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# Can South Africa replicate the 1994 magic?

Global and South Africa overview

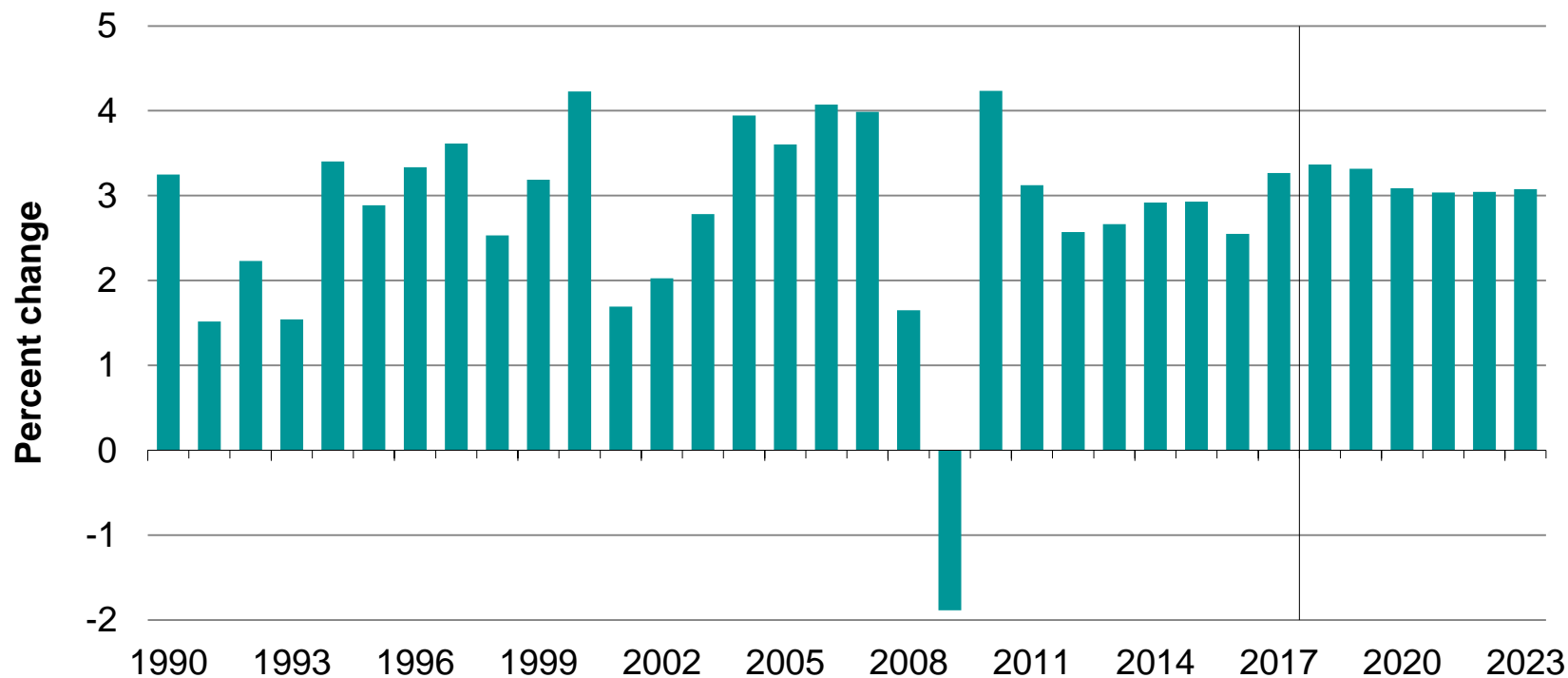
13 June 2018

# **World economic outlook**

## How can the party end?

# Global real GDP is growing at its fastest pace since 2010

## Real GDP



Source: IHS Markit

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## The global outlook: Summary

- Global economic growth is expected to edge up from 3.2% in 2017 to 3.4% in 2018 and 2019, its fastest pace since 2010—but assertions about synchronization are overstated.
- The US economy will experience robust growth, thanks to tax cuts and increased government spending.
- Eurozone growth is slowing, but remains above trend—UK growth is being undermined by the uncertainty regarding Brexit.
- Japan's growth is also decelerating after a strong run.
- China's growth is holding steady, but will gradually slow as the government aims to reduce excesses in industrial capacity, debt, housing, and shadow banking.
- Asia's other emerging markets will sustain robust growth.
- Russia and Brazil will continue to recover from 2015–16 recessions.

## The global outlook: Summary (continued)

- Businesses remain upbeat, despite policy and political risks.
- Trade is again an engine of growth.
- Commodity prices will rise only gradually—if at all—during the next two years.
- Given closing output gaps, inflation will move up—but probably slowly.
- Most central banks will take their time in reducing stimulus—with the US Federal Reserve at the head of the pack.
- The US dollar is likely to strengthen in the near term, but then weaken as the growing current-account deficit exerts downward pressure.
- Policy mistakes remain among the biggest threats to the current expansion.

## Risks ahead....

**Global trade:** The impact of the new U.S trade policy on global growth

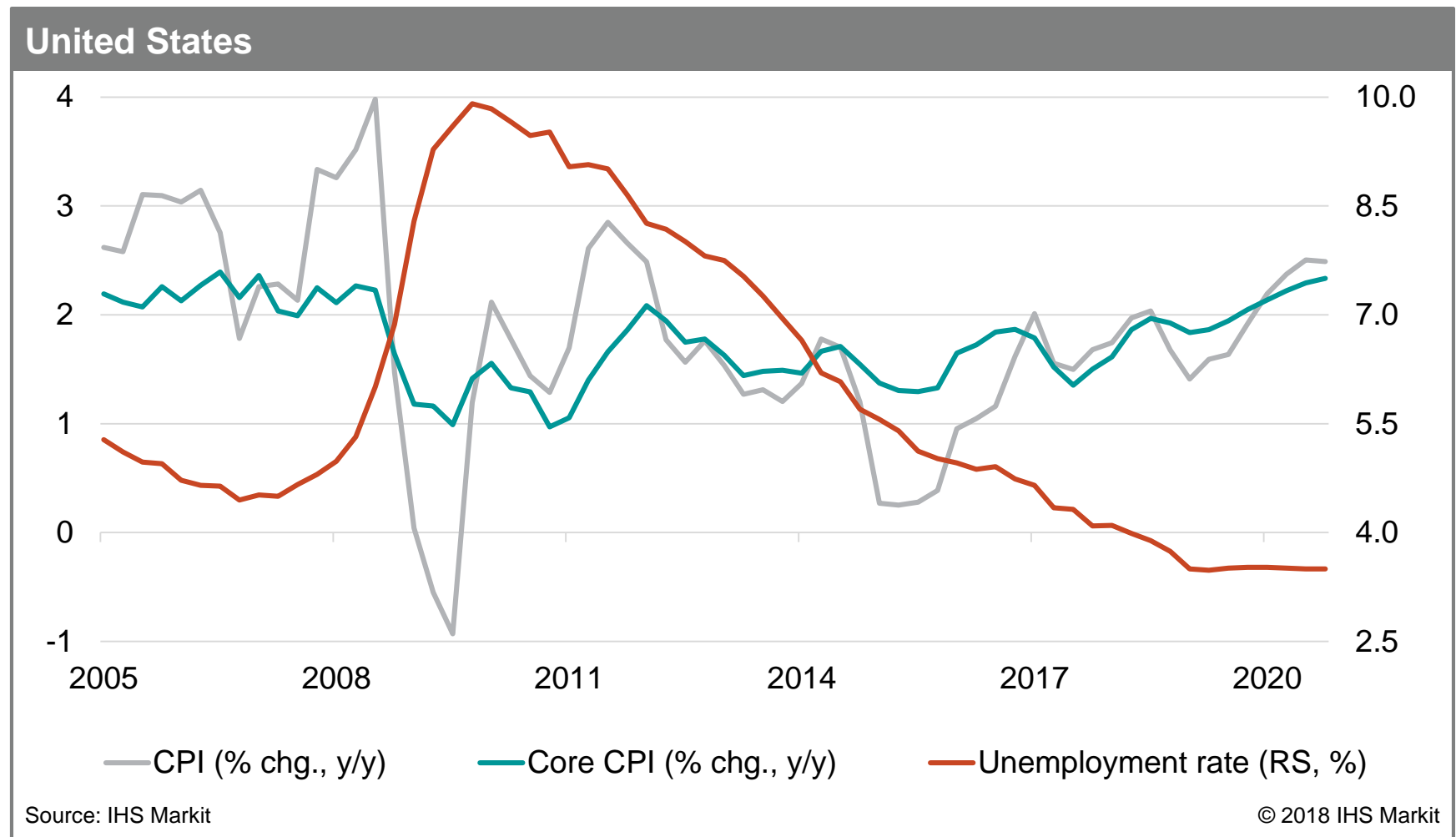
**Policy mistakes:** The pace of FED tightening. U.S. Dollar weakness and long period of low interest rates in Europe

**Populism:** Success of Eurosceptic parties in the Italian election; increase the risk of looser fiscal policies and less reforms

**Brexit:** Uncertainty regarding a trade agreement between the UK and Eurozone

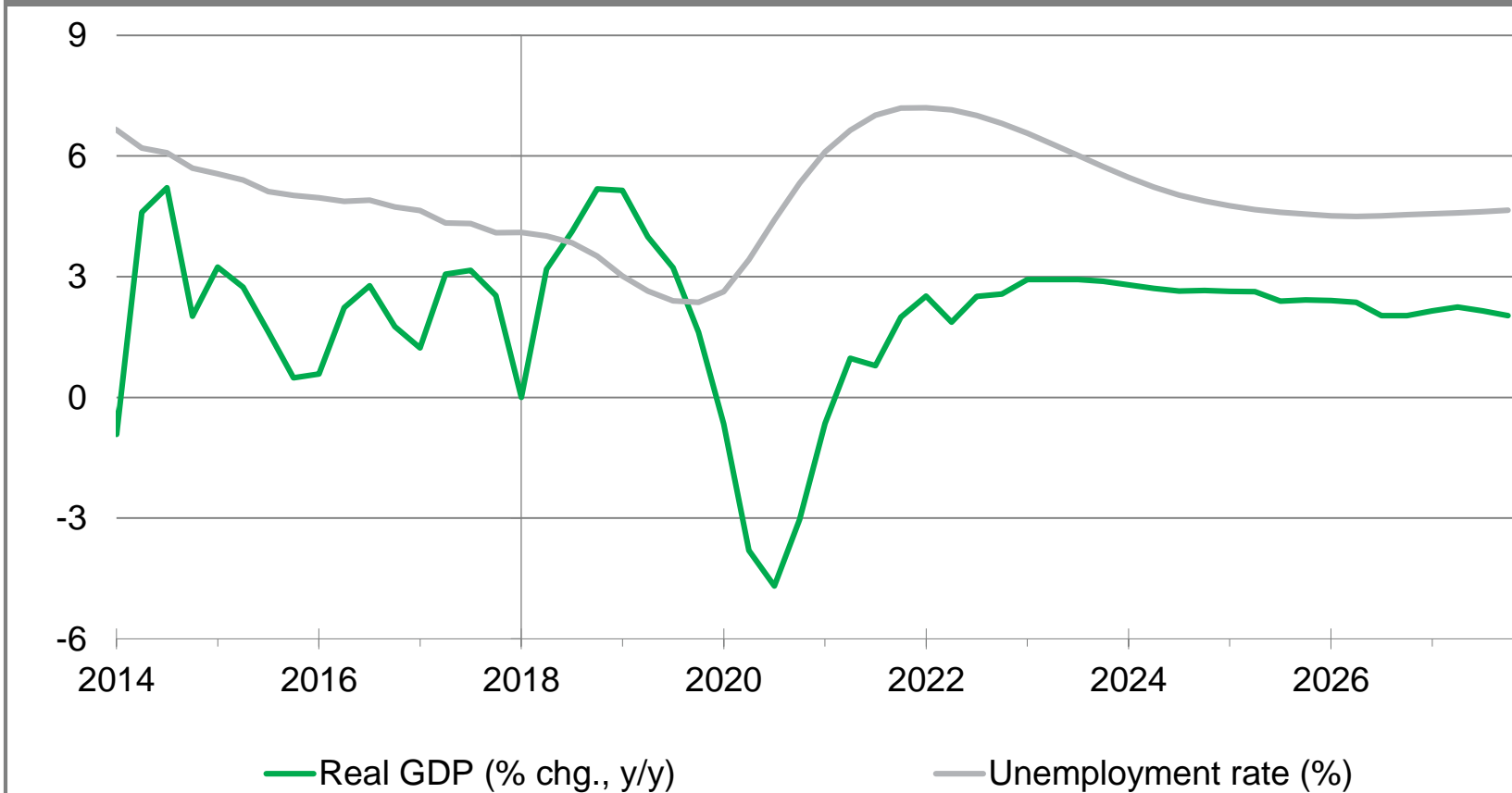
**Oil prices:** Where are oil prices heading?

# US inflation and unemployment



# Risk of a US boom/bust

## Risk of overheating—Boom/bust



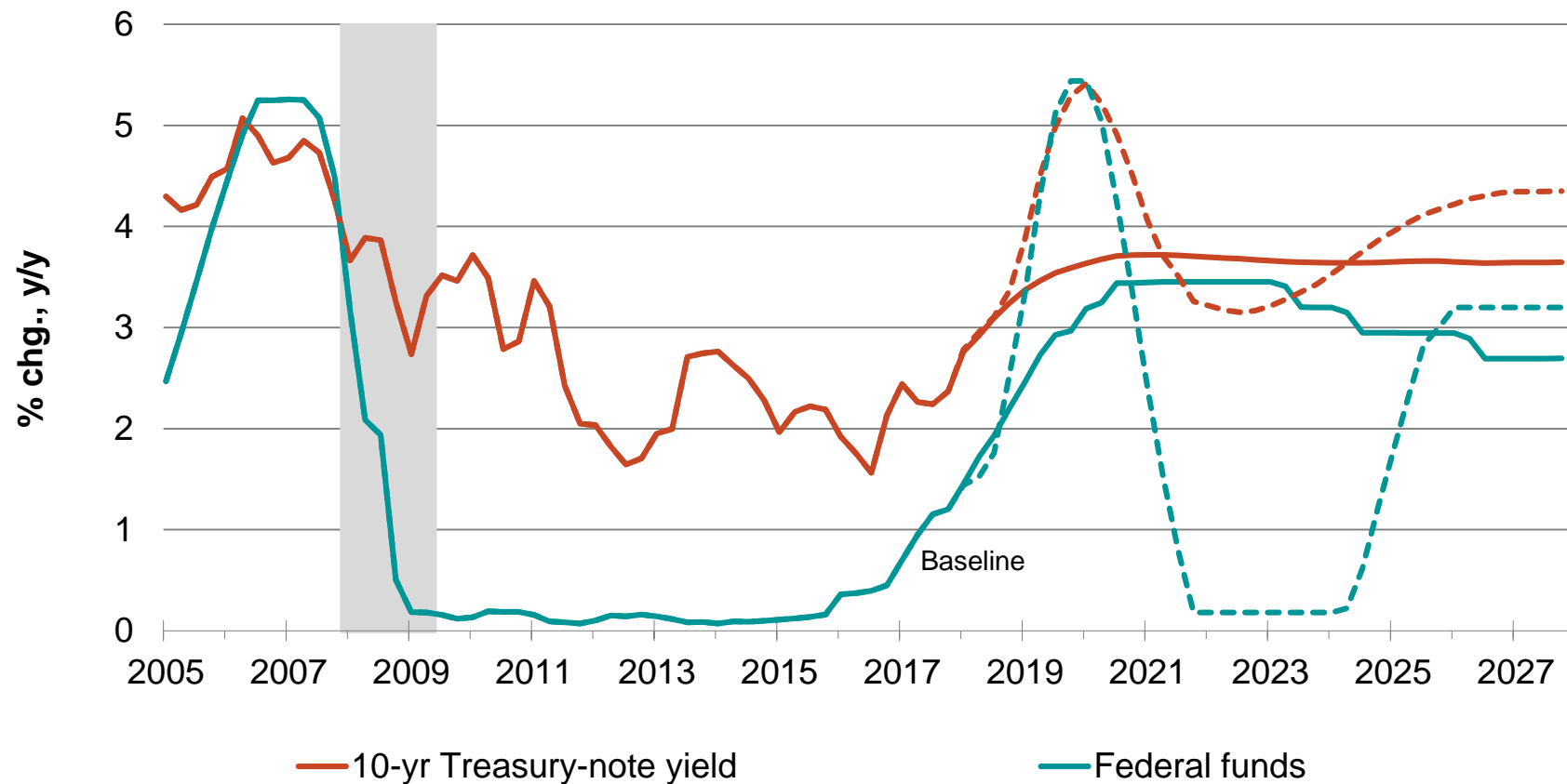
Source: BEA, BLS, Macroeconomic Advisers by IHS Markit

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# Risk of a US boom/bust

## Risk of overheating—Boom/bust



Source: Federal Reserve, Macroeconomic Advisers by IHS Markit

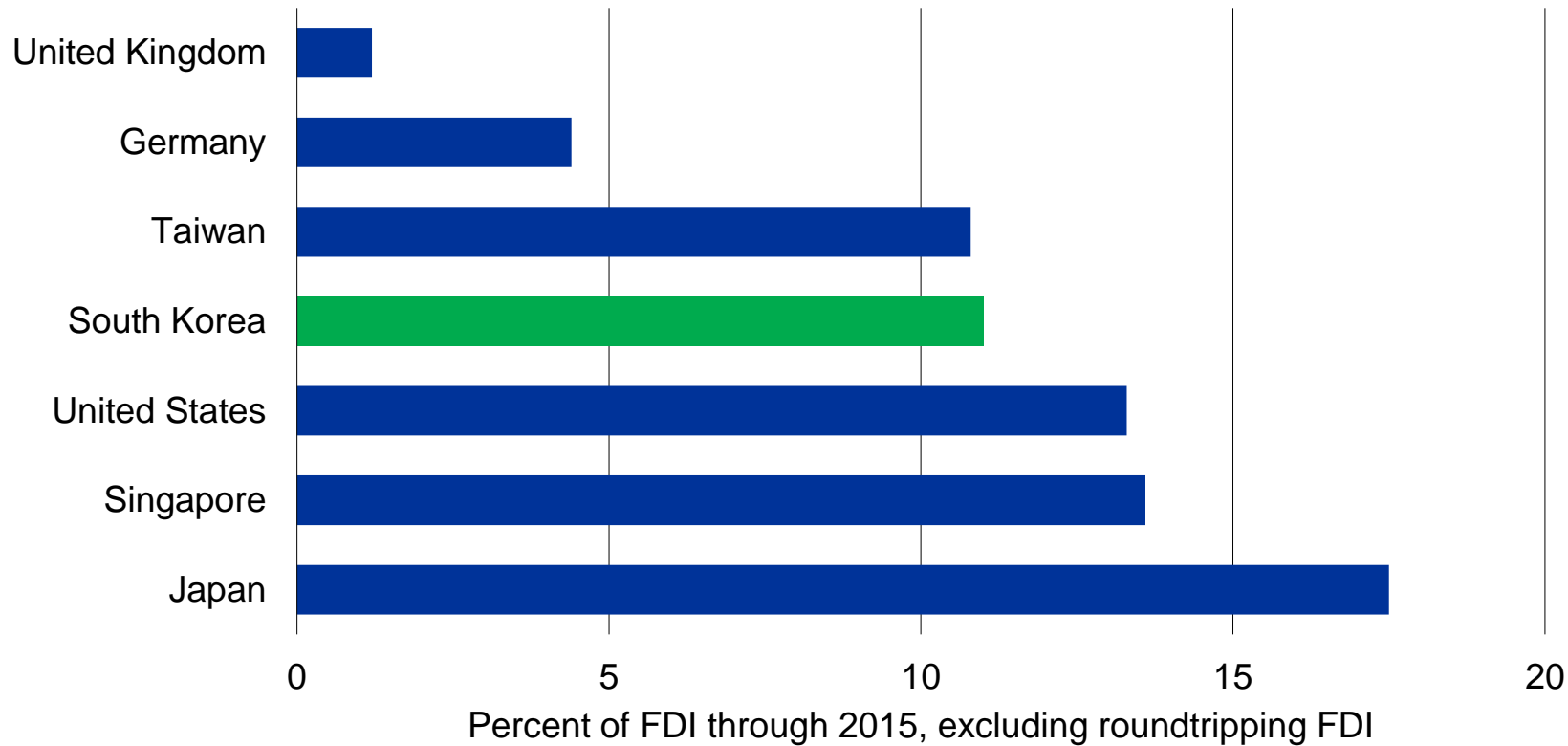
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## Even a limited tariff war could begin to wear down global economic growth

- The tariff increases between the United States and China run the risk of escalating into a broader trade war, which could derail global growth.
- For the moment, the probability of such an outcome appears low.
- The magnitude of tariffs being considered, so far, will have a limited impact on overall growth (a few tenths of a percentage point).
- Yet, the effects on global supply chains and specific industries could be significant.
- More insidiously, trade skirmishes could weigh heavily on financial markets and business investment plans.
- Business sentiment is beginning to erode, in part because of trade disputes.
- The good news is with growth momentum strong, the situation would need to become a lot worse before it would seriously threaten the global expansion.

## US has sizable direct investment in China

### Foreign direct investment



Source: China Ministry of Commerce

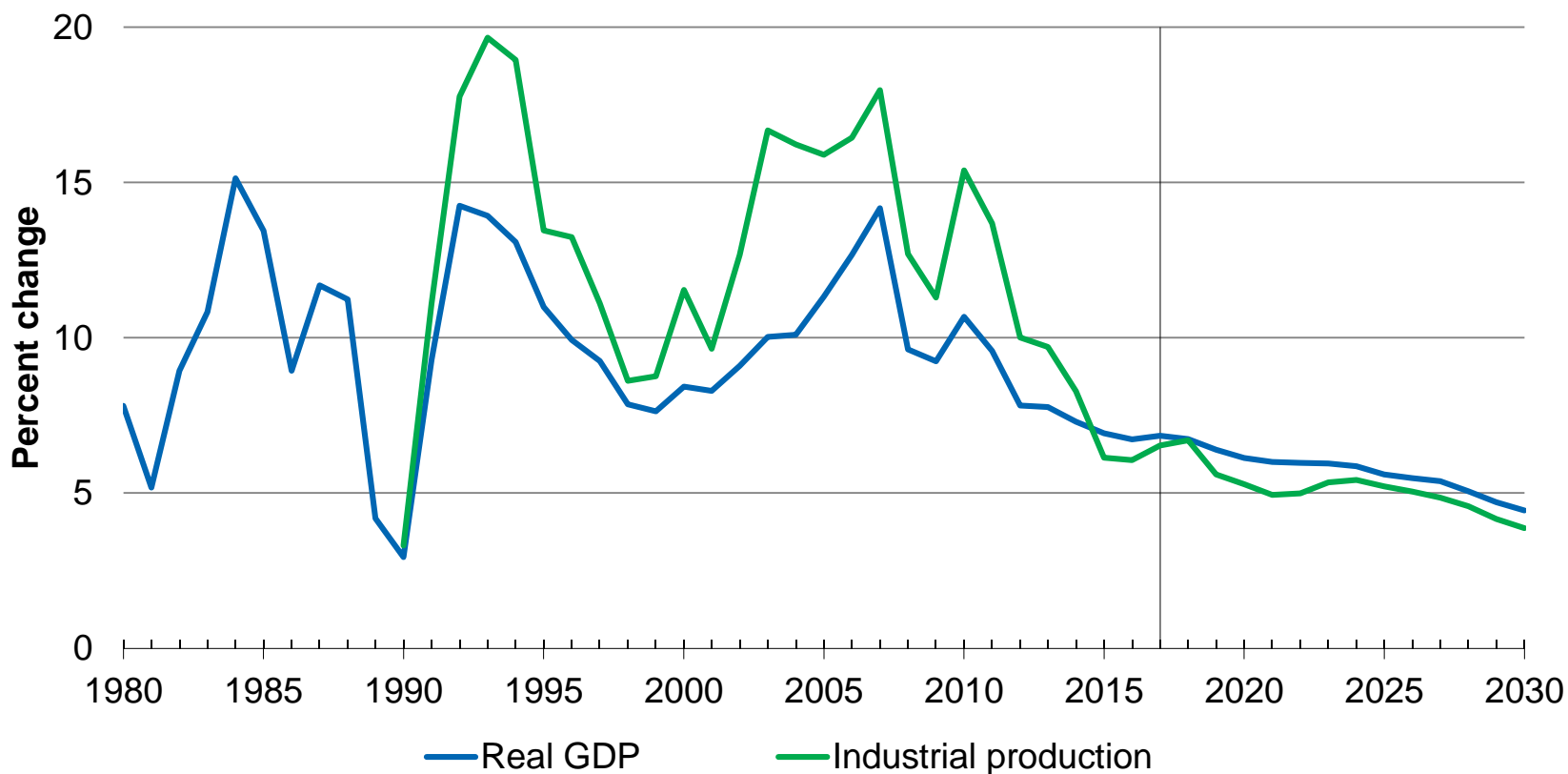
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## China's economic growth challenges

- China's growth is expected to moderate in the coming quarters as the deleveraging campaign restrains infrastructure investment and US-Sino trade frictions create additional uncertainties.
- Policymakers aim to reduce leverage in the economy through tighter financial supervision and regulation, including a crackdown on shadow banking.
- The challenges of reducing leverage and excess industrial capacity without doing serious damage to growth are daunting.
- Xi Jinping's prolonged tenure ensures policy stability but is a step backwards for a political system that is increasingly at odds with China's economy.
- The key long-term challenge is a reversal of the recent drop in productivity growth via aggressive reforms.
- Unfortunately, strong productivity growth and authoritarian regimes typically do not go hand in hand.

# China's economic growth will downshift in the long run

Real GDP and industrial production

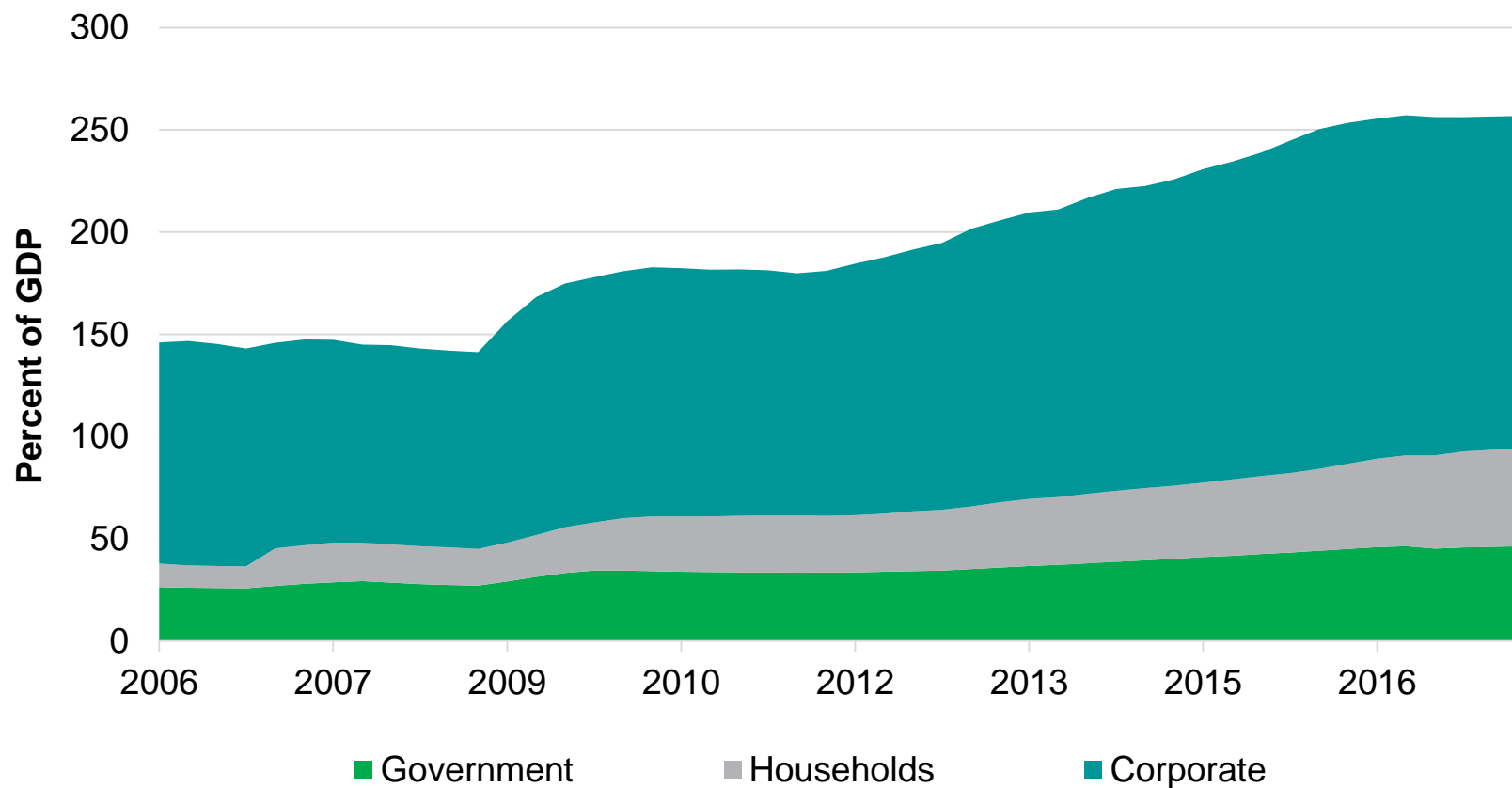


Source: IHS Markit

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# China's massive debt will constrain future monetary policy, credit growth, and investment

## Debt stock by sector

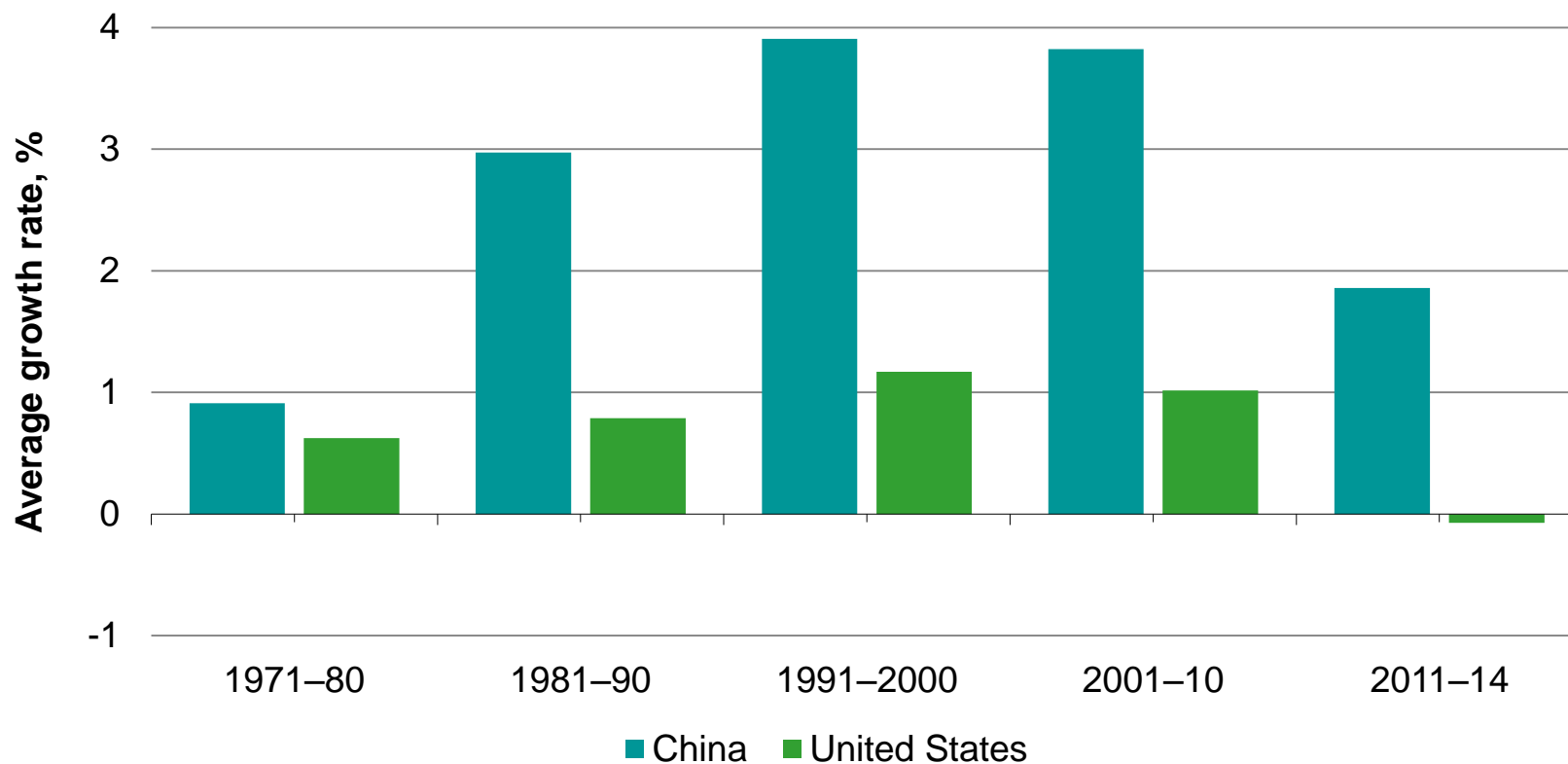


Source: Bank for International Settlements (BIS)

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# China's productivity catch-up growth is slowing

## Total factor productivity

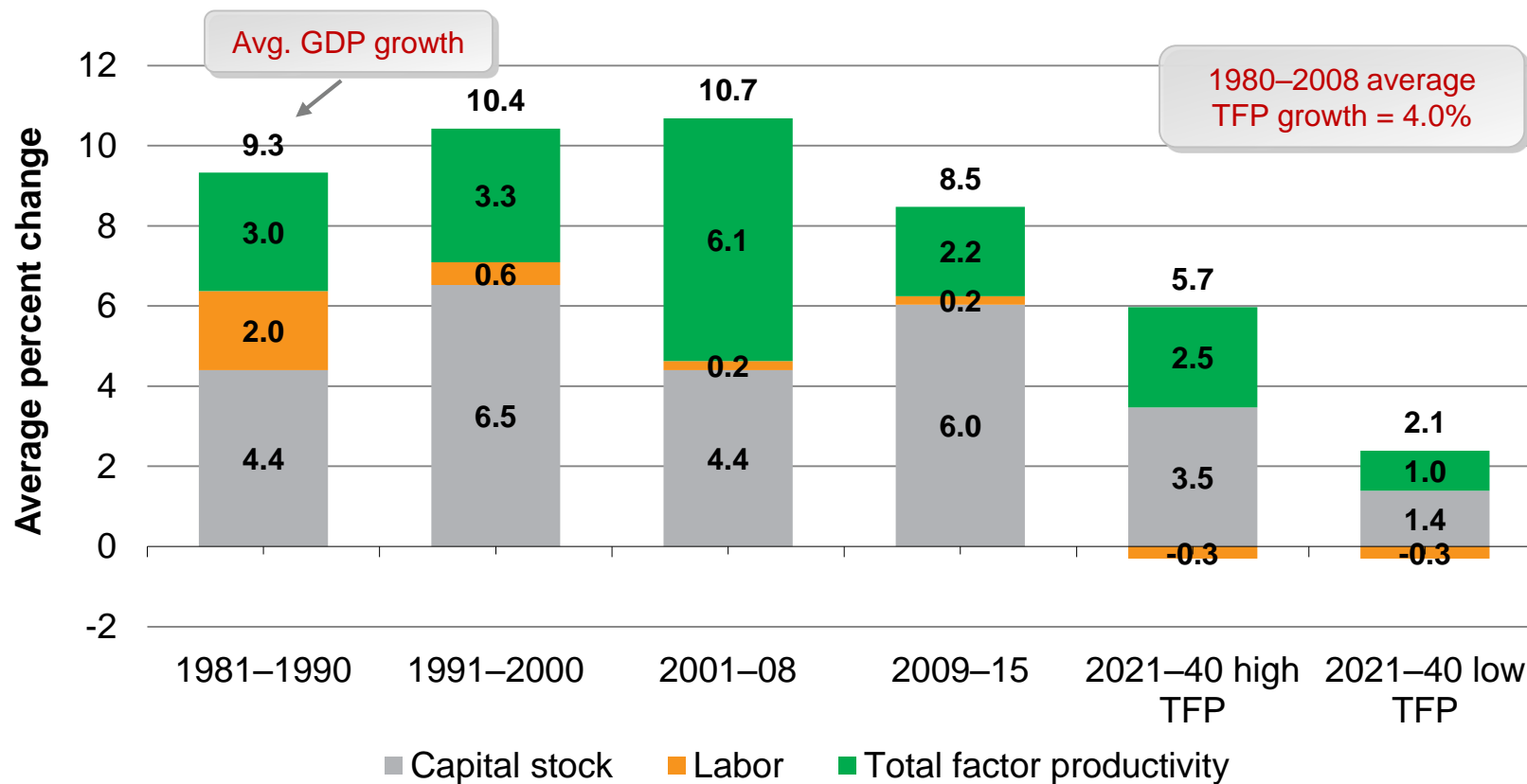


Source: IHS Markit

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# China's long-term economic prospects depend on reform-induced productivity growth

## Real GDP growth decomposition



Source: IHS Markit

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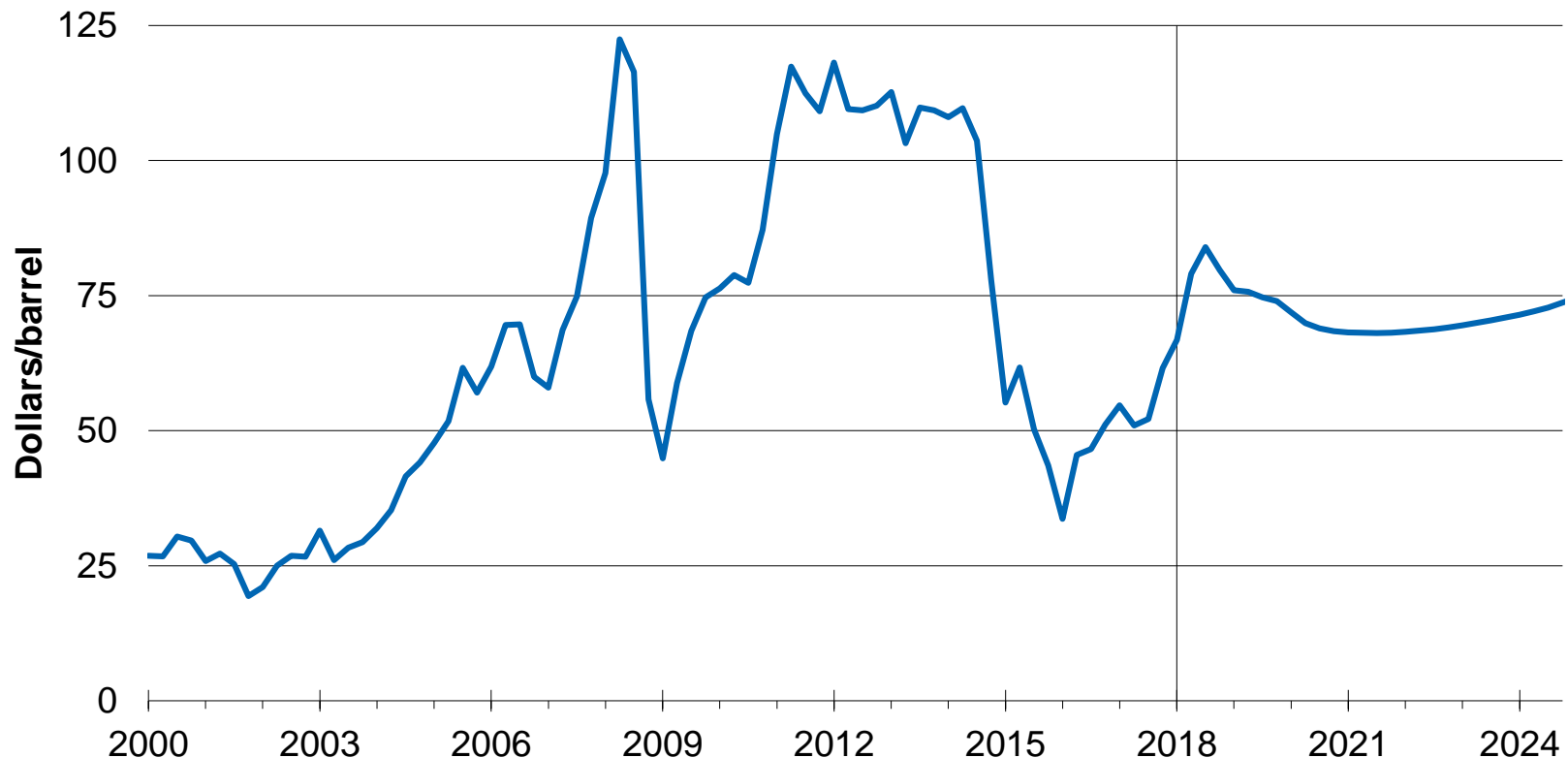


## Geopolitical risks are supporting crude oil prices

- Our near-term price forecast has been raised in response to new US sanctions on Iran and the collapse in Venezuelan output.
- Sanctions will reduce Iran's oil exports by roughly 200,000 barrels/day (b/d) in the second half of 2018 and 500,000 b/d in 2019.
- The projected price of Dated Brent has been revised upward to USD77/barrel in 2018 and USD75/barrel in 2019.
- US oil supply is responding to higher prices; crude oil output is projected to rise from 9.3 million barrels per day (MMb/d) in 2017 to 10.5 MMb/d this year and 11.6 MMb/d in 2019. Logistical constraints in the Permian Basin are preventing faster increases.
- World liquids demand growth will remain strong at 1.9 MMb/d in 2018 but slow to 1.5 MMb/d in 2019, leading to a slight build in global liquids stocks and downward pressure on prices.

# After a 2018 surge, crude oil prices will be restrained by rising US production

Price of Dated Brent crude oil

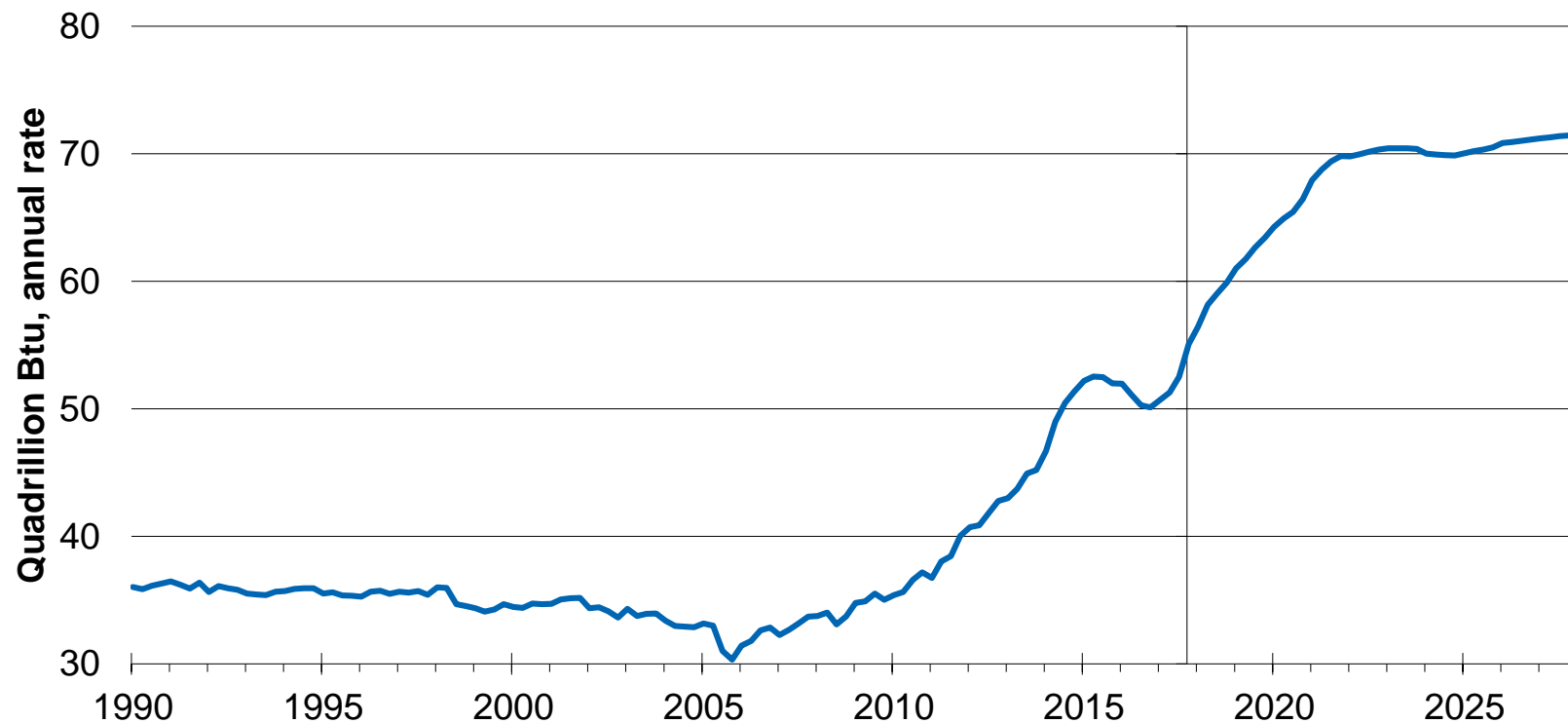


Source: IHS Markit

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## US oil and gas production keeps rising

### Oil and gas production



Source: IHS Markit

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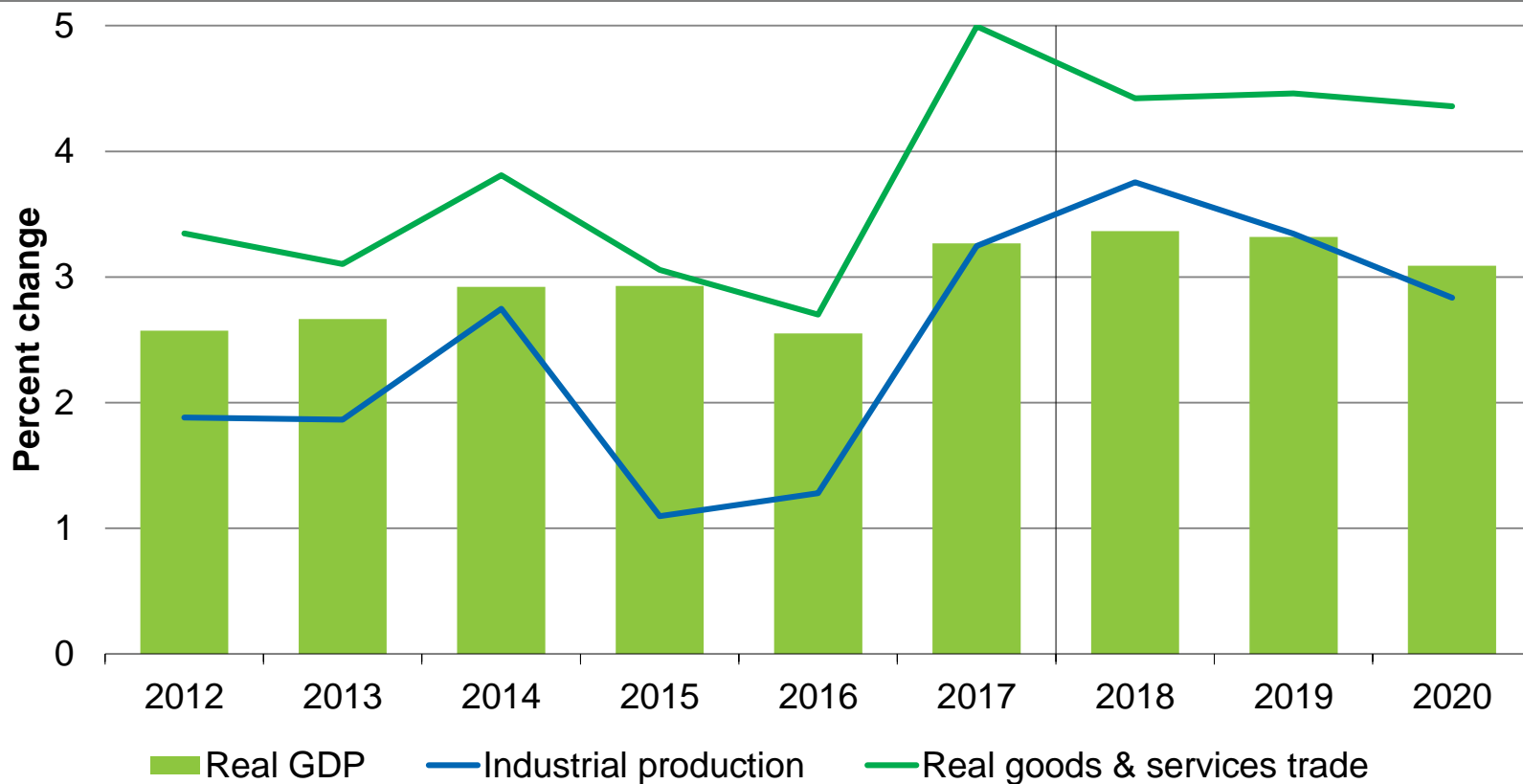
## How much longer?

- There is no shortage of risks, yet a stronger and more broadly based global expansion is better positioned to withstand a shock.
- The most significant “endogenous” risk is an unexpectedly sharp rise in inflation and interest rates—in other words, a boom-bust.
- The US, UK, German, Australian, and Canadian economies may face the highest risk of a boom-bust scenario; so far, there are few signs of a rapid rise in inflation anywhere.
- Major policy risks include a trade war between the United States and its key trading partners and a mismanaged deleveraging in China.
- The United States is likely to break longevity records next year.
- Bottom line: Left to its own devices, the global expansion can continue in 2018 and into 2019.

# South Africa: Can we replicate the 1994 magic?

# Global trade and production have accelerated

Global real GDP, industrial production, and real exports



Source: IHS Markit

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## South Africa's economic outlook post-tax changes

South Africa		2015	2016	2017	2018	2019	2020
GDP growth	y/y%	1.4	0.6	1.3	1.4	1.8	1.9
Household spending	y/y%	1.9	0.7	2.2	2.5	2.6	3.1
Government spending	y/y%	0.2	1.9	0.6	1.2	0.9	0.7
Fixed investment	y/y%	2.4	-4.1	0.3	1.4	1.9	3.8
Exports of goods and services	y/y%	3.5	1.0	-0.1	4.9	6.2	4.2
Imports of goods and services	y/y%	5.3	-3.8	1.9	6.8	7.2	8.4
Current account deficit	% of GDP	-4.4	-3.2	-2.5	-3.8	-4.0	-4.2
Rand exchange rate (average)	R/US\$	12.75	14.70	13.35	12.68	13.23	13.30
Budget deficit	% of GDP	-3.0	-3.0	-4.1	-3.8	-3.5	-3.3
Policy rate (end-of-period)	%	6.25	7.00	6.75	6.50	6.50	6.50
Inflation rate	y/y%	4.6	6.3	5.3	5.2	5.2	5.0

# Pertinent structural factors triggered the stronger growth path in 1994

## The **1994** structural reforms

- Stronger government income and capped government spending triggered improved fiscal backdrop and lower public sector debt levels.
- A surge in foreign direct investment (FDI) post-1994 as foreign investor sentiment surged.
- **Sanctions lifted.** South Africa re-enters the global platform through rising trade flows. Sanctions lifted.
- Job creation in the private and public sector resulted in a larger middle income class.
- Financial sector inclusion boosted private sector credit extension. Credit act introduced in 2008, which curtailed rapid household credit extension.

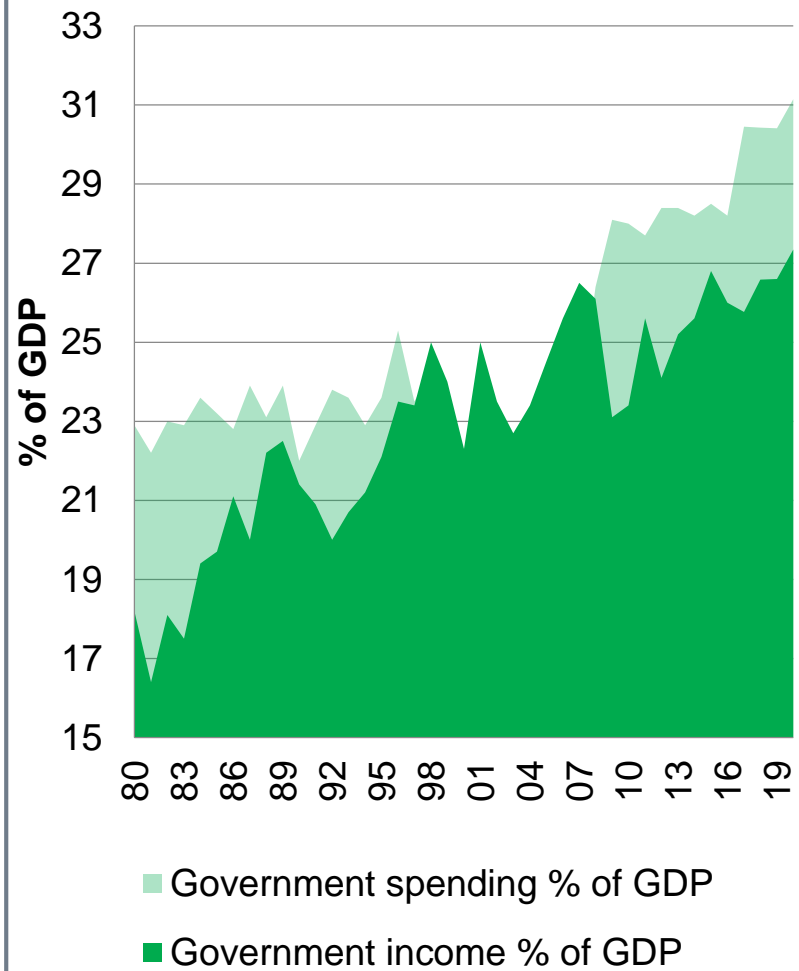
What will higher taxes and higher spending mean for the South Africa economy this time around?



## 1994 introduced rapid fiscal consolidation

- Public sector debt lowered to 27.1% of GDP by 2007 from 47.8% of GDP in 1994.
- Higher income and lower spending growth capped the fiscal deficit. Overall government expenditure remained broadly capped at 23% of GDP over the period 1994-2007. Government income rose to 26.5% of GDP in 2007 from 20% of GDP in 1994.
- Public sector investment (including public sector corporations) also fell to average of 29.5% of total fixed investment in 2007 from 38.2% of total fixed investment in 1992.
- Overall fixed investment in South Africa improved nonetheless to 20.6% of GDP in 2007 from 16.1% of GDP in 1994. South Africa's fixed investment as % of GDP is currently at 19.5% of GDP.
- Countercyclical-fiscal policy introduced during global financial crisis years in 2008. Broad based government spending.

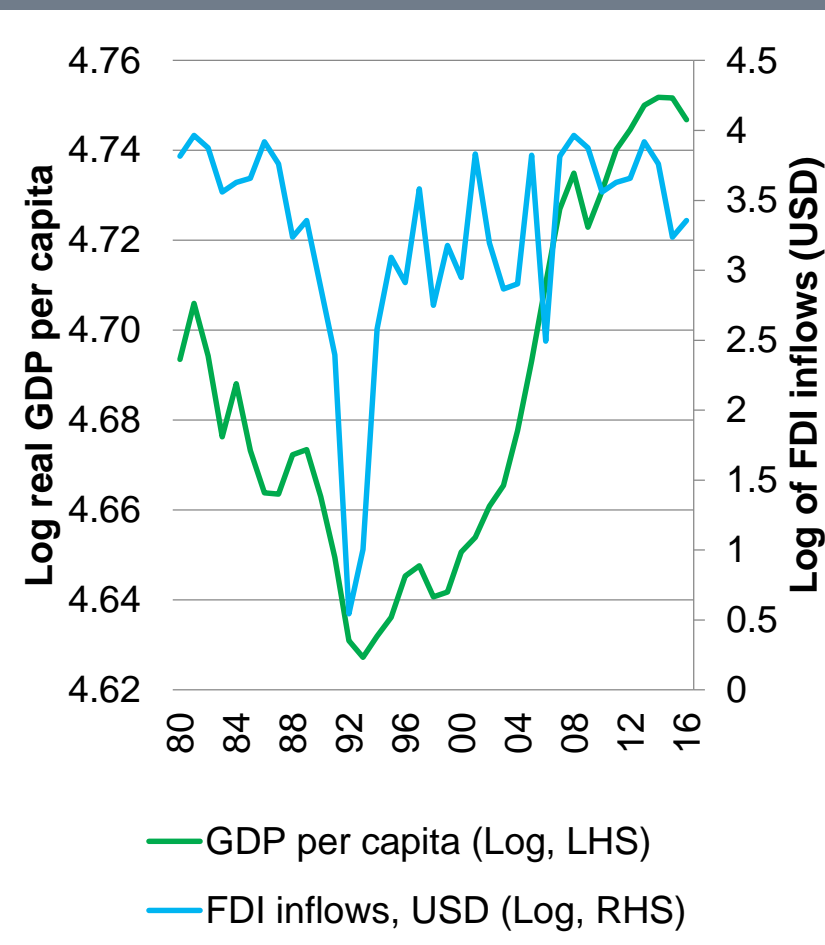
### Government's growing fiscal dilemma



## 1994 saw sharp improvement in international investor sentiment

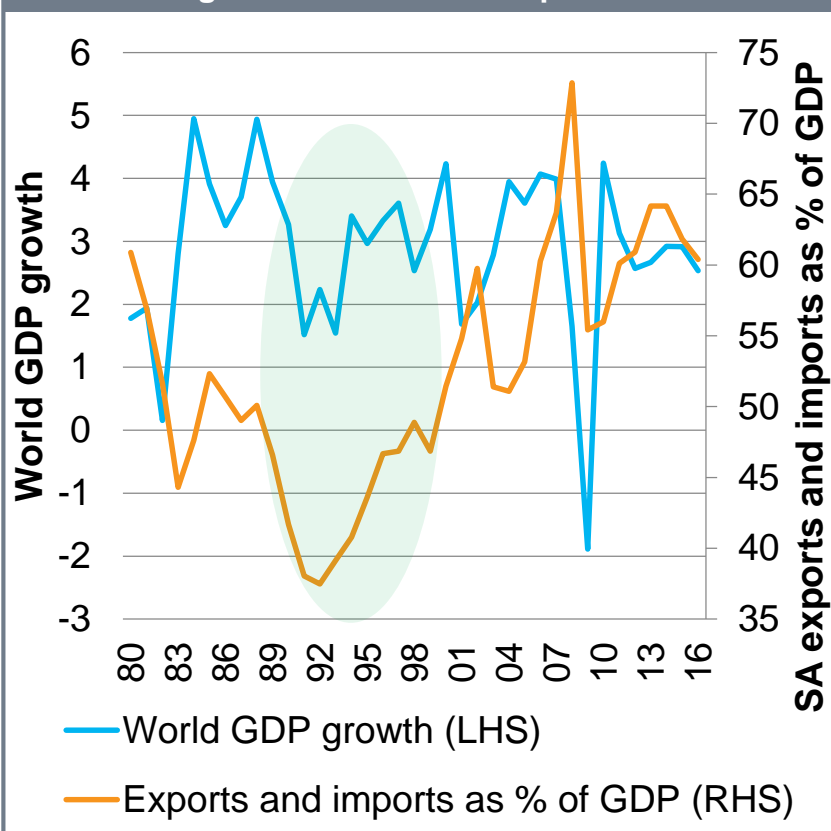
- South Africa remains reliant on international community to provide foreign direct investment inflows (FDI).
- Because South Africa still has a very low national savings rate.
- Gross national savings amounted to 20.7% of GDP in 1994 but fell to 14.9% of GDP in 2007. Dissaving by households contributed to less national savings.
- South Africa's gross national savings to GDP is now at 16.3% of GDP. Fixed investment spending as % of GDP is at 19.5% of GDP, still above the national savings to GDP ratio.
- The large fiscal deficit contributes to the low national savings ratio.

### Positive investor sentiment places South Africa on stronger growth path in 1994

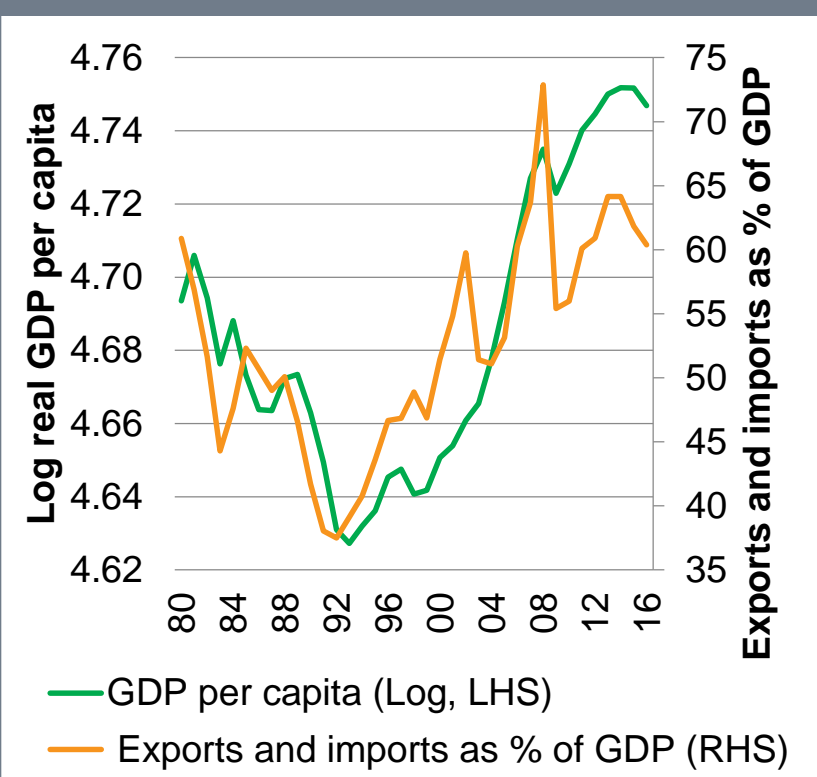


# 1994 enabled South Africa to re-enter the international arena through trade deepening

World GDP growth and SA trade openness



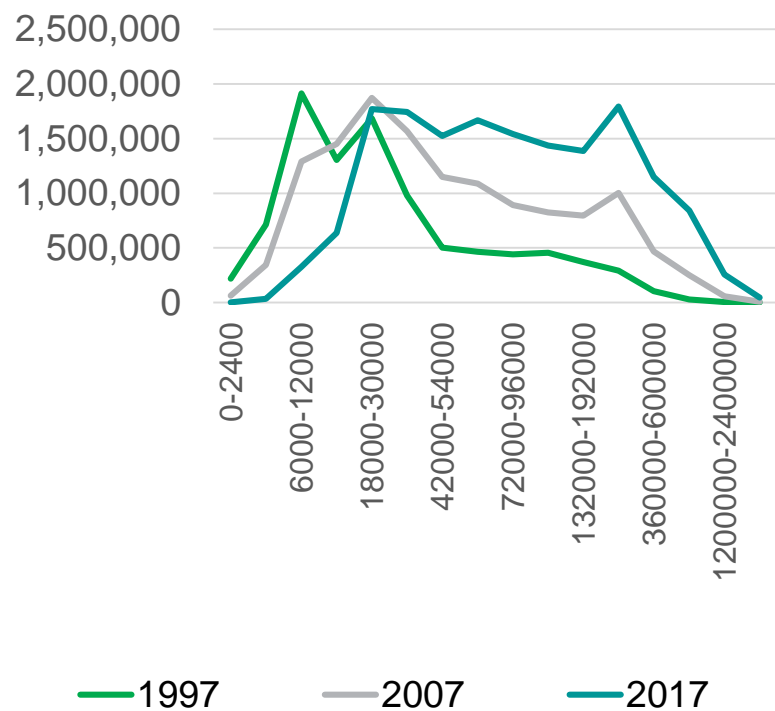
Trade openness contributed to wealth creation



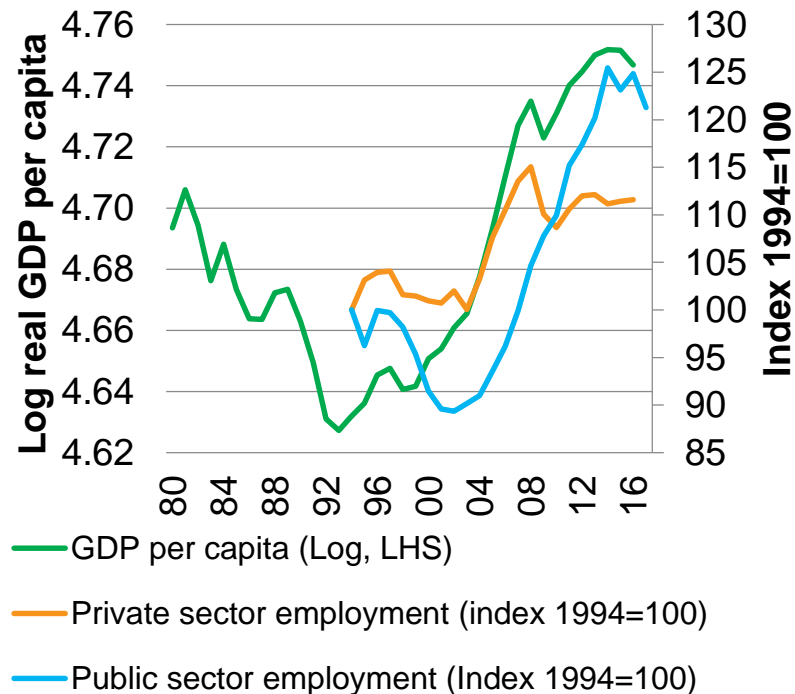
## 1994 enabled the emergence of a larger middle income class

Equal contribution between private and government employment until 2007, but global financial crisis trigger stronger public sector employment

### Rising middle class (number of households)

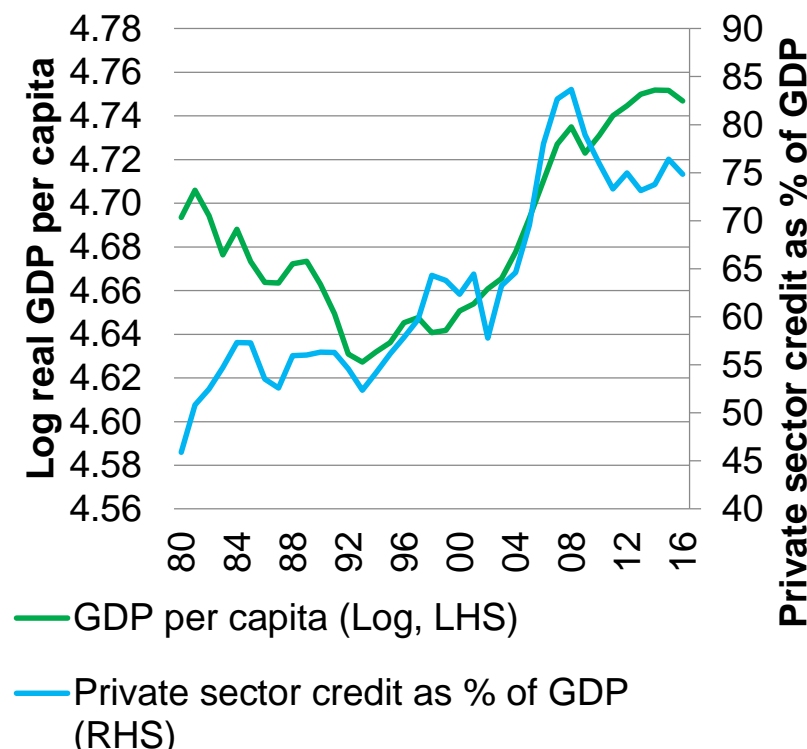


### Strong employment grows middle-income class

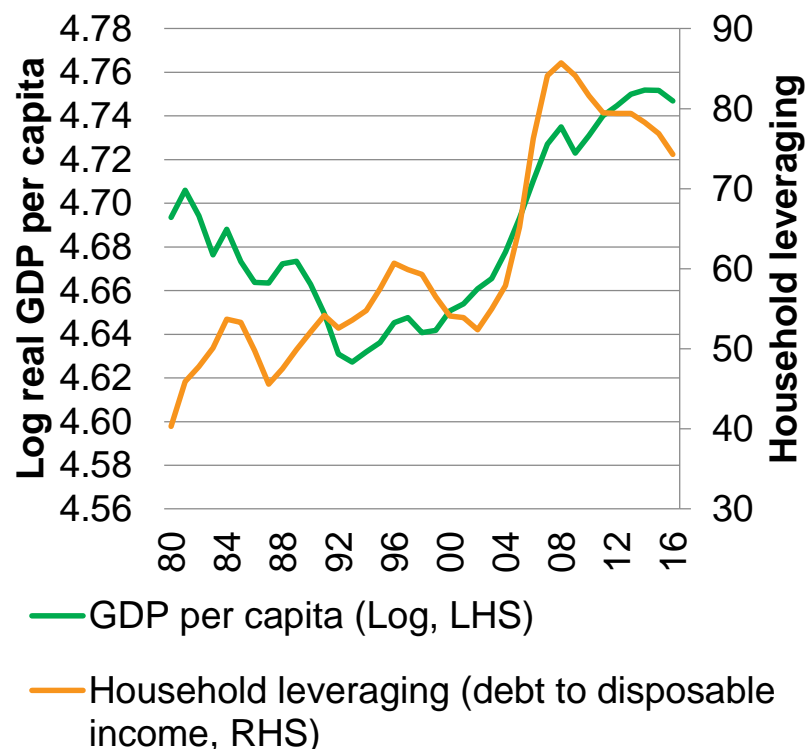


1994 enabled the start of financial sector inclusion, but credit act introduced in 2008 lowered household credit extension

### Financial sector inclusion



### Household leveraging moved up as a result until 2008



## Bottom line.....

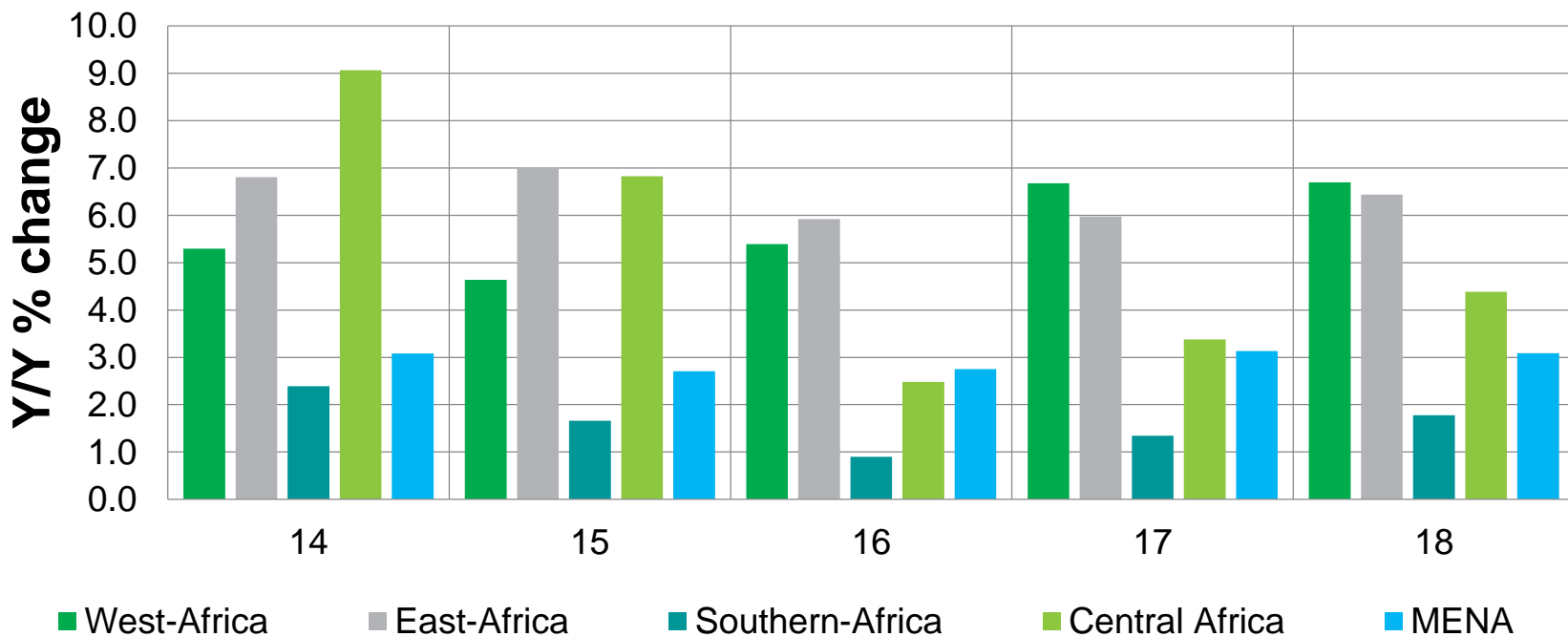
- Global growth environment remains favourable for South Africa. Recession risk for 2018 remains limited in IHS Markit's view.
- Nonetheless, South Africa's GDP growth rate unlikely to breach 2% in the near term.
- Cyclical upturn supported by lower inflation, lower interest rates and favourable global environment.
- Political changes have boosted consumer and business sentiment.
- Higher taxes and high government spending not necessarily a catalyst towards sustainable higher growth. Improvement in public sector debt levels necessary prerequisite.
- Structural changes will be required to place South Africa on a higher growth path.
- The most pressing issues in IHS Markit's view are unemployment, education outcomes, fiscal space and efficiency of State Owned Entities (SOEs), technological changes, climate change, ailing infrastructure, uncertainty over property rights.

# Sub-Saharan Africa

West Africa becomes the regional growth leader

## West Africa surpasses East Africa as the fastest growing region in Sub-Saharan Africa

Different growth outlook for non-oil exporting countries in MENA  
(real USD GDP)



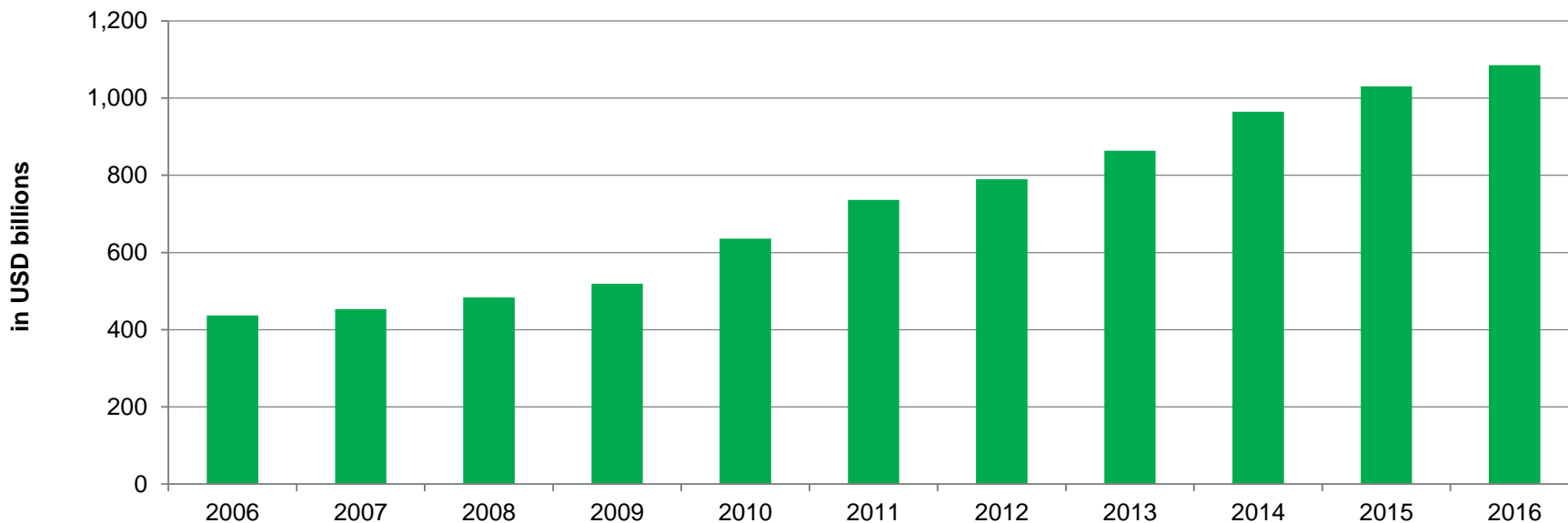
Source: IHS

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## Africa's total public sector debt nearly trippled between 2006 and 2016

Total Public debt in USD billions (domestic + external)

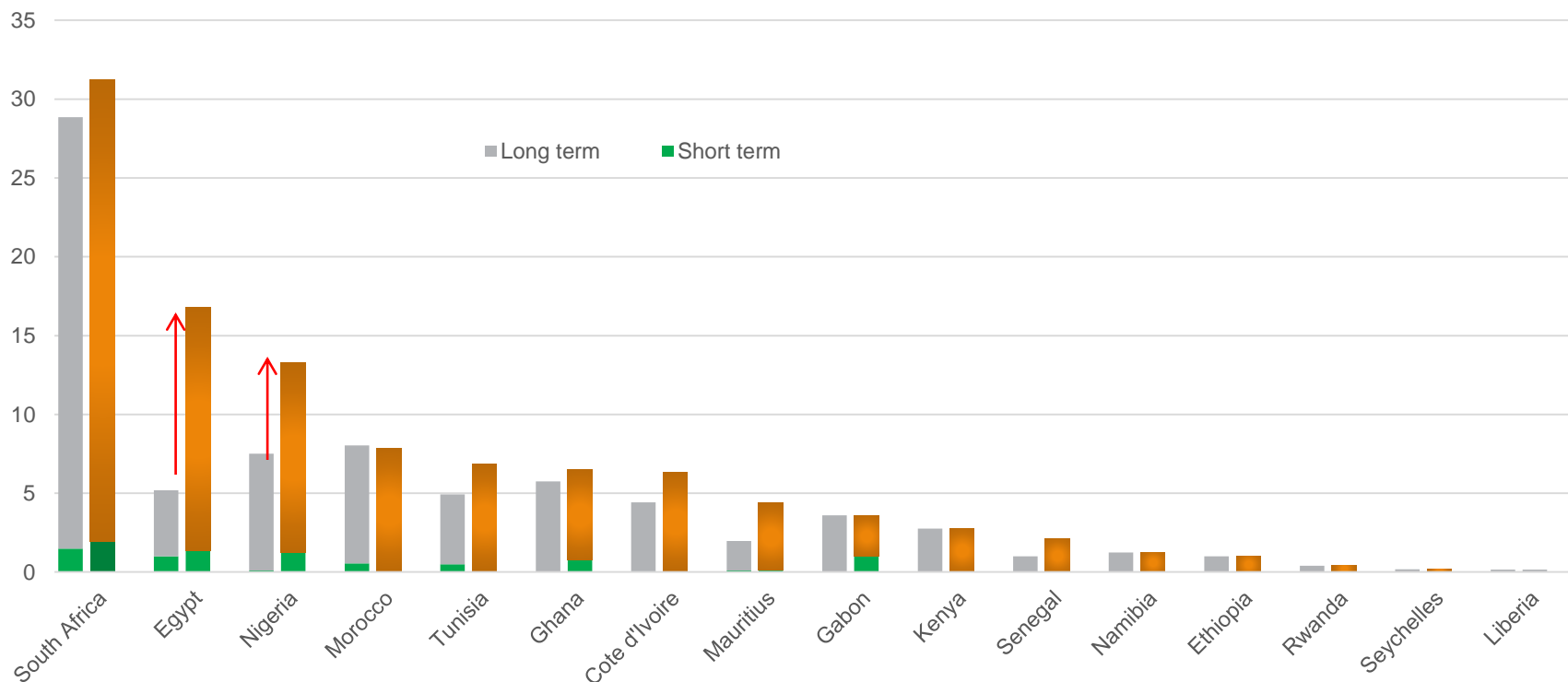


Source: IHS Markit, IMF

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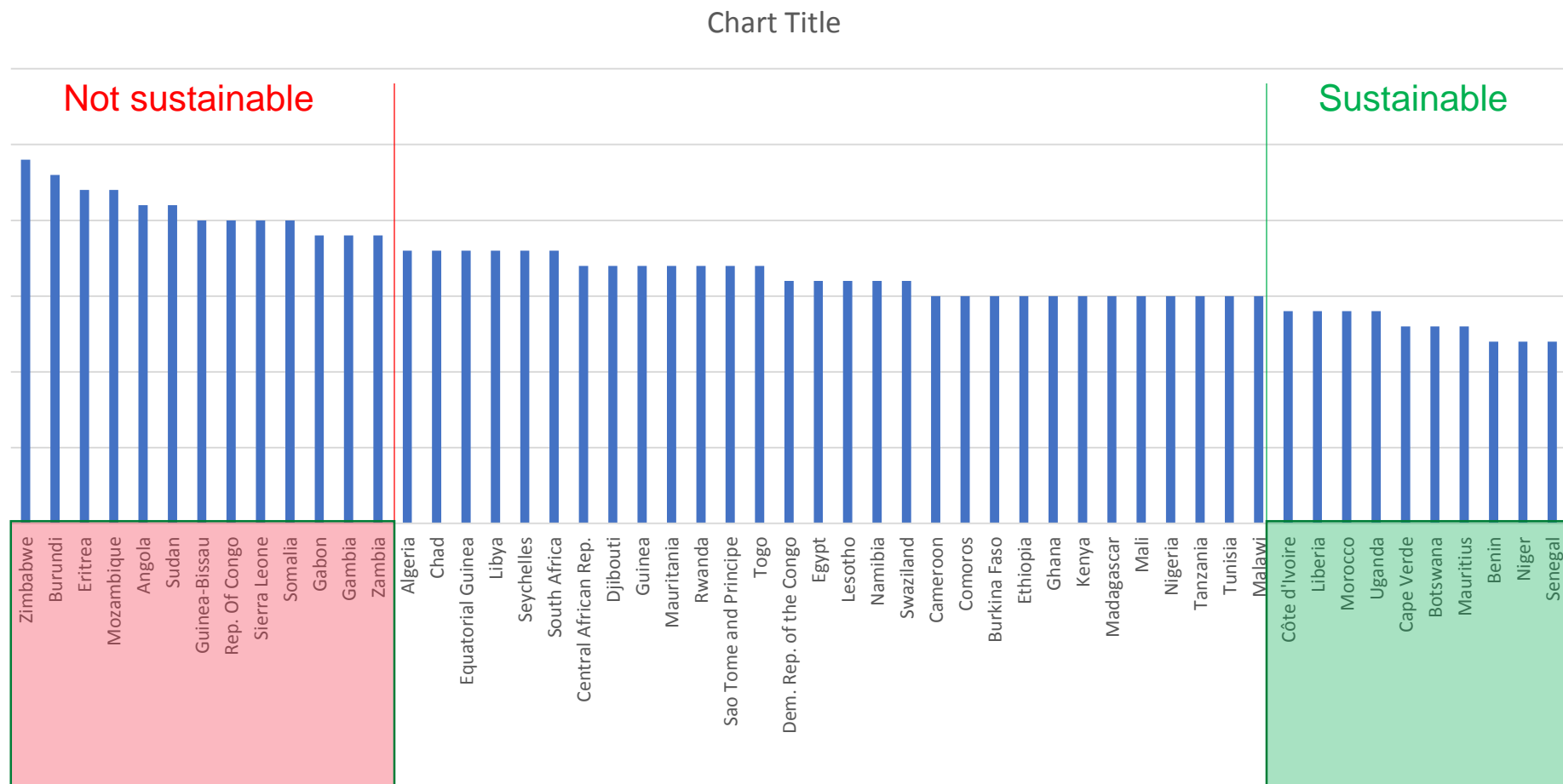
Thanks to easier access to global financial markets, debt issuance grew rapidly, notably in Egypt and Nigeria, facilitating the accumulation of debt

International debt securities outstanding, in USD billions, 2016Q2 vs 2017Q2



Source = BIS

# Ranking of the countries based on sustainability



**!!! Warning: the tallest bars correspond to the countries where debt sustainability is questionable !!!**

## Bottom line.....

- Sub-Saharan Africa's growth rate is expected to accelerate to 3.0% in 2018 from 2.6% in 2017.
- The West-Africa region is expected to become the fastest growing region in SSA, with growth in Cote d'Ivoire and Senegal taking the lead.
- Twin deficits prevail for most countries. A larger fiscal deficit requires increased domestic and foreign financing as national savings come under pressure.
- Stronger international commodity prices and capital inflows support currencies and import demand accelerates. Current account positions deteriorate in 2018.
- Debt sustainability increasingly under the spotlight.
- More structural adjustment necessary to place SSA on higher growth path. This includes fiscal reforms, sustained FDI inflows, low inflation, institutional reforms and further improvement in social indicators.
- Policy reforms mostly supportive of business environment, with the exception of South Africa, Namibia and Zambia

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