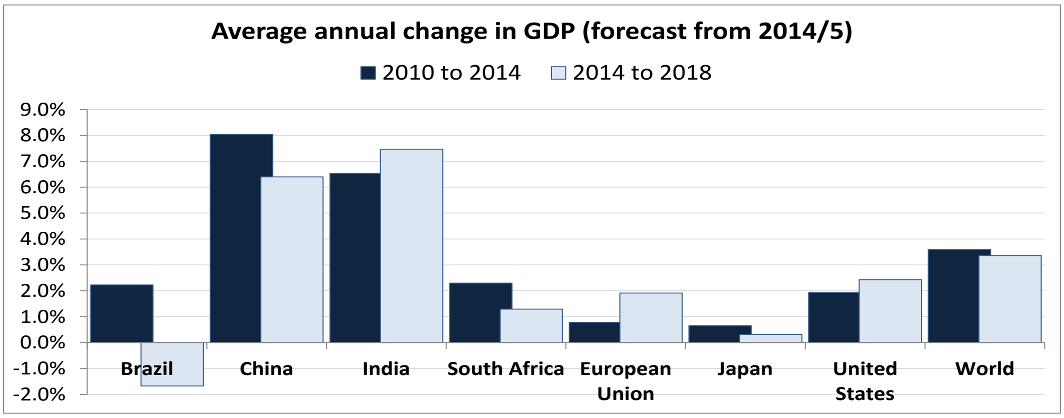
Behind the trends

A number of long-term factors continued to act as a drag on the South Africa economy, key among them being the depressed global economy, weak commodity prices, and the impact of the drought. These factors have been aggravated by pro-cyclical fiscal and monetary policies.

The global economy remains in a precarious state. China's reported growth slowed from 6,8% in the final quarter of 2015 to 6,7% in the first quarter of 2016 (the official figures are now generally considered exaggerated, but the trends appear to be reliable). For their part, both the US and the European Union saw an expansion of only 0,5% in the first quarter of the year. The IMF forecasts continued slow growth in key South African markets, with the exception of India. To date, its forecasts have tended to be overly optimistic Graph 10).

Graph 10

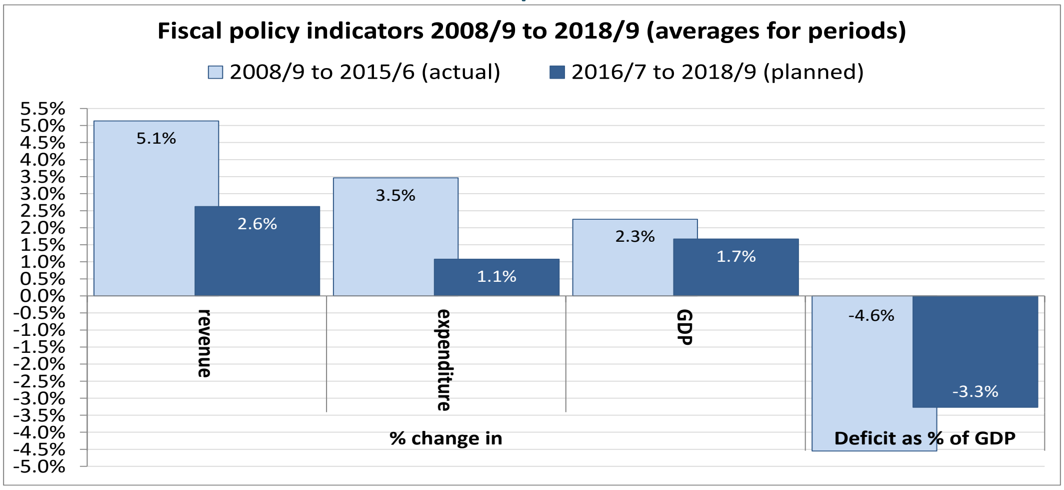


Source: Calculated from, IMF. World Economic Outlook. April 2016. Electronic database. Series on GDP growth in constant national currency. Downloaded from www.imf.org in June 2016.

South Africa has faced slower global growth while grappling with fiscal constraints and Reserve Bank concerns about inflation. These factors mean that macro-economic policy has been effectively pro-cyclical, with a slowdown in state spending and higher interest rates coming into play just as the global economy began to slow down.

As Graph 11 shows, state spending is expected to be substantially slower than GDP growth from 2016/17 to 2018/19. As a result, state spending per person is predicted to fall over this period.

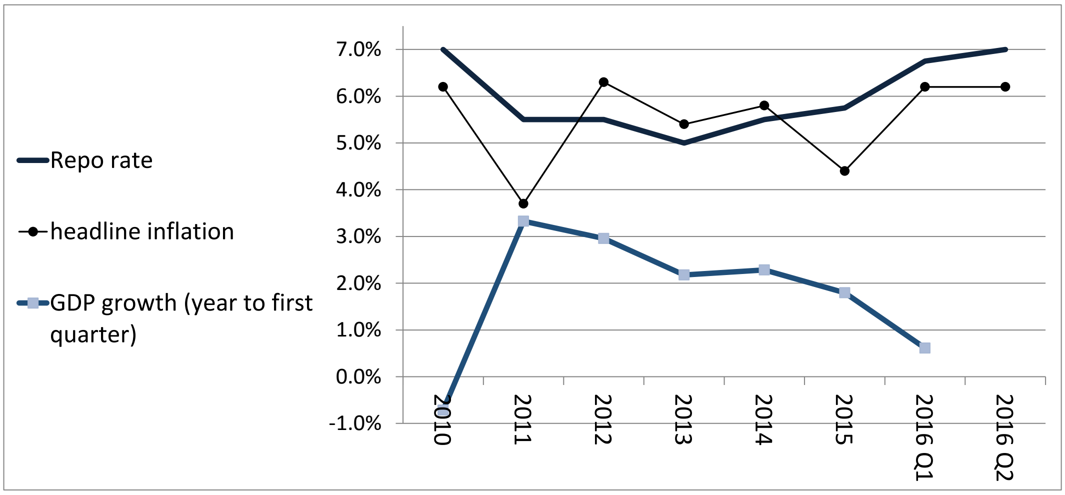
Graph 11



Source: Calculated from Budget Review. Statistics in excel format. Relevant series. Downloaded from www.treasury.gov.za in June 2016.

Furthermore, the Reserve Bank began to increase the repo rate just as economic growth began to decline, as Graph 12 shows. In large part, it sought to subdue inflation, which seemed likely to follow from rapid depreciation as export markets narrowed. But the effect was to aggravate the overall slowdown.

Graph 12



Source: Repo rate from SARB. Interactive data set. Series on the repo rate. Downloaded in June 2016. GDP growth calculated from Statistics South Africa. GDP data from 2003. Electronic database. Series on GDP in constant terms. Downloaded from www.statssa.gov.za in June 2016. CPI for March from Statistics South Africa. CPI History: 1960 Onwards. Downloaded from www.statssa.gov.za in June 2016.

While budget constraints are real, the risk is that the current combination of tightening fiscal and monetary stances will aggravate the threats of slow growth, unemployment and inequality. In these circumstances, South Africa should explore more innovative and creative levers to stimulate aggregate demand, going beyond the budget and the repo rate. Viable measures include the following:

- A two-year holiday on UIF contributions would effectively increase incomes for both workers and employers. It would take advantage of the current UIF surplus of over R100 billion, which is far in excess of the amount required to maintain spending even under current proposals to improve benefits. In addition, ways to invest the UIF surplus to generate more sustainable growth and more competitive industries should also be considered.

- A revised policy guideline to the Reserve Bank should ensure that interest rates do not increase as long as inflation is moderate by historical standards – below, say, 10% - and growth is under 1% a year.
- More vigorous action should be taken to monitor and where appropriate restrain regulated prices and to improve productivity by state-owned enterprises, public-sector schools and hospitals, and municipalities, most of which have increased their tariffs faster than inflation.
- Cabinet should impose a six-month freeze on amending regulations and laws to stabilise the policy environment and reduce compliance burdens. The only exception should be when Cabinet specifically approves a change on the grounds that it has nationally important and urgent aims. During the temporary freeze, government should engage with stakeholders on its legislative programme so as to ensure a higher degree of agreement on priorities and to establish processes to avoid unintended consequences.
- State agencies should be required to do more to ensure local procurement, especially for consumables, where the price differential is not excessive, in order to maximise the stimulus effects of government spending by reducing import leakages.
- Government should identify additional levers to encourage private companies also to buy local.