SOUTH AFRICA RELEASES THE 2008 INTERNATIONAL MONETARY FUND'S ARTICLE IV REPORT AND FINANCIAL SYSTEM STABILITY ASSESSMENT REPORT

1. The International Monetary Fund (IMF) today released its 2008 Article IV Staff Report on South Africa. This Report is an assessment of South Africa's macroeconomic situation, including developments in the monetary, fiscal and financial sectors of the economy. Article IV consultations are conducted annually for each of the Fund's member countries.

2. The Report comes after the release this year of the Financial System Stability Assessment (FSSA) Report for South Africa by the IMF and World Bank. The FSSA Report was released after a Financial Sector Assessment Programme (FSAP) mission was conducted in April-May 2008, assessing the stability of the country's financial sector. The IMF introduced the FSAP in 1999 to increase efforts toward improving member countries financial systems. A previous FSAP was undertaken in South Africa in 2001.

3. Both reports are broadly supportive of the fiscal, monetary and financial policies of the South African Government, and were positively received by the IMF's Executive Board at its meeting on 8 September 2008.

4. The above reports were compiled after the 2008 National Budget in February, but before the Medium Term Budget Policy Statement (MTBPS) which was tabled yesterday, 21 October 2008. The IMF has updated its projections in October 2008, as published in its World Economic Outlook (WEO). The MTBPS therefore indicates that both the SA government and the IMF are reasonably close in their projections of economic growth, inflation and the current account deficit for 2008 and 2009. A table detailing recent forecasts is included in the annexure.

An annexure is included below, providing an overview of both reports. The full reports are also available on the IMF website, **www.imf.org**, or on the National Treasury website, **www.treasury.gov.za**. Also included is an IMF document known as the Selected Issues Paper (SIP), which is an annexure of the Article IV Report.

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ANNEXURE

1. PROJECTIONS – NATIONAL TREASURY AND IMF

	IMF Art IV	IMF WEO	National Treasury
	Aug-08	Oct-08	Oct-08
2008 forecast			
GDP growth	3.8	3.8	3.7
CPIX inflation, average	11.3		11.6
Current account	-9.0	-8.0	-7.6
2009 forecast			
GDP growth	3.7	3.3	3.0
CPI inflation, average[1]	9.2	8.0	6.2
Current account	-9.6	-8.1	-7.8
2010 forecast			
GDP growth	4.4	4.2	4.0
CPI inflation, average	6.5	5.7	5.3
Current account	-9.5	-8.3	-8.9
2011 forecast			
GDP growth	4.8	4.8	4.3
CPI inflation, average	4.8	5.5	4.7
Current account	-9.3	-8.4	-8.8

1. From 2009, National Treasury's inflation forecasts are based on the new Headline CPI for all urban areas

2. OVERVIEW OF THE 2008 ARTICLE IV REPORT

2.1 The 2008 Article IV Report notes the strong economic progress made by SA in recent years, supported by good macroeconomic management and favourable external conditions. Growth reached a high of 5-5½ percent, inflation was in the mid-single digits, employment grew steadily, public finances were strengthened and the external reserve position improved. Private investment was propped up by strong business confidence and high commodity prices. Household consumption increased on the back of a growing disposable income and wealth effects from rising housing and stock prices.

2.2 Importantly, at a time of global financial instability, the Article IV report agrees with the FSSA Report that SA's financial system is fundamentally sound and well-capitalised. According to Article IV the financial system has shown remarkable resilience through the global financial turmoil. Further, SA's good fundamentals would assist in mitigating the impact of any adverse external shocks on the economy. It cites as an example the country's "low level of external debt (26½ percent of GDP at the end of 2007) 40 percent of which is denominated in rand and gross reserves exceed short term foreign currency debt by a comfortable margin".

2.3 The report states that since the beginning of 2008, the economy has been buffeted by a series of economic shocks. Real GDP growth has slowed down in 2008 having been affected by both domestic conditions and the current global economic environment. The IMF Report projects growth as moderate at 3.8 percent for 2008 and 3.7 percent for 2009. It regards the major risks to the economy and their forecast as power supply constraints, lower demand in partner countries, the cumulative effect on consumption of a tightening monetary policy and elevated debt service burdens among households.

2.4 It highlights that SA has not been immune to the inflationary pressure arising from increases in global food and oil prices. Since breaching the 3 – 6 percent inflation target in April 2007, inflation has continued to rise, but is expected to peak later this year before beginning a downward trajectory.

2.5 The IMF projects the current account deficit at 9 percent of GDP in 2008 and 9.6 percent in 2009, compared to the National Treasury's more optimistic 2008 budget forecast of 7-8 percent of GDP. The rising current account deficit and inflation pose a critical challenge in the period ahead if we want to continue to accelerate growth and spur job creation. It supports current policy by the SARB and National Treasury to build up of reserves when market conditions are favourable.

2.6 The IMF also supports SA's flexible exchange rate system and shares the view that the floating exchange rate provides an important buffer against external risks. It notes that the rand is a volatile currency reflecting the relatively high proportion of offshore trading. The IMF is supportive of the South African authorities' view that it is counterproductive to influence the level of the real exchange rate through intervention.

3. The Financial System Stability Assessment Report

3.1 The separate FSAP update mission met with financial regulators, including the Bank Supervision Department in the SA Reserve Bank, the Financial Services Board, the Johannesburg Stock Exchange and Bond Exchange of SA, the National Credit Regulator, all the major financial institutions like banks and life insurance companies, and National Treasury officials. It conducted stress tests on the major banks and life insurance companies, and an IOSCO assessment of securities markets.

3.2 The report concludes that "South Africa's sophisticated financial system is fundamentally sound", and that the system is "diversified and spans a broad range of activities that are supported by an elaborate legal and financial infrastructure and a generally effective regulatory framework". It notes that the regulatory framework for banks has been reinforced with the implementation of Basel II on 1 January 2008. The banking system is not significantly exposed to sub-prime related products in the United States. For the aforementioned reasons, the South African financial system has weathered the global financial turmoil reasonably well.

3.3 The IMF staff state in the report that further liberalisation in the exchange control system “would be challenging in the light of the volatility of financial markets, heavy reliance on portfolio inflows, and corporate deposits in the banking system”. It recommends that the “authorities should continue with the cautious approach to the liberalisation of exchange controls, and prepare banks for the necessary diversification of their funding base”.

3.4 The National Treasury, SARB and financial regulators regard the FSSA report as very positive and complimentary. The National Treasury will work with the SARB and financial regulators, as well as financial institutions, to consider the recommendations made by the FSSA, and how or to what extent they can be implemented.