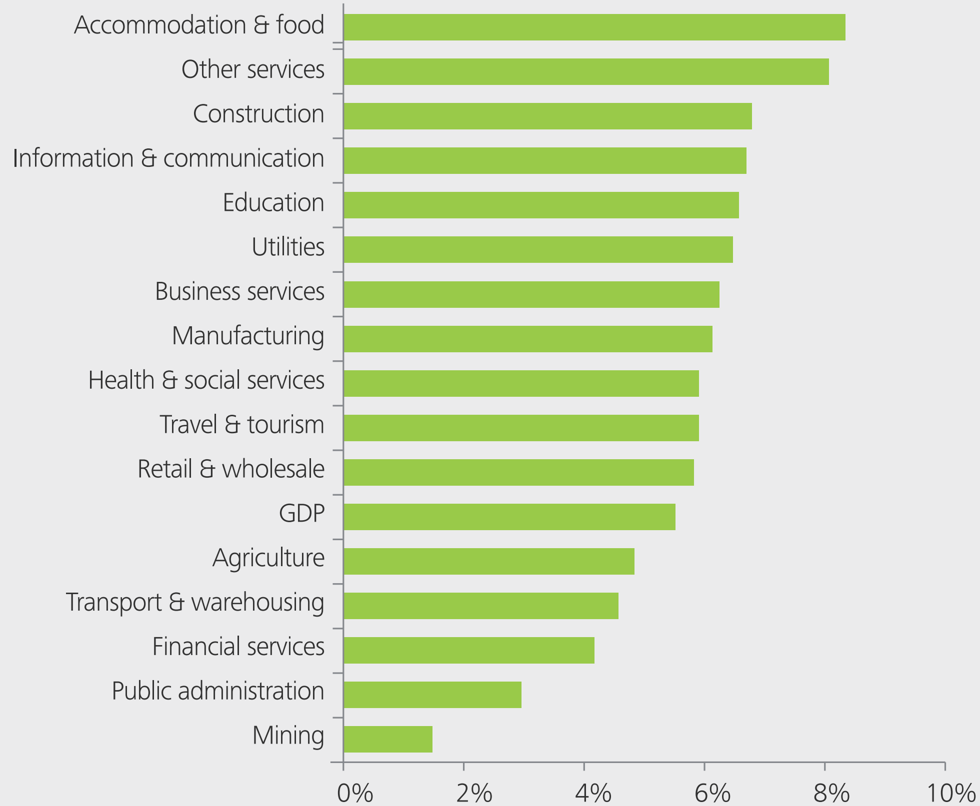
Nigeria—Catching the next wave: industry outlook and opportunity

When the size of Nigeria's economy was dramatically recalculated in 2014, sectors like the mobile phone industry and film-making were accorded much heftier weight in the national output statistics. Two decades ago, for example, the country had only one telecom operator with around 300,000 telephone lines. Now, nearly a dozen operators service Nigeria's 120 million mobile phone subscribers. "Nollywood," as the cinema and culture complex centered around Lagos is known, contributed 1.42 percent to the national economy last year. Annual revenue for Nollywood is estimated to be around US$590 million. These adjustments reflect the real potential for Nigeria to move beyond oil production and agriculture to more value-added and services industries over the next 20 years.

Moreover, the nation's rapid growth makes it a testing ground for companies hoping to become important players in Nigeria's consumer sector, which explains why a company such as Procter & Gamble has recently added a factory in the country. SAB Miller, the global brewing company, has also expanded into Nigeria. Indeed, beer sales, one measure of growing urban prosperity, have grown by at least 10 percent a year over the past decade—more Guinness is sold in Nigeria than in any other nation, including Ireland. Even with this growth, there is ample room for market expansion. Average per capita consumption of beer is still relatively low, at about 10 liters a year, compared with 60 liters in South Africa, the continent's biggest market, and nearly 80 liters in the United States.

Projections suggest sectors such as tourism, food services, and telecommunications will have a major impact on Nigeria's development over the next 20 years. The country's economic output is expected to grow by 5.6 percent per year—almost tripling in size in real terms.[47]

Fig. 22: Nigeria sector growth over the next 20 years
CAGR 2015-34 by industry (%)



Source: Oxford Economics

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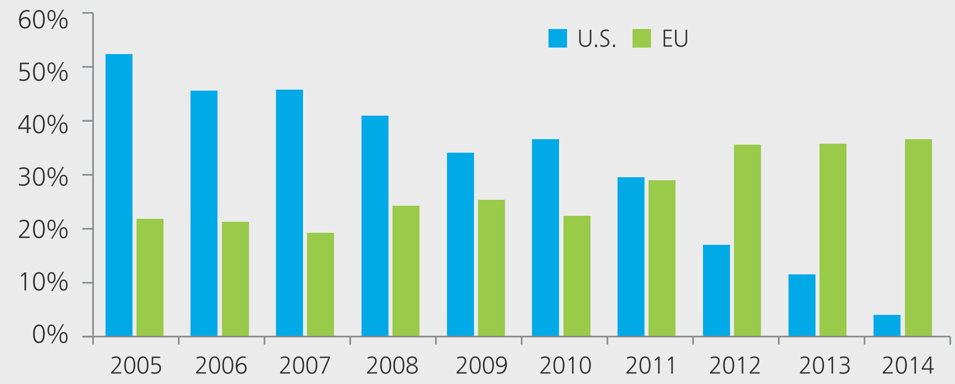
The information and communication sectors will expand more than three times faster than the underlying growth in the economy over the next two decades, while accommodation, construction, and general services will also experience rapid growth as the urban middle class expands.

As with South Africa, Nigerian exports to Europe have grown more rapidly than those to the U.S., reflecting the fact that energy dominates Nigeria's export sector, and that the U.S. "tight oil" revolution reduced the country's dependence on foreign imports. However, as with European interests, Chinese companies have also been keen to invest in Nigeria's energy sector.[47]

Fig. 23: Nigeria exports by destination

Exports by destination

(% of merchandise exports)



6. Kenya

When al-Shabaab extremists massacred more than 140 students at a university in the northern city of Garissa in April 2015, their cruel targeting of young innocents was not completely haphazard or random. They knew their acts would pose dire economic consequences for a nation that has been gaining increased interest from foreign investors and, from an economic standpoint, punching far beyond its relatively modest size.

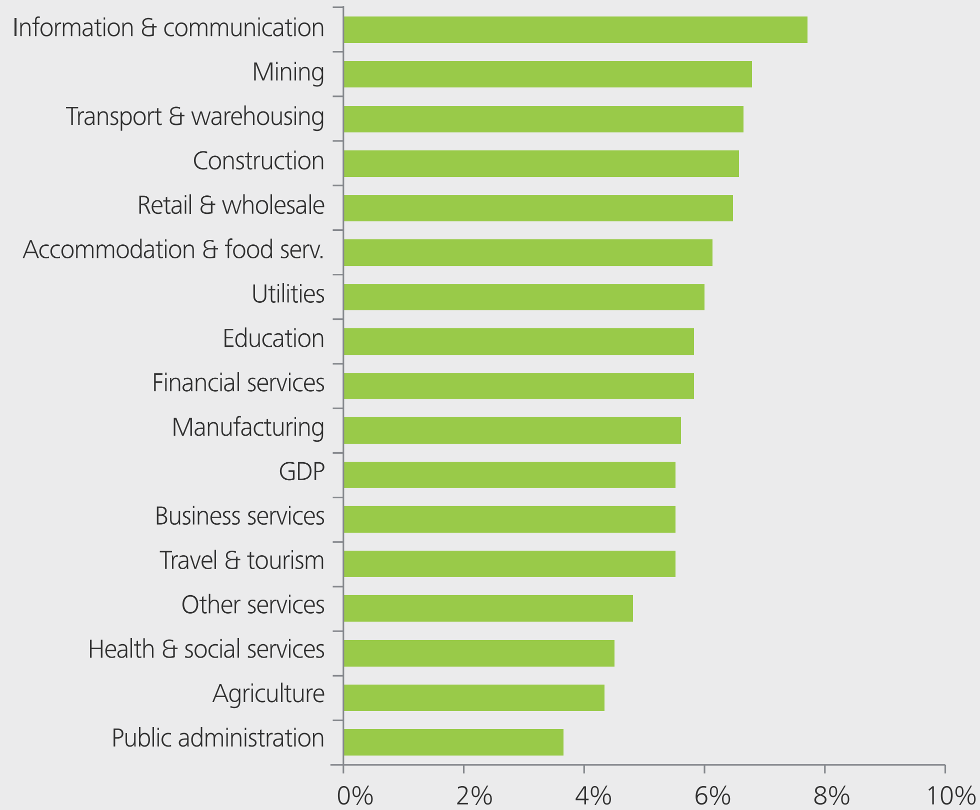
In a diversified economy of US$55 billion[48], far smaller than either South Africa or Nigeria, tourism and burgeoning trade represent key opportunities for growth in Kenya. Textile and other manufacturing shows promise. But, stabilizing the Somali border and reducing the threat of terrorism will remain major government priorities, as unsettling attacks will deter foreign visitors from venturing into Kenya's vast and impressive wildlife preserves on safari.

The rebasing of Kenya's national accounts at the end of September 2014 added 25 percent to the nation's GDP, making Kenya the ninth-largest economy in Africa. The decline in tourism sparked by the attack at the Westgate Mall in September 2013, however, caused national growth to fall to 5.3 percent in 2014 after growing at a 5.7 percent pace the previous year.

Agriculture still accounts for more than 25 percent of the nation's economic output, so factors like weather can affect Kenya's performance. But, the country also has great potential to transform itself more rapidly into a regional trading hub if a series of major infrastructure improvements can be successfully completed. Manufacturing represents about 12 percent of GDP, but has been held back by frequent shortages of foreign exchange, a lack of investment, and power shortages. Moreover, since much of the manufacturing sector is involved in processing agriculture products, poor harvests can affect supplies of raw materials and final outputs.

Robust growth is projected in Kenya due in part to strong growth across sub-Saharan Africa, as well as investment in key industries, with growth expected to average 5.6 percent annually to 2034.

Fig. 24: Projected growth by sector in Kenya
CAGR 2015-34 by industry (%)



Source: Oxford Economics

Kenya—Catching the next wave: industry outlook and opportunity

One potential positive surprise for the country could come from Kenya's recent entry into the energy sector. Oil was first discovered in 2012, and since then, the sector has become an important source of inbound FDI. Nonetheless, there is significant uncertainty surrounding growth in the sector, as it has yet to be determined whether oil extraction in Kenya is commercially viable. The government must also remain cautious that the benefits of FDI to citizens and the economy are realized—FDI directed toward the resource sector can provide less well-being and stability than resources directed to other industries.[49] While the full potential of the sector is not yet known, early signs seem positive.

Still more exciting is Kenya's rapid emergence as a hub of technology and innovation for the African subcontinent. Even in the face of the ongoing terrorist threat, important global IT players like Google, Microsoft, IBM, and Samsung have all chosen to set up regional offices in Nairobi, the city that pioneered the use of mobile money. Moreover, Kenya boasts one of the highest rates of urban Internet access on the continent, estimated at 72 percent of the population.[50]

Indeed, growing investor confidence has meant that capital inflows have financed the country's large current-account deficit, which is estimated to have exceeded 10 percent of GDP in 2014. Buoyed by the foreign response, Kenya was able to issue a US$2 billion Eurobond in June 2014 to help finance badly needed infrastructure investments. Though the budget and trade deficits remain high, they are expected to shrink in the medium term.

Like Nigeria, Kenya's working-age population is projected to expand rapidly, so a focus on education and training will be critical. This population is expected to grow at a compound 2.8 percent over the next 20 years, just slightly below the 3 percent CAGR expected in Nigeria.[51] Fortunately, compared to its economic peers, Kenyan citizens have better access to advanced education, allowing them to take advantage of the rising number of skills-based jobs.[52]

A significant accelerant to growth in Kenya should come from construction spending on ambitious infrastructure projects. Some US$3.6 billion of Chinese investment in the standard gauge railway (SGR) running from Mombasa to Nairobi could significantly boost Kenya's regional trade opportunities, although land disputes with displaced communities have posed challenges. Completion of the project could boost overall growth by a full 2 percent. Chinese interests are also likely to be keenly interested to invest in Kenya's nascent energy sector.

The SGR is just the first leg of what could be the most ambitious infrastructure program in the country's history. Last August, Kenya's port authority signed a US$467 million contract with China Communication Construction Company to start work on the first three berths at a planned new port at Lamu that could eventually include a total of 32 wharves. The whole program, encompassing rail, ports, and oil refineries, could create far more vibrant trade links to Ethiopia and South Sudan and improve connections to Rwanda and Uganda.

Another major infrastructure project is the construction of a regional pipeline linking oil fields in Uganda, Kenya, and South Sudan, which the World Bank pledged some US$600 million to facilitate in October of 2014. The Uganda-Kenya Crude Oil Pipeline (UKCOP) would transport crude oil from Uganda's oil fields in Northern and Western Uganda to Lamu. And as tourism is also very important, Kenya is investing in the nation's air transport infrastructure. A new terminal has opened at Nairobi's international airport, and additional investments are slated to help upgrade the airport in Mombasa.

Agriculture and food processing also represent a significant growth sector. Dairy production has become more successful in the country, and Danone, the multinational dairy company, purchased a 40 percent stake in Brookside Dairy, East Africa's largest dairy manufacturer, with annual revenue estimated at about US$176 million. The company manages the largest milk-collection network in East Africa and is supported by more than 140,000 farmers. Brookside Executive Chairman Muhoho Kenyatta is the younger brother of Kenyan President Uhuru Kenyatta.[53]

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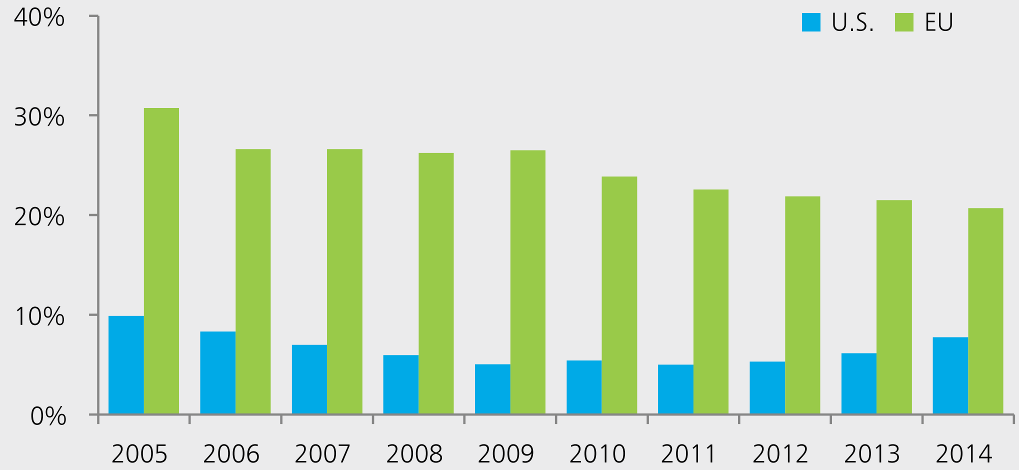
Food processing in general represents another growth opportunity. While agriculture represents 30 percent of annual GDP and one-third of total manufacturing, much of the products of the nations' farms and fields remain unprocessed. Tea and coffee, for example—major export commodities that earn the country approximately US$1 billion per year—are mainly shipped raw.

Textiles is another segment of the manufacturing economy where prospects are promising. Although it employs only an estimated 30,000 workers today, the government is hoping to lure producers to the country with incentives, like reduced rates for electric power. While factory wages are beginning to exceed US$500 per month in China, comparable salaries in Kenya are about US$120 to US$150.

The expansion of textile trade with Kenya represents one of the success stories of the AGOA and European initiatives. Textiles and apparels have dominated the composition of Kenya's exports to the U.S. and, in 2013, knit and woven apparel totaled more than $300 million.[54] Textile employment could suffer, however, if the AGOA, which is now slated to expire in September 2015, is not renewed.

However, Kenya also exports more than $530 million in flowers and more than $300 million in fresh produce to European countries, making it one of the most important contributors of foreign exchange. The EU takes about 40 percent of Kenya's fresh produce exports, and duty free access will continue to be important after the EU reinstates the country to the list of privileged under the Market Access Regulation.[55] Information and communications may represent the most exciting opportunity for a growing Kenya. Just three years after access to undersea cables gave Kenya faster Internet connections, a series of entrepreneurs and startups are now working to create innovative websites and services—all geared to the nation's rapidly expanding base of mobile phone users, who are also very comfortable using phones for banking and commerce. mPesa, the mobile phone-based banking application, has revolutionized commerce across the country by offering banking services to millions who never had it and allowing for payments via an inexpensive SMS message on phones that do not require an Internet connection.

Fig. 25: Kenya exports by destination
(% of mechandise exports)



Source: Oxford Economics

Today, it is not unusual to see Masai herdsmen using their mobile phones to make payments from their remote villages.

The Kenyan government is now pouring some US$14 billion into the development of a “techno center” nearly 40 miles outside of Nairobi. Officials believe they can turn the Konza Tech Center into a bustling city of 20,000 workers employed in business outsourcing fields like call centers and back-office clerical processors within 20 years.

But, growth in the IT sector could also be constrained due to a lack of educated talent. One government study indicated that the country would be unable to meet the expected demand for 10,000 qualified IT professionals by 2014.[56]

In addition, the adoption of e-commerce remains relatively light in Kenya despite good Internet connectivity and high usage of mobile payment services. Among the challenges are the absence of a low-cost delivery service, high customs duties on imports, and inadequate cybersecurity protections to guard against fraud. Even so, the drive to boost technology and infrastructure speaks to the growing urbanization of the country and the growing power of the nation’s consumer sector. Buoyed by the changing lifestyle of Kenyans and the ongoing urbanization, demand for shopping has spurred a rise in the number of malls constructed in Kenya.

Financial services firms have already seen great opportunity in Kenya, using technology to leapfrog into the 21st century. Nairobi has the potential to become a financial hub for all of East Asia. Moreover, remittances from Kenya’s far-flung diaspora have doubled since 2010. One promising sign was the initial public offering of the Nairobi Stock Exchange, which raised US$7 million in its debut in late 2014.

Despite the promise of these sectors, governance remains a challenge, especially when it comes to attracting and holding on to foreign investment and technology. Kenya is rated poorly on Transparency International’s ranking of corruption, at 25 (where 100 is considered “highly clean,”) versus the African average of 32.8. Moreover, it has not yet achieved dramatic progress in efforts to improve the wellness, education, and housing of its people. According to the Social Progress Index, it ranks 104 of 133 countries, with weakness noted in education, sanitation, and infant mortality rates.[57] Likewise, the World Bank ranks Kenya 136 out of 189 countries in its “ease of doing business” survey, citing the costs of obtaining construction permits, heavy taxes and duties, and weak enforcement of contracts[58].

7. Conclusion

Across sub-Saharan Africa, major opportunities are unfolding to generate stronger growth, improve the lives of its people, and become important hubs of global trade and commerce. Foreign investors and multinationals are becoming more focused on the continent, while new technologies offer the well-educated the opportunity to launch and grow their own entrepreneurial enterprises.

Nigeria and, increasingly, Kenya can use their energy reserves to fund productive investments in basic infrastructure and higher-valued manufacturing. South Africa, the most mature of the continent's economies, can use its expertise in finance, design, technology, and other services to help guide, plan, and implement programs to boost regional competitiveness and incomes. Stronger intra-regional trade can also boost the trajectory of all three economies. Focusing on the basic building blocks of economic development—such as road and bridge construction, port expansions, and reliable power generation capacity—is a crucial first step toward faster and more sustainable long-term growth.

The democratic transfer of power now taking place in Nigeria is a hopeful sign for the entire continent. With better governance and tighter implementation of well-designed economic plans, all three nations can generate the job growth they will need to bring economic well-being to the next generation of African workers and consumers.

However, each will have to be more determined to curb corruption, improve the accountability of public officials, and contain civil strife in order to boost civic engagement. And all three must work more diligently to reduce economic inequality, spread the new wealth they create from their vast potential more broadly, and commit to implementing policies committed to "social inclusion" in order to help drive real and sustainable growth and a prosperous future.

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