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South Africa Economic Outlook

Unlocking Foreign Direct Investment (FDI) as a driver of business and economic development.

What companies can do to increase their attractiveness to foreign investment.

29 April 2024

pwc

Ten key messages from this report.

South Africa Economic Outlook April 2024

1

Foreign direct investment (FDI) can prove instrumental in driving business and economic development, and companies need to remain receptive to the opportunities that it presents. FDI refers to direct investment equity flows, where an investor based in one country acquires at least 10% equity ownership in a company based in another country.

2

Notwithstanding the myriad issues facing the country, many South Africans would be surprised to find that the country has attracted a net inflow (inflows minus outflows) of FDI every year since the global financial crisis. Most recently, in 2023, South Africa recorded FDI inflows amounting to R96.5 billion, equivalent to 1.4% of its GDP.

3

The cumulative value of inward investment stock totalled nearly R3 trillion in 2022. Manufacturing is the industry with the largest investment stock followed by mining and financial services. SA's factory sector is home to production facilities for some of the world's largest producers of vehicles, food products and building materials, amongst others.

4

From a foreign investor perspective, SA's public governance is not dismal by international standards. Research by Bloom Consulting found that non-residents' perceptions of SA's public sector governance is 'moderately positive'. This is consistent with data from the World Bank which places SA near the middle of countries ranked on the quality of governance.

5

According to a 2022 report by Bloom Consulting, non-residents have a 'moderately positive' perception of SA's economy and business ecosystem. This correspond with other inter-national rankings that situate SA in the middle of the range of countries for investment appeal, underscoring SA's strong fundamentals like investor protection and corporate

6

At a company level, the advantages of FDI are easy to comprehend. These include, among many other benefits, expansion of business into new markets, cost reduction through economies of scale (as part of a larger international commercial entity), and skills enhancement of domestic employees through exposure to new technologies.

7

To understand the economic impact of FDI, we modelled the contribution to the SA economy of a R5bn brownfield capex investment in automotive manufacturing. With 68% of this spent locally (and the rest on imports), the investment would create R3.5bn in additional GDP, create and/or sustain 9,000 jobs in the upgrade process, and contribute R673m to the fiscus.

8

Potential foreign investors want prospective investment targets in SA to demonstrate 1) a track record of commercial sustainability across the systemic crises the country has experienced; 2) that they are well positioned to maintain their performance into the future; and 3) they have capabilities that can be exported to solve emerging issues in other territories.

9

Financial due diligence (FDD) provides peace of mind to buyers by analysing and validating the financial, commercial, operational and strategic assumptions being made. It uses past trading experience to form a view of the future maintainable earnings, key value drivers, inherent risks in the business and confirms that there are no 'black holes'.

10

Commercial due diligence (CDD) assesses the historical and forecast assumptions and performance from the perspective of the markets, customers, competitors and internal capabilities of the organisation. The due diligence provides insight of the growth projections used as a basis for the proposed deal.

About this document

It would come as a welcome surprise to many South Africans to learn that, despite the country's many challenges, our economy attracted almost R100 billion in foreign direct investment (FDI) inflows in 2023, equal to 1.4% of GDP. Equally surprising would be data showing that non-residents have a 'moderately positive' impression of the country's business ecosystem and standards of public governance.

FDI can prove instrumental in driving business and economic development. It provides local industries and the economy with capital inflows, expansion of business into new markets, cost reduction through economies of scale, and skills enhancement of domestic employees. At a macroeconomic level, FDI adds to the country's GDP, increases employment and household income, and contributes taxes to the national fiscus.

South African businesses need to be aware of the possibilities that foreign investment offers them. This, in turn, requires enterprises to have available the right financial and other data that potential funders will be looking for when considering an investment. Enterprises need to show resilience to past shocks and robust future growth prospects to create a market for foreign interest.

Key elements of this report include:

- FDI trends: SA continues to receive strong foreign investment inflows, with manufacturing as the most capitalised industry.
- What non-residents think about SA: moderately positive impressions of public governance and the business ecosystem.
- Illustrative example: economic impact simulation of a R5 billion foreign investment in local automotive manufacturing.
- Shine your shoes: what South African companies can do to attract foreign deal interest.

Lastly, we comment on how PwC assists our clients with structuring investment deals and measuring the economic impact of investments.

Macroeconomic forecasts (April 2024)				
Baseline scenario	**2022**	**2023**	**2024f**	**2025f**
ZAR/USD	16.36	18.45	18.90	19.40
Consumer price inflation (%)	6.9	6.0	5.3	4.8
Repo rate (end-of-period)	7.00	8.25	8.00	7.25
Real GDP growth (%)	1.9	0.6	0.9	1.2
Unemployment rate (%)	32.7	32.1	32.5	32.8
Probability weighted average	**2022**	**2023**	**2024f**	**2025f**
ZAR/USD	16.36	18.45	19.05	19.48
Consumer price inflation (%)	6.9	6.0	5.3	4.9
Repo rate (end-of-period)	7.00	8.25	7.98	7.30
Real GDP growth (%)	1.9	0.6	0.9	1.1
Unemployment rate (%)	32.7	32.1	32.5	32.9

FDI can play a significant role in business and economic development in South Africa. It provides local industries and the economy with capital inflows, expansion of business into new markets, cost reduction through economies of scale, and skills enhancement of domestic employees. At a macroeconomic level, FDI adds to the country's GDP, increases employment and household income, and contributes taxes to the national fiscus. South African businesses need to be aware of the possibilities that foreign investment offers them and the country.

Lullu Krugel, PwC South Africa Chief Economist

FDI trends: SA continues to receive foreign investment inflows, with manufacturing the most capitalised industry.

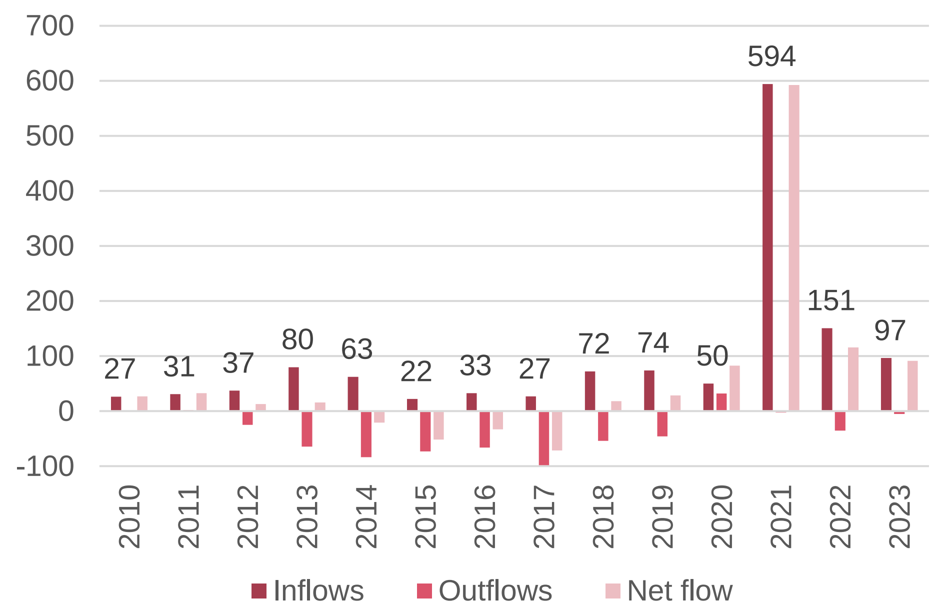
South Africa Economic Outlook April 2024

Summary: Despite its challenges, South Africa has seen a positive net FDI flow every year since the global financial crisis. Most recently, the country recorded FDI inflows of R96.5 billion in 2023, equal to 1.4% of GDP. Manufacturing is the industry with the largest inward investment stock (38.5% of the total stock) followed by mining (24.2%) and financial services (20.0%). Inward investment stock totalled nearly R3 trillion in 2022.

FDI inflows reached R96.5 billion in 2023 despite the country's myriad of economic challenges.

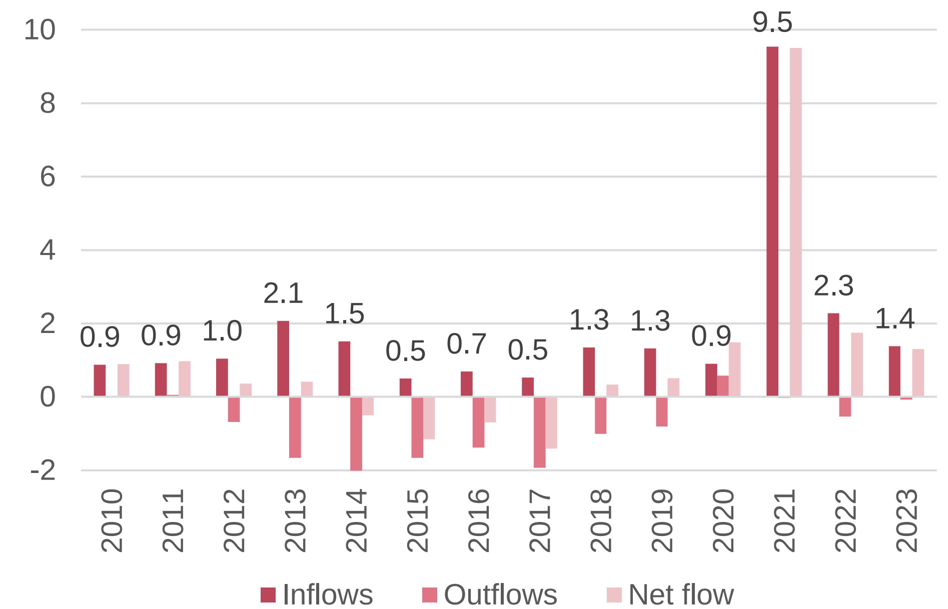
South Africa has seen a net FDI inflow (inflows minus outflows) every year since the global financial crisis. This may come as a surprise to some considering the country's economic challenges and obstacles faced by private business. Many would expect that outflows would overshadow inflows. However, data from the South African Reserve Bank (SARB) shows that the country's net FDI flows averaged R58 billion per annum after the global financial crisis when excluding 2021. The year 2021 was an outlier due to the disruptive effects of COVID-19. In 2021, many of 2020's stalled deals were concluded, while many lockdown-hit companies had to make new strategic deals to keep their doors open.

Figure 1: FDI flows (R billion)



Source: SARB

Figure 2: FDI flows (% of GDP)



Source: SARB

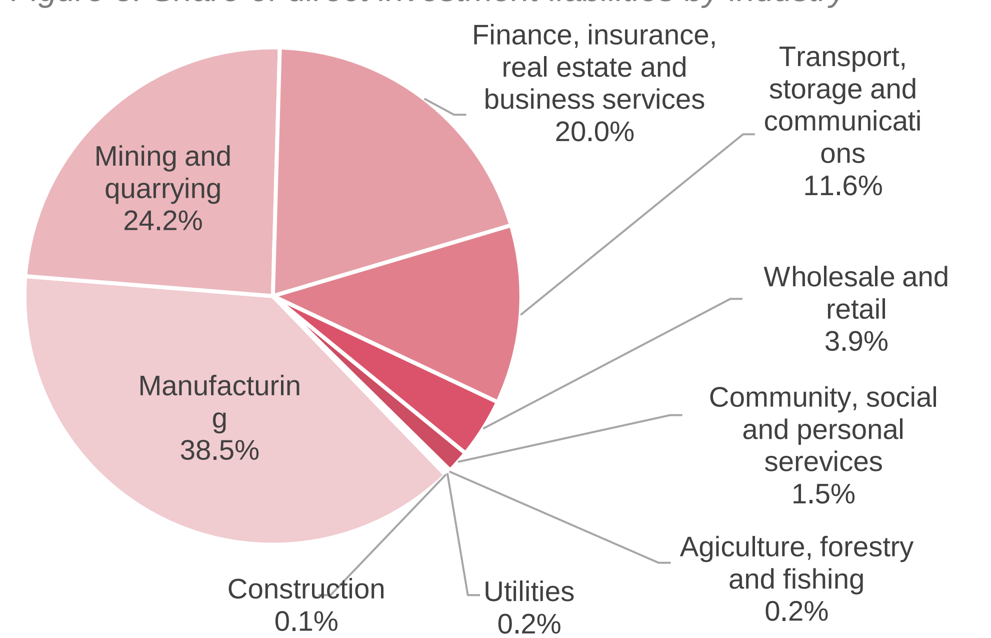
Most recently, South Africa recorded FDI inflows of R96.5 billion (1.4% of GDP) in 2023 and outflows of R5.2 billion (0.1% of GDP), for a net inflow of R91.3 billion (1.3% of GDP).

Manufacturing industry is the biggest FDI target in SA, holding 38.5% of inward foreign investment stock.

Data from the South African Reserve Bank (SARB) shows that the cumulative value of foreign liabilities – including debt instruments, equity and investment fund shares – amounted to nearly R3 trillion in 2022. (Foreign liabilities represent the value of inward foreign investment stock and refer to the liabilities or obligations of the domestic company to its international investor.) In terms of the industries that received this investment:

- Manufacturing is the industry with the largest (38.5%) foreign liabilities (inward investment stock). South Africa is home to production facilities owned by some of the world's largest producers of vehicles, food products and building materials, amongst others.
- Mining and quarrying has the second-largest inward FDI stock (24.2% of total) which is not surprising when considering the country's 170-year history in this industry. South Africa is currently the world's largest exporter of platinum group metals (PGMs).
- Financial services is the industry with the third-largest stock of inward FDI (20.0% of total). South Africa is home to some of the largest banks and insurance firms on the continent, and relies on its globally competitive financial services industry as a positive attribute to attract FDI in other industries.

Figure 3: Share of direct investment liabilities by industry



Source: SARB

What non-residents think about SA: Moderately positive impressions of public governance and business ecosystem.

South Africa Economic Outlook April 2024

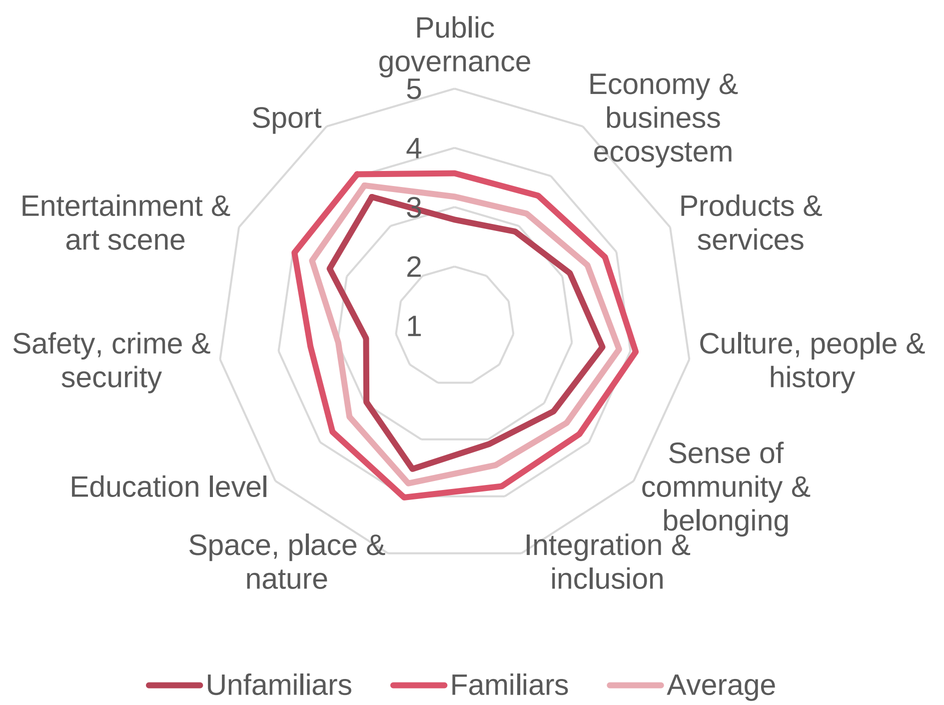
Summary: The perception amongst non-residents of SA's public governance and business ecosystem are 'moderately positive', according to research by Bloom Consulting. The opinion-based assessment is in line with international indices showing that SA's performance in these two important areas for foreign investors are near the middle of the pack when countries are ranked – and not as dismal as some South Africans might think.

Public sector governance is ranked near the middle of the pack - and not as dismal as some South Africans might think.

In mid-2022, nation branding experts Bloom Consulting published an analysis of South Africa's international reputation, based on the perceptions of non-residents. This is the most recent comprehensive review of perception amongst non-residents about South Africa based on diverse factors, including the economy and business sector. Bloom Consulting surveyed the views of people familiar with the country as well as those who are unfamiliar with it. On all the metrics considered, those familiar with South Africa had a better opinion about the country compared to those who were not familiar with the country. Figure 4 reflects the quantification for each attribute, scored between one and five. The results are 'moderately positive' amongst those who are unfamiliar (with an average score of 3.1 across categories) and can be considered close to 'positive' amongst those who are familiar (3.8).

From an FDI perspective, two key considerations that would strongly inform investment decisions are the quality of public governance as well as the nature of the economy and business ecosystem. South Africa has challenges regarding public governance and service delivery. (See the January and March 2024 editions of this report for elaboration on this point.) While South Africans generally have a negative perspective on the trend in the quality of public governance, and while the trend on the majority of its data tracked by the World Bank's Worldwide

Figure 4: Non-residents' perceptions about South Africa



Source: Bloom Consulting

1 = extremely negative, 2 = negative, 3 = moderately positive, 4 = positive, 5 = extremely positive

Governance Indicators (WGIs) has certainly been negative of late, we need to emphasise the positive news as well: South Africa's scores on the WGI metrics are not dismal as many South Africans would think. The country's average percentile rank across the six indicators is 47; this indicates that South Africa is near the middle of all countries considered, with 0 representing the lowest rank and 100 the highest rank. In other words, the World Bank's quantification of South Africa's public governance quality is similar to that found by Bloom Consulting: a 'moderately positive' view. The perception assessment places the country near the middle of the data range (between one and five) with an average score of 3.2 between those familiar and unfamiliar. This is close to the level of 3.0 considered 'moderately positive'.

South Africans have high expectations of public service delivery because we are a strong democracy. This feature should support quality public services. Because the country has seen an extended period of deterioration in some key institutional metrics, South Africans all too often view the country as severely underperforming in comparison to what they think many countries in the rest of the world are getting right. However, the WGIs show a middle-of-the-pack performance rather than something more dismal. And foreign investors have a 'moderately positive' view as well, which is consistent with the country's performance on the WGIs.

Positive business environment attributes support continued interest in South Africa as an investment destination.

The January and March 2024 editions of this report also highlighted some of South Africa's biggest challenges to a thriving economy and business ecosystem. These negative points most often overshadow the positive attributes of South Africa's economy and business ecosystem. Positives include world-class financial services and communication industries, a deep capital market, quality tertiary institutions producing graduates with internationally-comparable qualifications, abundant natural resources (including renewables), a strategic geographical location for entry into the rest of Sub-Saharan Africa, a transparent legal system, and a certain degree of political and policy stability, among many other features.

On the international stage, these positive attributes contribute to continued interest in South Africa as an investment destination. This is also reflected in international investment attractiveness rankings. For example, the Venture Capital & Private Equity Country Attractiveness Index produced by the IESE Business School places South Africa 66th out of 125 countries in 2023, placing us in the company of Malta, Croatia and Slovakia. South Africa is again ranked near the middle of the pack, similar to its performance in public governance. This aligns with the 'moderately positive' outcome found by Bloom Consulting, with an average score of 3.3 for this indicator.

Despite its challenges, the South African economy is more diversified and stable compared to many other African economies. The country has a very strong financial services and deep capital market, which is more sophisticated than most markets in Africa. South Africa's banking industry offers clients access to a comprehensive suite of financial instruments and services alongside a robust banking regulatory framework that ensures the safety and soundness of financial institutions and their clients.

Olusegun Zaccheaus, PwC West Africa Strategy& Leader

Illustrative example: Economic impact of a R5 billion foreign investment in local automotive manufacturing.

South Africa Economic Outlook April 2024

Summary: To understand the economic impact of FDI, we modelled the contribution to the economy of a simulated R5.0 billion brownfield capex investment in a local automotive manufacturing facility. Investing this money in the upgrade of an existing plant – with 58% spent locally – would create R3.5 billion in additional national GDP, create and/or sustain 9,000 jobs during the upgrade process, and contribute R673 million to the fiscus.

Upgrading a vehicle manufacturing facility would create and/or support 9,000 jobs during the retooling phase.

What would the broader economic impact be of a large foreign investment transaction? There are many variables around such a transaction and many potential outcomes. To simulate what the impact of a specific investment could look like, we considered the possible economic impact of a R5.0 billion investment worth of offshore-funded capital expenditure (capex) in the vehicle manufacturing sector. (There have been several capex investments of this scale announced by the local vehicle manufacturing industry in the past several years.) We conducted an Economic Impact Assessment (EIA)– based on the share of the R5.0 billion spent locally – using the Social Accounting Matrix (SAM) methodology to estimate how the capex would affect the South African economy. This impact simulation tool is useful for quantifying the economic impact of a specific investment. Around the world, firms are using information of this kind to increase transparency about proposed projects.

In our simulation, we consider the different economic impacts of both greenfield and brownfield investments. Greenfield refers to the construction of a new facility while brownfield refers to the upgrade or retooling of an existing facility. In our automotive example, this would refer to the construction of a new manufacturing facility and the upgrade of an existing facility to produce a new model line, respectively. Table 1 lists our assumptions of how the R5.0 billion investment is spent under these two conditions, both in terms of what assets are being acquired as well as whether the money is spent locally or abroad (for imported goods). Overall, for a greenfield investment, we estimate 68% of the total investment to be spent locally, with the rest spent on imported items like vehicle production machinery. For a brownfield investment, the local content is estimated at 58%, with a larger share of the overall spend going to importing capital equipment and high-tech machinery created specifically for the production of vehicles.

Table 1: Allocation of automotive manufacturing investment by asset class

	Asset	Share of total capex spending		Share of asset spend at local suppliers (vs. imports)	
Greenfield	Land and buildings	R2.25 bn	45%	R2.50 bn	100%
Greenfield	Plant and machinery	R2.50 bn	50%	R1.00 bn	40%
Greenfield	Other assets	R0.25 bn	5%	R0.14 bn	55%
Greenfield	Total	R5.00 bn	100%	R3.39 bn	68%
Brownfield	Land and buildings	R1.25 bn	25%	R1.23 bn	98%
Brownfield	Plant and machinery	R3.50 bn	75%	R1.47 bn	42%
Brownfield	Other assets	R0.25 bn	5%	R0.14 bn	55%
Brownfield	Total	R5.00 bn	100%	R2.83 bn	58%

Source: PwC

Using our SAM model for South Africa, we have estimated the impact of these investments on GDP, employment, household income and taxes. As reflected in Table 2, the local greenfield investment of R3.4 billion would add R4.5 billion to national GDP, create and/or sustain 12,600 jobs during the construction process, and contribute R876 million to the national fiscus. In contrast, the local brownfield investment of R2.8 billion would add R3.5 billion to national GDP, create and/or sustain 9,000 jobs during the upgrade process, and contribute R673 million to the national fiscus. The GDP generated and the employment created and/or sustained by these investments are computed based on three impacts, namely direct, indirect and induced. Direct employment refers to jobs on the construction site; indirect employment are jobs created and/or supported from the procurement of inputs from suppliers; and induced employment are supported through the money spent on goods and services by those directly and indirectly employed due to this investment.

Table 2: Domestic economic impact of R5.0 billion investment in automotive manufacturing

Greenfield (68% of R5 bn spent locally)	Direct impact	Indirect impact	Induced impact	Total impact
GDP	R2.58 bn	R0.61 bn	R1.31 bn	R4.50 bn
Employment	8,200	1,500	2,900	12,600
Skilled jobs	*1,600*	*400*	*700*	*2,700*
Semi-skilled jobs	*3,700*	*600*	*1,200*	*5,500*
Unskilled jobs	*2,900*	*500*	*1,000*	*4,400*
Household income				R2.41 bn
Taxes				R0.88 bn
Brownfield (58% of R5 bn spent locally)	**Direct impact**	**Indirect impact**	**Induced impact**	**Total impact**
GDP	R1.97 bn	R0.54 bn	R0.99 bn	R3.50 bn
Employment	5,300	1,500	2,200	9,000
Skilled jobs	*1,100*	*400*	*500*	*2,000*
Semi-skilled jobs	*2,500*	*600*	*900*	*4,000*
Unskilled jobs	*1,700*	*500*	*800*	*3,000*
Household income				R1.82 bn
Taxes				R0.67 bn

Source: PwC

Shine your shoes: What South African companies can do to attract foreign deal interest.

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Summary: Companies can use information provided by Vendor Due Diligence (VDD) to make important data available to potential investors. To attract FDI interest, SA companies need to show 1) a track record of commercial sustainability across the systemic crises the country has experienced; 2) that they are well positioned to maintain their performance into the future; and 3) they have capabilities that can be exported to other territories.

Vendor Due Diligence (VDD) allows a seller to get the right information ready to attract potential foreign investors.

If a company is in search of foreign investment, it is customary to enlist the expertise of a financial or deal advisor to help facilitate the process. The financial advisor is tasked with compiling a preliminary investment memorandum, which serves to familiarise potential international buyers with the fundamental aspects of the business. During this sell-side phase, the company seeking the investment can undertake a Vendor Due Diligence (VDD). This is an independent and comprehensive assessment of the business – encompassing its performance and prospects – that provides comfort to both the seller and potential buyers. VDD specialists work alongside company management and other advisers to ensure opportunities and issues are understood and the correct steps are taken to address these.

The VDD approach also gives the seller greater control over the process and eliminates the need for the buyer to conduct their own due diligence, thereby expediting the overall investment timeline. Note, however, that this approach will result in considerable costs for the seller. Most often, the prospective buyer is responsible for due diligence processes and costs, including financial and commercial due diligence.

We are of the view that potential foreign investors are looking for three specific things from prospective investment targets in South Africa:

1. Demonstrate a track record of commercial sustainability across all of the systemic crises the country has experienced over the last 30 years.

Financial due diligence (FDD) provides peace of mind to both corporate and financial buyers, by analysing and validating the financial, commercial, operational and strategic assumptions being made. It uses past trading experience to form a view of the future maintainable earnings, key value drivers, inherent risks in the business and confirms that there are no 'black holes'. Deals experts look at the following when conducting an FDD:

- Assess the business relative to buyer's economic and operational objectives, and the assumptions underpinning the deal.
- Provide greater certainty over the nature of the business, inherent risks and the characteristics of the cash flows generated by the business.
- Help inform pricing decisions and the level of gearing the structure will support.
- Help add credibility to the facts, figures and information provided by the seller and in the sales memorandum, in order to support negotiations.
- Identify value critical issues and financial risks.

2. Demonstrate that they are well positioned to maintain their performance/growth into the future. That means having relevance in a growth industry underpinned by strong fundamentals.

Commercial due diligence (CDD) assesses the historical and forecast assumptions and performance from the perspective of the markets, customers, competitors and internal capabilities of the organisation. The due diligence provides insight of the growth projections used as a basis for the proposed deal. Deals experts assist with the following when conducting a CDD:

- Establish commercial assumptions underpinning the deal.
- Provide greater certainty over the nature of the economy, industry, markets, the customer base and competitors.
- Help inform pricing decisions by gaining better insight into the markets and competitive landscape.
- Help add credibility to the commercial and market assumptions provided by the seller in the sales memorandum.
- Identify value critical issues and market risks and assumptions.
- Inform on effective environmental, social and governance (ESG) risk mitigation and value creation opportunities.

The fundamentals that underpin future performance can be strengthened by the company conducting a presale checkup and taking corrective actions where needed. The checkup is a diagnostic overview undertaken before the CDD that pinpoints the areas to prepare for sale. This checkup asks questions such as: are information systems robust enough? How strong is the management team – and how capable is it of running the business without the owner? What is the status of company assets? What's the situation regarding relationships with customers? What improvements can be made that a new buyer will appreciate and want to pay a premium for? Corrective actions can be wide-ranging, including making sure audited financial statements are easily at hand; shoring up accounting systems; improving the quality of financial reporting; paying attention to contracts with customers, suppliers, and employees; and securing and/or protecting the rights to the company's intellectual property. Particular complexity, hidden opportunities, and risks surround human resources issues, and tax considerations. If a sale to an international buyer is a possibility, the ability to demonstrate a preparedness to cope with foreign legislation may also assist to maximise value.

3. Demonstrate capabilities that can be exported to solve emerging issues in other territories.

For many companies doing a deal is the best, or only way, of tapping into growth markets, largely because it is faster than going-it-alone. Deals in growth markets are not just about low-cost manufacturing, access to natural resources, or market access to basic products. Doing a deal in a growth market can also provide buyers with access to best practice in core operations, innovation capabilities and capital. Akin to participants in the Dragons' Den show, the seller needs to show differentiated capabilities that makes their business model, goods or services attractive for deployment in other markets. Strategic buyers often emerge from the same industry and seek a good fit in this regard with some aspect of the seller's business. If the buyer is strategic, adoption of the right mind-set often means understanding the benefits and costs of integration, including the potential opportunities, inherent sales and distribution channel synergies, purchasing power increases, production and administrative efficiencies, working capital improvements, and more.

Economics services and contacts.

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How we can help.

- **Deals due diligence** - Our Deals division provides comprehensive commercial, financial, economic and strategic advice to companies facing significant business growth opportunities. We have developed a reputation for excellent advice, strong relationships and high levels of independence. These attributes, coupled with a vast range of experience, have made PwC Deals a key corporate adviser in the South African market, and our position has been reinforced through the completion of key local and cross-border deals. (See case studies here.) We assist companies involved in acquisitions, divestitures, strategic alliances and access to local and global capital markets. Our services include financial due diligence (buy side), vendor due diligence, vendor assistance, commercial due diligence, sale and purchase agreement advice, capital markets, bid support and defence, deal strategy, delivering deal value and merger & acquisition tax.
- **Economic impact assessment** - Our economists have deep technical expertise and experience applying rigorous economic research methods. We have supported many of the country's largest firms to understand the wider socio-economic impact of their activities. To estimate the economic impact of a business or investment decision, our experts conduct an Economic Impact Assessment (EIA). We use the Social Accounting Matrix (SAM) methodology for the relevant country to estimate how specific business activities could affect other sectors of the economy. The approach details the economic linkages within the economy and show the direct, indirect and induced effects of a specific flow of money on, for example, GDP, taxes, employment and household income. The practical results of this estimation is evidenced in the quantification of our firm's economic impact here.

Our services

The PwC South Africa Strategy& Economics team is a specialised unit of economists who serve our clients in a variety of ways. Our services include:

Measure your impact on the economy and society

- Economic Impact Assessment (EIA)
- Socio-Economic Impact Assessment (SEIA)
- Regulatory Impact Analysis (RIA)
- Environmental, Social and Governance (ESG)
- Total tax contribution
- Localisation calculations

Make decisions about risk and investment

- Macroeconomic research
- Market entry analysis
- Country and industry risk assessments
- Commercial due diligence assistance

Plan for future economic scenarios

- ESG scenario planning
- Economic and political scenario planning
- Industry and macroeconomic modelling
- IFRS 9 audit assist

Please visit our website to learn more:
https://www.strategyand.pwc.com/a1/en/solutions/purpose-led-economics.html

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