national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

MEDIA RELEASE: THE INTERNATIONAL MONETARY FUND STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION WITH SOUTH AFRICA

The International Monetary Fund (IMF) today released its Staff Report for the 2011 Article IV Consultation with South Africa. This report is an assessment of South Africa's macroeconomic conditions, including developments in the monetary, fiscal and financial sectors of the economy.

The IMF conducts regular consultations with its member countries to discuss the national and international consequences of their economic and financial policies, to fulfill its global economic and financial surveillance objectives as required under Article IV of its Articles of Agreement. This includes engaging the country's authorities and other stakeholders on recent economic developments and the country's economic outlook.

The IMF Staff Mission undertook the Article IV Consultation with South Africa on 25 May-7June 2011. The Cabinet of South Africa considered the report compiled by the IMF Staff Mission on 24 August 2011.

IMF comments

The IMF report forecasts that the South African economy will grow by 4 per cent in 2011 and 4.2 per cent in 2012. This is above the latest growth forecast by the South African Reserve Bank which sees the economy expanding by 3.7 per cent in 2011, and the National Treasury's February Budget forecast of 3.4 per cent.
The IMF sees the output gap closing by early 2012, two years earlier than it had forecast at the time of the 2010 Article IV consultation.

The report views South Africa's economic recovery as uneven, with downside risks to their forecast. These are primarily external, and are evident in the recent global economic events. The close economic ties between South Africa and advanced economies, particularly core euro zone countries, is a central concern given the sluggish recovery and continuing sovereign debt concerns.

On the domestic side, the IMF identifies high household debt as a restraining factor to household consumption, which has been a principal driver of growth during the recovery.

The prudent and countercyclical fiscal and monetary policies implemented by the Government of South Africa were commended in the report. These policies were effective in building buffers during the upswing that buttressed domestic demand during the global financial crisis and domestic recession.

The report also welcomed the explicit fiscal guidelines to inform future fiscal policy formulation as outlined by the Minister of Finance in the 2011 Budget Speech. Given the IMF staff estimates of the output gap, the report recommends a tighter fiscal stance than is currently envisaged over the medium term. It raises concerns about the marked increase in the government wage bill and argues for a rebalancing in the composition of spending towards raising potential growth and enhancing public service delivery.

In terms of monetary policy, the report suggests that uncertainties about the economic outlook support a delay in monetary tightening until there is clear evidence of a pronounced increase in core inflation. On the management of capital inflows, the IMF report encourages the market-based exchange rate system, but notes that South Africa faces persistent competitiveness problems reflected in, among others, the poor performance of export volumes during the recovery. The report acknowledges the low interest rate environment in advanced economies as one contributory factor to appreciation pressures and attributes the competitiveness problem equally to rising labour and other domestic costs of production.

With competitiveness as a concern, rather than an overheating economy, the IMF suggests that capital flow measures such as controls are unlikely to help much, noting that the implications for government financing are likely to be significant while any benefits are likely to be transitory. As such, the IMF recommends exchange rate flexibility, further reserve accumulation and a gradual recalibration of the fiscal-monetary mix as constituting the most practical response to capital inflows in South Africa. The report concludes that gains in long-term competitiveness can only occur from reforms that control the domestic cost of production.

The IMF endorses government’s focus on job creation and agrees that much faster economic growth is required to achieve the jobs targets outlined in the New Growth

Path. The IMF staff estimates that sustained growth rate of 6-7 per cent a year is needed. Within the context of a more moderate annual growth outlook of 4 per cent, reforms to raise the labour intensity of growth are essential. Further, the IMF highlights the need for broad-based reforms to strengthen competition and competitiveness including more aggressive efforts to attract new entrants into key network industries, moderating economy real wage growth and addressing structural factors behind unemployment.

The report commends the strength and resilience of South African banks and is positive about national improvements in financial regulation and supervision, and in particular, the move toward the 'twin peaks' regulatory and supervisory framework. The stability of South Africa's financial sector remains a pillar of strength in today's uncertain global environment and will be important through the current turmoil affecting financial markets.

The report also notes South Africa's ambition towards greater regional integration and recognises the impact of the financial crisis on the SACU revenue pool and the revenue and budget implications that this has had for a number of countries, particularly Swaziland.

View of the South African government

The South African government welcomes engagement opportunities with institutions such as the IMF, as well as others like the Organisation for Economic Cooperation and Development (OECD), and the World Bank. These organisations are important as independent evaluators of government's economic policies.

Though the government does not share all the views expressed in the IMF report, the report is a fair assessment of the economic conditions in South Africa, and will be considered, together with other similar assessments, during policy formulation by the government.

Many of the issues raised by the IMF report are already reflected in the priorities and outcomes that government has set itself, including work on inclusive growth, policies aimed at accelerating job creation and measures to improve the efficiency and effectiveness of government spending.

National Treasury continues to view the conservative fiscal consolidation path outlined at the time of the Budget as appropriate for the South African economy. The Budget macroeconomic forecast sees the output gap closing at the beginning of 2014, two years later than in the IMF report, largely as a result of differences in growth forecasts and estimates of the economy's maximum rate of growth.

Government will update its macroeconomic forecasts on 25 October 2011 when the Minister of Finance tables the 2011 Medium Term Budget Policy statement.

A copy of the full Staff Report can be downloaded from the International Monetary Fund website (www.imf.org) or the National Treasury website (www.treasury.gov.za).

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