Changing the trajectory of South Africa’s economic environment

South Africa has been stuck in a low growth rut for the last decade. The country’s growth has lagged behind many emerging markets and most of its African peers (some countries, such as Ethiopia, Ghana and Rwanda, have doubled their economies in size, growing 7% or more on average this past decade).

South Africa’s deteriorating economic environment, compounded by political instability and policy uncertainty, drought and unstable electricity supply, as well as a weak external environment, has had a drag on business and consumer confidence, alongside income and spending. The inability to address much-needed structural reforms has also worsened South Africa’s relative international rankings on competitiveness and doing business.

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Low growth, more debt

Hinged on even lower 2019 GDP growth expectations than initially assumed in the 2019 Budget, the Medium-Term Budget Policy Statement (MTBPS) presented a widening fiscal deficit and quicker rising debt-to-GDP ratio outlook. This is based on lower tax revenue projections (reflecting weak in-year collections and a lower tax base outlook) and spending pressures that increased since the 2019 Budget. The latter included additional support to struggling state-owned enterprises (SOEs), and a reversal of the proposed savings from compensation measures such as early retirement.

Particularly worrisome was the projected ongoing growth in nominal debt cost, which is growing at a substantially higher rate than GDP and faster than any other spending category over the three-year forecast period. With R11.50 of every R100 currently spent by government on debt service costs and R34 of every R100 on public sector compensation, this further limits key areas that spending should be focused on, including education, health and infrastructure.

Acknowledging that the growth and revenue outlook has deteriorated, government has taken first steps towards stabilising the debt-to-GDP ratio, by reducing planning baselines, including goods and services and transfers, by about R80bn over the next three years. But as reported by National Treasury, these measures are not sufficient. In fact a total of R150bn in savings over the next five years are required to stabilise South Africa’s debt-to-GDP outlook – something that ratings agencies will be monitoring closely.

Changing the trajectory

From the perspective of the National Treasury, it is clear that economic reforms are urgently required. Although many reforms might not have immediate impact on GDP growth (expected around 1% in the short term), they have the potential to unlock higher and job-creating growth outcomes in years to come.

A number of short, medium and longer-term interventions were proposed in a detailed August 2019 Treasury publication. The MTBPS then added that some of these reforms can be implemented using minimal state resources and with immediate effect. For example, government can reduce the cost of travelling to South Africa through an open-skies agreement, and cutting the red tape for small businesses in the tourism sector.

It can facilitate the diversification of power generation by granting licences to the roughly 30 small-scale energy projects. Telecommunications services can be expanded by fairly allocating spectrum, thus enabling the rapid expansion of the country's fibre infrastructure and a reduction in costs. The cost of doing business can be lowered by automating registration and tax filing processes.

Such interventions could create fertile ground for longer-term reforms. Furthermore, medium-term reforms should begin immediately within the transport, water, telecommunications, and industrial and trade policy.

With hard work lying ahead, the upcoming 2020 Budget Speech will need to signal the right messages to the market, i.e. that government will stabilise the economy and make some hard fiscal and structural choices. Although some of the stricter fiscal measures and proposed reforms are likely to be unpopular and are only anticipated to pay economic dividends in the medium term, they will assist in boosting certainty, upping productivity and reducing inefficiencies in order to create the necessary conditions for growth.

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