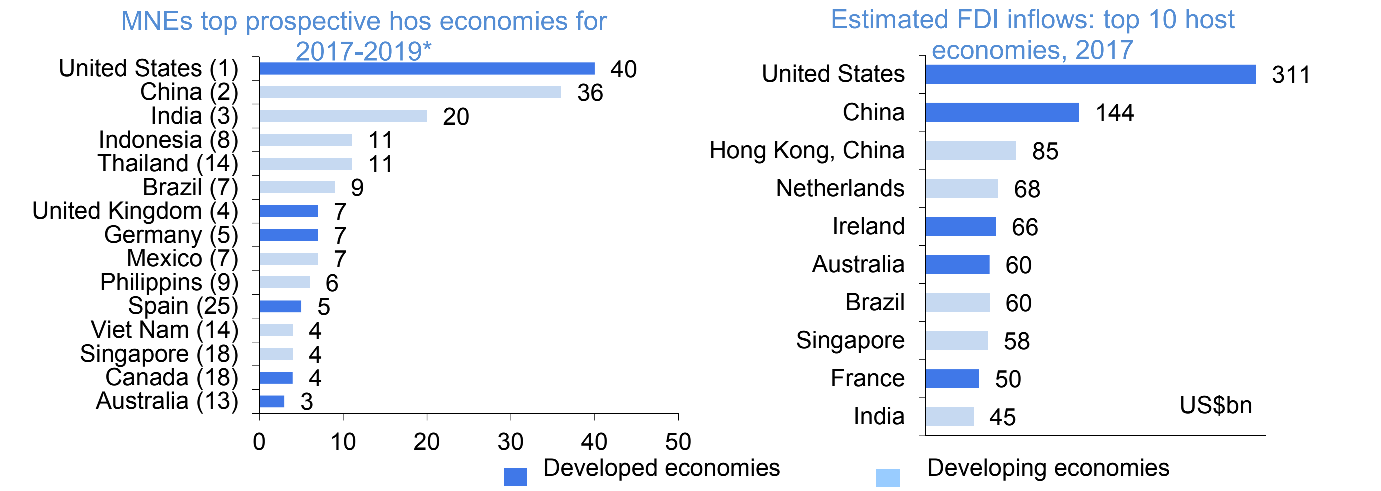
Investec

# Fixed investment outlook: expectations of higher economic growth lift expansion plans, engendering actual substantial growth and employment

2nd February 2018

Figure 1: MNEs top prospective host economies for 2017 and FDI inflows




Source: UNCTAD. Note: * % of executives responding

With South Africa already low on the global FDI (foreign direct investment) radar, global foreign direct investment (FDI) fell 16% y/y in 2017 (to US$1.52tr) as per Unctad's (United Nations conference on Trade and Development) latest Investment Trends Monitor, in contrast to the lift in global growth and international trade. Indeed, the rise in global economic growth expectations, commodity prices and trade flows (see "Q1 Macro-economic Outlook: 2018 – 2022: Global growth is expected to strengthen somewhat further; for SA's growth free market policies are key", 5th January 2018, see website address below) would normally point to a lift in FDI, but geo political risks and policy uncertainty were elevated, including fears of a trade war, concerns over the impact of Brexit, terrorism and uncertainty over US tax reforms. However, 2018 is expected to see global FDI flows reach US$1.8tr as business confidence improves, and South Africa is also expected to see business confidence improve and its growth outlook brighten on the recent reduction in its political uncertainty. FDI in SA averages about 0.5% of GDP, with a net outflow over 2014 to 2016, and similar in 2017 data available, although evidence is beginning to point to the possibility of  some inflows for 2018 should investor sentiment improve materially for South

| Figure 2: forecasts | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|
| GFCF, total (real, %) | 0.3 | 1.0 | 1.2 | 3.2 | 3.7 | 4.2 | 4.9 |
| GFCF as % of GDP | 19.9 | 19.8 | 19.7 | 19.9 | 20.2 | 20.5 | 20.9 |
| Private sector (real, %) | -1.4 | 1.0 | 3.6 | 4.5 | 4.2 | 4.4 | 5.0 |
| Government (real, %) | 2.9 | 0.9 | -2.2 | 1.1 | 2.9 | 3.9 | 4.7 |
| Non-residential GFCF (real, %) | -1.6 | 1.6 | 3.5 | 4.8 | 4.4 | 4.5 | 5.0 |
| Residential buildings (real, %) | 0.0 | -2.3 | 3.9 | 2.9 | 2.9 | 4.0 | 4.7 |

Source: SARB, Investec. Note: Please note: all data can be subjected to historical revisions



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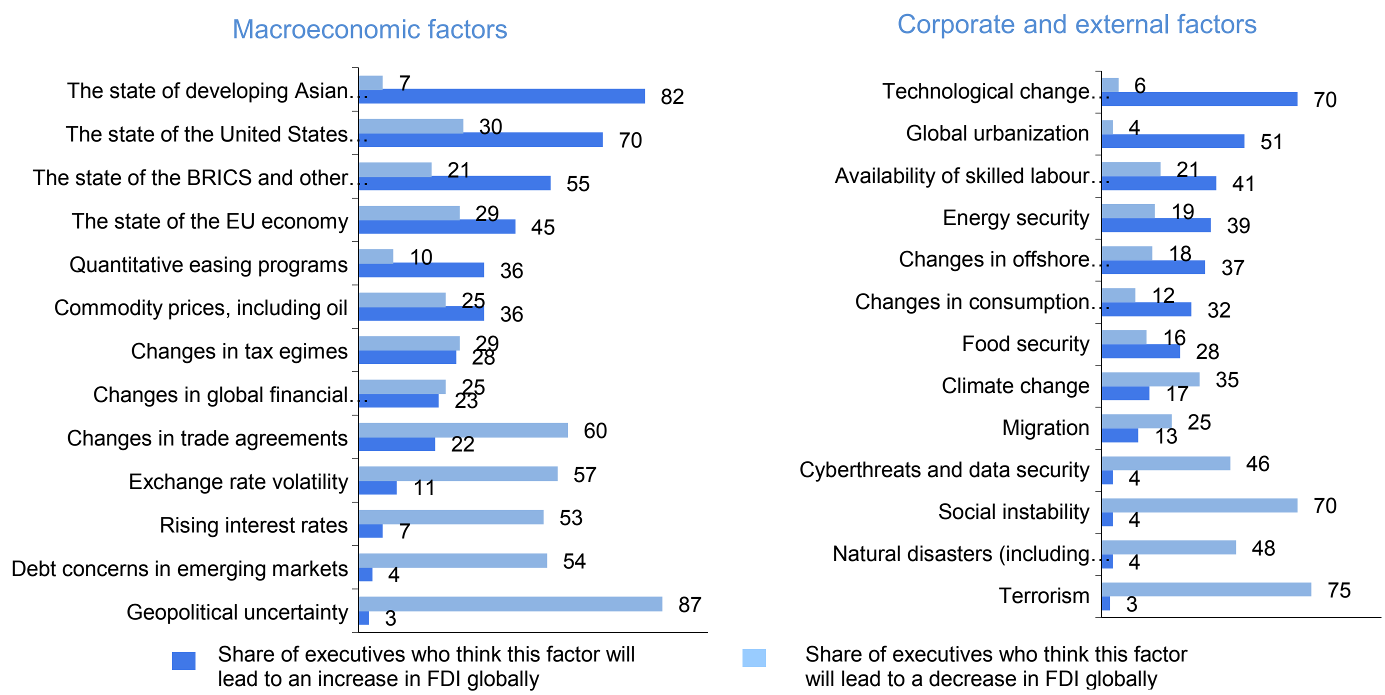
Figure 3: Factors influencing future global FDI activity (% of executives)




Source: UNCTAD

Africa. Indeed, with key global business leaders and investors gathered in Davos recently, South Africa is seen to have performed well in engendering positive investor sentiment towards the country, with the leader of SA's delegation, Deputy President Cyril Ramaphosa, stating that business leaders were buoyed by the new mood in SA, and that his team returned with a "bag full of investment commitments", with SA still seen as a good base to expand into the rest of Africa. However, while SA is identified as a key emerging market for 2018, as the rand has strengthened materially and the new ANC leadership is seen as market friendly, free market reforms are necessary to keep the sentiment positive. SA's outlook can brighten to GDP growth of 2.0-3.0% (see "Business cycle note: leading indicator should improve in 2018 as an outlook for stronger economic growth argues against credit rating downgrades", 23rd January 2017) with the right growth positive reforms, which would lift FDI investor appetite, and anecdotal evidence already points to significant foreign investor interest on hopes of higher economic growth, restoration of SOE governance and public finances back to levels that allow for BBB+ / A level credit ratings, and the repair of the impasse in the mining sector following the latest charter, to name a few of the key issues.

Also on the financial account, South Africa has seen lower foreign portfolio investment inflows compared to other key EM countries. Domestic financial markets would become very attractive should these free market reforms take place, which could see these portfolio inflows lift substantially. The rise in commodity prices makes these reforms key for the mining sector as well, in order to avoid SA missing out on yet another global commodity price upswing, which is of particular concern as SA is a commodity exporter, and employs four hundred and forty six thousand people. FDI has historically been significant in SA's mining sector but began to pull back from 2012 as politics in the sector became substantially more volatile.


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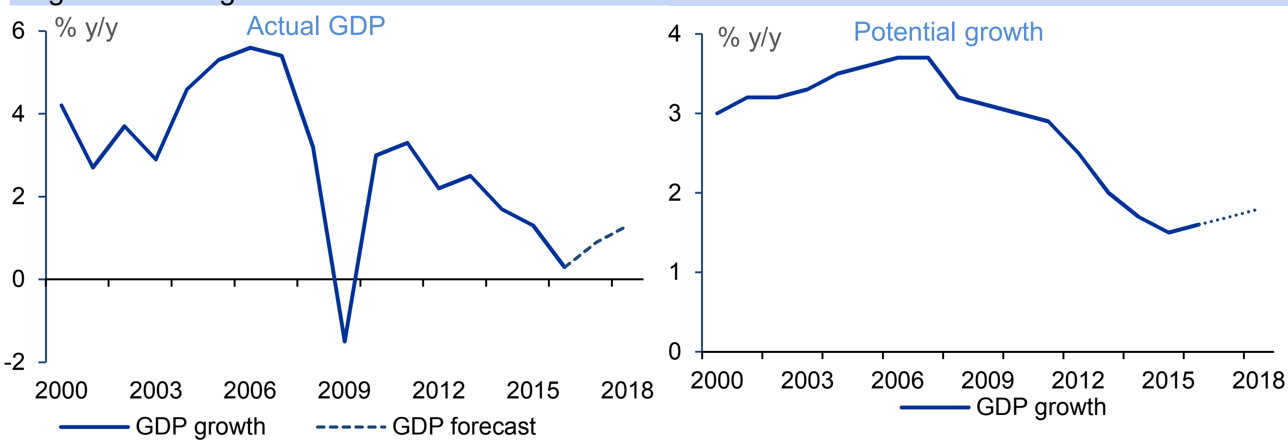
Figure 4: GDP growth




Source: Stats SA and SARB

Unctad says that "half of the top ten host economies" for FDI are developing economies. Developing Asia saw inflows of US$459bn in 2017, chiefly into China, Hong Kong and Singapore (see figure 1). Flows were flat into Africa, while developing Asia remained the largest FDI recipient globally, followed by the EU and USA. The type of FDI into developing Asia was mainly cross border M&A activities of foreign companies in Hong Kong (China), India and Singapore. For Africa flows saw a 1.0% y/y decline, to US$49bn in 2017, as the impact of the previous collapse in commodity prices was still felt, despite commodity prices having started to rise. South Africa saw FDI of US$3.2bn in 2017, a low figure by historical standards. Expected accelerating global and domestic economic growth should see South Africa benefit from FDI in 2018, as confidence in the economy lifts (see "Consumer Confidence –

Figure 5: FDI inflows, cross-border M&As and announced greenfield projects, by region, 2016-2017

| (US$ billions) | FDI inflows | | | Cross-border M&As | | | Announced greenfield project values | | |
|---|---|---|---|---|---|---|---|---|---|
| Region | 2016 | 2017[a] | Growth rate (%) | 2016 | 2017[a] | Growth rate (%) | 2016 | 2017[a] | Growth rate (%) |
| World | 1 814 | 1 518 | -16 | 869 | 666 | -23 | 834 | 571 | -32 |
| Developed economies | 1 109 | 810 | -27 | 794 | 553 | -30 | 254 | 282 | 11 |
| European Union | 500 | 370 | -26 | 363 | 127 | -65 | 148 | 146 | -1 |
| North America | 494 | 330 | -33 | 372 | 295 | -21 | 69 | 105 | 53 |
| Developing economies | 638 | 653 | 2 | 69 | 100 | 44 | 515 | 261 | -49 |
| Africa | 50 | 49 | -1 | 10 | 3 | -64 | 94 | 41 | -57 |
| Latin America and the Caribbean | 139 | 143 | 3 | 18 | 24 | 34 | 74 | 61 | -17 |
| Developing Asia | 448 | 459 | 2 | 42 | 73 | 74 | 347 | 158 | -54 |
| Transition economies | 67 | 55 | -17 | 5 | 13 | 157 | 65 | 28 | -56 |

Source: UNCTAD

[a] Preliminary estimates

Note: World FDI inflows are projected on the basis of 159 economies for which data are available for at least part of 2017, as of 18 January 2017. Annual figures are estimated based on available partial-year data, in most cases up to the third quarter of 2017. The proportion of inflows from these economies in total inflows to their respective region or subregion in 2016 is used to extrapolate 2017 regional (and global) data. Data exclude the offshore financial centres in the Caribbean.



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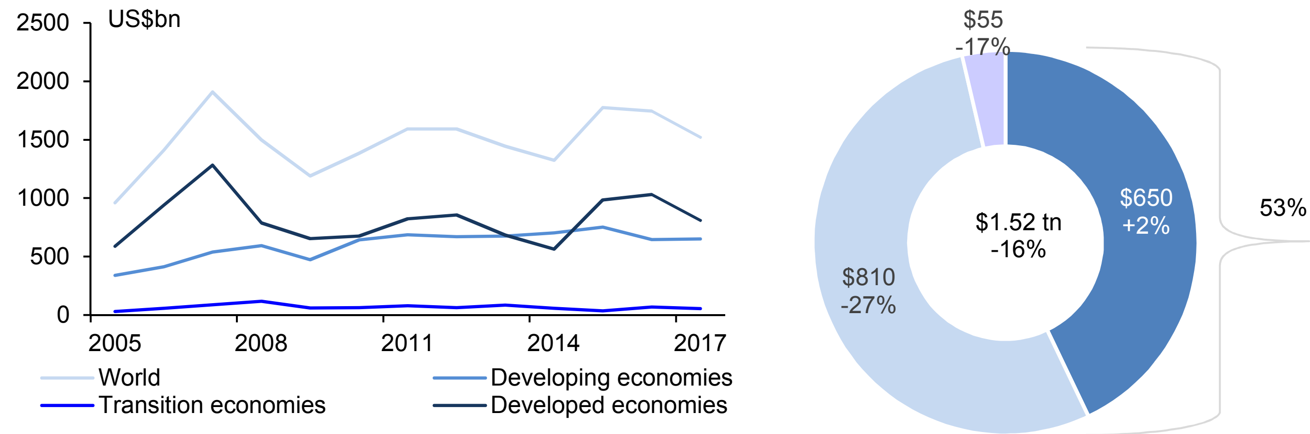
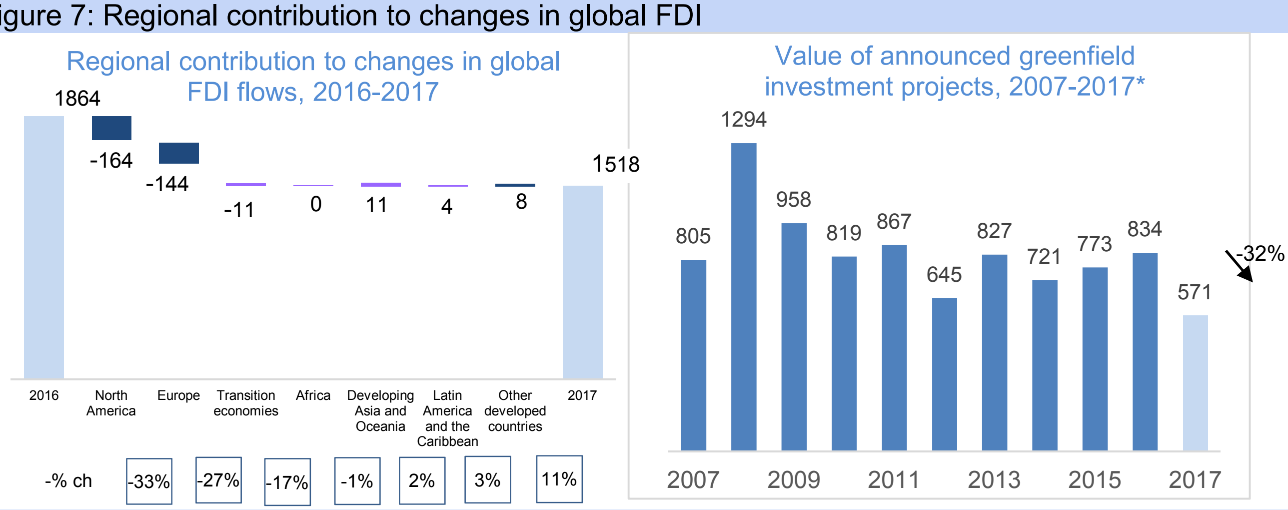
Figure 6: FDI inflows: global and by group of economies, 2005-2017




Source: UNCTA

moderates fractionally in Q4.17 … reading pre ANC conference", 31st January 2018). Greenfields FDI typically brings employment, economic growth and skills transfers, which in turn can stimulate domestic fixed investment (or labelled Gross Fixed Capital Formation (GFCF) by the SARB). While the IMF has recently reduced its forecasts of South Africa's economic growth materially for 2018 and 2019 in its start of year publication, these forecasts would have been made before the growth in optimism that has been building in South Africa post December's ANC elective conference. South Africa's BER business confidence reading for Q1.18 is only due for publication mid-March, but is expected to show a significant lift on the depressed reading of 34 in Q4.17, where 66% of firms were dissatisfied with business conditions. The latest fixed investment readings show private business disinvested by 6% y/y in 2016, and fell 9% y/y for the first three quarters of 2017.

Figure 7: Regional contribution to changes in global FDI




* Based on cross-border M&A database for M&As and information from the Financial Times Ltd

Source: UNCTA



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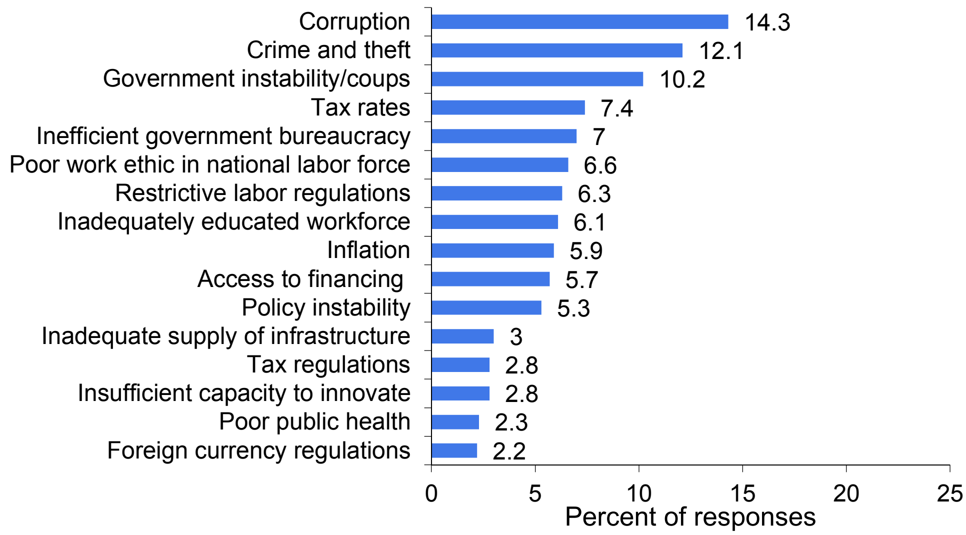
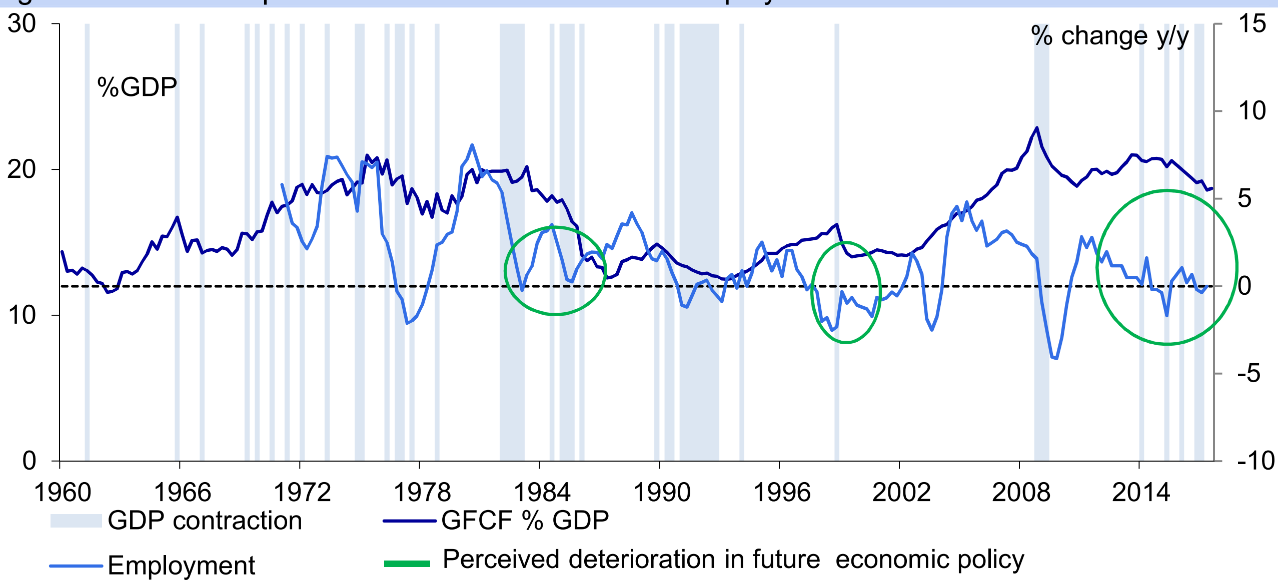
Figure 8: The most problematic factors for doing business in SA




Source: WEF The Global Competitiveness Report 2017/18

Repairing business confidence will be key to kick-starting faster economic growth, and stimulating both foreign direct investment and domestic fixed investment into SA. As investor sentiment improves so does fixed investment if the outlook is positive, which stimulates capital investment and employment. However, South Africa has lost a lot of capacity as low levels of investment have occurred on depressed

Figure 9: Relationship between fixed investment and employment




Source: SA Reserve Bank, Investec



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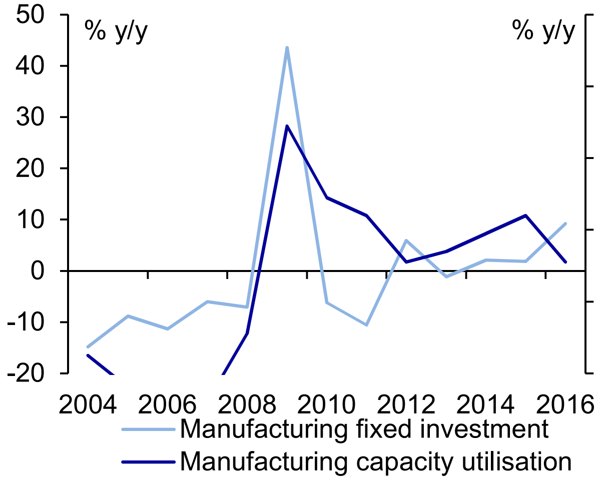
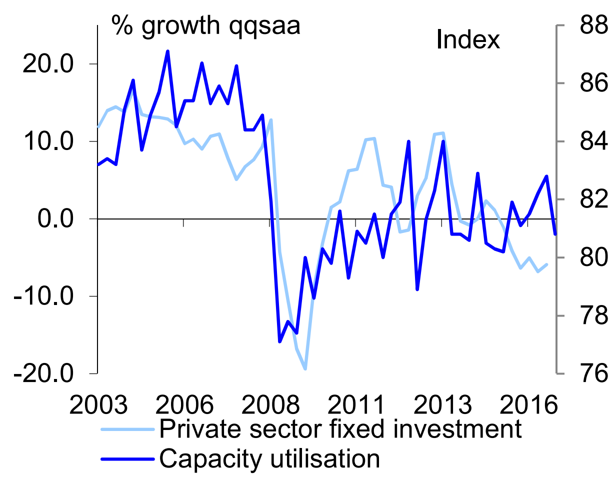
Figure 10: Capacity utilisation

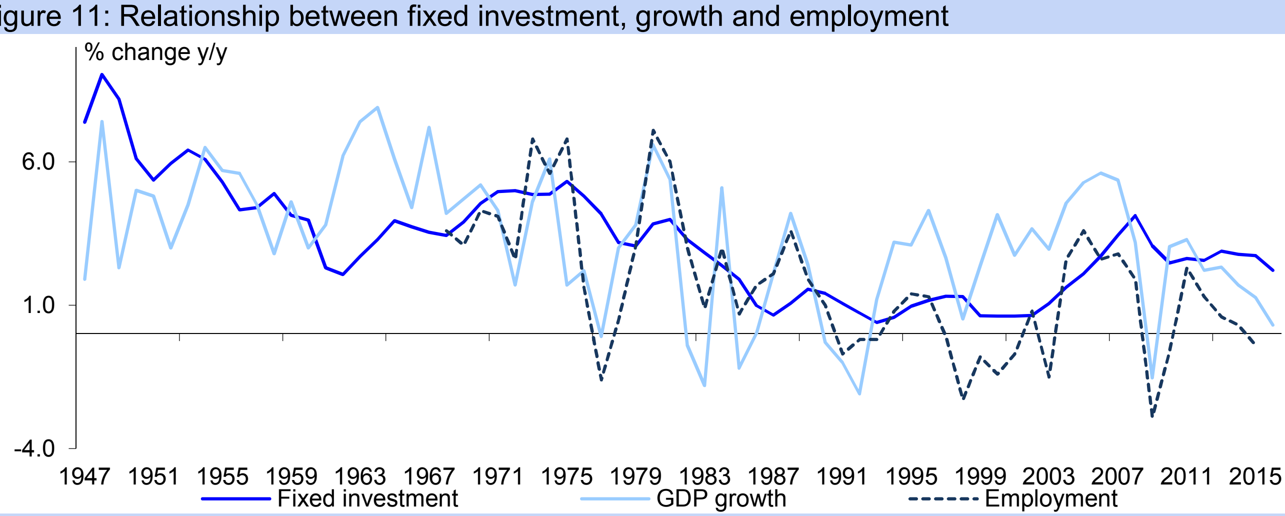



Source: SA Reserve Bank, Stats SA

sentiment since 2009. An economy's full capacity for output is heavily determined by its fixed investment, or more specifically the ratio of fixed investment to GDP, including the private sector, government and public utilities. The higher private sector fixed investment to GDP, providing government and public utility fixed investment is sufficient, the faster economic growth is if human capital is sufficient (and so employment lifts, see figure 9). In South Africa the GFCF to GDP ratio is reported below 20% with the norm at least 25% for good economic growth. Indeed, this ratio had dipped to 15% in the early 2000s, with economic growth moderating as SA's low level of domestic fixed investment was limiting its growth potential below that needed to meaningfully reduce the country's unemployment rate. Government then both stated its intention to intensify fixed investment, and undertook the upgrading of SA's infrastructure, in an environment of ongoing fiscal consolidation. Fixed investment growth accelerated to double digits,

Figure 11: Relationship between fixed investment, growth and employment




Source: SA Reserve Bank


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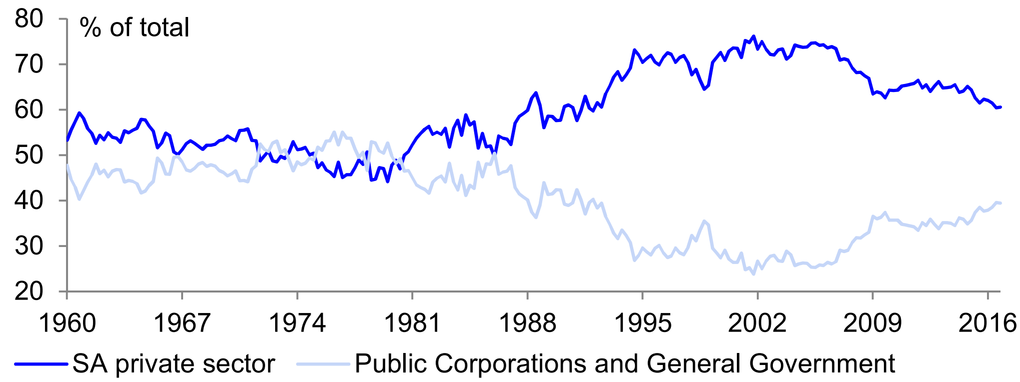
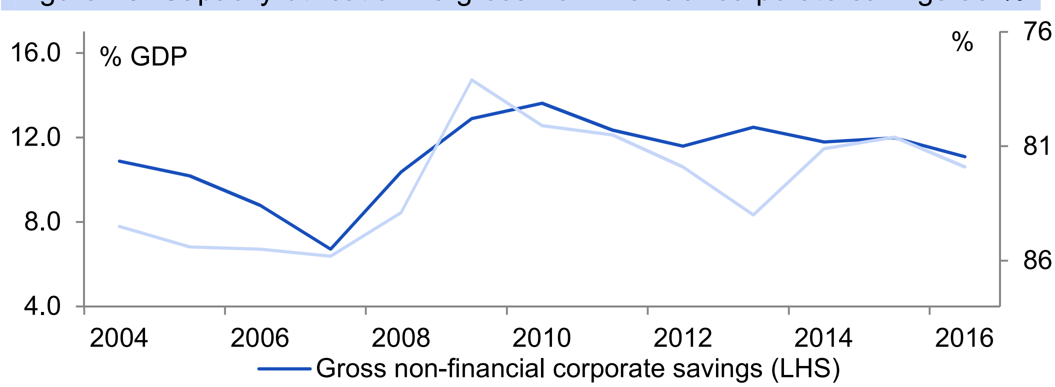
Figure 12: Private sector shoulders the burden of capital expenditure




Source: Investec, SA Reserve Bank

propelling economic growth above 5.0% y/y and unemployment down to below 22% (see figure 11). Specifically, growth rose above the 2-3% range it has been stuck in since 1994, to average 3-4%, and then 4-5% plus as productive capacity rose, positive, robust consumption expenditure occurred on the back of this. Improved production allowed exports to rise to meet trade demand. Credit rating upgrades ensued, with an A grade rating from Moody's. Through improved fiscal management, money was available to spend on infrastructure, as well managed fixed investment yielded quality infrastructure delivered on time, within budget and which supported private corporate sector expansion. Successful delivery by government of its part in productive capacity (including well managed, well financed and efficient SOEs that are not a drag, but instead make a profit, contributing to public finances) is a prerequisite to drive domestic growth. For economic growth of 5% plus to be sustained (for the purpose of reducing unemployment to single digits over the long-term), fixed investment growth in SA needs to run in double digits. At least 25% of GDP needs to be constantly reinvested in the economy via fixed investment, particularly from government and utilities, not just the private sector. Only through permanently reducing unemployment can we anticipate a sustained lowering of SA's socio-economic inequalities, and the ultimate eradication of poverty. With the perceived reduction in political risk in 2018,

Figure 13: Capacity utilisation vs gross non-financial corporate savings as %




Source: SA Reserve Bank, Stats SA



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Figure 14: Major capex projects in the next five years

| Announced date | Project Name | Company Name | Est. value (m) | Est. completion date |
|---|---|---|---|---|
| Apr 2012 | Transnet's Market Demand Strategy (MDS) – Railway projects | Transnet | 300 000 | Apr 2020 |
| Apr 2011 | Passenger Rail Agency of SA (Prasa) rolling stock fleet-renewal programme | Passenger Rail Agency of South Africa | 151 500 | Dec 2030 |
| Feb 2007 | Project Kusile (formerly called Bravo) | Eskom | 141 500 | Jun 2021 |
| Jan 2014 | Durban dug-out port | Transnet | 75 000 | Jan 2024 |
| Aug 2000 | Spoornet's capital renewal programme | Spoornet | 54 000 | Jun 2020 |
| Jan 2017 | Sibaya Coastal Precinct project | Tongaat Hulett Developments | 50 000 | Dec 2038 |
| Aug 2016 | Musina-Makhado special economic zone (SEZ) energy and metallurgical industrial park | Limpopo Department of Economic Development, Environment and Tourism | 40 000 | Apr 2021 |
| Aug 1996 | Coega Industrial Development Zone (IDZ) | Portnet | 25 200 | Dec 2030 |
| Oct 2015 | KiPower independent power plant project | KiPower | 24 300 | Dec 2018 |
| Oct 2013 | Savana City Mixed-use Development | Basil Read and Old Mutual's housing Impact Fund of SA | 24 000 | Dec 2023 |
| Apr 2015 | The Department of Energy (DoE) fourth Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) | Department of Energy (DoE) | 23 000 | Dec 2018 |
| Mar 2013 | Venetia underground diamond mine | De Beers Consolidated Mines South Africa (DBCM) | 20 000 | Dec 2021 |
| May 2012 | Umzimvubu water resources development project | Department of Water Affairs (DWA) | 20 000 | Jan 2018 |

Source: Nedbank Capex

Figure 14 (continued): Major capex projects in the next five years

| Announced date | Project Name | Company | Est. value (m) | Est. completion date |
|---|---|---|---|---|
| Apr 2016 | Ivanplats Platreef project – platinum group metals (PGMs) nickel copper and gold mine – pase 1 | Ivanhoe Mines owns 64% of the Platreef project through its subsidiary Ivanplats and manages all project developmet work | 15 000 | Dec 2019 |
| Mar 2007 | Anglo Coal South Africa expansion | Anglo Coal South Africa | 15 000 | Dec 2023 |
| Aug 2011 | Lesotho Highlands Water Project – Phase 2 | Department of Water Affairs | 12 000 | Aug 2020 |
| Jan 2016 | South African State-owned vehicle manufacturing plant project | The Industrial Development Corporation (IDC) and the Beijing Automotive Group Corporation (BAIC) | 12 000 | Dec 2017 |
| Feb 2008 | Impala no. 17 shaft – Rustenburg | Implats | 11 100 | Dec 2021 |
| Feb 2009 | The Cradle City project | Amari Land | 11 000 | Dec 2039 |
| Jul 2009 | Fisantekraal housing project | Basil Read, in association with Garden Cities | 9 500 | Dec 2020 |
| Mar 2015 | Palabora Copper's Lift 2 project | Bauba Platinum | 9 300 | Dec 2033 |
| May 2012 | The Square Kilometre Array (SKA) project – Phase 1 | Department of Science and Technology | 8 900 | Dec 2023 |
| May 2017 | The Leeuwpoort housing project | Gauteng Department of Human Settlements | 8 900 | Dec 2024 |
| Sep 2008 | Cape Town Bus Rapid Transmit (BRT) | City of Cape Town | 8 680 | Dec 2020 |
| Apr 2017 | Higher Education and Training infrastructure investment | Department of Higher Education and Training | 7 000 | Dec 2019 |
| Apr 2017 | Clayville mixed-use housing project | Gauteng Department of Human Settlements | 6 000 | Dec 2022 |
| Aug 2015 | Gamsberg zinc mine | Vedanta Resources | 8 700 | Mar 2018 |

Source: Nedbank Capex

Figure 14 (continued): Major capex projects in the next five years

| Announced date | Project Name | Company Name | Est. value (m) | Est. completion date |
|---|---|---|---|---|
| Apr 2015 | Cell C Long-term Evolution infrastructure programme | Cell C | 8 000 | Apr 2018 |
| Apr 2007 | Wesizwe Platinum's Bakubung Platinum-Group Metals Mine Project (formerly known as the Ledig Frischgewaar platinum project) | Wesizwe Platinum Limited | 7 900 | Apr 2018 |
| Oct 2008 | Styldrift 1 expansion project | Royal Bafokeng Platinum and Anglo American Platinum | 7 500 | Oct 2008 |
| Jan 2015 | Department of Higher Education and Training's development plan | The Department of Higher Education and Training's (DHET's) | 7 100 | Jan 2015 |
| Oct 2015 | BMW Rosslyn plant upgrade | BMW | 6000 | Oct 2015 |
| Sep 2005 | Zimbali (All Projects) | Moreland Development & IFA (International Financial Advisers) | 5 000 | Jun 2021 |
| Mar 2002 | Alice Quarry – Eastern Cape | Alice Quarry | 5 000 | May 2022 |
| Apr 2013 | BP Capital Investment plan | BP Southern Africa | 4 700 | Jun 2018 |
| Aug 2012 | Boikarabelo coal project | Resource Generation (ResGen) | 4 500 | Jul 2018 |
| May 2017 | The Blyde at Riverwalk Estate project | Crystal Lagoons in partnership with Balwin | 4 200 | Dec 2019 |
| Apr 2016 | Leratong City Integrated nodal development project | A joint venture between McCormick Property Development, Calgro M3 and Sasuka Logistics Services | 4 200 | Dec 2020 |
| Jun 2015 | Vaal River City development project | Gauteng provincial government and the River City Development Company | 4 000 | Dec 2020 |
| May 2017 | Titanium beneficiation project | Nyanza Light Metals | 4 000 | Dec 2018 |

Source: Nedbank Capex

Figure 14 (continued): Major capex projects in the next five years

| Announced date | Project Name | Company Name | Est value (m) | Est. completion date |
|---|---|---|---|---|
| Nov 2006 | Bridge City shopping and residential centre development | Joint venture between Moreland and eThekwini municipality | 4 000 | Dec 2019 |
| Jun 2016 | Moloto Road upgrade | Department of Transport | 3 700 | Dec 2021 |
| Jan 2011 | Passenger Rail agency of SA (Prasa) rail signalling system | Passenger Rail Agency of SA | 3 700 | Dec 2018 |
| Jun 2014 | Exxaro Belfast coal mine | Exxaro Resouces | 3 800 | Dec 2017 |
| Mar 2016 | Clairwood Logistics Park and Distribution Centre | Fortress Income Fund | 3 500 | Dec 2020 |
| Jan 2016 | Gautrain rolling-stock procurement programme | Gautrain Manjagement Agency (GM\A) | 3 500 | Dec 2020 |
| Apr 2015 | Roggeveld wind farm project | Gauteng provincial | 3 420 | Sep 2018 |
| Nov 2005 | IDC Titanium Project | Government and the IDC | 3 280 | Jun 2019 |
| May 2008 | The Houghton development project | Asvid Holdings | 3 000 | Dec 2018 |
| May 2009 | Eastern Cape roads repair project | Eastern cape Department of Roads and Transport | 3 000 | Mar 2019 |
| Feb 2017 | Health facility revitalization | Department of Health | 3 000 | Mar 2020 |
| Mar 2017 | Thabametsi coal mine project | Exxaro Resources | 3 000 | Dec 2022 |
| Feb 2016 | Masingita City mall project | Joint venture between Masingita Group of Companies, Redefine and Ellerines Brothers | 3 000 | Oct 2018 |
| Mar 2015 | Ngqura liquid-bulk terminal storage | Oiltanking Grindrod Calulo Holdings | 2 900 | Mar 2019 |

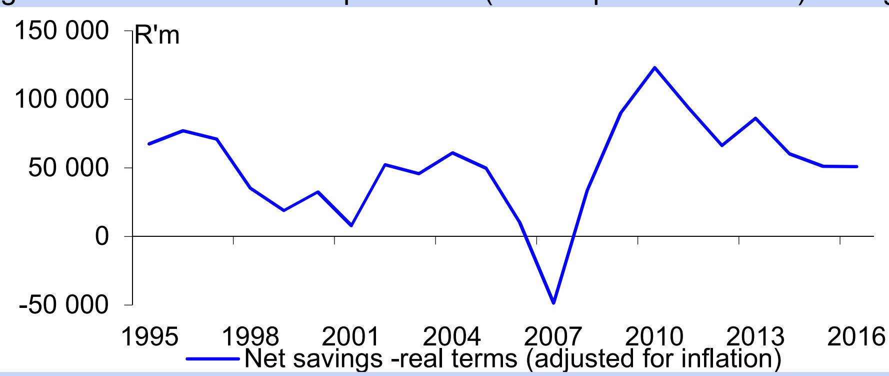
Source: Nedbank Capex

Figure 14 (continued): Major capex projects in the next five years

| Announced date | Project Name | Company Name | Est. value (m) | Est.Completion date |
|---|---|---|---|---|
| Jun 2014 | Royal Bafokeng Platinum housing development | Royal Bafokeng Platinum's (RBPlat's) | 2 800 | Dec 2020 |
| Jun 2013 | Redstone solar thermal power project – Round 3 of the DoE's Reneweable Energy | Department of Energy | 2 400 | Jun 2018 |
| Mar 2013 | Bay West Mall | Abacus Asset Management and the Billion Group | 2 000 | Jun 2025 |
| Jul 2014 | One on Whiteley construction project | Amdec Property Developments | 2000 | Mar 2018 |
| Aug 2014 | Coega aqua-farm | Coega Development Corporation | 2 000 | Dec 2020 |
| Oct 2014 | Nestle South Africa investment plan | Nestle South Africa | 2 000 | Dec 2020 |
| Nov 2014 | South Hills mixed housing development | Standard Bank and Calgro | 1 950 | Dec 2020 |
| Oct 2014 | Mining town development – housing projects | Department of Human Settlements | 2 100 | Dec 2017 |
| Mar 2013 | Malibongwe ridge mixed-use development project | Gauteng department of local government and housing and the City of Johannesburg | 1 850 | Mar 2018 |
| Ma 2013 | Mogale City (Leratong City) Regional Mall | Trendville Consortium | 2 000 | Jun 2023 |

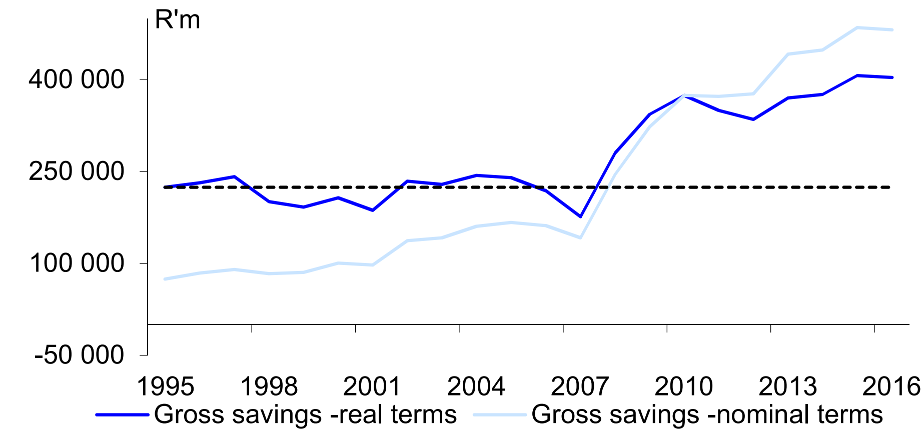
Source: Nedbank Capex

Figure 15: Non–financial corporate net (after depreciation costs) savings




Source: SA Reserve Bank

Figure 16: Non–financial corporate gross savings

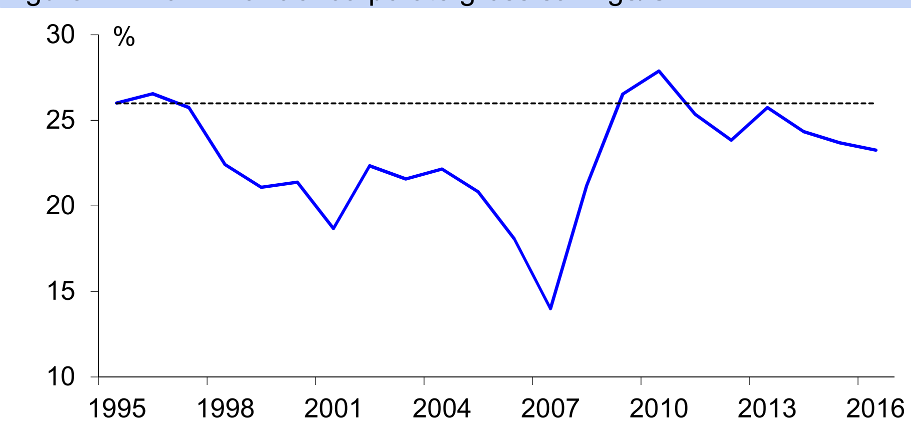



Source: SA Reserve Bank

SA's corporate sector and foreign investors are believed to be increasingly interested in investing in South Africa (see figures 12 and 13). However, not all corporates are sitting on significant savings, and Statistics South Africa shows SA corporate borrowing is up 5.9% y/y for 2016, to R5.7trillion (broadly spread across key industries), as the formal business sector has relied more on debt than on equity to fund operations since 2009 (see figures 18 to 21).

Public sector expenditure (which excludes infrastructure but includes civil servants salaries and wages) has risen to close to 30% of GDP from closer to 20% in the 2000s, while employment in the public sector has risen to above 3million people. This is in contrast to the GFCF (fixed investment) ratio which has dropped to 19% of GDP from close to 30% of GDP in the early 1980s when GDP growth reached 5.0% y/y and above, and public sector expenditure fell below 13% of GDP. A higher ratio of GFCF to GDP tends to be supportive of higher potential economic growth, which is the rate at which it is deemed that the economy can grow without overheating – i.e. causing significant upwards pressure on inflation.

Figure 17: Non–financial corporate gross savings/GDP




Source: Statistics SA


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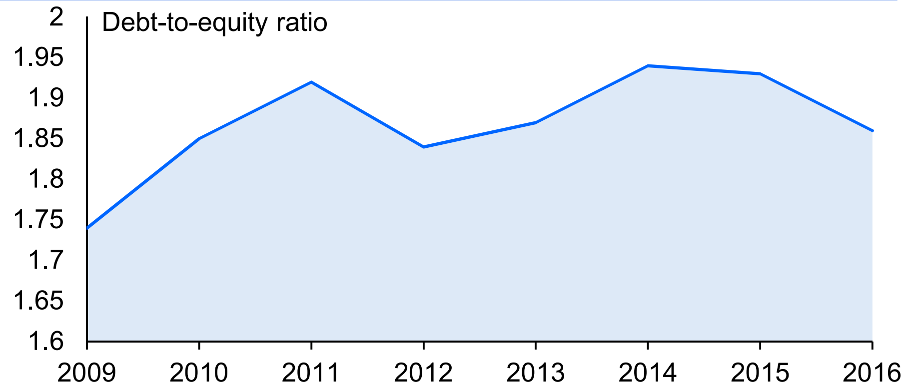
Figure 18: Debt-to-equity ratio for South African businesses



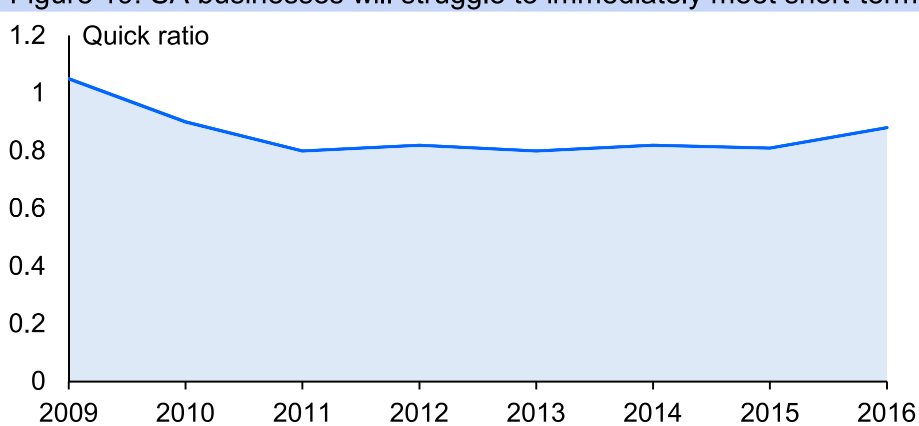

Source: Statistics SA

The formal business sector relies more on debt than on its investors to finance operations
In 2016, debt amounted to R1.86 for every rand of equity

South Arica's potential economic growth subsided between 2014and 2016 according to the SARB but then is expected to lift by 2019, with the output gap widening as economic growth approaches 2.0% y/y (see figure **4**). 2014 to 2016 saw very weak GFCF growth rates but we expect GFCF growth to pick up in 2018 and particularly in 2019 on rising investor confidence (see "Economic outlook 2017–2023: Global growth is expected to strengthen somewhat further; for SA's growth free market policies are key", 5th January 2018, website address below.)

South Africa's SOE's have been in the news and are heavy investors into SA's infrastructure (see figures **25** & **28**), but have relied on substantial borrowings to fund this, especially in recent years with substantial government guarantees to this debt (see figure **23**). It is the quantum of these guarantees, particularly the large ones (see "SA Gilts: flattish on perceived reduction in political uncertainty, but higher rates on

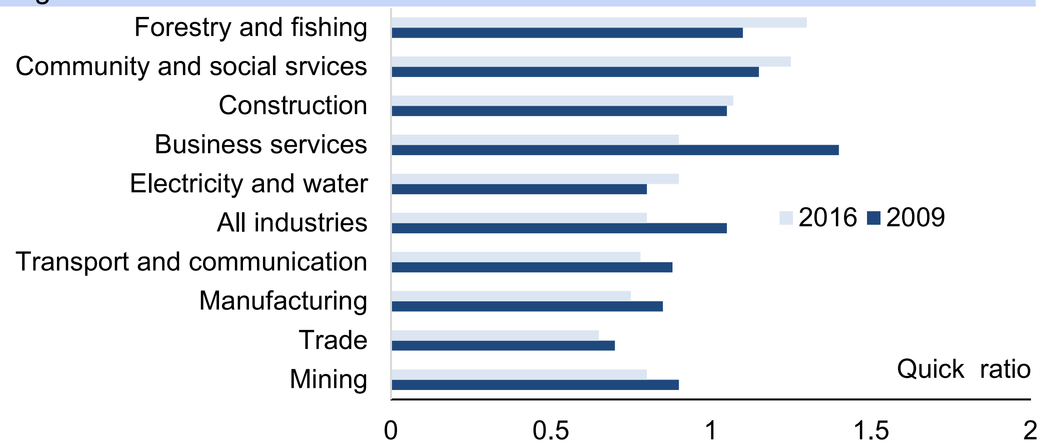
Figure 19: SA businesses will struggle to immediately meet short-term debts




Source: Statistics SA

Quick ratio = liquid assets/short-term debt
If the ratio<1: will not be able to pay back short-term debt from assets that can be easily turned into cash

Figure 20: Quick ratio for industries in the South African formal business sector

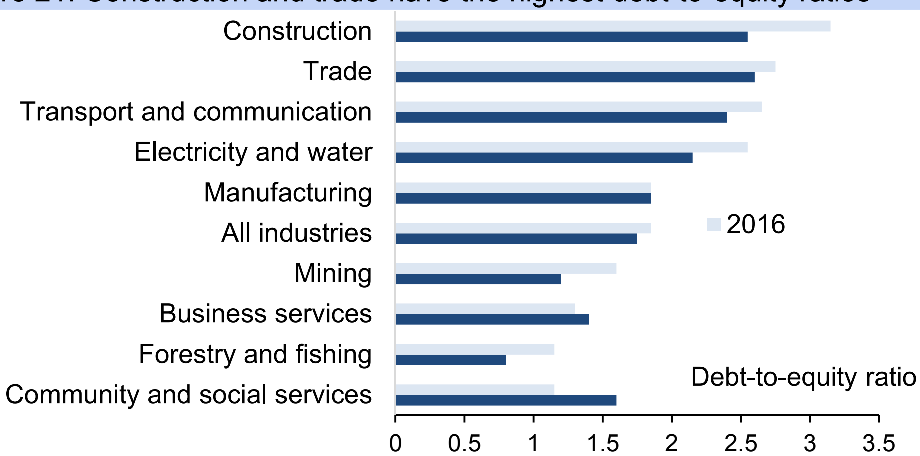



Source: SA Reserve Bank

Quick ratio = liquid assets/short-term debt

If the ratio<1: will not be able to pay back short-term debt from assets that can be easily turned into cash

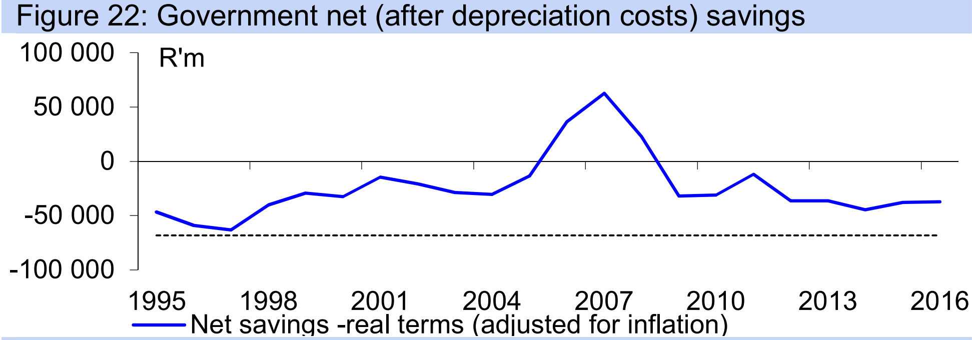
Figure 21: Construction and trade have the highest debt-to-equity ratios




Source: Statistics SA

They rely, more so than other industries, on debt rather than on equity to finance operations

Figure 22: Government net (after depreciation costs) savings




Source: SA Reserve Bank



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http://www.investec.co.za/research-and-insights/economy/economic-research-v1.html •

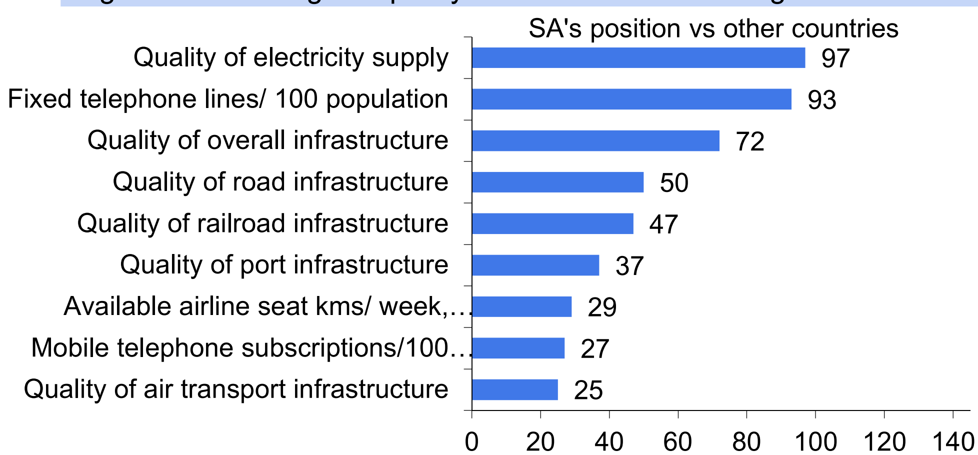
Figure 23: Government guarantee exposure[1]

| Institution | 2014/15 | | 2015/16 | | 2016/17 | |
|---|---|---|---|---|---|---|
| R billion | Guarantee | Exposure[1] | Guarantee | Exposure[1] | Guarantee | Exposure[1] |
| **Public Institutions** | **469.6** | **220.9** | **469.9** | **255.8** | **477.7** | **308.3** |
| of which | | | | | | |
| Eskom | 350.0 | 149.9 | 350.0 | 174.6 | 350.0 | 218.2 |
| SANRAL | 38.9 | 27.4 | 38.9 | 27.2 | 38.9 | 30.1 |
| Trans-Caledon Tunnel Authority | 25.6 | 20.8 | 25.8 | 21.2 | 25.7 | 20.7 |
| South African Airways | 14.4 | 8.4 | 14.4 | 14.4 | 19.1 | 17.9 |
| Land and Agricultural Bank of SA | 6.6 | 2.1 | 6.6 | 5.3 | 11.1 | 5.4 |
| Development Bank of Southern Africa | 12.9 | 4.1 | 13.9 | 4.4 | 12.7 | 4.2 |
| South African Post Office | 1.9 | 0.3 | 4.4 | 1.3 | 4.4 | 3.9 |
| Transnet | 3.5 | 3.8 | 3.5 | 3.8 | 3.5 | 3.8 |
| Denel | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 |
| South African Express | 1.1 | 0.5 | 1.1 | 0.5 | 1.1 | 1.0 |
| Industrial Development Corporation | 1.6 | 0.3 | 2.0 | 0.2 | 1.9 | 0.2 |
| South African Reserve Bank | 7.0 | - | 3.0 | - | 3.0 | - |
| Independent power producers | 200.2 | 96.2 | 200.2 | 114.0 | 200.2 | 125.8 |
| Public-private partnerships[2] | 10.1 | 10.1 | 10.3 | 10.3 | 10.9 | 10.9 |

Source: National Treasury Budget 2017

1. Total amount of borrowing and accrued interest for the period made against the guarantee
2. This amount only includes the national and provincial PPP agreements

Figure 24: Ranking the quality of SA's infrastructure against other countries




Source: WEF The Global Competitiveness Report 2017/18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http://www.investec.co.za/research-and-insights/economy/economic-research-v1.html •

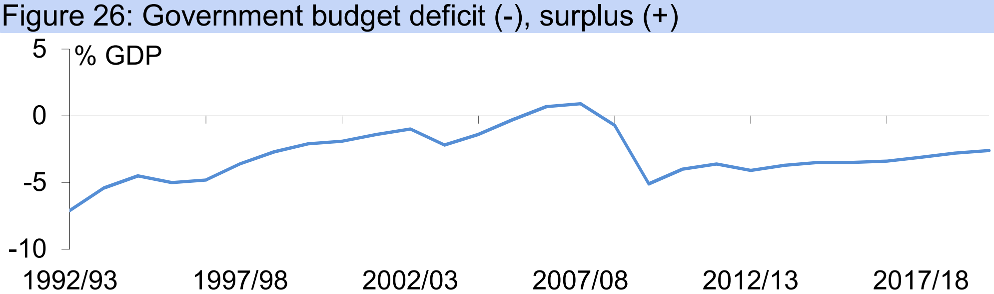
Figure 25: Public-sector infrastructure expenditure and estimates

| R billion | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | MTEF |
|---|---|---|---|---|---|---|---|---|
| | | Outcomes | | | Estimates | | | Total |
| Energy | 69.6 | 67.8 | 65.9 | 75.0 | 78.3 | 81.9 | 74.3 | **234.5** |
| Water and sanitation | 25.8 | 29.5 | 31.5 | 37.2 | 39.3 | 41.2 | 44.9 | **125.4** |
| Transport and logistics | 77.8 | 92.4 | 81.3 | 91.4 | 104.6 | 105.7 | 117.4 | **327.7** |
| Other economic services | 13.0 | 13.0 | 13.2 | 16.0 | 12.6 | 12.9 | 13.0 | **38.5** |
| Health | 10.0 | 8.7 | 10.3 | 11.0 | 11.2 | 11.9 | 12.5 | **35.6** |
| Education | 13.7 | 15.4 | 18.0 | 17.3 | 17.6 | 15.8 | 16.7 | **50.1** |
| Human settlements[1] | 17.0 | 17.1 | 18.3 | 18.3 | 20.0 | 21.1 | 22.3 | **63.4** |
| Other social services | 12.9 | 13.1 | 16.3 | 15.6 | 16.1 | 16.6 | 17.5 | **50.2** |
| Administration services[2] | 5.0 | 5.2 | 6.5 | 7.9 | 7.1 | 7.2 | 7.5 | **21.7** |
| **Total** | **244.8** | **262.2** | **261.2** | **289.8** | **306.7** | **314.3** | **326.1** | **947.2** |
| National departments | 11.9 | 13.5 | 14.5 | 16.6 | 16.7 | 16.0 | 15.0 | **47.7** |
| Provincial departments | 55.2 | 56.4 | 60.6 | 62.3 | 64.1 | 65.1 | 68.9 | **198.2** |
| Local government | 47.1 | 53.2 | 54.7 | 58.2 | 56.7 | 59.1 | 63.9 | **179.6** |
| Public entities[3] | 15.4 | 19.2 | 17.8 | 22.0 | 23.9 | 23.6 | 24.9 | **72.3** |
| Public private partnerships | 3.9 | 4.0 | 4.3 | 4.8 | 5.1 | 5.5 | 5.9 | **16.5** |
| State-owned companies[3] | 111.2 | 115.8 | 109.3 | 125.8 | 140.3 | 145.0 | 147.5 | **325.8** |
| **Total** | **244.8** | **262.2** | **261.2** | **289.8** | **306.7** | **314.3** | **326.1** | **947.2** |

Source: National Treasury Budget 2017

1. Human settlements includes public housing to households and bulk infrastructure amounting to R63.4 billion over the MTEF period.
2. Administration services include infrastructure spending by the Department of International Relations, the Department of Home Affairs, the Department of Public Works, Statistics South Africa and their entities
3. Public entities are financed by capital transfers from the fiscus and state-owned companies are financed from a combination of own revenue, borrowings and private funding

Figure 26: Government budget deficit (-), surplus (+)




Sources: SARB

Figure 27: Projected state debt and debt costs

| R billion | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|---|
| **Net loan debt** | **2 008.3** | **2 294.2** | **2568.5** | **3 179.4** |
| *Percentage of GDP* | *45.6%* | *49.1%* | *51.7%* | *53.9%* |
| **Debt-service costs** | **146.5** | **163.3** | **183.1** | **203.3** |
| *Percentage of GDP* | *3.3%* | *3.5%* | *3.7%* | *3.8%* |

Source: National Treasury MTBPS 2017

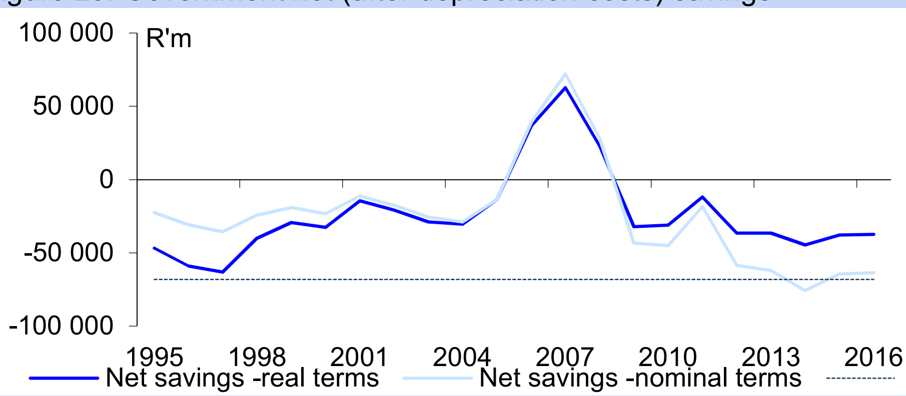
Figure 28: Eskom expenditure and estimates

| R billion | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|---|---|
| Medupi power station | 9.5 | 8.8 | 9.6 | 11.0 | 15.2 |
| Kusile | 14.7 | 14.0 | 13.3 | 12.3 | 9.8 |
| Ingula pumped storage scheme | 3.6 | 1.6 | 0.2 | - | - |
| Matla refurbishment project | 0.5 | 0.5 | 0.4 | - | - |
| Komati | - | - | - | - | - |
| Duvha power station | 0.4 | 0.3 | 0.3 | 0.3 | 0.4 |
| 765kV projects | 0.9 | 0.2 | 0.5 | - | - |
| Northern grid projects[1] | 1.2 | 1.3 | 2.7 | 3.8 | 0.5 |
| Cape grid projects[1] | 0.9 | 1.0 | 1.4 | 0.8 | |
| Central grid projects[1] | 0.4 | 0.8 | 1.8 | 1.1 | 0.1 |
| Majuba rail | 1.2 | 1.5 | 0.6 | - | |
| Other[2] | 23.7 | 33.2 | 36.7 | 42.1 | 39.1 |
| **Total** | **57.0** | **63.1** | **67.2** | **71.4** | **65.1** |

Source: National Treasury Budget 2017

1. Grid projects involve installation of transmission lines, new transformers and upgrading of substations
2. Other represents a collection of projects to enhance the system at generation, transmission and distribution level including maintenance projects

Figure 29: Government net (after depreciation costs) savings




Source: SA Reserve Bank

Figure 30: Borrowing requirement of selected state-owned companies,[1] 2013/14-2017/18

| | 2015/16 | | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|---|---|---|
| R billion | Budget | Outcome | Revised | Medium-term estimates | | |
| **Domestic loans (gross)** | **65.5** | **98.5** | **53.1** | **39.0** | **46.2** | **47.1** |
| Short-term | 13.8 | 21.8 | 23.3 | 7.8 | 12.4 | 11.9 |
| Long-term | 51.7 | 76.7 | 29.8 | 31.2 | 33.9 | 35.1 |
| **Foreign loans (gross)** | **42.6** | **29.5** | **49.5** | **62.7** | **55.7** | **56.4** |
| Long-term | 42.6 | 29.5 | 49.5 | 62.7 | 55.7 | 56.4 |
| **Total** | **108.1** | **128.0** | **102.6** | **101.7** | **102.0** | **103.4** |
| Percentage of total | | | | | | |
| Domestic loans | 60.6% | 77.0% | 51.7% | 38.4% | 45.3% | 45.5% |
| Foreign loans | 39.4% | 23.0% | 48.3% | 61.6% | 54.7% | 54.5% |

Source: National Treasury Budget 2017

1. Airports Company of South Africa, Eskom, SANRAL, SAA, Transnet and Trans-Caledon Tunnel Authority

Figure 31: Combined financial position of selected categories of public institutions

| R billion | 2013/14 | 2014/15 | 2015/16 |
|---|---|---|---|
| **State-owned companies** | | | |
| Total assets | 912.5 | 1 042.2 | 1 180.9 |
| Total liabilities | 635.0 | 738.9 | 819.0 |
| **Net asset value** | **277.5** | **303.3** | **361.8** |
| **Development finance institutions**[1] | | | |
| Total assets | 249.1 | 243.6 | 254.3 |
| Total liabilities | 106.6 | 113.5 | 125.7 |
| **Net asset value** | **142.5** | **130.2** | **128.6** |
| **Social security funds** | | | |
| Total assets | 144.8 | 174.1 | 191.1 |
| Total liabilities | 111.4 | 151.7 | 194.4 |
| **Net asset value** | **33.4** | **22.4** | **-3.2** |
| **Other public entities**[2] | | | |
| Total assets | 684.6 | 763.8 | 805.2 |
| Total liabilities | 138.1 | 154.4 | 167.9 |
| **Net asset value** | **546.5** | **609.5** | **637.3** |

Source: National Treasury Budget 2017

1. Institutions listed in schedule 2, 3A and 3B of the PFMA
2. State-owned institutions without a commercial mandate and listed in either schedule 1 or 3 of the PFMA such as the National Library of South Africa

the horizon”, 19th January, see website address below) and the financial health of the SOEs which raise concern. In particular, Eskom’s perceived increased potential for default on its debt has raised concerns. With government providing guarantees for Eskom debt, failure by the utility to roll over, or meet, its debt

Figure 32: Consolidated expenditure by function[1]

| | 2016/17 Outcome | 2017/18 Revised | 2018/19 | 2019/20 Medium term estimates | 2020/21 | Average annual growth 2017/18-2020/21 |
|---|---|---|---|---|---|---|
| **Learning and culture** | **295.3** | **317.8** | **340.7** | **367.3** | **395.7** | **7.6%** |
| Basic education | 216.9 | 230.8 | 249.8 | 267.2 | 286.5 | 7.5% |
| Post-school education and training | 68.7 | 76.7 | 80.1 | 88.8 | 97.0 | 8.2% |
| Arts, sport, recreation and culture | 9.7 | 10.4 | 10.8 | 11.3 | 12.1 | 5.3% |
| **Health** | **176.1** | **189.6** | **204.5** | **220.0** | **235.5** | **7.5%** |
| **Peace and security** | **184.8** | **195.5** | **206.2** | **220.7** | **235.5** | **6.4%** |
| Defence and state security | 47.9 | 49.8 | 51.4 | 54.7 | 58.2 | 5.3% |
| Police services | 86.9 | 93.7 | 100.0 | 106.8 | 114.2 | 6.8% |
| Law courts and prisons | 41.3 | 43.6 | 46.5 | 49.7 | 53.1 | 6.7% |
| Home affairs | 8.7 | 8.4 | 8.3 | 9.5 | 10.0 | 6.1% |
| **Community development** | **181.4** | **193.5** | **210.1** | **226.5** | **243.1** | **7.9%** |
| **Economic development** | **175.9** | **190.9** | **202.2** | **217.7** | **229.9** | **6.4%** |
| Industrialisation and exports | 32.3 | 33.2 | 36.0 | 38.9 | 41.2 | 7.5% |
| Agriculture and rural development | 25.9 | 26.5 | 28.1 | 30.1 | 31.8 | 6.3% |
| Job creation and labour affairs | 17.9 | 20.0 | 21.3 | 22.5 | 23.9 | 6.1% |
| Economic infrastructure and network regulations | 83.3 | 93.7 | 98.7 | 107.1 | 112.6 | 6.3% |
| Innovation, science and technology | 16.6 | 17.5 | 18.1 | 19.2 | 20.4 | 5.2% |
| **General public services** | **60.4** | **62.3** | **64.7** | **67.5** | **71.6** | **4.8%** |
| Executive and legislative organs | 13.1 | 14.8 | 16.2 | 16.9 | 17.7 | 6.1% |
| Public administration and fiscal affairs | 39.5 | 14.8 | 16.2 | 16.9 | 17.7 | 4.8% |
| External affairs | 7.8 | 7.4 | 7.8 | 7.6 | 8.1 | 3.1% |
| **Social development** | **218.2** | **234.2** | **251.2** | **269.0** | **286.9** | **7.0%** |
| Social protection | 165.1 | 178.7 | 192.8 | 207.3 | 221.7 | 7.5% |
| Social security funds | 53.1 | 55.5 | 58.4 | 61.7 | 65.2 | 5.5% |
| **Payments for financial assets** | **7.2** | **19.5** | **5.0** | **5.2** | **5.5** | **-** |
| **Allocated by function** | **1 299.2** | **1 403.3** | **1 484.5** | **1594.0** | **1 703.8** | **6.7%** |
| Debt-service costs | 146.5 | 163.3 | 183.1 | 203.3 | 223.4 | 11.0% |
| Contingency reserve | - | - | 3.0 | 5.0 | 8.0 | - |
| **Consolidated expenditure** | **1 445.7** | **1 566.6** | **1 670.6** | **1 802.3** | **1 935.1** | **7.3%** |

Source: MTBPS October 2017

[1] Consisting of national and provincial departments, social security funds and public entities


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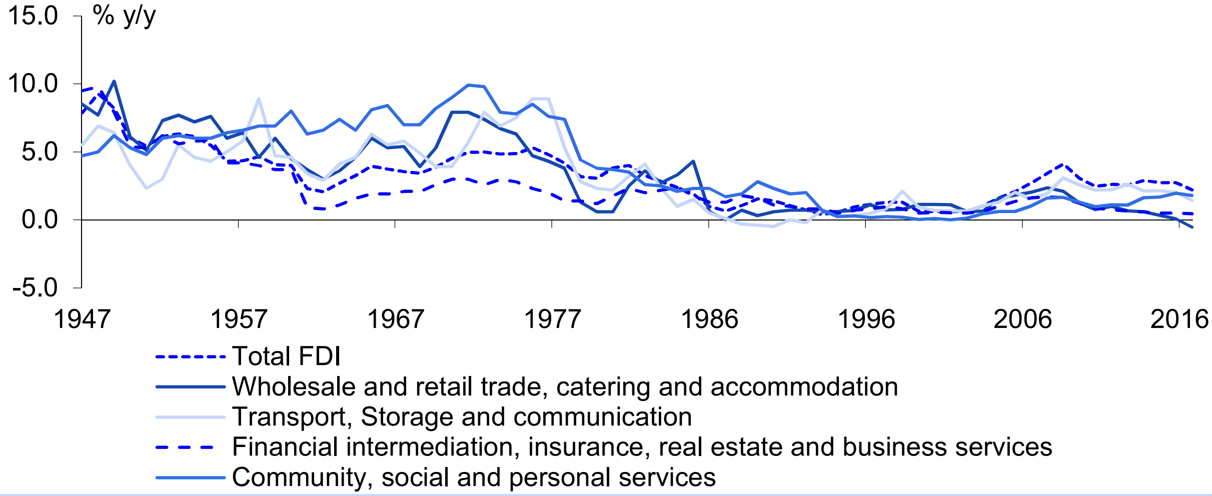
Figure 33: Fixed Capital Stocks - Sectors

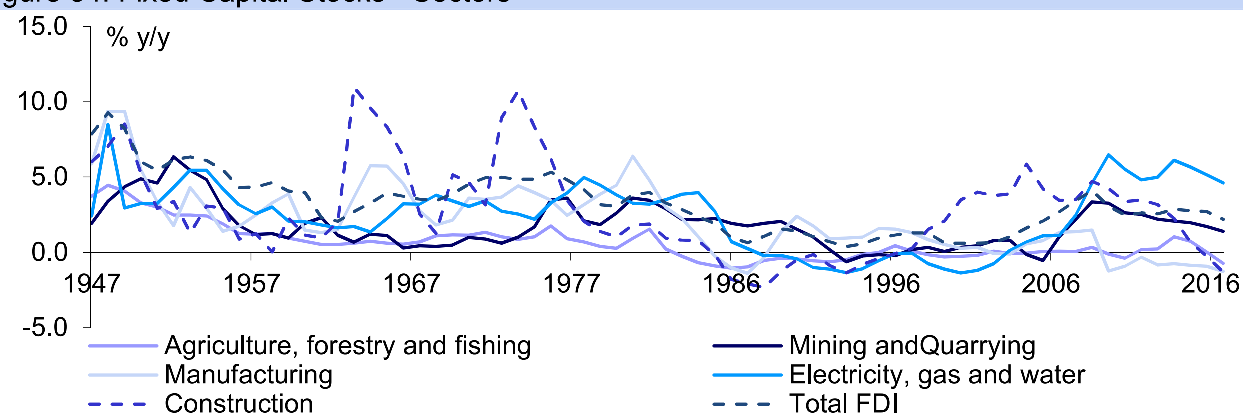



Source: SA Reserve Bank

obligations would mean government is liable. However, SA's public finances cannot repay Eskom's debt without issuing considerably more SA government debt. This would put marked downwards pressure on SA's credit ratings from key agencies S&P, Fitch and Moody's, and so bring SA into the down case of lower sub-investment grade ratings. Indeed, Eskom has seen recent downgrades on its debt following the release of its much delayed financial results. The release of the results avoid its suspension from the JSE.

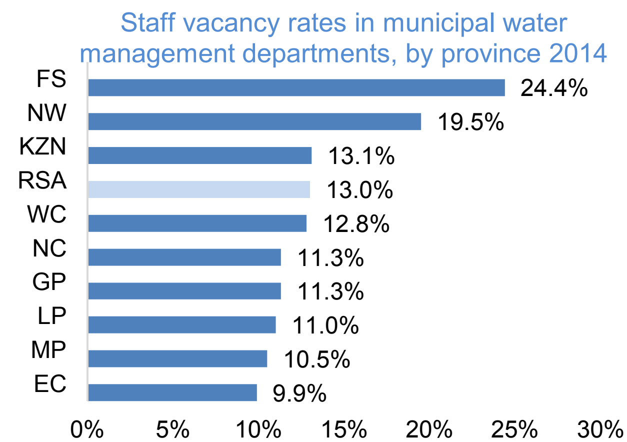
South Africa is classified as a dry country and fast approaching globally unprecedented water restrictions for Cape Town absent considerable rainfall into the catchment areas. These restrictions will require suburbs to need to access water at collection points of a certain literage per day per person, as piped water is turned off. Termed day zero for the start of these emergency water

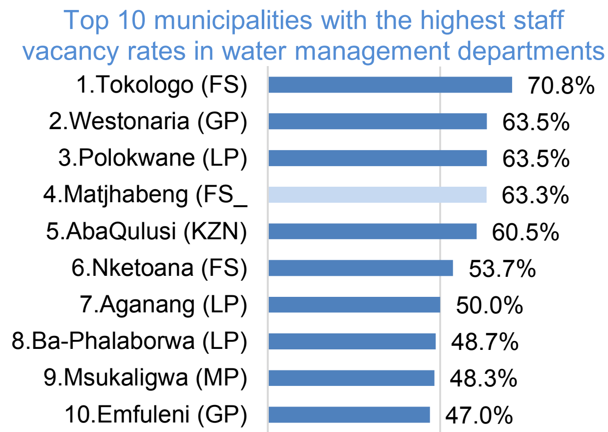
Figure 34: Fixed Capital Stocks - Sectors




Source: SA Reserve Bank

Figure 35: Navigating the water crisis: where do we need the skills?

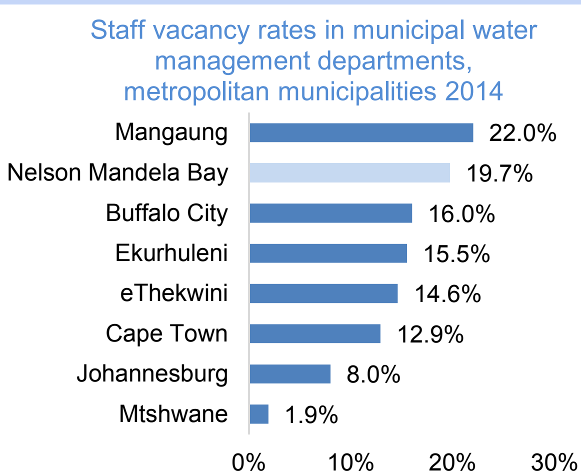


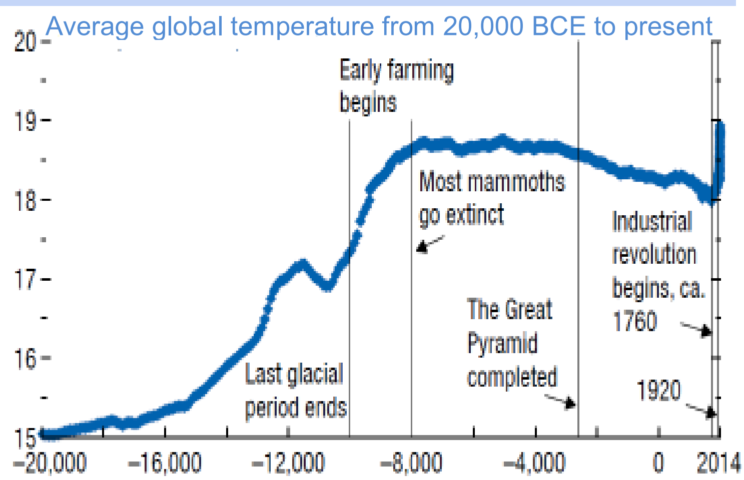




Source: Stats SA, Non-financial census of municipalities, 2014

restrictions, the date has fluctuated but latest calculations have put it at 16th April. The impact on the Western Cape economy, and on SA, clearly will depend on how long these emergency water restrictions last, it is estimated this could be for three months. Should day zero occur, and if weeks turn into months and then years, semigration to the Western Cape would likely slow, semigration out of Cape Town into surrounding areas with less restrictions rise and semigration out of the province to other provinces' economic hubs gather force. This should impact property prices, with first a decrease in residential property price growth in some areas, then should the crises persist, prices could stall and then turn negative in some areas. However, should this worst case scenario occur (years of no precipitation relief) sufficient time should see the Western Cape adapt, as successful economies exist in highly arid conditions. Adaptions and augmentations are expected to kick in longer term to mitigate the negative effects of the drought as well, should it persist (morph into a permanent situation). The IMF highlights that "the speed

Figure 36: Staff vacancy rates in municipal water departments and average global temperature




Source: Stats SA, Non-financial census of municipalities, 2014 and IMF, WEO October 2017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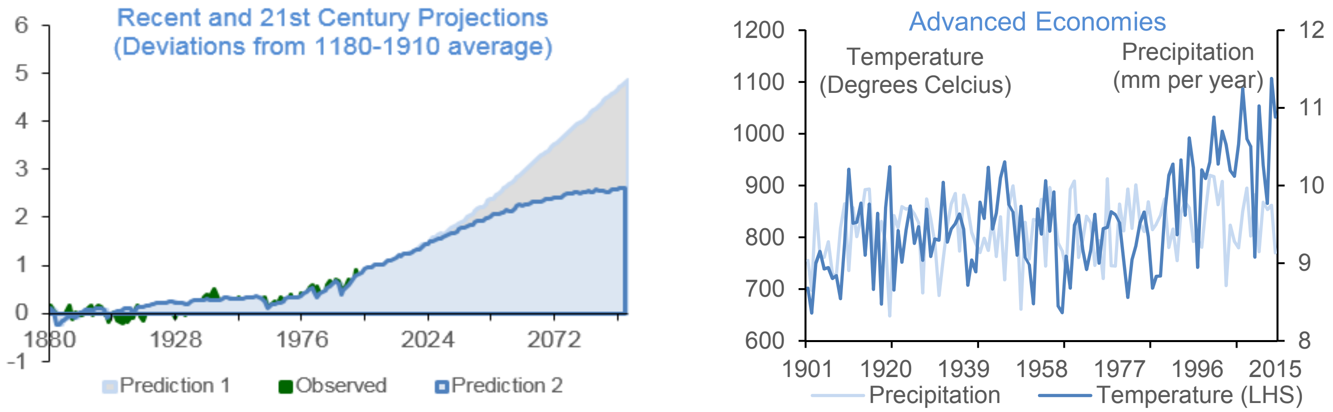
http://www.investec.co.za/research-and-insights/economy/economic-research-v1.html •

Figure 37: Average Global Temperature and Precipitation

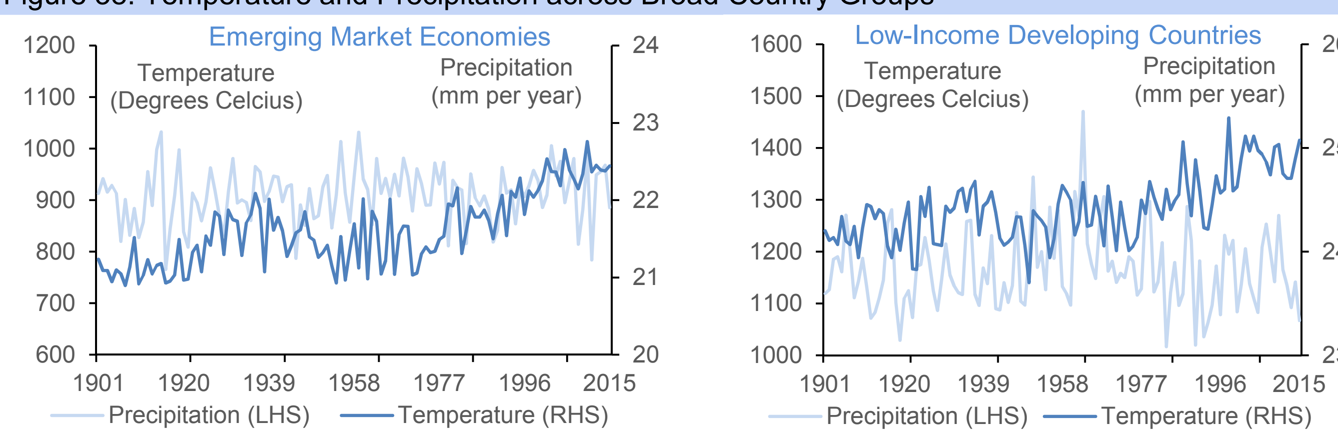



Source: IMF, WEO October 2017

at which the climate has changed over the past 30–40 years appears to be unprecedented in the past 20,000 years. … Most scientists agree that global temperatures are set to rise further, … . Extreme weather events, such as heat waves, droughts, and floods, are likely to become more frequent, and sea levels will rise" … "in countries with relatively hot climates, … a rise in temperature lowers per capita output, in both the short and medium term". Furthermore, "empirical evidence suggests that countries with better-regulated capital markets, higher availability of infrastructure, flexible exchange rates, and more democratic institutions recover somewhat faster from the negative impacts of temperature shocks." "Adaptation strategies that reduce specific climate change effects and risks, such as targeted infrastructure projects, adoption of appropriate technologies, and mechanisms to transfer and share these risks through financial markets, could also be part of the toolkit for reducing the economic damage caused by climate change."

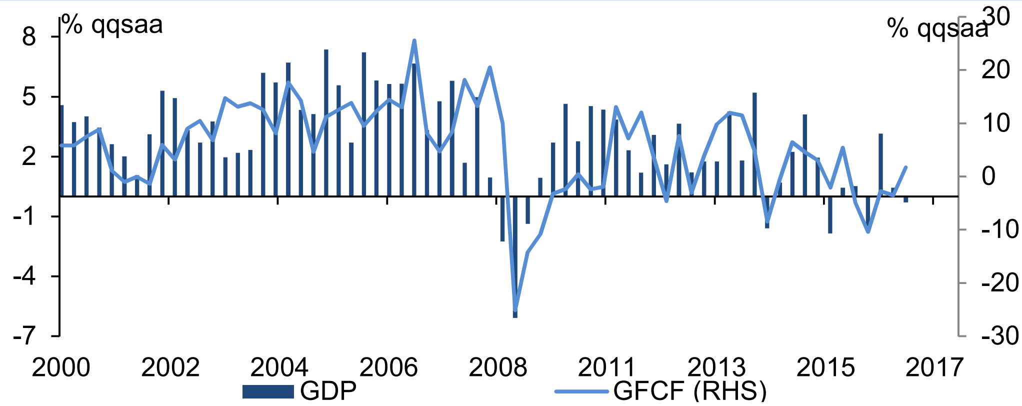
In summary, South Africa could see a better than expected economic growth outcome this year and next, compared to the consensus forecasts published at the start of January, but likely made before the ANC elective conference. The substantial upswing in investor sentiment subsequently could well see both

Figure 38: Temperature and Precipitation across Broad Country Groups




Source: IMF, WEO October 2017

Figure 39: GDP Growth vs GFCF

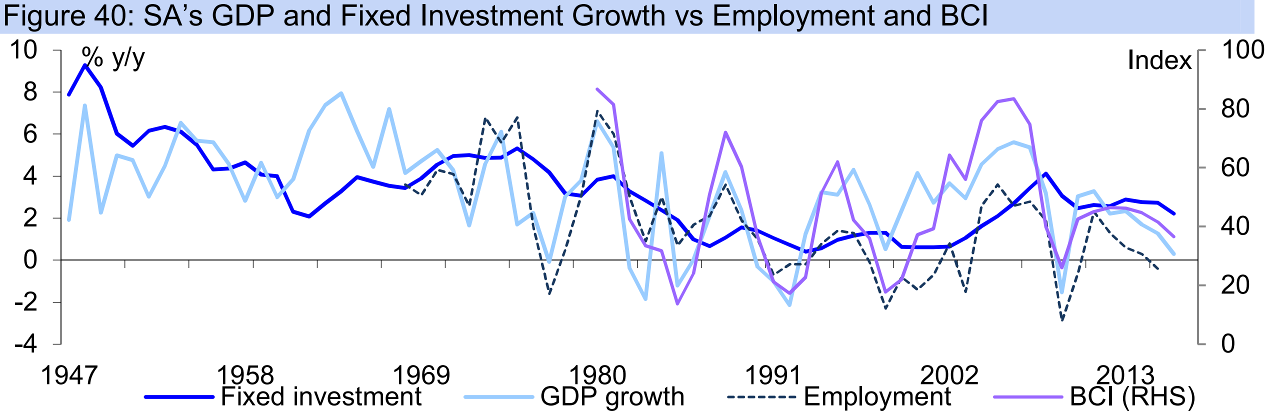



Source: SA Reserve Bank

higher FDI into South Africa, and markedly higher domestic fixed investment growth rates, which would spur economic growth above 2.0% y/y, towards 3.0% y/y, on a more sustainable basis than the drought-recovery-led growth of 2017. While higher commodity prices have given the mining sector some lift, substantial direct investment (both foreign and domestic) would bring both this sector and the manufacturing industry back to life after almost a decade of weak outcomes on high political and policy uncertainty levels.

While South Africa's outlook looks brighter than it did several weeks ago, many hurdles need to be overcome including funding and governance of SOEs other than just Eskom, the extreme expenditure pressure on public finances which has resulted in over borrowing and credit rating downgrades (with SA now facing full sub-investment grade status), the lack of substantial free market, structural reforms and many poor performing government departments. With Cyril Ramaphosa still not president of SA, many of these urgent issues have not received the impetus they need to be resolved despite positive communications from him on these issues. Sustained faster economic growth for SA (from around the 1.0% or less doldrums it has sunk to on an annual basis since 2010 and 2011), will take time, as significant deterioration has occurred in previous key fundamental strengths, but for this repair to take place requires

Figure 40: SA's GDP and Fixed Investment Growth vs Employment and BCI




Source: SA Reserve Bank, BER



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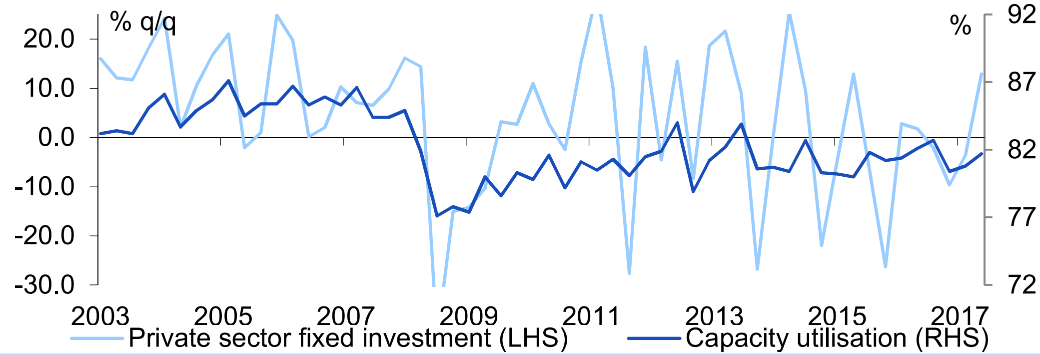
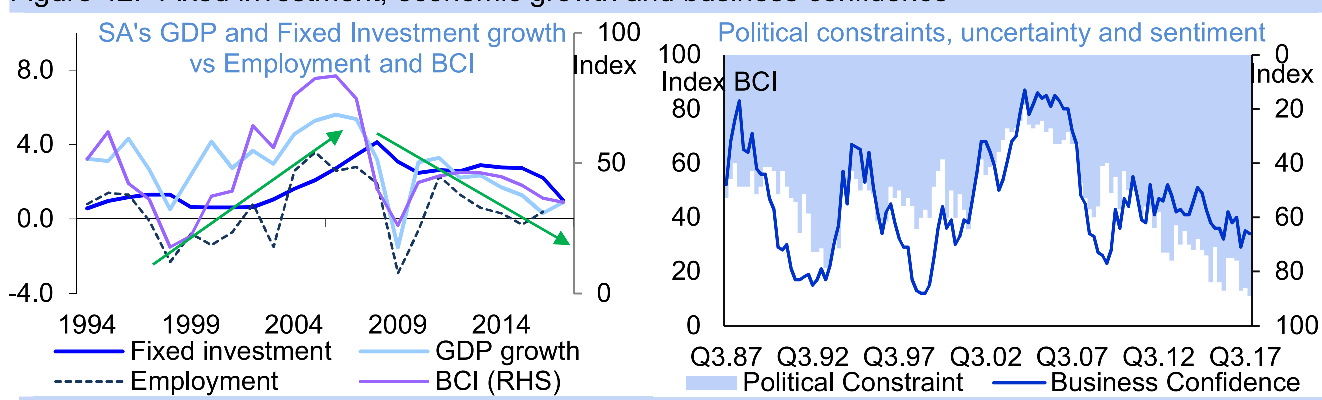
Figure 41: Capacity utilisation vs private sector GFCF




Source: SA Reserve Bank, Stats SA

many more urgent interventions now. Lack of these interventions is what is holding back both domestic and foreign investors from substantial direct investment into South Africa's economy, private sector investment that would generate substantial employment, significantly faster actual and potential economic growth, raise the country's fixed capital stock and GFCF ratio to GDP, and substantially aid in sustainable revenue collection for government, and reduce social tensions. Many of the service delivery strikes are not just about services but rather poor economic prospects on the dimming in the economic growth outlook that has occurred over the past decade. Without government holding up its own side in a growth compact, the urgent interventions are not materialising that are needed into the governance of SOEs (other than Eskom), the extreme expenditure pressure and over borrowing in public finances and credit rating downgrades, the lack of substantial free market, structural reforms and many poor performing government departments. It is a mammoth task but as more of these free market reforms are completed, the economic growth outlook will brighten on growing business and consumer confidence and so more interest will develop from both foreign and local investors to make the much needed high levels of private sector fixed investment into SA. South Africa can regain it's A grade credit ratings, see unemployment drop below 22% and have sustained economic growth above 5.0% y/y again, and repair both its public and SOE finances as it has the capacity to do so, but must now reduce the size of the state substantially, and allow conditions that see the private corporate sector triple in size.

Figure 42: Fixed investment, economic growth and business confidence




Source: SARB, Stats SA, BER

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