BER BUREAU for ECONOMIC RESEARCH

Redefining South Africa’s economic trajectory

How structural reform can lift South Africa from its slump

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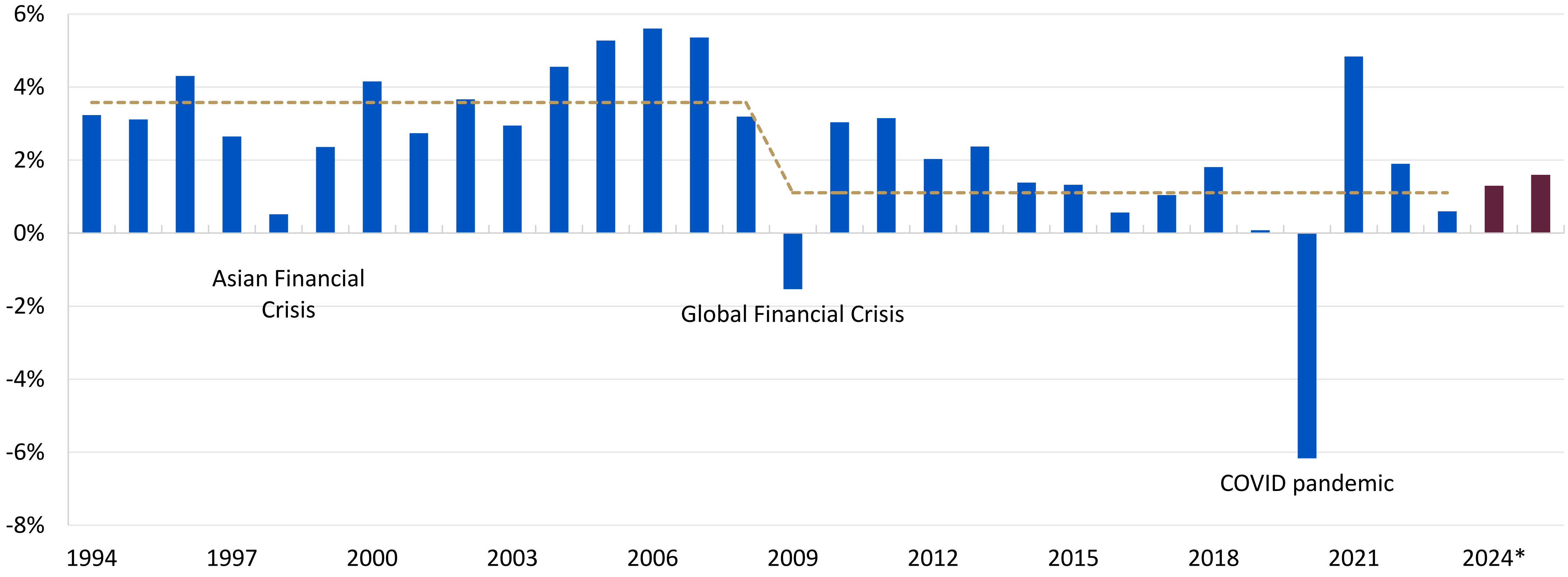
Lets take a longer-term growth perspective

Annual GDP growth

CONSTANT PRICES, Y-O-Y % CHANGE



Source: Stats SA, BER
**BER baseline forecast*

Methodology

Used BER's May 2024 quarterly forecast as a baseline that relies on a set of assumptions we made around the global and domestic economy

Our scenario models the successful implementation of the remaining structural reforms and continued progress within the four network industries—energy, railways, ports, and infrastructure—outlined by Operation Vulindlela (OV) (and the Economic Recovery and Reconstruction Plan, ERRP)

Shocked some of the domestic assumptions made in the baseline to study the impact over time

For example, what if we see an improved energy availability factor (EAF) and logistics become more efficient and enable more exports than assumed in our baseline?

Sometimes, there was a clear lever to pull in the model, but other times, we had to assume how a policy change would impact the model.

Another important focus of OV has been on the visa system to encourage tourism growth and attract the skills needed to grow the economy

- Our model likely underestimates this (it would further boost sentiment and aid with much-needed export earnings): a sensible visa framework would boost growth beyond what we have estimated

Understanding the BER's macroeconometric model

The BER's core macroeconometric model is a medium-sized semi-structural demand-orientated model with specific supply-side elements

- We estimate GDP from the expenditure side (by adding up household and government spending, investment and net trade)
- These components are determined by several interlinked model relationships, which in turn, are sometimes based on an assumption (i.e. we take a specific view on a forecast figure) or other times based on model outcomes (i.e. the model produces a forecast figure)
- The interlinked nature means that changing one thing impacts everything else
  - for example, assuming a weaker rand →higher inflation → higher interest rates → lower consumption → lower growth → stronger rand → lower inflation, etc
- This is important because it ensures we stay consistent.

There is one important caveat: the model is not designed to capture the feedback loops like an economy-wide Computable General Equilibrium (CGE) model would

- Such a model would also test how economic actors change their behaviour in response to policies
- In short, this means that we are likely underestimating the positive impact of pursuing these policies on growth, potentially significantly so
- Furthermore, CGE models allow you to disentangle what policy 'does what' to growth – see this paper by the National Treasury for such an exercise
- The paper is from 2019 and thus may seem somewhat dated, but the core structure of the economy has not changed much since, and a repeat of the study is likely to result in similar outcomes

Reforms to accelerate growth: Fundamental assumptions

The South African constitution and Rule of Law are maintained overarches everything, and the judiciary remains independent

The SARB remains independent and can pursue its mandate without fear of interference

Fiscal discipline remains intact, with a commitment to bring down government debt to GDP levels over time

We assume policy uncertainty diminishes as reform momentum gathers pace

In our model, much also hinges on sentiment → helps to reduce the risk premium in the economy →boosts house prices → improves household income → banks less risk-averse → looser credit standards and higher demand for credit → lifts household consumption (especially on durable goods and services) and investment (particularly private investment)

Reforms to accelerate growth: Energy

Better electricity outcomes through leveraging private sector generation to supplement Eskom's efforts

Higher private sector generation lowers the demand for Eskom's energy

Proper maintenance will further increase Eskom's EAF

This will support economic activity while bolstering potential growth through higher production capacity.

A finance model for transmission, including private sector participation, allows for the implementation of Eskom's transmission capex plan

Local electricity distribution needs to be reorganised too

Allowing privately generated power to be transmitted across the national grid further aids in creating more sustainable energy availability, cementing improved sentiment and stronger investment and productivity outcomes

Reforms to accelerate growth: (Water) infrastructure

Water security concerns are addressed by expanding water infrastructure at the municipal level, overseen by an independent authority

Implementing licensing for local governments as water entities will streamline water management and ensure the efficient delivery of water services to communities

These measures aim to enhance infrastructure, ultimately contributing to sustainable water resource management and improved access to water

Reforms to accelerate growth: Logistics network (ports and railways)

Reformed logistics network driven by public and private sector collaboration, particularly in rail and ports

Examples include:

A successful partnership between the Durban container pier and a private sector operator

A new National Ports Authority that operates the ports independently from Transnet

An independent economic regulator

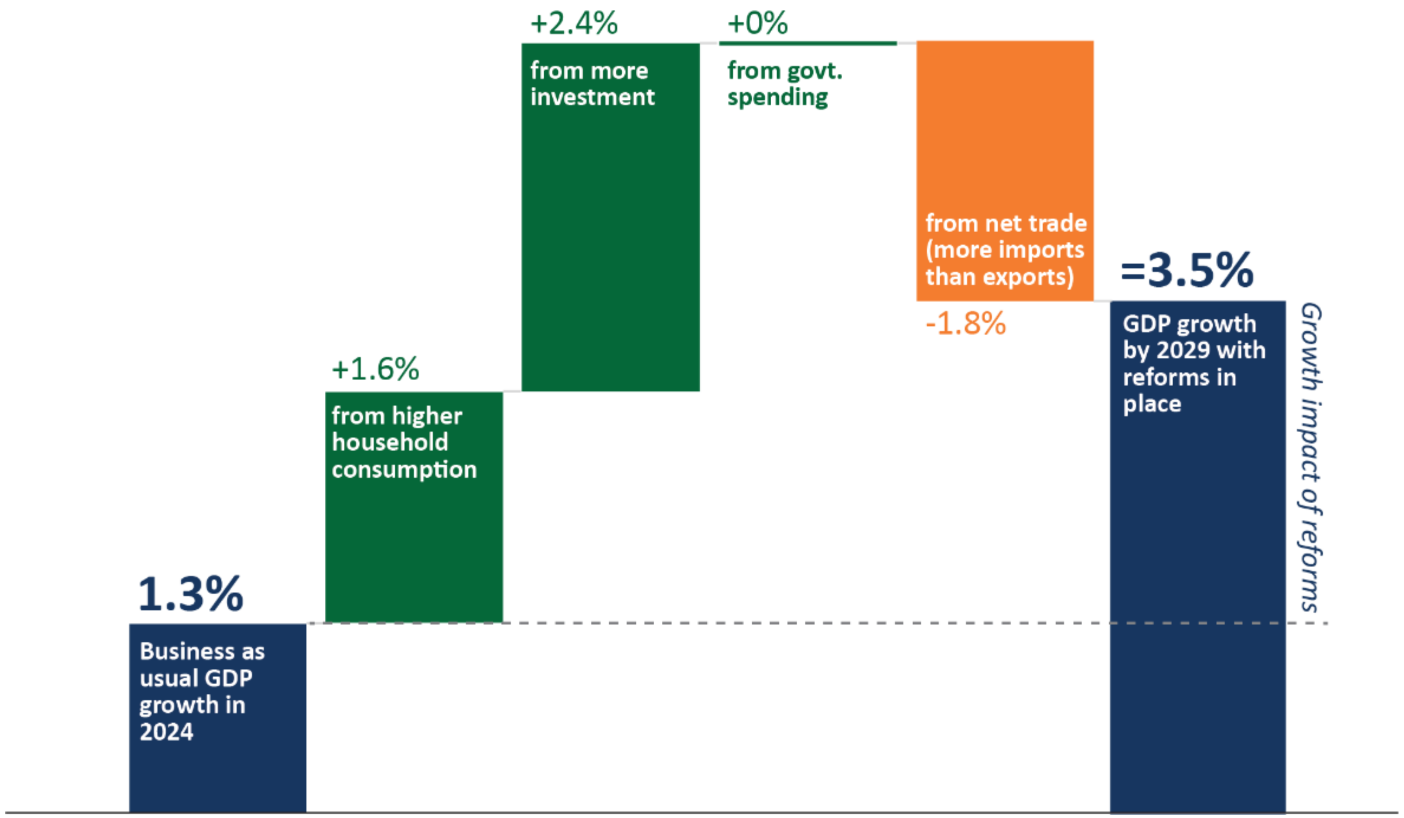
The conclusion of the 25-year concession on the City Deep/Durban line

The private sector's involvement in logistics improves operational efficiencies and enhances SA's export capabilities

Assuming railways and ports were operating at full capacity, stronger tax receipts from higher exports would contribute to the fiscus, allowing for more productive expenditure

GDP growth is boosted by private sector participation in energy and other infrastructure and improved sentiment that lifts consumer spending, but it is import intensive

- Implementing these reforms can boost real GDP growth by 1.5% pts by 2029: 3.5% vs. the 2% modelled in our baseline
- The largest driver of this improvement in the growth trajectory stems from fixed investment, which is 4% pts higher by 2029, underpinned by robust private fixed investment
- Given the improved energy availability and access to ports and railways, exports perform much better, reaching growth of almost 5% in 2029 vs. 3% modelled in the baseline
- We've steered clear of making an assumptions around fiscal policy choices other than that the fiscus will remain "disciplined".



Source: BER

However, relative to the baseline, the faster investment growth (largely import-intensive) leads to higher imports, limiting the boost to GDP growth

- Higher investment and household consumption pushes import growth to 6.6% by 2029 (compared to 3.6% in the baseline)

- However, successfully lowering the cost of doing business in South Africa would make local production more competitive and result in even faster GDP growth than we have forecast as the production capacity expands and the need for imports declines

- In the scenario modelled, higher imports also keep our current account in a relatively large deficit, which holds back the potential gains for the rand exchange rate

Additional growth in expenditure components

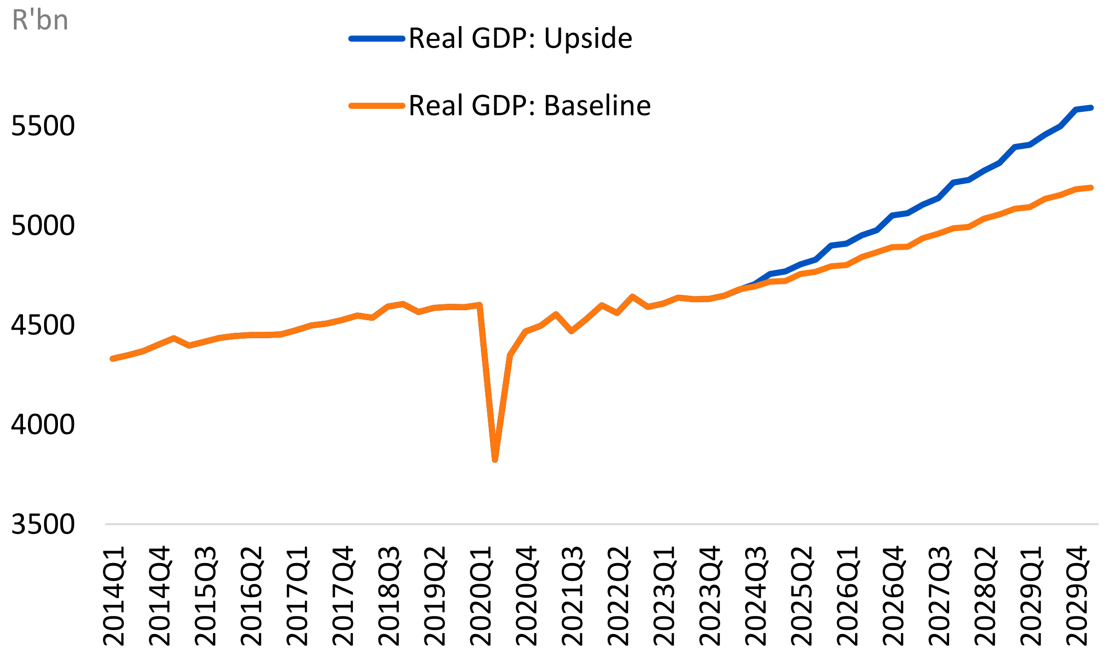
Percentage points (% pts)

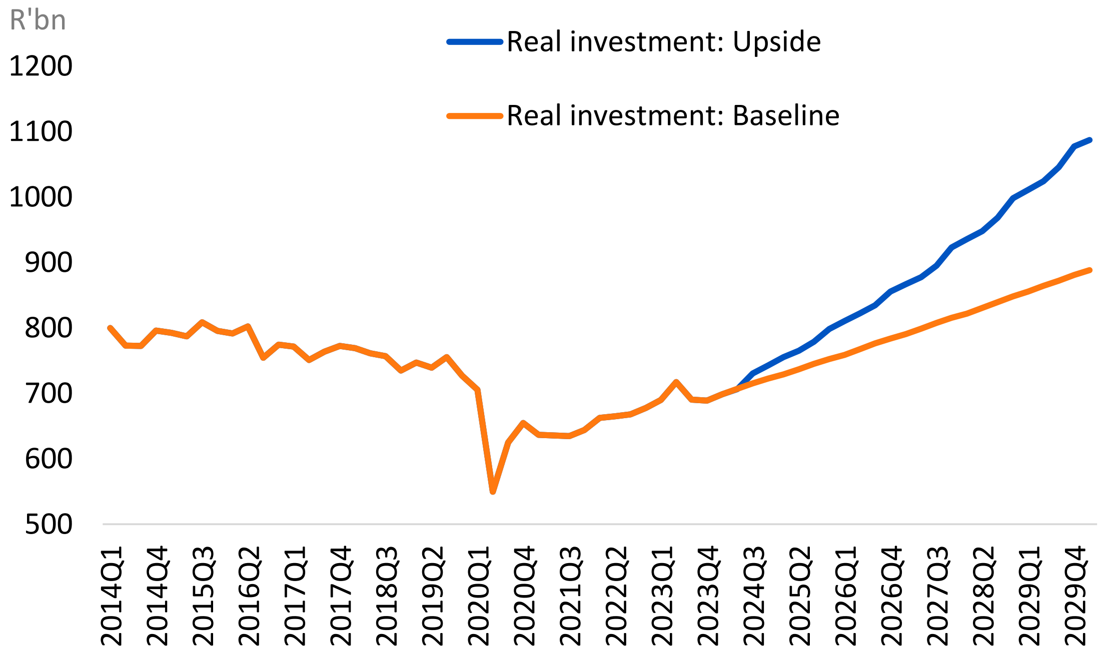
	Short term **2024**	Medium term **2025-2026**	Long term **2027-2029**	Average **2024-2029**
Real household consumption expenditure	0.3	1.3	1.6	1.3
Real private fixed investment	0.2	3.4	4.5	3.4
Real gross domestic expenditure	0.4	1.4	1.8	1.5
Total real exports	0.5	1.7	1.6	1.4
Total real imports	1.0	2.5	2.9	2.5
Real gross domestic product	0.2	1.1	1.4	1.1

Source: BER

Successive implementation of reforms has a large impact on GDP and investment over time

The differences may seem small, but they significantly impact the level of GDP and investment over time. In this scenario, real GDP is R399.6bn **(+7.7%)** higher than in the baseline, and investment is a staggering R196.7bn **(+22.3%)** higher by 2029





Source: BER

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- With a functional developmental state, the government's efforts to maintain **fiscal** prudence result in borrowing at better rates due to a reduced risk premium → lower bond yields free up fiscal space, allowing for increased productive expenditure without exacerbating debt levels → debt-to-GDP ratio ends about 2% pts lower than the baseline, while the budget deficit remains largely in line with the baseline

- The **rand** trades about R1/$ stronger by 2029 relative to the baseline owing to improved sentiment towards South Africa and a lower risk premium
  - The currency could end up a lot stronger than modelled in this scenario, with spillover implications for trade, capital flows, inflation and interest rates

- The stronger rand exchange rate → lower price increases, while administrative prices ease with lower electricity prices **→ Inflationary pressures** ease, outweighing any inflation caused by increased demand → creates scope for the SARB to cut by 75 basis points (bps) more in 2024 than the baseline
  - Over the longer term, the SARB cuts by a cumulative 125bps more than in the baseline, implying the terminal rate ends at 5.75% instead of 7%

- The lower inflation and reduced interest rate outcomes lead to a more favourable credit environment → boosts **consumer and business confidence** → increases household spending, business investment, and overall economic activity

Summary comparison of main macroeconomic variables

%, unless otherwise stated

	Average 2016-2022	2023	Average 2024-2029	
Main economic indicators	Actuals		Baseline BER forecast	Positive Scenario
Rand/US dollar (level)	14.76	18.45	18.40	17.58
CPI inflation	5.0	5.9	4.6	3.6
Real prime interest rate (%)	4.2	5.5	6.2	6.1
Real private fixed investment	-0.4	4.9	4.6	8.0
Real gross domestic expenditure (GDE)	0.8	0.8	1.9	3.4
Total real exports	0.9	3.5	2.9	4.4
Total real imports	1.3	4.2	3.3	5.8
Real gross domestic product (GDP)	**0.7**	**0.6**	**1.8**	**2.9**

Source: BER

Conclusion

We are often asked what is needed to lift SA's growth trajectory from our current 'just below 2%' medium-term view

Answer: We need sustained implementation of existing structural reform plans

- This note, taking Operation Vulindlela (OV) as a starting point, explored what would be needed to lift SA's trajectory to a faster, stronger growth path (i.e. no new initiatives are required as many of the building blocks are in place. No need for miracles or fairytales
- This will improve our competitiveness, reduce the cost of doing business and lift sentiment
- Unfortunately, even in this positive scenario we still face a huge challenge in overcoming structural unemployment and vast inequality
- The scenario is just one of the ways the coming years could play out - it is easy to tell a much more negative or positive story than presented in our baseline

If implemented successfully, the anticipated improvement in business confidence and private sector investment will also play an important role in "Redefining South Africa's economic trajectory" upward and improve the lives of all South Africans

THANK YOU.

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