INTERNATIONAL MONETARY FUND

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SOUTH AFRICA

January 2020

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SOUTH AFRICA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with South Africa, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 24, 2020 consideration of the staff report that concluded the Article IV consultation with South Africa.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 24, 2020, following discussions that ended on November 21, 2019, with the officials of South Africa on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 9, 2020.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for South Africa.

The documents listed below have been or will be separately released.

Selected Issues

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 20/23
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January 30, 2020

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with South Africa

On January 24, 2020, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with South Africa.

Given structural impediments to growth, South Africa's economic performance remains subdued, and risks are materializing. Weak private investment and productivity growth have dampened economic activity to levels insufficient to raise per-capita income and foster greater social inclusion. While the sophisticated services sector has been growing, most other sectors have been stagnant or contracting. South Africa thus remains an extremely unequal society, with high and rising unemployment (29 percent), particularly among the youth. Inflation is estimated to have moderated in 2019 to below the midpoint of the inflation target range, aided by one-off factors. The current account deficit is relatively wide and largely financed by non-FDI inflows. Banks are sound, albeit with pockets of vulnerabilities.

Fiscal deficits have been persistently large due to continued high expenditure despite weakening revenue performance and state-owned enterprise (SOE) bailouts. The government deficit is projected to reach 6½ percent of GDP in FY19/20, resulting in significant debt accumulation—projected to exceed 60 percent of GDP in FY19/20—and leaving South Africa with no fiscal space. Weaknesses in public enterprises are resulting in poor service delivery and weighing on the fiscus through bailouts or administrative interventions. An earlier monetary policy tightening was unwound in mid-2019 following inflation moderation, and the policy rate has remained unchanged since.

Policymakers have taken initial steps to advance reforms and streamline regulations with the purpose of reigniting growth and fostering greater social inclusion. The Medium-Term Budget Policy Statement (MTBPS) released in October proposed savings from a rationalization of spending in goods and services to partially offset large bailouts to the electricity company Eskom, but projects increasing government debt that does not stabilize.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

On current policies, staff projects a lackluster growth recovery from an estimated 0.4 percent in 2019 to 0.8 percent in 2020 and 1.5 percent in the outer years. Inflation is projected to rebound in 2020 (from an estimated 4.2 percent in 2019) before easing to slightly below 5 percent in the medium term. The current account deficit is expected to widen to around 4 percent of GDP over the medium term. The outlook is subject to risks derived from further delays in adjustment and reform or changes in investors' appetite for emerging markets.

Executive Board Assessment[2]

Directors commended South Africa's monetary framework, anchored on a credible inflation targeting regime, flexible exchange rate system, and highly developed financial system. Notwithstanding these buffers, Directors noted that South Africa is in a difficult situation, given subdued growth, rising debt, and high poverty and unemployment rates. In that context, they encouraged the authorities to implement strong fiscal consolidation and SOE reforms to ensure debt sustainability, accompanied by decisive structural reform measures to boost private-sector led, inclusive growth.

With public debt on the rise, Directors encouraged the authorities to focus on maintaining medium term debt sustainability, through a growth friendly and expenditure based fiscal consolidation. Noting that the upcoming budget discussion provides an opportunity for the authorities to undertake necessary reforms, Directors suggested reductions in the public wage bill and fiscal contingencies from SOEs, coupled with improved tax administration and compliance. Directors also highlighted the importance of protecting priority pro poor social spending and making education and health spending more efficient given high poverty and unemployment rates. They also supported introducing a debt anchor to the fiscal framework and institutionalizing periodic spending reviews.

Directors were concerned with the risks emanating from SOEs, especially from the electricity company Eskom, and emphasized that budget support to SOEs needs to be conditioned on well-defined governance and operational and financial performance targets. They noted that tackling Eskom's challenges would not only reduce fiscal deficits and debt but would also boost business confidence, encourage private investment, including in green energy, improve macroeconomic policy credibility, and convey a genuine ambition by the authorities to address state capture legacies.

Directors also encouraged the steadfast implementation of structural reforms to fully harness South Africa's economic potential and foster greater social inclusion. Beyond the initial steps

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

undertaken, Directors called for particular focus on product and labor market reforms, including greater competition and private participation in network industries, and efforts to improve the business climate and human capital, and to promote an environment conducive to job creation, particularly for the youth. Directors also encouraged the authorities to accelerate reforms to strengthen governance and fight corruption, including enhancing the AML/CFT framework.

Directors commended South African Reserve Bank's (SARB) credibility and strong performance. Amid rising fiscal risks and volatile global conditions, Directors stressed the importance of continuing to durably anchor inflation expectations at the targeted level by closely monitoring upside and downside risks in the context of the flexible exchange rate regime. They noted that monetary policy has limited potency to boost growth at this juncture given structural impediments to growth and called for close coordination between monetary and fiscal policies. In the context of ongoing SARB reform discussions, Directors indicated that the SARB's independence and inflation mandate should be preserved.

Directors welcomed the resilience of the financial sector and called for continued vigilance, given the recent pick up in unsecured lending. They also encouraged the SARB to use the forthcoming FSAP as an opportunity to further strengthen its supervisory and regulatory framework. Directors welcomed the entry of new players and technological innovations to promote financial inclusion.

South Africa: Selected Economic Indicators, 2014–2021

Social Indicators

GDP		**Poverty (percent of population)**	
Nominal GDP (2018, billions of US dollars)	368	Lower national poverty line (2015)	40
GDP per capita (2018, in US dollars)	6,354	Undernourishment (2016)	6
Population characteristics		**Inequality (income shares unless otherwise specified)**	
Total (2018, million)	58	Highest 10 percent of population	51
Urban population (2017, percent of total)	66	Lowest 20 percent of population	3
Life expectancy at birth (2017, number of years)	63	Gini coefficient (2015)	63

Economic Indicators

	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.	
National income and prices (annual percentage change unless otherwise indicated)								
Real GDP	1.8	1.2	0.4	1.4	0.8	0.4	0.8	1.0
Real GDP per capita	0.3	-0.3	-1.1	-0.1	-0.7	-1.1	-0.7	-0.5
Real domestic demand	0.5	2.0	-0.9	1.9	0.9	0.7	0.8	1.1
GDP deflator	5.5	5.2	7.2	5.3	3.9	4.2	5.2	5.0
CPI (annual average)	6.1	4.6	6.3	5.3	4.6	4.2	5.2	5.0
CPI (end of period)	5.3	5.3	6.7	4.7	4.9	4.0	5.2	5.0
Labor market (annual percentage change unless otherwise indicated)								
Unemployment rate (percent of labor force, annual average)	25.1	25.4	26.7	27.5	27.1	28.6	29.8	30.7
Unit labor costs (formal nonagricultural)	5.2	5.4	5.5	5.1	4.6	4.2	5.2	5.0
Savings and Investment (percent of GDP)								
Gross national saving	15.4	16.3	16.3	16.3	14.4	14.2	13.8	13.8
Public (incl. public enterprises)	1.2	1.9	1.9	1.3	1.1	0.4	0.0	-0.1
Private	14.3	14.4	14.4	14.9	13.3	13.9	13.9	13.9
Investment (including inventories)	20.5	20.9	19.2	18.8	17.9	17.6	17.5	17.5
Public (incl. public enterprises)	6.9	7.3	6.9	6.3	5.7	5.9	5.9	6.1
Private	13.5	13.0	12.5	12.5	12.5	12.0	11.9	11.7
Fiscal position (percent of GDP unless otherwise indicated) 1/								
Revenue, including grants 2/	27.6	28.2	28.6	28.3	29.1	29.1	29.1	29.1
Expenditure and net lending	31.9	32.9	32.7	32.6	33.4	35.2	35.9	36.0
Overall balance	-4.3	-4.8	-4.1	-4.4	-4.3	-6.1	-6.7	-6.8
Primary balance	-1.2	-1.5	-0.6	-0.8	-0.5	-2.1	-2.4	-2.2
Structural balance (percent of potential GDP)	-4.1	-4.2	-3.8	-3.8	-3.6	-4.6	-4.9	-5.2
Gross government debt 3/	47.0	49.3	51.5	53.0	56.7	60.8	65.3	69.6
Government bond yield (10-year and over, percent)	8.0	9.7	8.9	9.2	9.4	9.0	...	...
Money and credit (annual percentage change unless otherwise indicated)								
Broad money	7.2	10.5	6.1	6.4	5.6	4.6	5.4	5.5
Credit to the private sector	7.2	8.0	4.7	4.3	5.5	3.1	3.7	3.7
Repo rate (percent, end-period)	5.8	6.3	7.0	6.8	6.8	6.5	...	...
3-month Treasury bill interest rate (percent)	5.8	6.1	7.2	7.3	7.2	7.1	...	...
Balance of payments (annual percentage change unless otherwise indicated)								
Current account balance (billions of U.S. dollars)	-17.8	-14.7	-8.5	-8.9	-13.1	-11.9	-13.4	-14.1
percent of GDP	-5.1	-4.6	-2.9	-2.5	-3.5	-3.3	-3.7	-3.7
Exports growth (volume)	3.6	2.9	0.4	-0.7	2.6	0.5	3.4	3.2
Imports growth (volume)	-0.6	5.4	-3.9	1.0	3.3	1.5	3.2	3.2
Terms of trade	-1.5	2.8	1.7	4.5	-2.6	1.4	-0.5	0.0
Overall balance (percent of GDP)	0.4	-0.3	0.9	0.5	0.2	0.6	-0.6	0.0
Gross reserves (billions of U.S. dollars)	49.1	45.8	47.4	50.7	51.6	53.8	51.5	51.7
Total external debt (percent of GDP)	41.3	39.1	48.2	49.6	46.8	51.1	51.0	51.2
Nominal effective exchange rate (period average)	-9.6	-5.2	-10.4	9.8	0.0	-5.2	...	...
Real effective exchange rate (period average) 4/	-6.1	-2.5	-6.3	12.7	1.8	-1.8	...	...
Exchange rate (Rand/U.S. dollar, end-period)	11.6	15.6	13.7	12.3	14.4	14.0	...	...

Sources: South African Reserve Bank, National Treasury, Haver, Bloomberg, World Bank, and Fund staff estimates and projections.

1/ Consolidated government as defined in the budget unless otherwise indicated.

2/ Revenue excludes "transactions in assets and liabilities" classified as part of revenue in budget documents. This item represents proceeds from the sales of assets, realized valuation gains from holding of foreign currency deposits, and other conceptually similar items, which are not classified as revenue by the IMF's Government Finance Statistics Manual 2010.

3/ Central government.

4/ January-October 2019 average.

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

January 9, 2020

KEY ISSUES

Context: Subdued private investment and exports, and increased uncertainty have depressed growth and worsened social indicators. State-owned enterprises' (SOEs) risks are materializing, triggering government bailouts of Eskom and administrative intervention in other entities. High fiscal deficits have boosted debt. Nonresident investors are shedding equities and local currency bonds but showing appetite for foreign currency sovereign bonds amid supportive global financing conditions. The external position is moderately weaker than implied by fundamentals and desirable policies. Inflation has slowed to around the mid-point of the target band, aided by one-off factors, but inflation expectations are higher. Banks are sound, albeit with pockets of vulnerabilities.

Outlook and Risks: Real GDP growth is estimated at about 0.4 percent in 2019 and projected to moderately rise to 1½ percent in the medium term on current policies—a level insufficient to raise per-capita income and reduce unemployment. Domestic downside risks are prominent and stem from weak public finances and slow reform implementation to tackle structural impediments to growth. External risks arise from changes in appetite for emerging market (EM) assets or a tightening of global liquidity conditions that could increase capital outflows. The flexible exchange rate, favorable currency and maturity compositions of public debt, low currency mismatches in the economy, and deep capital markets provide important economic buffers. On the upside, steadfast reform implementation and debt stabilization would boost medium-term growth, support job creation, and reduce poverty.

Staff Advice: In the absence of fiscal space, a gradual and growth-friendly fiscal consolidation and increased spending efficiency are needed. The authorities should establish a credible debt anchor to stabilize debt in the medium term. Given the structural nature of the growth slowdown, the consolidation should be accompanied by reforms that reduce the cost of doing business and boost private investment. These include improving governance, promoting competition in product markets currently dominated by a few players, making labor markets more flexible to align wages with productivity, and urgently addressing SOE weaknesses, including by encouraging private sector participation in network industries. The monetary policy stance is appropriate and would need to adapt to the evolving inflation outlook. There is a need to closely monitor banking sector developments given the weak economy and continue strengthening the crisis management framework.

Approved By
D. Robinson (AFR)
M. Gonzalez (SPR)

A staff team comprising Ms. Ana Lucía Coronel (head, AFR) and Messrs. Ken Miyajima, Alejandro Simone, Vimal Thakoor (all AFR), and Hui Tong (SPR) visited South Africa during November 6–21, 2019. Mr. Montfort Mlachila (senior resident representative) assisted the mission. Ms. Mmatshepo Maidi (OED) participated in key discussions. The mission held discussions with Ministers Mboweni (Finance), Gordhan (Public Enterprises), and Patel (Trade and Industry) as well as Governor Kganyago (South African Reserve Bank), senior government officials, private sector participants, trade unions, development partners, and academics. Mses. Dotto Masters, Sandra du Plessis, Yiruo Li, and Zhangrui Wang provided logistical and research support. Ms. Cecilia Prado and Mr. Hatem Alsokhebr supported the preparation of the report.

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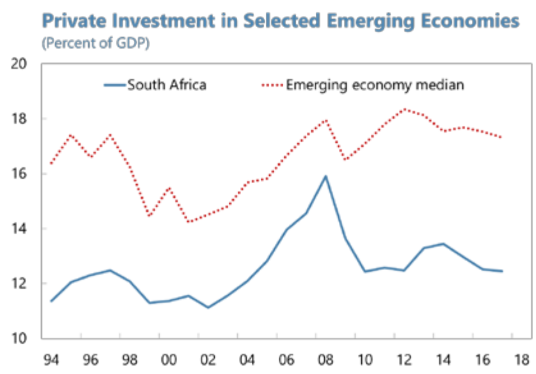
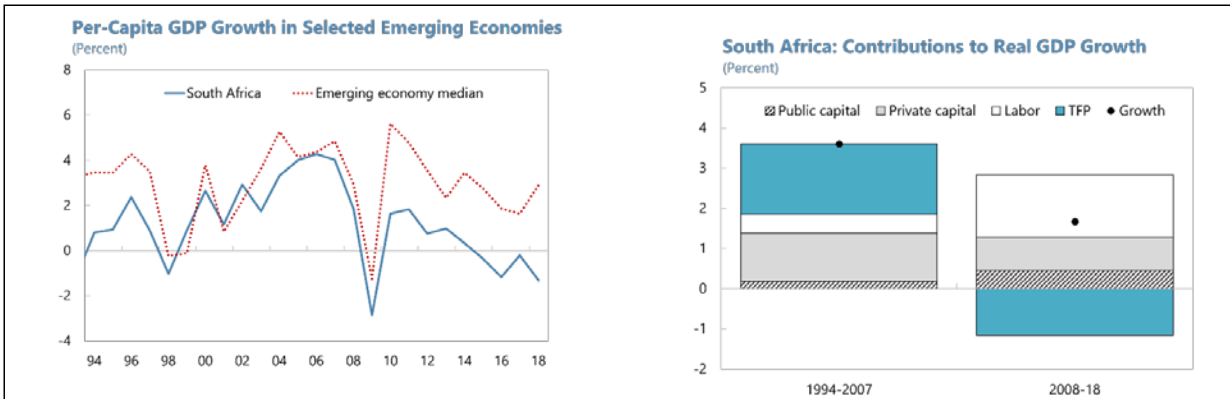
PERSISTENTLY WEAK GROWTH AMID A COMPLEX BACKDROP

1. South Africa's economic performance has deteriorated drastically (Figures 1 and 2). In the early and mid-2000s, annual output growth averaged about 4 percent, fiscal deficits turned to small surpluses, and public debt declined to 27 percent of GDP. By contrast, starting in the late-2000s, private investment's contribution to growth fell considerably, and total factor productivity (TFP) growth became negative, dampening growth to slightly above 1 percent. Following the countercyclical easing at the time of the global financial crisis, fiscal deficits have remained wide at around 4½ percent of GDP, more than doubling public debt to close to 60 percent of GDP. With increasing interest payments to nonresident investors, the external current account deficit has widened to 3½ percent of GDP. Average inflation has remained above 5 percent, and its volatility has declined significantly as the inflation targeting framework gained credibility.



2. Against a difficult political backdrop, the administration has faced challenges to turnaround stagnating growth and rein in rising debt. After Mr. Ramaphosa's accession to the Presidency in February 2018, and particularly after the May 2019 election, market expectations for growth-enhancing reforms were high. However, sluggish implementation and persistent policy uncertainty did not validate those expectations, and business confidence is now close to all-time lows. Moreover, financial difficulties in SOEs, which had been lingering for years because of operational inefficiencies and governance problems, manifested themselves through faulty service delivery and serious liquidity shortfalls that in some cases required government bailouts, jeopardizing fiscal consolidation plans and weighing heavily on debt accumulation.



Sources: Haver, IMF WEO, and IMF staff calculations.

3. With structural constraints largely unaddressed, economic growth remains on a trend decline. Unlike other major emerging markets (EMs), growth failed to benefit from the global recovery in the last decade following governance weaknesses and persistent structural rigidities (Text chart, and Annex I. Assessing Macro-Financial Linkages). With annual growth reaching only 0.2 percent in January-September 2019, per-capita GDP growth is set to contract for the fifth year in 2019. Sub-par returns and falling business confidence, derived from policy uncertainty and rigid labor and product markets, have depressed private investment and exports, and weakened the pace of productivity improvements. Fiscal spending has focused on current outlays with a low growth multiplier, increasing the relative price of non-tradable goods while crowding out investment.

4. Low growth has exacerbated already high unemployment, poverty, and inequality. While the sophisticated services sector has been growing, most other sectors have been stagnant or contracting, generating uneven growth dynamics.[1] South Africa remains one of the most unequal societies (Gini coefficient of above 0.6), facing high and rising unemployment (29 percent) and elevated poverty. Youth unemployment—about double the overall rate—is alarming. Children, the elderly, and Black Africans, especially women, are the most vulnerable groups.[2] Poverty is closely correlated with access to employment, which is largely driven by educational attainment, and the quality of education is generally weak for the disadvantaged groups. Social grants have a progressive impact on income distribution but are not long-term substitutes for the robust private-sector led job creation needed to employ an expanding labor force.

5. Amid negative per-capita growth and high unemployment, policymakers are focused on reviving the economy. The authorities are in the process of building support around a policy mix to boost growth. A recent discussion paper urges implementation of reforms centered on modernizing network industries, lowering barriers to entry, promoting agriculture, improving export competitiveness, and implementing flexible industrial and trade policies.[3] However, some senior politicians have called for alternative measures believed to support growth, which, if implemented, would prove counterproductive. These include land expropriation without compensation; establishment of a largely unfunded universal medical insurance scheme; and extension of tax incentives to selected industries. A debate on the nationalization of the South African Reserve Bank (SARB), currently owned by private shareholders, has been ongoing, raising concerns about changes in its mandate. Policies such as "quantitative easing" and "prescribed assets" by financial institutions to absorb public debt have also been floated.[4]

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[1] See accompanying Selected Issues Paper on growth for a discussion on the drivers of growth.

[2] See Chapter 2 of the Selected Issues Paper accompanying the 2018 Article IV Report: https://www.imf.org/en/Publications/CR/Issues/2018/07/30/South-Africa-Selected-Issues-46133

[3] See http://www.treasury.gov.za/comm_media/press/2019/Towards%20an%20Economic%20Strategy%20for%20SA.pdf

[4] Prescribed assets are investments legally forced by government regulations.

UNFAVORABLE MACRO-FINANCIAL SPILLOVERS OF THE FRAGILE ECONOMY

6. Subdued growth has had negative spillovers to domestic finances and the external accounts (Figures 3, 4, and 5).

- ***Financial asset prices***. Data on local asset trading, commonly used as a real-time indicator of portfolio flows in South Africa, show that nonresident investors have been sustaining net selling of portfolio assets (mainly equity), bucking the trend in other EMs.[5] The rand and government yields have been trading weaker than "fair values" likely reflecting adverse domestic factors.[6] Eskom's local bond yields have traded significantly above the sovereign's, reflecting the company's financial distress. Sovereign credit quality continues to weaken, with Moody's and S&P downgrading the outlook to negative. A possible downgrade by Moody's to below investment grade would remove South Africa from a large global bond index, and trigger forced selling by some institutional investors, although high yield-seeking investors could step in to some extent.

- ***Investor composition***. Amid weakening sovereign credit quality, investor composition has shifted toward more volatile absolute return-seeking funds, such as hedge funds and exchange-traded funds. With supportive global financing conditions, in September 2019 the sovereign placed $5 billion in Eurobonds, more than initially planned, taking advantage of large investor interest.[7] By contrast, rand-denominated bond issuances are increasingly absorbed by domestic investors, with some auctions being undersubscribed.

- ***Domestic lending***. Private sector credit edged up moderately, explained partly by unsecured lending to individuals as large banks sought to diversify their product mix to boost profitability. Lending growth by small and medium-sized banks turned negative in the first quarter of 2019 for the first time in years, followed by a recovery. Household debt started to edge up relative to disposable income after having declined for several years.

- ***Bank soundness***. Bank revenues weakened despite efforts to compensate subdued interest income with fees, but cost-cutting lent some support to profitability. Bank holdings of Eskom bonds are relatively small, at 2–3 percent of total assets, and their holdings of government bonds increased to slightly above 10 percent of total assets in response to higher liquidity

[5] These data, from the Johannesburg Stock Exchange (JSE), capture a representative subset of registered cross-border trades of local assets. However, these data include trades that could be later cancelled, and transactions outside of the JSE, creating gaps with balance of payments data, which reflect settled trades globally.

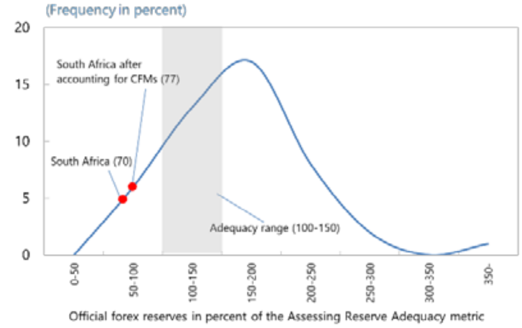
[6] The fair value of the rand is implied by the U.S. dollar nominal effective exchange rate (so-called DXY index). The fair value of the sovereign yield is estimated as the sum of the US yield, inflation expectation differentials with the US, and South Africa's sovereign external credit spread.

[7] The sovereign raised $1 billion more than initially planned. The auction was oversubscribed (2.7x) partly as the sovereign's credit had cheapened relative to its peers.

requirements.[8] Bank asset quality worsened gradually (beyond the initial impact of IFRS9 introduction), partly as the construction sector came under pressure, following a glut of real estate and negative real house price growth.

- ***External flows***. The current account (CA) deficit in 2018 was financed by cross-border bank lending and repatriation by residents, as portfolio investment inflows, traditionally the main source of financing, weakened. At 18 percent of GDP, gross external financing needs remained large. Exports did not benefit much from a weaker rand due to structural rigidities.[9] With exports underperforming, the external position is moderately weaker than implied by fundamentals and desirable policies, implying moderate overvaluation of the exchange rate. Based on staff estimates, this remains the case for 2019. (Annex II. External Sector Assessment).[10] The stock of official reserves is at 70 percent of the unadjusted reserve adequacy (ARA) metric and 77 percent of the ARA metric adjusted for capital flow management measures.

Global Distribution of Reserve Adequacy, 2018
(Frequency in percent)



Sources: IMF ARA database and staff calculations.

- ***Outward spillovers***. Weak economic activity has negative regional spillovers through various channels. South Africa is an important source of FDI and remittances for regional economies. It is also an export destination, although its importance has somewhat declined. Moreover, custom transfers to the Southern African Customs Union (SACU) economies, the largest revenue source for most of them are highly volatile, and past declines have created fiscal pressures in recipient countries. Monetary and exchange rate developments also have significant implications for the economies with currency pegs to the rand. However, South African banks' lending to sub-Saharan Africa has remained relatively stable.

RECENT POLICY DEVELOPMENTS

7. High fiscal deficits have not materially boosted growth as intended, instead drastically lifted the debt-to-GDP ratio and left South Africa with no fiscal space (Figure 6). Staff projects the government deficit to reach 6½ percent of GDP in FY19/20 (2 percentage points of GDP higher than in FY18/19), significantly increasing debt accumulation. About one half of the increase is projected to be driven by transfers to SOEs (see ¶8 and ¶9), and the remainder mainly by other transfer, compensation, and interest costs—the latter now the fastest growing budget item.

[8] About 50 percent of bank holdings of government bonds corresponds to short-term treasury bills.

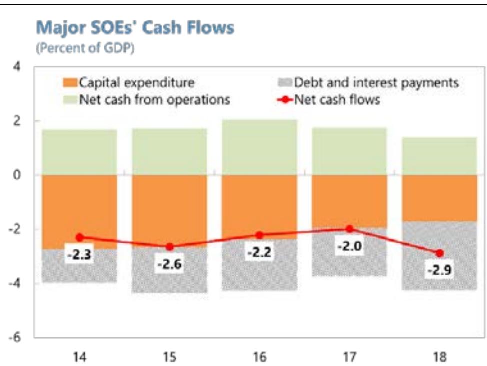
[9] Rahul Anand, Roberto Perrelli, and Boyang Zhang. 2016. "South Africa's Exports Performance: Any Role for Structural Factors?" IMF Working Paper 16/24.

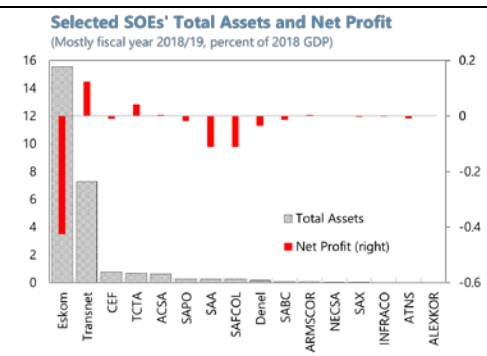
[10] Based on actual data up to Q3, 2019 and staff projections, the CA gap in 2019 is estimated to have been similar to that in 2018, with the CA deficit still being financed mostly by non-FDI capital flows.

Domestic borrowing is expected to finance most of the deficit. Reflecting the worsening fiscal conditions, the structural primary deficit is set to reverse the slightly declining trend exhibited in recent years (Box 1). The deficit is mostly expenditure driven as South Africa's tax revenue relative to output is one of the largest in EMs while the wage bill-to-GDP ratio is among the highest.[11]

8. The budget composition, tilted toward current spending, has reduced the government's ability to support infrastructure and other priorities. Spending efficiency has suffered, with public investment declining, transfers to local governments for investment projects underutilized, and the effectiveness of health and education outlays deteriorating. Furthermore, the government has had to rescue SOEs. After years of poor performance by Eskom, the government agreed to support it with exceptional financing, committing so far to transfers equivalent to 4¾ percent of GDP over 10 years (2⅓ percent over the next 3 years). Transfers to other SOEs, including South African Airways (SAA) have been also persistent. Additional pressure on the budget comes from tax expenditures and subsidies—not always well targeted.

9. Major SOEs have been unable to generate meaningful positive returns for many years due to structural inefficiencies and governance weaknesses. Most SOEs face elevated costs arising from bloated wage bills and costly procurement. Cost increases have outstripped tariff increases and cuts in capital expenditure, and debt service burden has risen, keeping SOEs' net cash flows negative. Eskom is by far the largest SOE and its position is particularly critical, with an operational balance insufficient to service its high debt—around 10 percent of GDP (text chart and Box 2). Amid declining sales, elevated procurement costs, and a rising wage bill, Eskom faced a liquidity crisis in March 2019 that prompted a bridge bank loan and urgent budget support. SAA was placed in an insolvency protection mechanism in December after an additional bailout, and the passenger railway company, PRASA, was put under administration after continued poor operational and financial performance.





Sources: National Treasury South Africa and IMF calculations.
Note: SOEs' net profit is after interest and tax.

10. On current policies, the medium-term fiscal trajectory is not projected to improve. The October Medium-Term Budget Policy Statement (MTBPS) candidly confirmed the vulnerable fiscal

[11] See Chapter 1 of the Selected Issues Paper accompanying the 2018 Article IV Report: https://www.imf.org/en/Publications/CR/Issues/2018/07/30/South-Africa-Selected-Issues-46133

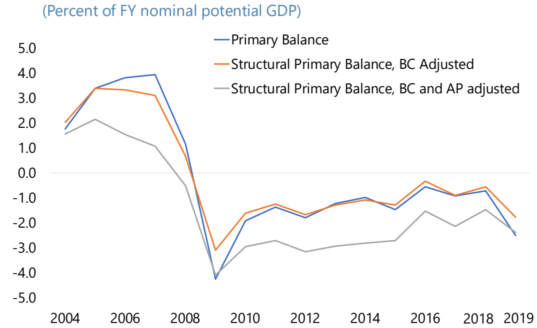
and debt situations—marred by weak tax revenue, rigid spending, and persistent operational and financial difficulties at Eskom and other SOEs—projecting government debt that increases significantly and does not stabilize.

Box 1. The Fiscal Stance: How has it Evolved?

The structural balance. The calculation of the structural fiscal balance corrects the standard overall and primary balance deficits for factors that may obscure the underlying fiscal position and its change, the fiscal impulse. Following the methodology of Bornhorst and others (2012), staff adjusts the primary balance for: (i) the business cycle (BC) to correct revenue and expenditure outturns for the effects of temporary deviations from economic potential; and (ii) the asset price cycles (AP) to correct the fiscal position for booms and busts in housing and stock market prices.

The fiscal stance over time. In the years preceding FY09/10, growth was performing above potential and was accompanied by rapidly increasing credit expansion, which provided tailwinds to the fiscal position. The associated profitability in the financial and corporate sectors likely contributed to increases in income tax and VAT revenue. Housing price increases fueled capital gains and property taxation related revenue. The structural primary balance calculations suggest that prior to FY09/10 the underlying fiscal position was less favorable than what standard indicators would suggest. The BC and AP adjustments combined may have amounted to about 3 percentage points of potential GDP, mainly reflecting unusually high revenue. After FY10/11 and until FY18/19, the slightly improving trend in the structural primary balance has mainly reflected revenue improvements as primary expenditure has largely been trending up. In FY19/20, the trend of the structural primary balance reversed owing to the deterioration in structural spending levels associated with growing current expenditure and SOE bailouts.

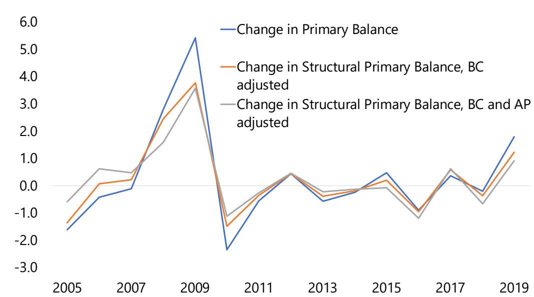
Structural Primary Balance, Consolidated Government
(Percent of FY nominal potential GDP)



Source: IMF Staff estimates.

Fiscal stimulus. Fiscal impulse calculations show that the fiscal expansion that followed the global financial crisis was only partially reversed. Of the large deterioration in the structural primary balance in FY08/09 and FY09/10 estimated between 5 and 6 percentage points of GDP, only about 40 percent is estimated to have been reversed in the years that followed excluding the significant deterioration anticipated for FY19/20. Moreover, about 60 percent of the improvement in the structural primary balance funded interest payments, making the improvement in the structural overall balance considerably smaller.

Fiscal Impulse
(Percent of FY nominal potential GDP)



Source: National Treasury and Fund Staff estimates.

The broader public sector. The broader definition of government further supports the findings identified by narrower coverage indicators. The standard overall balance and primary balance including the rest of the non-financial public sector is weaker by 0.7 and 1.2 percent GDP, on average, than the same measures for the consolidated government. This is because non-financial public entities were running overall and primary cash deficits and debt accumulation, with deficits also deteriorating sharply since FY08/09.

Box 2. Eskom: What Went Wrong?

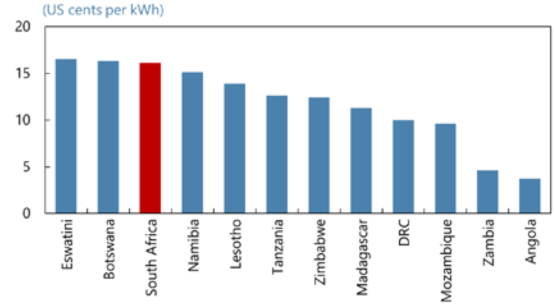
Eskom's macro-criticality. Eskom, the national power company with commercial and developmental mandates, provides 90 percent of the domestic electricity consumption, and exports energy to regional neighbors. With assets estimated at 16 percent of GDP, and strong interlinkages with coal suppliers, independent power producers, businesses, households, and creditors, the company is systemically important. Eskom's debt represents almost 10 percent of GDP, of which 80 percent is guaranteed by the government. A potential Eskom failure to pay its debt could trigger cross-default or acceleration clauses.

Sources of the financial troubles. The steady decline in Eskom's performance is explained by:

- *Major governance and technical weaknesses.* Corruption, delays in debt-financed investments, and expensive procurement have generated cost-overruns and left Eskom reliant on outdated plants vulnerable to breakdowns (the average age of the fleet is 37 years). This has forced increased recourse to expensive fuel generation. With low cashflow, maintenance has been delayed.
- *Declining electricity demand.* Low growth and frequent cuts in electricity supply over a decade have contributed to grid-defection as competition from cheaper renewable power producers came online.
- *Unsustainable revenue sources*. Even though tariff increases have been substantial (50 percent in real terms since 2005), they have not covered all costs related to governance and efficiency weaknesses, as in recent years the regulator has moderated Eskom's tariff increase requests.[1] Moreover, failure to collect outstanding electricity bills from municipalities and townships have dampened revenue further.
- *Rising input, employment and interest costs.* Eskom has been purchasing coal and other inputs at significantly above world prices. Since the mid-2000s, the workforce has increased by 50 percent and wages by 50 percent in real terms, consistently outstripping productivity. Rising debt levels and financing costs have inflated the interest bill, bringing Eskom to near-default on various occasions.

Costs to the economy. Eskom's direct cost to the budget has exceeded 9 percent of GDP cumulatively between FY08/09 and FY18/19, reflecting a combination of direct transfers (6 percent of GDP) and debt service costs. Unquantified indirect costs include the adverse impact of governance weaknesses, frequent power outages, and high electricity and financing costs on taxpayers, investors and consumers. South Africa now has one of the highest electricity tariffs in the region.

Electricity Tariffs 2019, Selected Countries
(US cents per kWh)



Source: World Bank Doing Business Report 2020.

Actions taken. As part of the clean-up efforts, the government replaced the board and management teams and a chief restructuring officer was appointed. A roadmap and a resource plan outlining changes in Eskom's business model and the electricity sector have been published. However, coal costs remain elevated reflecting scarce readily available cost-effective suppliers; tariffs are not yet cost-reflective; technical deficiencies continue to force heavy reliance on expensive generation turbines; and disruptive power outages continue. Eskom's wage bill suffered a set-back with a 2018 decision to grant above-inflation wage increases for three years as compared to the intended wage freeze. Eskom ended FY18/19 with record losses and debt levels.

[1] The formula used to determine electricity tariff adjustments has been undermined by different interpretations by Eskom and the regulator of the company's operational income and costs. Eskom is contesting in court the regulator's recent decision to consider government transfers as operational revenue. Eskom is also asking for reimbursement of what it considers as "prudently incurred" expenditures denied by the regulator.

11. Initial steps have been taken to advance reforms. The tax administration capacity is being rebuilt, including by reinstating the large taxpayers' unit within the South Africa Revenue Service (SARS). Moreover, some action has been taken to streamline regulation for mining exploration, ease visa restrictions for tourists, initiate the allocation of broadband spectrum, expedite company registration, and ask private power producers to provide options to help ease electricity shortages. However, substantive and coordinated implementation will be needed to complete these reforms and advance the others needed to lift South Africa out of the low growth trap (Text Table 1).

Text Table 1. South Africa: Main Reform Priorities

Issue	Actions	
	Implemented	**To be implemented**
Visa	Removed birth certificate restrictions for tourists.	Facilitate work permit for high-skilled professionals.
Spectrum allocation	Initiated process to allocate spectrum.	Allow competitive use of spectrum to private sector participants.
Mining	Published charter.	Address industry concerns on domestic procurement and ownership to unlock private investment.
Financial inclusion	Issued permits to three digital banks to inject competition and reduce banking cost.	Continue to leverage fintech to promote savings and access to credit.
Red tape	Enabled registration of business in one day.	Create one-stop-portal for remaining investment procedures.
Competition	Limited predatory pricing and exclusive agreements in retail.	Remove regulations that allow market dominance and rigidities in the labor market.
Network industries	Published Eskom Roadmap and Integrated Resource Plan. Took initial steps to address governance deterioration.	Stabilize financial situation to reduce fiscal burden. Review regulatory tariffs to promote efficient pricing. Allow private sector participation to inject competition.

12. The monetary policy stance is moderately accommodative (Figure 7). The SARB hiked the policy rate by 25 basis points to 6.75 percent in November 2018 to help anchor inflation and inflation expectations closer to the mid-point of the 3–6 percent target range. In July 2019, after inflation moderated, aided by supply factors and subdued demand pressure (growth contracted in Q1), the SARB unwound the earlier hike and kept the rate at 6.5 percent in September and November. Despite recent favorable outturns, which could be temporary if fuel and food price inflation rebounds, South Africa's headline inflation remains above that of its trading partners. Medium-term inflation expectations are sticky, remaining above 5 percent. The real policy rate

Real Policy Rate

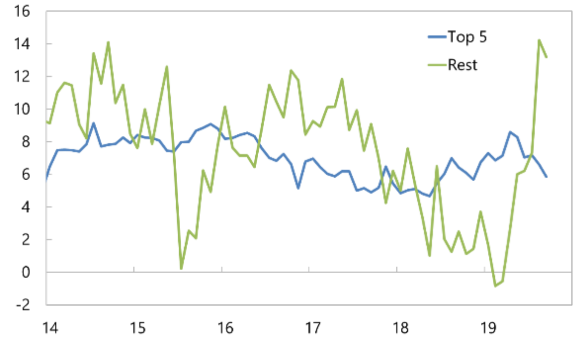
(Percent, relative to 1 year-ahead inflation expectations)

Sources: BER South Africa, Haver, and IMF staff calculations.

declined in line with economic activity but is relatively low against other benchmarks (the neutral rate appears in the range of 1¾–2¼ percent).[12]

13. The financial sector is strong and resilient but exposed to weak economic growth given its high interconnectedness and some vulnerabilities in small banks (Figure 8; Annex III. Collective Investment Schemes).[13] Banks are fully compliant with Basel III solvency and liquidity requirements. Solvency risk is low, even though NPLs have risen (to 3.8 percent of gross loans). Unsecured lending picked up in banks looking to boost profit. Banks are required to provide debt relief for low-income borrowers, which could be costly and deter financial inclusion. The resolution framework is being buttressed. To further enhance the system's resilience, the authorities have sought assistance from international bodies (Financial Stability Board peer review, Financial Action Task Force assessment, and the ongoing IMF Financial Sector Assessment Program). Discussion is ongoing with the OECD with respect to the Codes of Liberalization of the capital account.

Bank Loan Growth by Bank Size
(Percent, year on year)



Sources: South Africa Reserve Bank BA900 and IMF staff calculations.

OUTLOOK AND RISKS

14. Absent major policy changes, staff projects that per-capita GDP would continue to contract in the near term (Figure 9). Staff's baseline scenario assumes that partial reform implementation and continued governance improvement will lift business confidence and gradually allow a limited recovery of investment and consumption. Inflation will remain somewhat above current levels as fuel and food price inflation returns to the historical average. The CA deficit would persist, reflecting subdued exports and an increasing debt service burden. Confidence losses may be contained, but economic growth would edge up only marginally in the outer years.[14]

[12] The SARB estimates the neutral rate to rise from 2.2 percent in 2019 to 2.4 percent in 2021.

[13] The 2014 FSAP warns that banks' reliance on money market funds for short-term wholesale funding and active trading in over the counter derivatives markets make South Africa susceptible to contagion and sudden stops. However, it also finds that all banks are able to meet the liquidity coverage ratio with support from the SARB in the form of a Committed Liquidity Facility, an alternative framework approved by Basel.

[14] Partial reforms refer to further incremental steps that build on already taken initial actions in the mining, telecom and tourism sectors.

Baseline Projections – Real and External Sectors
(Percent of GDP unless otherwise noted)

	2016	2017	2018	2019	2020	2021	2022	2023
Real GDP growth (percent)	0.4	1.4	0.8	0.4	0.8	1.0	1.3	1.5
Per-Capita Real GDP growth (percent)	-1.1	-0.1	-0.7	-1.1	-0.7	-0.5	-0.2	0.0
Headline inflation (percent)	6.3	5.3	4.6	4.2	5.2	5.0	4.9	4.9
Private sector credit growth (percent)	4.7	4.3	5.5	3.1	3.7	3.7	4.2	4.8
Output gap (percent of potential real GDP)	-0.6	-0.2	-0.3	-0.5	-0.4	-0.3	-0.2	0.0
Gross national saving	16.3	16.3	14.4	14.2	13.8	13.8	13.8	13.8
Public 1/	1.9	1.3	1.1	0.4	0.0	-0.1	-0.2	-0.4
Private	14.4	14.9	13.3	13.9	13.9	13.9	14.0	14.1
Investment 2/	19.2	18.8	17.9	17.6	17.5	17.5	17.5	17.6
Public 1/	6.9	6.3	5.7	5.9	5.9	6.1	6.1	6.2
Private	12.5	12.5	12.5	12.0	11.9	11.7	11.7	11.8
Current account balance	-2.9	-2.5	-3.5	-3.3	-3.7	-3.7	-3.7	-3.9

1/ Includes public enterprises.
2/ Includes inventories.

15. The projected fiscal trend would exacerbate macro-financial risks. Limited adjustment in consolidated government accounts alongside the needed SOE bailouts, all in the context of low growth and slow reform implementation, would result in high fiscal deficits in the medium term (6½ to 7 percent of GDP). As a result, the government debt trajectory is anticipated to deteriorate significantly compared to previous staff projections, pushing debt to 77 percent of GDP by 2023. Both debt and gross financing needs are projected to rise beyond the Debt Sustainability Analysis (DSA) risk thresholds in 2022 and 2020, respectively (Annex IV. Public DSA). With debt escalating and SOEs still fragile, asset price volatility would likely increase, and resilience of some banks could become under pressure.

Baseline Projections – Fiscal Sector
(Percent of GDP unless otherwise noted, calendar year)

	2016	2017	2018	2019	2020	2021	2022	2023
Overall balance	-4.1	-4.4	-4.3	-6.1	-6.7	-6.8	-6.8	-6.8
Primary balance	-0.6	-0.8	-0.5	-2.1	-2.4	-2.2	-1.8	-1.5
Gross debt	51.5	53.0	56.7	60.8	65.3	69.6	73.5	77.1

16. On current policies, the economy's still strong policy buffers would be compressed. South Africa's sophisticated financial system and its flexible exchange rate are key sources of strength.[15] Large domestic financial assets provide a buffer against potential nonresident capital outflows, albeit increasingly at a higher cost. Foreign currency debt is generally relatively well-hedged (Annex V. External DSA). While high and increasing, public debt risks are mitigated by the long maturities (about 13 years) and high share of rand denomination (close to 90 percent), which limit the fiscal impact of rand depreciation.[16] South Africa's access to global financial safety nets—the BRICS Contingent Reserve Arrangement ($10 billion) and a bilateral swap line with China (about $4.3 billion worth)—is another helpful buffer.

[15] See Selected Issues Paper on the impact of exchange rate volatility on investment in South Africa.

[16] Sovereign bond issuance in foreign currency rose, increasing currency mismatches moderately, but reducing the immediate funding cost. The local currency 10-year yield spread to dollar yield is up by some 400 basis points.

Text Table 2. South Africa Vulnerabilities and Buffers

Type	Description
	Vulnerabilities
Protracted low growth worsens social outcomes	Growth averaged about 1.5 percent over the past decade, worsening per-capita income poverty, unemployment, and inequality.
Weakening SOEs pose risks to fiscus and growth	Many SOEs are in poor financial condition, with the main risk coming from the national energy company, Eskom.
Depleted fiscal buffers reduce resilience to shocks	Persistently elevated fiscal deficits have eroded fiscal space, and increasing government debt has raised the interest bill and crowded out growth-enhancing investment.
GEFN are financed by more volatile inflows	Gross external financing needs (GEFN) are large and financed by non-FDI inflows that are more dependent on global financial conditions and susceptible to abrupt reversal.
Protracted decision-making processes for policies and reforms	The need for consensus to implement reforms is a welcome way to build support for the needed changes but hinders timely implementation when agreement is not achieved.
	Mitigating Factors
Economic policy making institutions are sound	The SARB and the National Treasury command good international reputation of adhering to generally sound macroeconomic policies.
Flexible exchange rate is an important shock absorber	Central bank credibility is supported by a persistent policy of letting the market determine the value of the rand and refraining from FX intervention.
Large and well-capitalized banks show resilience	Banking system assets exceed 100 percent of GDP. High capital adequacy and low NPL ratios support the system's stability.
Public debt composition reduces rollover risks	The average maturity of government debt is about 13 years, short-term debt represents about 10 percent of total debt, and the share of government FX debt is low, at 10 percent.
Open and liquid capital markets attract investors	Financial asset turnover and market capitalization are large relative to other EMs. Nonresident investors face no restriction to invest/divest in capital markets.
Non-banks and corporates are large and resilient	Assets of non-bank financial institutions amount to more than 200 percent of GDP. Large corporates with FX debt have natural (revenues in FX) or financial hedges.

17. **Major downside risks to the baseline scenario relate to further delays in adjustment and reform, while large external risks arise from a tightening of global liquidity conditions** (Annex VI. Risk Assessment Matrix). Staff discussed with the authorities a scenario to illustrate the potential impact of the materialization of these adverse risks.

- ***Domestically***, a failure to address Eskom's weaknesses, any policy missteps, and governance setbacks would reduce market confidence, raise debt, possibly beyond 90 percent of GDP in the next few years, elevate financing costs, further discourage private investment, and increase the size and duration of capital outflows. Inflation would rise should the rand depreciate. Protracted low growth would harm bank asset quality and liquidity conditions, further weakening lending, and potentially affecting financial stability. Poverty and unemployment would rise to unprecedented levels.

- ***Externally,*** rising protectionism and retreat from multilateralism could worsen the external accounts and growth through disruption of trade flows. Structurally weak growth in key advanced markets and China would worsen South Africa's twin deficits, especially if accompanied by lower prices for its commodity exports. Importantly, South Africa is currently benefiting from supportive global financing conditions. Should this change, non-FDI net inflows, the main source of CA financing, would seriously suffer.

Downside Scenario 1/

	2019	2020	2021	2022	2023
Real GDP growth (percent)	0.4	-0.3	-1.9	-1.0	-0.4
Per-Capita Real GDP growth (percent)	-1.1	-1.8	-3.4	-2.5	-1.9
Headline inflation (percent)	4.2	5.7	4.9	4.4	4.2
Private sector credit growth (percent)	3.1	2.5	-0.5	-1.6	-0.8
Fiscal Deficit (percent of GDP)	-6.1	-7.2	-9.3	-10.9	-11.9
Public debt (percent of GDP)	60.8	66.7	76.1	86.2	96.3
Current account balance (percent of GDP)	-3.3	-3.0	0.3	1.8	2.2

1/ Scenario analysis starts from 2020. Calendar year based fiscal data for 2019 differ slightly from baseline values as the underlying fiscal year based values are affected by 2020Q1 inflation.

Authorities' Views on the Outlook and Risks

18. The authorities acknowledged the difficult juncture South Africa is at, although their baseline medium-term outlook is slightly more positive than staff's. They project subdued short-term growth, but expect a somewhat stronger recovery in confidence moving forward that would boost GDP growth of 1.7 percent by 2022. Also, inflation projections are slightly below staff's, stemming from differences in the core and non-core components. Both staff and the authorities project the current account deficit to widen at a similar pace, and government debt to remain well above 70 percent of GDP—the DSA benchmark, in the medium term.

19. As staff, the authorities see that the economic outlook is subject to risks. For them, the high fiscal burden and global trade tensions are major and concerning risk factors. They added, however, that the economy is resilient to these shocks, noting that a significant share of gross external financing is denominated in rand and that the domestic financial markets are deep and sophisticated.

POLICY DISCUSSIONS

A. Macroeconomic Policies

20. Consolidating the government and SOE positions is critical to improving the effectiveness of fiscal and monetary policies. Persistent structural rigidities have damaged macroeconomic policy credibility by diminishing the effectiveness of standard macroeconomic policy tools and thus limiting their transmission to the broader economy. With growing current expenditure pressures, the government's borrowing requirements and interest bill have escalated, crowding out growth-enhancing public and private investment. The fiscal stance and associated uncertainty are constraining monetary policy formulation.

Addressing General Government and SOE Difficulties

21. Staff urged the authorities to use the February's FY20/21 budget to articulate growth-friendly consolidation measures. Staff projections point to a somewhat bleaker fiscal outlook than the one presented in the MTBPS. Staff projections incorporate the savings contemplated in the

MTBPS from a rationalization of spending in goods and services, and also some action on the wage bill as indicated by the authorities. However, projections also assume higher medium-term transfers to Eskom as the company would continue to require support while completing the unbundling of its operations. On account of these additional transfers and a weaker growth outlook than assumed in the MTBPS, staff's deficit and debt projections are somewhat higher than the authorities'. Staff emphasized that if not timely addressed, the deterioration of the fiscal position would lead to higher financing costs and force a more abrupt adjustment in the future, which would in turn magnify the adverse impact on growth and social indicators.

22. Importantly, staff urged the authorities to target medium-term debt stabilization by establishing a credible anchor. Staff made the case for basing the fiscal framework on a public debt anchor given the challenges presented by the current nominal expenditure ceiling.[17] While such ceiling played a useful role in guiding countercyclical policies in the past, a debt anchor is now needed to help guide a reversal in the debt trajectory in the medium term. A debt anchor would help minimize increases in debt during the projection period to gradually converge to the levels of the EMs that sustain investment grade ratings (Box 3).

23. Stabilizing government debt at the current level after the unavoidable support to SOEs would require reducing the fiscal deficit by 4–4½ percent of GDP over the next four years. Assuming that growth-enhancing structural reforms are adopted in support of the envisaged fiscal adjustment, evenly-spread measures of about 3–3½ percent of GDP would be needed to make the consolidation gradual. The remaining adjustment of 1–1½ percent of GDP would be achieved through improved tax buoyancy as growth picks up; reduced safety net benefit payments as job creation helps curtail the number of eligible beneficiaries; and lower interest payments in response to reduced borrowing needs and costs. Well-targeted social spending must be safeguarded to protect the poor.

24. The recommended consolidation should largely be expenditure-based and growth-friendly. Given the key role of expenditure in deficit increases, the relatively robust tax-to-GDP ratio, the uncertain yields of tax measures in a weak economy, and the largely revenue-based efforts to consolidate in recent years, an expenditure-based adjustment is recommended. Broad action to address high compensation costs will be needed, including some combination of natural attrition and below-inflation wage increases to achieve savings of about 2 percent of GDP over a four-year period. In addition, staff estimates that if Eskom and the other SOEs swiftly address their inefficiencies and cut their costs, government transfers could be reduced by ½–1 percent of GDP, mainly in the outer years of the projection period. Improving expenditure efficiency by institutionalizing periodic spending reviews, especially in the areas of education, health and infrastructure, and limiting tertiary education subsidies to only poor households would help save the remaining ½ percent of GDP. Any additional spending initiatives should be made budget neutral.

[17] See 2018 Article IV consultation report for a more detailed discussion.

Box 3. Public Debt: Why Should it be Reduced to More Comfortable Levels?

A vulnerable public debt situation. South Africa's debt-to-GDP ratio has doubled in a decade and stands well above the EM average (the 6th in a sample of 20 EMs). Three of the countries with a higher debt level have used assistance from international financial institutions to help cover their financing needs. Emerging markets with similar sovereign ratings than South Africa's have considerably lower debt levels.[1, 2]

Increasing contingent liabilities. SOE-related contingent liabilities have also increased sharply since 2007 reflecting their difficulties to borrow on the strength of their balance sheets. In addition, several SOEs—the electricity company (Eskom), the national airline (SAA), the post-office (SAPO), the arms manufacturer (Denel), and the broadcasting corporation (SABC)—have required significant budget transfers and may require more if adequate corrective actions are not taken.

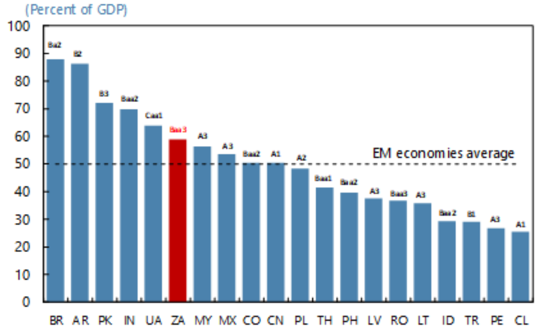
A non-stabilizing debt outlook. Under staff's baseline projections, the debt-to-GDP ratio is expected to continue to rise. Assuming limited implementation of reforms and a modest reduction of policy uncertainty that could provide a small boost to private investment and consumption, the envisaged fiscal path would drive debt to above 80 percent of GDP by FY24/25 and keep rising, posing high risks to growth. This is why staff recommends introducing a debt anchor to the fiscal framework.

Rising real borrowing costs. At about 4 percent, the real cost of borrowing has been on an upward trend, more than doubling since 2009, and becoming higher than in comparable EMs. In a sample of 16 countries for which data are available, only three EMs are paying higher real rates than South Africa on their 10-year domestic currency bonds. Also, 5-year CDS spreads have converged to levels of economies that do not enjoy investment grade sovereign ratings. Investors' unease has been captured in the several rating downgrades that have left South Africa with a borderline investment grade (only by Moody's).

Deteriorating composition and efficiency of debt-financed expenditure. Debt accumulation has largely financed current expenditure (wage and interest bill increases), as opposed to productive capital expenditure or growth-enhancing investments that could generate additional revenues in the future. Moreover, even in the social spending area, which is of a recurrent nature, the efficiency of health and education expenditure is low compared to other countries that spend considerably less but achieve higher quality outcomes.

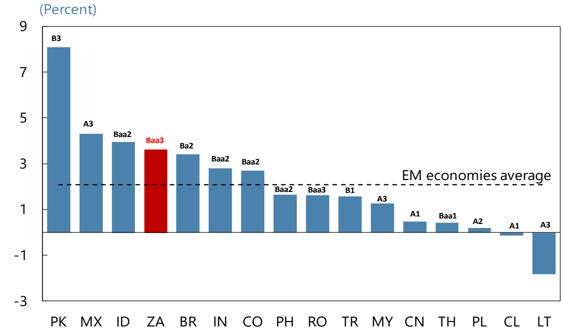
Depleted room to respond to shocks. The availability of fiscal space proved useful to deal with the effects of the global financial crisis as countercyclical fiscal policy smoothed the impact of the global downturn. The current debt levels, contingent liabilities, and increasing interest bill have left the economy with no fiscal space, forcing larger adjustments than would otherwise be desirable in the context of subdued growth.

Emerging Markets: General Government Gross Debt, 2018
(Percent of GDP)



Sources: IMF World Economic Outlook and staff calculations.

Emerging Markets: Real 10-year Govt. Bond Yield, 2019
(Percent)



Sources: Country authorities, IMF WEO, Reuters, Tullett Prebon, and IMF staff calculations.

[1] Moody's ratings are shown given its broader coverage of EMs and to ensure comparability of the ratings methodology. Moody's ratings from EMs range from A1 to C where C reflects the highest risk. Ratings below Baa3 are below investment grade.

[2] Even though Latvia and Lithuania are not included in the IMF's WEO Emerging Market list, the analysis in Box 3 uses the definition of emerging markets that major rating agencies use, to facilitate comparability across countries.

25. Improved tax administration and tax efficiency would help support the expenditure-based adjustment. The ongoing strengthening of the SARS's administration capacity would help boost revenue collection, although quantifying the gains is difficult at this stage. Staff recommended making good use of the recently revamped large taxpayers' unit to improve revenue buoyancy and collection of tax arrears. On the tax policy front, it would be important to review legislation to limit base erosion and profit shifting opportunities, reduce tax expenditures including those related to special economic zones, and gradually increase the carbon tax introduced this year.

26. Staff called for making SOEs lean, efficient, and competitive, especially those operating in network industries (e.g., electricity and transport). Efforts to improve SOEs' performance through reforms and restructuring, including closure or divestiture, should be accelerated. There is a need to expeditiously implement measures to harden budget constraints and increase private sector participation. In Eskom's case, closely linking any additional borrowing to productive investments is crucial. In particular, all further budget transfers should be subject to adopting measures to: (i) reduce primary energy costs through improved procurement of coal and cost-efficient electricity generation; (ii) enhance service delivery to help improve demand; (iii) collect arrears; and (iv) rationalize the wage bill. Financial restructuring (e.g., transfers of Eskom debt to special purpose vehicles) that leave the main vulnerabilities in Eskom or other SOEs unaddressed would undermine reform incentives and should be avoided. There remains significant scope to leverage the private sector's financing capacity and technical expertise to deliver reliable and cost-competitive electricity, and simultaneously reduce the pressure on Eskom's stretched capacity and balance sheet.

Authorities' Views on Fiscal and SOE Issues

27. The authorities indicated they are working on attaining consensus for the needed fiscal consolidation. They clearly saw the necessity of tightening the fiscal position to rein in debt accumulation. To guide consolidation plans, the authorities plan on targeting a primary balance excluding support to SOEs by 2022/23. Needed measures were proposed in the MTBPS and negotiations are underway to roll them out. To partially compensate for the support to Eskom and other SOEs, the authorities are planning cuts in transfers to local governments and spending on goods and services. They are also working on alternative measures to achieve broad-based wage bill savings. Raising tax revenue in the current low growth environment could be challenging but given that the reform agenda is expected to begin yielding results only over time, they may opt for measures to step up revenue mobilization.

28. The extent and pace of SOE reform and their implications for the fiscus and the economy are also under consideration. The budgeted fiscal transfers to Eskom are expected to help the company meet its debt obligations in the coming two years. The authorities plan to use this time to agree with different stakeholders on the governance structure, skill needs, and specific measures for improving the company's operations and finances. They indicated that several options are under consideration to reduce primary energy costs, contain compensation costs, and improve revenue in the near term. Measures to reduce the high debt burden that weighs on Eskom's finances will be pursued once significant improvements are achieved in financial and operational performance. While other SOEs are smaller, their resolution is also urgent and challenging, and initial steps have been taken in SAA and PRASA to halt the continued bailouts.

Maintaining Price Stability and Financial Sector Soundness

29. The role of monetary policy in helping reignite growth is limited by the structural nature of the growth impediments but its impact on inflation remains relatively strong. Relative to other EMs, South Africa's inflation volatility is affected mainly by inflation expectations and external prices and less so by the output gap. Staff analysis suggests that the negative impact of moderate hikes in the repo rate on economic activity has declined as private investment is constrained by structural factors, while its disinflationary impact through the expectations and signaling channels remains at work.[18] Moreover, the impact of credit shocks appears to have weakened in such an environment (Annex I. Assessing Macro-Financial Linkages).

30. To keep pursuing low and stable medium-term inflation, monetary policy could remain accommodative, but should continue to cautiously monitor upside and downside risks. Upside risks to inflation are related to possible reversals of supply-related disinflationary factors (e.g., unfavorable weather conditions for agriculture, domestic electricity prices, and global oil prices). Downside risks are linked to protracted subdued growth. The impact of the loose fiscal stance on inflation should also be closely monitored. Further monetary policy action may be required in the event of shocks to inflation and growth. Close fiscal/monetary coordination will be needed for ensuring appropriate monetary policy formulation in the uncertain environment.

31. External sector policies should remain consistent with inflation targeting. The flexibility of the rand as a shock absorber should be maintained. Once growth-enhancing reforms boost exports and capital inflows, seeking opportunities to accumulate international reserves is advisable. Nonresidents are free to move funds in and out of the country, but residents still face restrictions. Plans to further liberalize exchange controls to capital flows should be adequately sequenced. While considering the specific macroeconomic, financial, and institutional conditions in South Africa in line with the IMF's *Institutional View*, these plans should facilitate adherence to the OECD Codes of Liberalization over time.[19] Staff encouraged implementation of the African Continental Free Trade Agreements and cooperative WTO negotiations.

32. Amid low growth and increasing competition, financial stability should be preserved while advancing progress on financial inclusion. The recent increase in unsecured lending and vulnerabilities in small and medium-sized banks warrant close monitoring. More generally, the SARB's commitment to adapt supervision to the rising risks from the subdued economy and changes in banks' business models is welcome. The early warning system and crisis management framework need buttressing by complementing stress-testing with assessments of domestic and cross-border

[18] See Selected Issues Paper on the Growth-Inflation Tradeoff of Monetary Policy.

[19] The IMF co-organized a workshop in South Africa on this issue during November 21–22, 2019 and plans on following up with further TA on capital account liberalization and macroprudential policy, in coordination with the ongoing FSAP.

interconnectedness and enhancing the resolution regime, including the deposit insurance scheme. The Fintech space has expanded, particularly in payment services, which, together with the entry of several new banks, could reduce fees and improve access to financial products (Annex VII. Fintech and Financial Inclusion). The authorities' intention not to consider the calls for prescribing financial institutions to buy more public debt will prevent profitability and confidence from weakening further.

Authorities' Views on Monetary and Financial Sector Issues

33. The authorities highlighted the importance of maintaining price and financial stability.

- *On monetary policy,* they project the neutral interest rate to creep up, with the risk premium stemming mainly from the fiscal challenges. The SARB's somewhat lower-than-staff's headline inflation projection (4.5 percent by the end of 2021) reflects weak wage and rental price developments amid sluggish economic activity.
- *On the financial sector,* the authorities are determined to mitigate the potential impact of low growth and rising banking sector competition on financial stability, including by monitoring the increase in unsecured lending. So far, there are few signs that rising fiscal pressures have negatively affected banks through their holdings of government bonds. Going forward, deepening the local corporate bond markets would help widen the pool of high-quality liquid assets and reduce the sovereign-bank nexus. Enhancements to stress testing are expected to assist risk identification and improve supervision of riskier banks. Promulgation of the bank resolution bill is expected in 2020.
- *On financial inclusion,* there is evidence that the entry of new banks and furthering of digitalization have started to reduce fees.[20] The authorities highlighted the importance of mitigating broader obstacles to financial inclusion, both from supply (e.g., high unemployment) and demand (e.g., financial literacy) sides.
- *On external sector policies,* the authorities are making progress in simplifying remaining exchange controls on capital outflows for residents to have a more transparent and risk-based policy in line with international best practices. They highlighted that these efforts need to be appropriately timed and consistent with safeguarding financial stability. They also reiterated their willingness to accumulate foreign exchange reserves as opportunities arise.

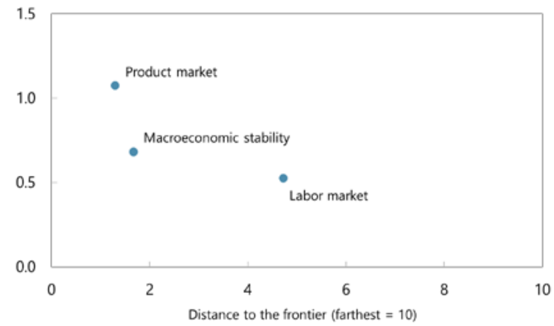
B. Structural Reforms

34. Comprehensive action is needed to address the structural impediments to robust and inclusive growth by reversing the deterioration in TFP (Figure 10). A growth diagnostic analysis suggests that closing the gap to the EM frontier in product markets would deliver the highest

[20] The complex fee structure of financial services complicates this assessment somewhat.

growth gain, compared to other reforms, implying the importance of advancing these reforms first. Many of the regulatory reforms have limited upfront fiscal costs and may, in some cases, even generate revenue through licensing.[21] Specifically, bringing to conclusion reforms already in the pipeline in energy, transport, telecommunications, and mining by establishing fair and clear investment rules, will help spur private investment. Improving governance and reducing confidence-sapping policy announcements will support an investment-friendly environment.

Growth Gains and Distance to the Frontier

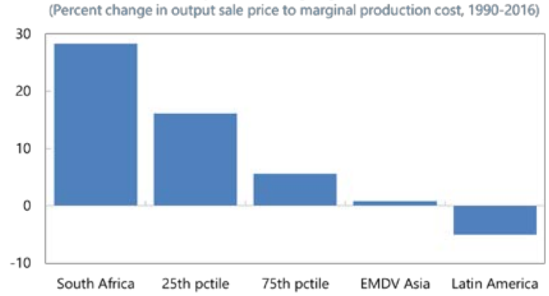


Source: IMF Staff estimates.
Note: Assuming distance to frontier closes in five years. A longer duration is assumed for institutional and human capital reforms. The frontier is the 75th percentile from a list of 20 EMs.

Encouraging Competition in Product Markets

35. Concentration in product markets and distortive regulations are serious constraints to growth with adverse distributional effects. Several economic sectors, including manufacturing and banking, are dominated by a handful of big players with significant market power. High concentration has inhibited the emergence of smaller firms, which are powerful job creators in other EMs. SMEs have shrunk in importance relative to large firms in the past decade. Staff analysis suggests that rising input costs and markups are associated with declining economic growth. This is clearly the case of large SOEs that pass-on high costs to businesses, thus sustaining elevated price levels and reducing the economy's competitiveness. Firms subject to restrictive procurement and labor regulations also suffer from high costs and low productivity. A distributional analysis suggests that the poor are more affected as they face both fewer employment opportunities and higher prices.[22]

Estimated Markups in Emerging Economies
(Percent change in output sale price to marginal production cost, 1990-2016)



Sources: Diez et al. 2018. "Global Market Power and Its Macroeconomic Implications," IMF WP 18/137 and IMF staff calculations.

36. Staff recommended creating an environment that encourages entrepreneurship by reducing the cost of doing business.

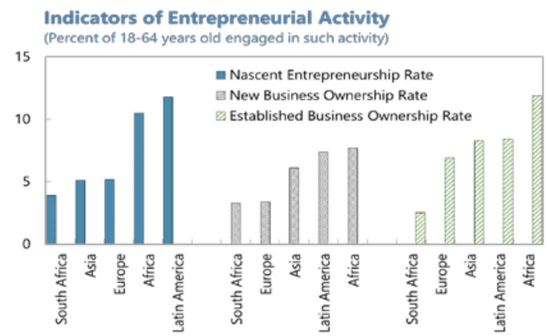
- ***Dealing with network industries***. Well-designed plans to restructure, liquidate, or divest SOEs based on commercial viability are needed. Transparency in pricing mechanisms would reduce uncertainty for the economy. On energy, the Eskom unbundling process under discussion should leverage the use of cleaner energy and private sector participation. On transport, greater competition in the port and railway sectors, including by sharing existing infrastructure with the private sector would reduce logistics costs and boost exports. The

[21] See Chapter 3 of the IMF WEO October 2019. https://www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019

[22] Similar conclusions are found in a cross-country study. See Sub-Saharan Africa Regional Economic Outlook, October 2019, Chapter 2: Competition, Competitiveness, and Growth in Sub-Saharan Africa. https://www.imf.org/en/Publications/REO/SSA/Issues/2019/10/01/sreo1019

airline industry needs to stop depending on budget support and be run on a strictly commercial basis.

- ***Making regulations conducive to entrepreneurship***. To meet private sector calls for clear and stable rules of the game, the government should avoid red tape and ensure that regulations improve South Africa's appeal as a competitive investment destination. Regulatory constraints inhibiting private investment, including by SMEs, need to be streamlined. Clarity on land reform is critical, particularly for labor-intensive sectors such as agriculture (Box 4). More generally, the industrial policy in place should switch from providing subsidies and tax breaks to selected sectors to facilitating favorable business conditions to attract any firms that can compete in global markets.



Sources: Global Entrepreneurship Monitor (GEM) 2016

Authorities' Views on Product Market Issues

37. Pointing to ongoing reforms, the authorities concurred with staff on the need to boost competition to reduce prices and encourage investment opportunities and job creation.

- *On their reform agenda*, they reiterated that implementation of the proposals to improve the cost-effectiveness of network industries, create conditions for growth in labor intensive sectors such as agriculture and tourism, and increase trade efficiency to tap regional markets will take time to implement but will boost the economy's competitiveness.

- *On the business environment*, they highlighted recent initiatives aimed at accelerating overdue reforms on visas and spectrum allocation as steps in the right direction. They also noted the efforts to eliminate red tape and revamp the competition law to reduce the market power of large players and allow for a greater role for SMEs. The authorities acknowledged the inherent efficiency-equity trade-off arising from regulatory requirements aimed at broadening citizens' participation in the economy and supporting the emergence of industries through localization.

- *On SOEs,* the authorities noted that the reform process is complex and will take time. They stressed that reversing the persistent state capture damage was critical for stabilizing SOEs governance and financial performance. On Eskom, they were confident that the recently issued Roadmap and Integrated Resource Plan would facilitate its unbundling, with a view to attracting increased private investment in electricity generation and optimizing the use of the transmission grid. The strategy would also pursue a greater role of renewables as South Africa advances in its international climate change commitments.

Box 4. Land Reform: What are the Main Factors Involved?

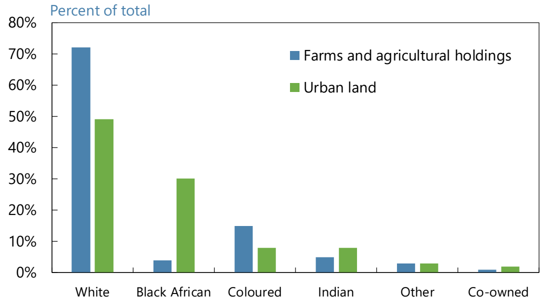
Importance of land reform. South Africa's skewed land ownership reflects the limited progress in achieving the land redistribution objectives set up after the end of apartheid. Black Africans, the majority of the population, hold less than 10 percent of agricultural land and about 30 percent of urban land owned by individuals (Land Audit Report, 2017). Against this background, a policy of "land expropriation without compensation (LEWC)" has been proposed to help reallocate land. The policy, however, raises property rights issues among present and prospective land owners.

Past experience with land redistribution. Despite several land redistribution initiatives and the provision of titles to some landowners, only one-third of the targeted land transfers has been achieved, with the government holding significant land which could be made available for redistribution. The redistribution process has been hurt by weak governance and inefficiencies in land recognition, records, and registers.

Current proposals. A constitutional review committee, put in place to define whether LEWC was consistent with the constitution, recommended amending section 25 of the Constitution. A Presidential Advisory Panel (PAP) was appointed in September 2018 to consider the conditions for LEWC, with the report delivered in May 2019. The PAP recommended providing for no compensation in expropriations related to unused, under-utilized, SOE-owned, abandoned, highly-indebted land or land obtained criminally or held for speculation. No compensation would apply also to informal settlements, inner-city buildings with absentee landlords and farm equity schemes. The PAP also recommended improving the overall governance of the redistribution program. Additionally, the private sector—churches, mining and other companies, and farmers—proposed voluntary land donations to support the overall process.

Individual Land Ownership by Race in 2015

Percent of total

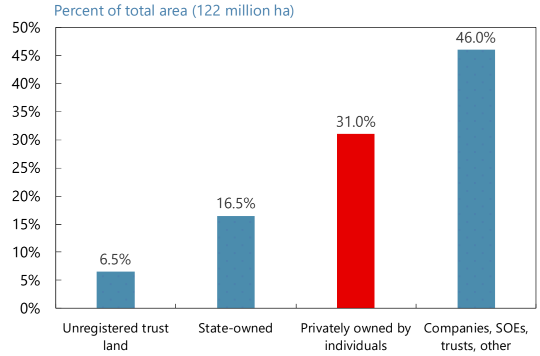


Note: Area categorized as farms and agricultural holdings owned by individuals is 37,078,289 hectares. Area of urban land owned by all races is 722,667 hectares.

Source: Land Audit Report, 2017.

Land Ownership by Entity

Percent of total area (122 million ha)



Source: Land Audit Report, 2017.

Improving Labor Market Dynamics

38. Low growth, a rising labor force, and persistent structural rigidities contribute to worsening unemployment (Box 5). South Africa has a higher level of unemployment and lower labor force participation than both regional and emerging economies. With skill mismatches and economic growth tilted toward the most sophisticated sectors (finance, information technology, and specialized business services), the bulk of job creation benefits high-skilled workers as opposed to low-skilled workers and labor-intensive industries including agriculture, tourism, and manufacturing. Further, labor cost increases exceed productivity improvements—largely a reflection of the centralized wage bargaining that transmits labor cost increases to the rest of the economy—systematically keeping demand for labor (including for new entrants) significantly below employment needs. Firm closures further worsen the dynamics.

39. Regulatory constraints and other rigidities inflate the cost of labor. Regulatory constraints that inhibit firms' ability to hire on a need basis limit employment opportunity, particularly for the inexperienced and the youth. To justify payment of centrally bargained wage levels, firms prefer to hire skilled and experienced workers, who represent a small percentage of the population. Reservation wages are high as a result of spatial inequalities and high costs of transportation to urban job centers. There is anecdotal evidence that social grants, which have a positive impact on income distribution, can in some cases increase reservation wages. While too early to assess, concerns have been expressed regarding the impact of the national minimum wage in some sectors.

40. Discussions focused on ways to promote a more flexible labor market and build human capital. Job creation and labor market dynamics will benefit directly from reforms to improve product market and public spending efficiency. The latter will enhance the quality of infrastructure and transport, thus alleviating constraints on workforce participation. Renewed focus should be placed on boosting the quality of education to address skills mismatches. In addition, wage bargaining needs to be decentralized and workforce management restrictions relaxed so that hiring decisions are aligned with business needs. Firms should have the option to hire young and less experienced workers, and better differentiate compensation between skilled and unskilled labor.

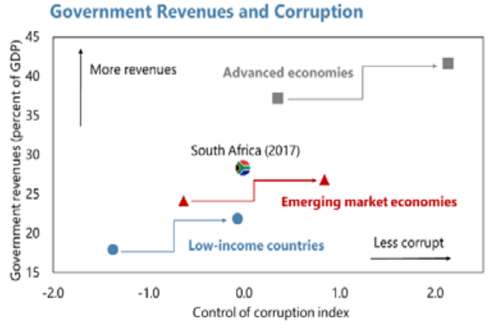
Authorities' Views on Labor Market Issues

41. The authorities concurred that promoting private sector-led growth is the best way of addressing the growing unemployment problem. They believe that a clearer focus on labor intensive sectors such as agriculture and tourism will help create employment opportunities. Longer-term policies need to overcome the challenges of the educational system at all levels and integrate the youth in the labor market through training and apprenticeships. Initiatives to reduce participation costs by setting up sustainable cities and inclusive transport systems will also help. The authorities noted the difficulties of addressing the constraints imposed by centralized bargaining, given strong opposition by unions.

Accelerating Reforms to Boost Governance and Fight Corruption

42. Governance weaknesses and policy uncertainty have debilitated key economic institutions. State capture inflicted damage to important institutions, such as the SARS and many SOEs. Fiscal outcomes were affected through lower revenue and procurement weaknesses, while the failure of one small mutual bank also reflected governance deficiencies. Delays in implementing long-announced policy measures have exacerbated uncertainty and hurt confidence.

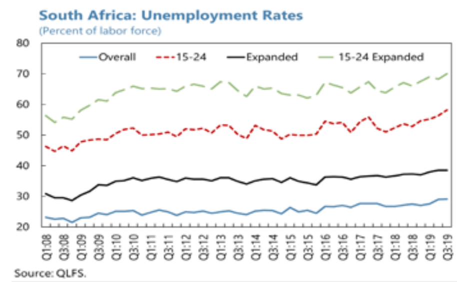
Government Revenues and Corruption



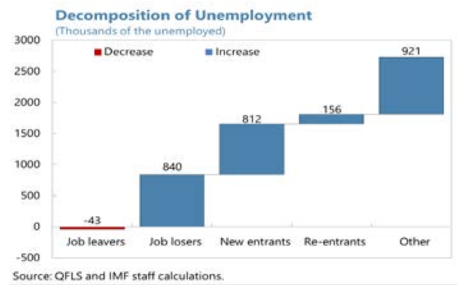
Note: Point estimates are subject to uncertainty.
Sources: IMF Fiscal Monitor April 2019, Worldwide Governance Indicators, and IMF staff calculations.

Box 5. High Unemployment: What are the Main Characteristics?

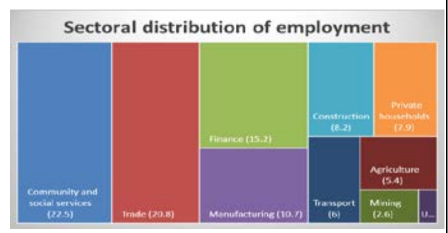
Rising unemployment. South Africa's overall unemployment rate is high. It has increased from a low of 21.5 percent at end-2008 to 29.1 percent. Youth unemployment (15–24 years) stands at 58.2 percent. The expanded definition, which includes discouraged workers, puts overall and youth unemployment at 38.5 percent and 70 percent, respectively. Significant spatial and racial disparities exist.



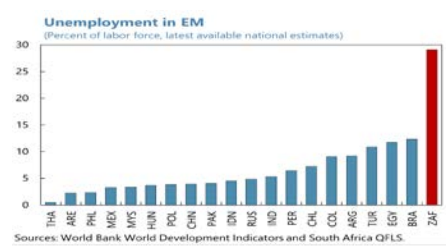
Low growth, rising labor force. Rising unemployment is attributable to low growth, the changing nature of job creation, and a rising labor force. Of the 2.7 million increase in the number of unemployed since end-2008, over 60 percent is equally attributable between job losses due to firm closures and new entrants joining the economy. The labor force is expected to increase by another 5 million over the next decade, further complicating the employment problem.



Weak job creation. Not only is the weak economy hindering job creation, but the generation of labor-intensive jobs has also slowed down. This reflects the mismatch between the skills required in the high-employment sectors and the ones the education system is producing. Ninety percent of the unemployed have secondary education or lower. In this environment, the churn in the labor market has slowed the number of people leaving their jobs voluntarily and made it difficult for those who exit to rejoin. Individuals in long-term unemployment (1 year or more) now exceed 70 percent (over 20 percent of the workforce).



Outlier. South Africa has the highest unemployment rate when compared to EMs and most SSA countries.[1] Among SSA countries, the rate is marginally higher than some other SACU countries. Among EMs, the level is more than twice the level in Brazil, and even higher than the one of other major EMs.



[1] The South African Quarterly Labor Force Statistics are aligned with the standard ILO definition of employment, which includes those working in the informal sector.

43. **Staff highlighted the need to accelerate reforms already initiated to strengthen governance and fight corruption** (Annex VIII. Progress in the Fight Against State Capture). Vulnerabilities to corruption could be further reduced by reforms to enhance governance of tax administration and SOEs (¶25–¶26) and easing regulatory constraints (¶35). Enhancing the autonomy of anti-corruption agencies would strengthen their effectiveness and accountability, and bolster coordination within the government. Efforts to expedite criminal prosecution against those engaged in corrupt activities should be further intensified. The ongoing AML/CFT framework assessment provides an opportunity to improve AML tools for combating corruption, including with respect to politically exposed persons, beneficial ownership, and the criminal justice system.

Authorities' Views on Governance Issues

44. The authorities noted that strong efforts are being made to reverse the decline in capacity arising from state capture. While results are slow to materialize, they are confident that the measures in place to prevent corruption and improve governance will bear fruit. The prosecution authority is being capacitated technically and financially to improve its capabilities. South Africa is collaborating with other jurisdictions in a bid to recover illegal outflows, including by freezing bank accounts during the investigation process.

C. Capacity Development

45. There is scope to continue robust capacity development (CD) engagement. South Africa's technical capacity is high, but demand-driven CD enjoys strong support from the authorities and has had a positive impact on surveillance. Recent CD support from the Fund includes financial and fiscal stress testing, transfer pricing, management of capital flows, and enhancement of seasonal adjustment as part of the rebasing of the national accounts. Looking ahead, priorities include fiscal risk management, tax administration, financial stability and inclusion, and national accounts statistics (Annex IX. Capacity Development in South Africa).

Authorities' Views on Capacity Development

46. The authorities plan to leverage Fund capacity development (CD) as needed. The SARS is looking to rebuild capacity and its particular needs will be guided by the outcome of a Tax Administration Diagnostic Assessment using the TADAT methodology. The SARB sees the forthcoming FSAP as an opportunity to strengthen its regulatory and supervisory framework. STATS SA appreciated CD to improve seasonal adjustment and is expected to request further CD to assess their progress in this area. The National Treasury is looking for assistance in setting overall risk limits on SOEs' contingent liabilities, which could potentially be assisted by IMF CD.

THE BENEFITS OF REFORM

47. An upside scenario analysis shows that comprehensive reform implementation would significantly boost growth while replenishing key buffers (Figure 9). Bold policy action to break the unfavorable fiscal-growth dynamics would increase per-capita income. Potential growth would be boosted by the effects of an improving business environment and lower costs of key inputs in network industries. Higher growth would meaningfully reduce unemployment and poverty. If a strong package of reforms and fiscal adjustment is implemented, public debt would start to decline in 2022 while bank lending would rise, creating virtuous macro-financial feedback loops and further financial deepening. Inflation and inflation expectations would fall over the medium term as the deflationary impact of higher competition and exchange rate appreciation counterbalances the inflationary impact of robust domestic demand. With fiscal consolidation and greater room for monetary policy easing, broader financing costs would decline. The CA deficit would initially widen as investment-related imports expand, before narrowing as higher competitiveness boosts exports.[23]

Upside Scenario 1/

	2019	2020	2021	2022	2023
Real GDP growth (percent)	0.4	1.4	2.2	3.0	3.7
Per-Capita Real GDP growth (percent)	-1.1	-0.1	0.7	1.5	2.1
Headline inflation (percent)	4.2	5.3	5.4	4.7	4.4
Private sector credit growth (percent)	3.1	4.6	6.3	8.4	10.5
Fiscal Deficit (percent of GDP)	-6.0	-6.0	-4.6	-3.2	-1.6
Public debt (percent of GDP)	60.6	63.6	64.4	63.5	60.9
Current account balance (percent of GDP)	-3.3	-4.0	-4.7	-4.9	-4.8

1/ Scenario analysis starts from 2020. Calendar year based fiscal data for 2019 differ slightly from baseline values as the underlying fiscal year based values are affected by 2020Q1 inflation.

STAFF APPRAISAL

48. Several years of persistently low growth have exacerbated already high levels of unemployment, poverty, and inequality. The country is estimated to have had the fifth year of negative real per-capita growth in 2019 and, on current policies, is set to continue this trend. Fiscal stimulus to growth has proven insufficient, since the supply-side nature of the growth constraints has not been addressed. There has been sluggish progress in transforming the excessively regulated and rigid product and labor markets into more flexible and business-friendly ones that facilitate private investment and exports. Meanwhile, large fiscal deficits have resulted in rapid public debt accumulation leaving South Africa with no fiscal space, and widening of the external current account gap, mainly financed by non-FDI inflows. High public debt constrains the space for monetary policy. Risks to growth are tilted to the downside if reforms do not take off or if financing conditions deteriorate.

49. South Africa's undeniable economic potential remains largely untapped and the recent economic performance points to rising risks. Impediments to growth have to be removed, vulnerabilities addressed, and policy buffers rebuilt. The economy faces three immediate challenges: (i) persistently weak economic growth attributable to stagnant private investment, exports, and productivity, worsening already high unemployment; (ii) deteriorating fiscal and debt positions, and weak quality of spending; and (iii) major difficulties in the operations of SOEs, which inflate the cost of doing business and financial support from the fiscus.

50. Against this background, a more decisive approach to reform implementation is urgently needed. Beyond the initial steps undertaken, expediting structural reform implementation is the only way to sustainably boost private investment and inclusion. Improving the cost-effectiveness of network industries will be crucial. In particular, determined and coordinated action will be needed to deliver an electricity sector that can provide reliable services at predictable and

[23] The estimated medium-term gains from the combination of structural reforms and fiscal consolidation add up to 2¼ percent of GDP.

reasonable prices without government support. To this end, the financial and technical capacity of the private sector in renewables must be actively pursued. Dominant market players in sectors lacking contestation should be subject to healthy competition. Regulatory requirements that unduly inflate production costs should be streamlined. Labor market rigidities should be tackled to help align wages more closely with productivity and facilitate employment, including in SMEs.

51. Complementary reforms are needed in terms of governance and efficiency of public spending. The significant steps undertaken to address state capture are welcome. However, more needs to be done to deter corruption. Efforts to strengthen criminal justice institutions, restore the integrity of key state entities, and empower tax collection and prosecution authorities should be complemented with vigorous prosecution of those identified to have been involved in corrupt activities. AML/CFT tools should be accordingly enhanced. Making public education and health spending more efficient is critical to nurture a more productive labor force and make economic growth more inclusive. Gradually reducing inefficient subsidies and tax breaks is another important way of bolstering the efficiency of public spending while enhancing competition.

52. Restoring fiscal soundness would require a gradual, decisive and growth-friendly consolidation to accompany the recommended growth-enhancing structural reforms. The FY20/21 budget to be presented in February should articulate meaningful measures to put the economy on a stronger fiscal and debt path. The adjustment needs to be mainly expenditure based and focused on containing increases in compensation costs and rationalizing support to SOEs. SOE support should be conditioned on improving governance and meeting well-defined quantitative operational and financial performance targets. In parallel, improvements in the composition of spending should support infrastructure and well-targeted social outlays, reducing the share of unproductive expenditure. On the revenue side, reforms to deter transfer pricing and profit shifting while strengthening tax administration are essential to complement the consolidation.

53. Adding a debt anchor to the fiscal framework would help guide debt stabilization at prudent levels. Government financing of SOE current spending has not been growth enhancing, and alongside high fiscal deficits has led to a large, rapid and dangerous deterioration in debt dynamics. On current policies, public debt would exceed 70 percent of GDP in the near term and would not stabilize. To support the recommended fiscal policy adjustment, the fiscal framework should be bolstered by complementing the nominal expenditure ceiling with a debt anchor. The government should target a reversal in the debt trajectory to contain borrowing costs, enhance confidence, and attract investment.

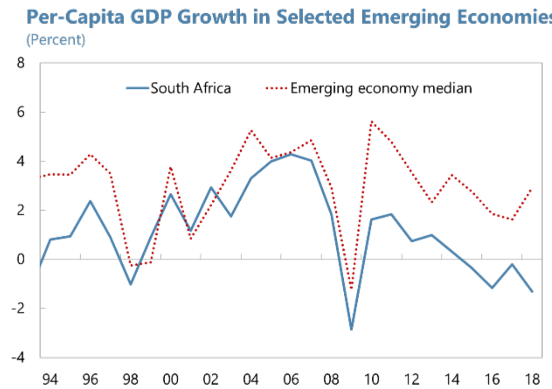
54. Monetary policy should continue to focus on pursuing low and stable medium-term inflation. Amid rising fiscal risks and volatile global conditions, the SARB should maintain its hard-won monetary policy credibility by continuing to monitor upside and downside risks to inflation with a view to durably anchor inflation expectations at the targeted level. This is particularly the case because monetary policy has limited potency to boost growth in South Africa at this juncture when the main binding constraints are of a structural nature. The SARB independence and inflation mandate should be preserved.

55. Financial sector resilience is an asset and should be maintained. The banking system is dominated by large banks with strong balance sheets, but pockets of vulnerability should be monitored, including those related to the recent pick-up in unsecured lending; the operations of small and medium-sized banks; and the strong bank interconnectedness with the broader financial system. Entry of new players and technological innovation to help reduce costs and improve access to financial services should continue to be encouraged.

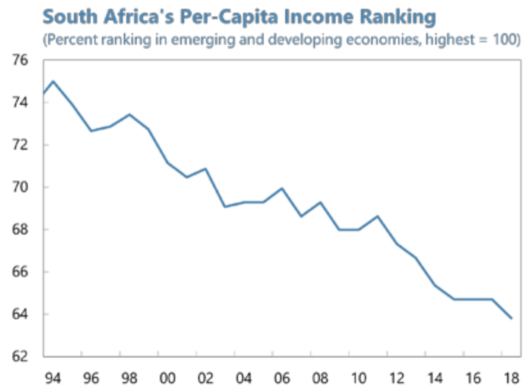
56. It is proposed that the next Article IV consultation with South Africa take place on the standard 12-month cycle.

Figure 1. South Africa: Weak Growth and Social Indicators

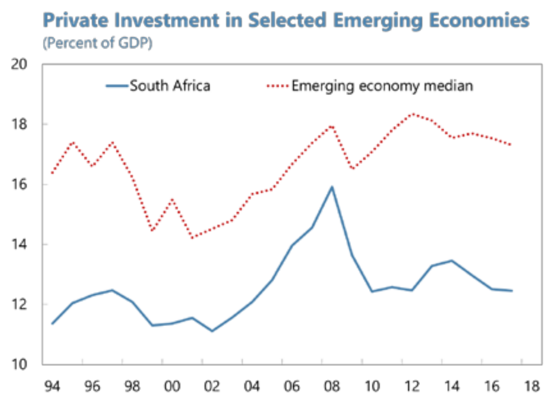
South Africa's per-capita growth failed to rebound as much as in other emerging economies...



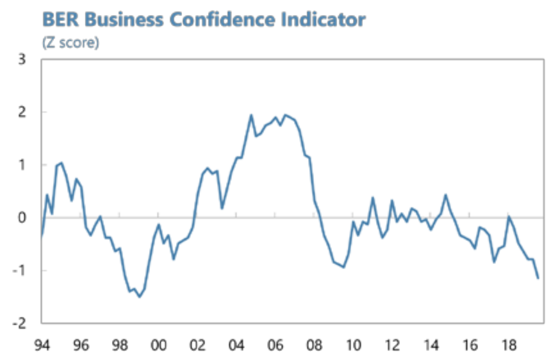
...losing further ground relative to peers ...



...as private investment stagnated notably...

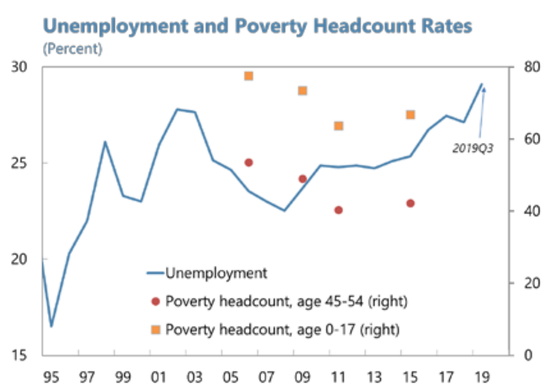


...depressed by weak business confidence...

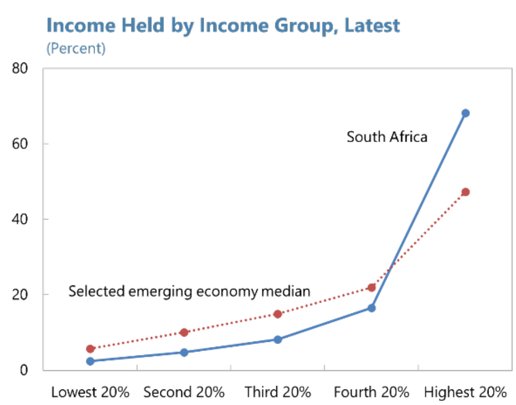


Note: Z score represents the distance from average in the number of standard deviation. Data spanning 1975Q1-2019Q3 are used.

...worsening unemployment, keeping poverty high...



...and making the income distribution less inclusive.

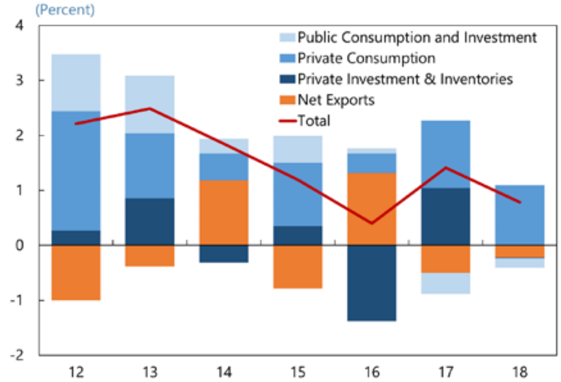


Sources: BER South Africa, IMF WEO, Haver Analytics, World Bank, and IMF staff calculations.

Figure 2. South Africa: Real Sector Developments

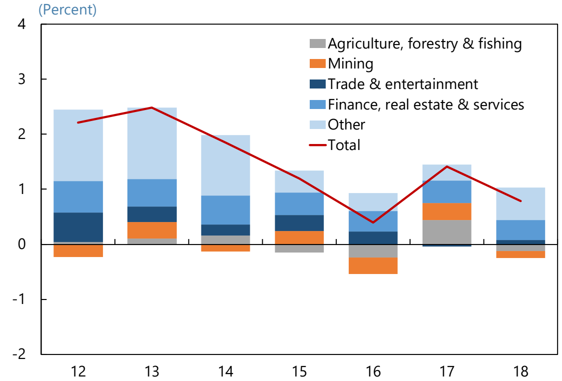
Growth has been recently sustained by private consumption, with investment and exports being a drag.

Contributions to Real GDP Growth - Demand
(Percent)



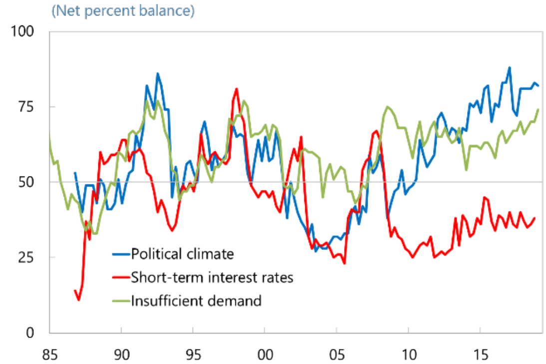
Contributions of agriculture and mining turned negative in 2018.

Contributions to Real GDP Growth - Supply
(Percent)



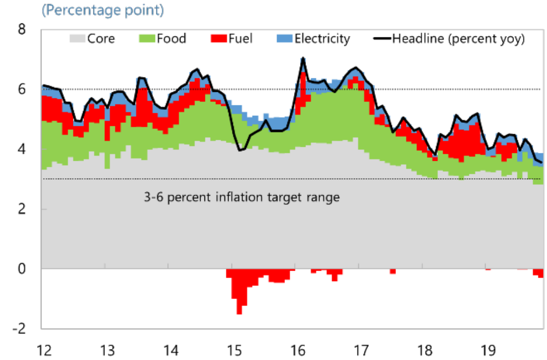
The political climate is a major constraint to manufacturing activities.

Key Constraints to Manufacturing Activities
(Net percent balance)



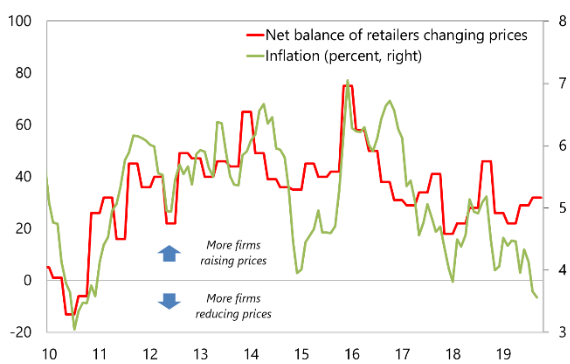
Inflation fell to around the midpoint of the target band aided by a favorable supply shock amid weak growth…

Contributions to Headline Inflation
(Percentage point)



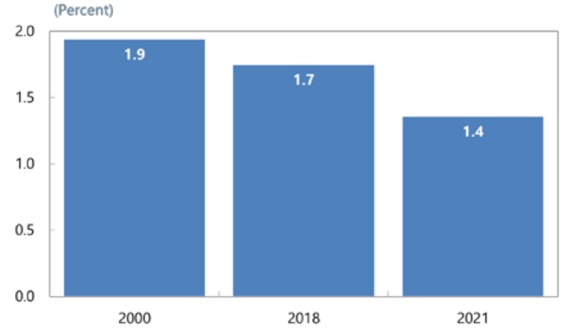
…prompting less retailers to raise prices…

Direction of Retail Price Changes and Inflation



…but inflation is expected to remain persistently above that in export destinations.

South Africa Inflation Differential to Export Destinations
(Percent)



Note: October 2019 WEO data. BER 2-year ahead inflation expectations for South Africa.

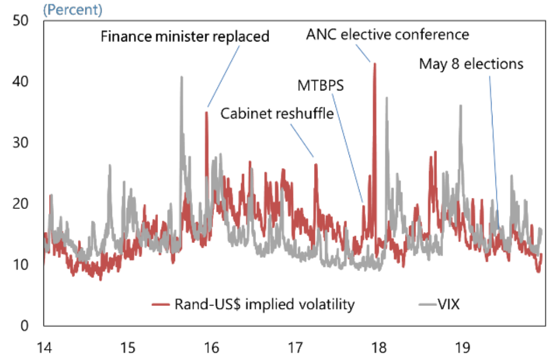
Sources: BER South Africa, IMF WEO, Haver Analytics and IMF staff calculations.

Figure 3. South Africa: Financial Market Developments

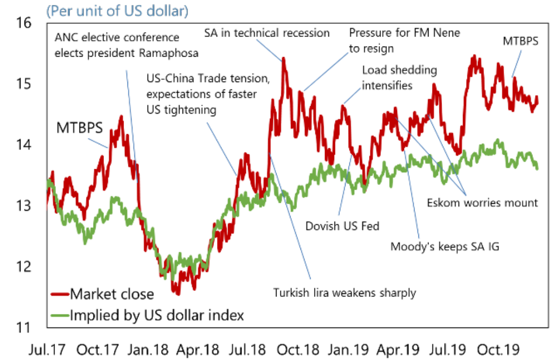
Uncertainty rose moderately before the May 2019 elections but has remained subdued…

…even though the rand has traded relatively weak…

Volatility of Rand-US Dollar and US Equities (VIX)
(Percent)



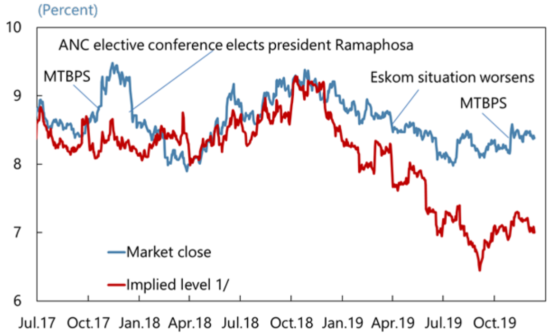
South African Rand
(Per unit of US dollar)



Local currency sovereign yields failed to decline as much as implied by global yields likely on fiscal worries…

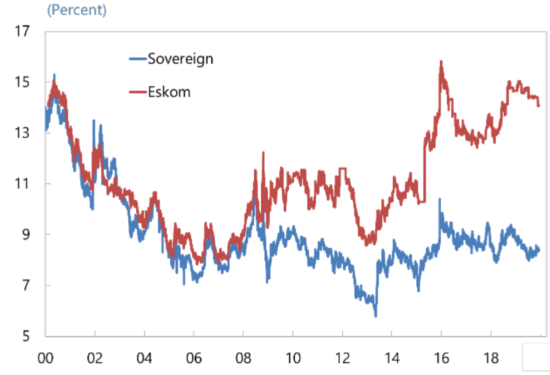
…as Eskom's credit risk has surged…

Local Currency Sovereign 10-year Yield
(Percent)



Note: 1/ US 10-year yield + 5-year inflation expectations differential + South Africa 10-year sovereign CDS.

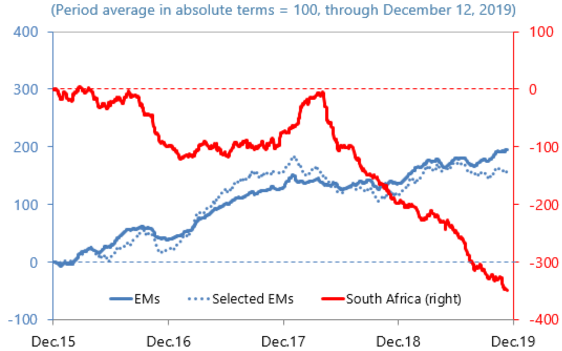
Public Sector Local Currency Long-Term Yields
(Percent)



…amid persistent nonresident selling of local assets, bucking EM trend…

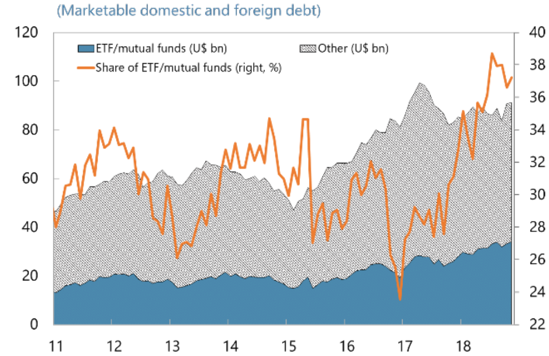
…accompanied by higher shares of ETF and mutual funds in nonresident government bond holdings.

Cumulative Cross-Border Portfolio Daily Inflows
(Period average in absolute terms = 100, through December 12, 2019)



Note: Selected EMs = India, Indonesia, Brazil, Mexico, and Turkey.

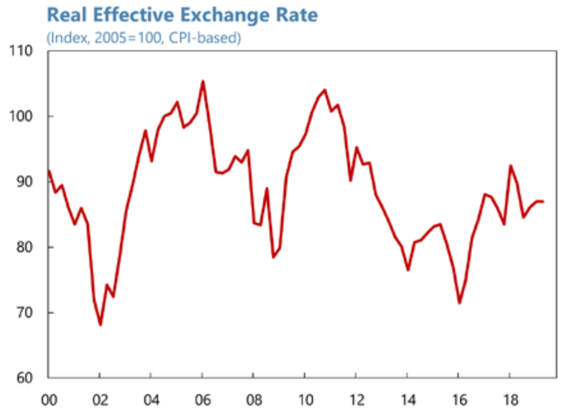
Nonresident Holdings of Government Debt
(Marketable domestic and foreign debt)



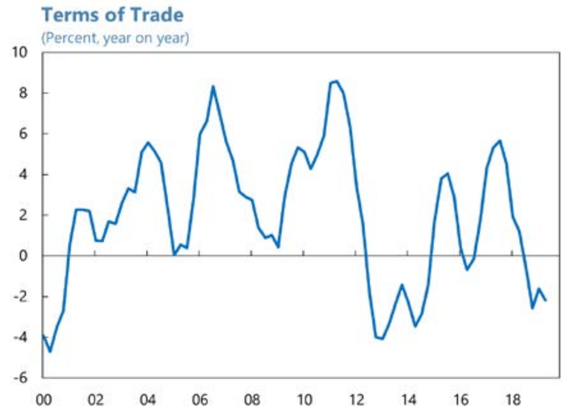
Sources: Bloomberg, EPFR, Haver Analytics, IIF, and IMF staff calculations.

Figure 4. South Africa: External Sector Developments

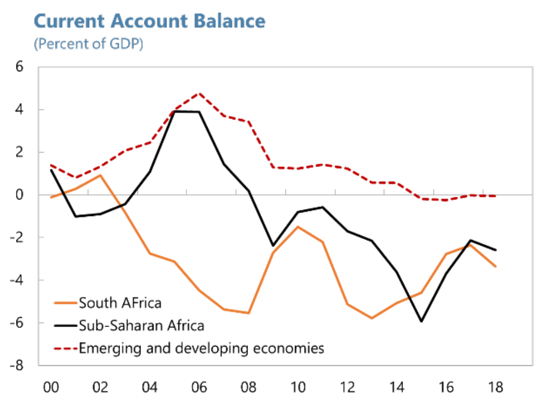
The real effective exchange rate remained range bound…



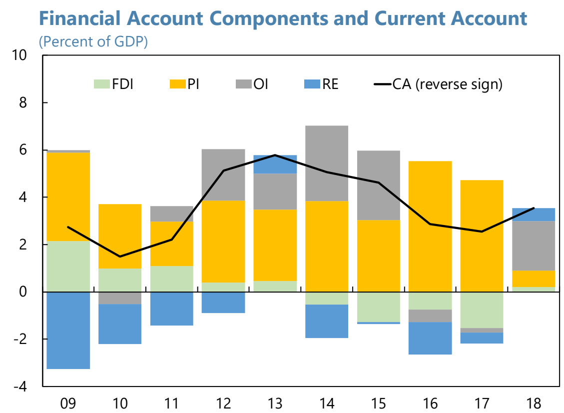
…while terms of trade weakened…



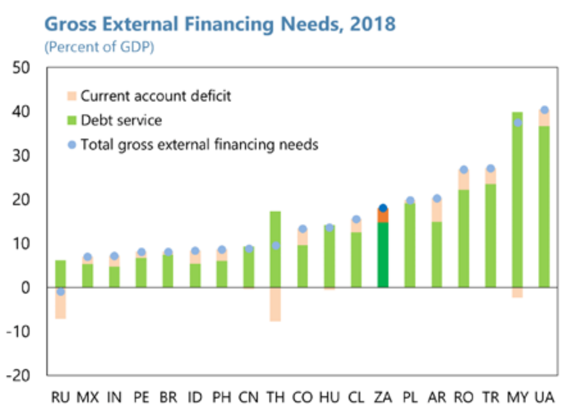
…and the current account deficits widened…



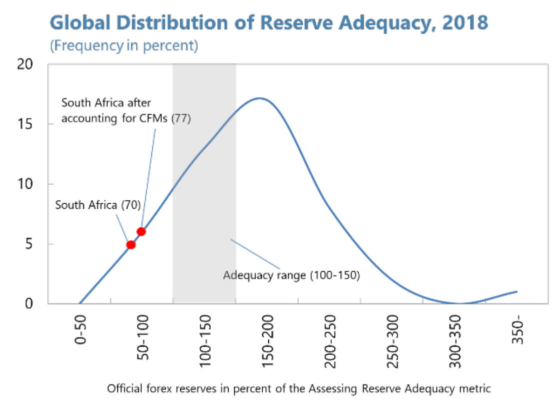
… financed mainly by foreign bank lending and potentially nonbank repatriation.



Gross external financing needs remained relatively large.



There is room for boosting official reserves as opportunities arise.



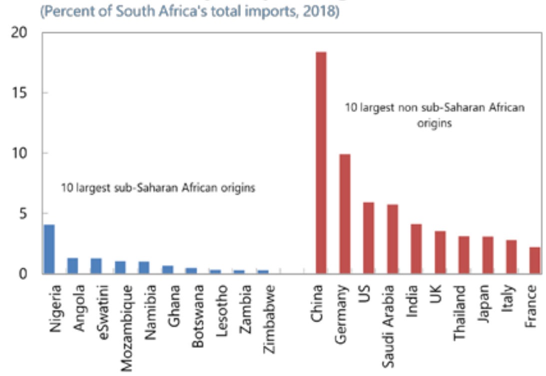
Sources: Haver Analytics, IMF WEO, and IMF staff calculations.

Figure 5. South Africa: Spillovers from South Africa

Most of South Africa's major import origin countries are outside of SSA.

South Africa's Major Import Origins

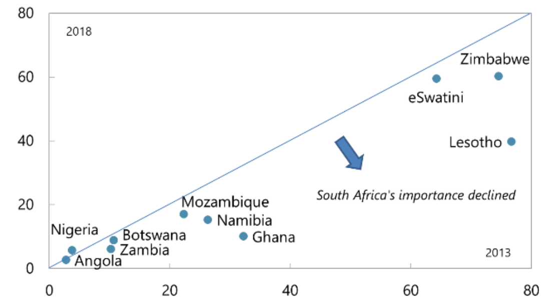
(Percent of South Africa's total imports, 2018)



South Africa's importance as export destination has declined for partners in SSA...

Exports to South Africa by Major Sub-Saharan African Origins

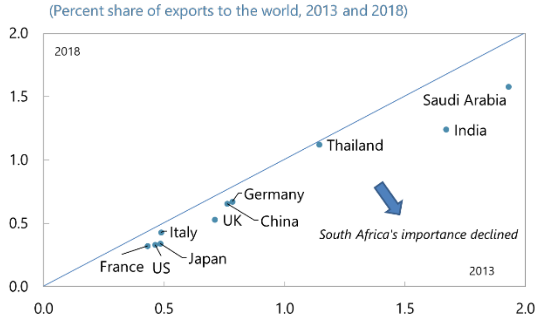
(Percent share of each country's exports to the world, 2013 and 2018)



...and outside.

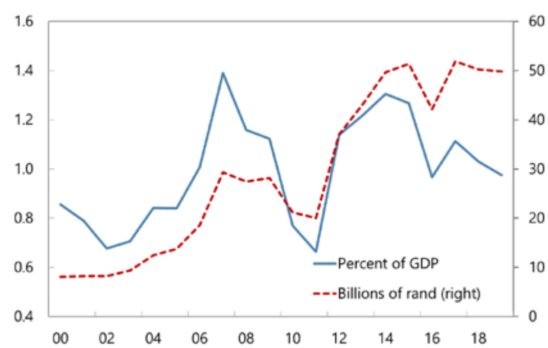
Exports to South Africa by Major Non Sub-Saharan African Origins

(Percent share of exports to the world, 2013 and 2018)



SACU transfers, an important source of revenue for the recipients, have stagnated.

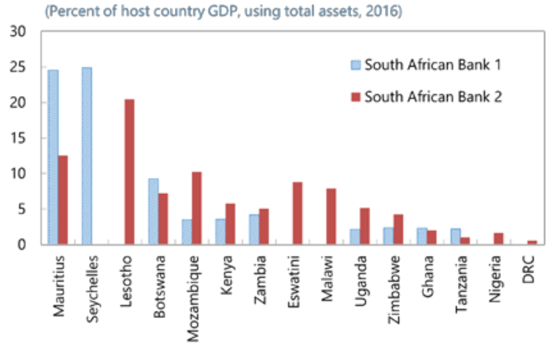
SACU Transfers from South Africa



South African large banks are present across the region in larger scales relative to host country GDP...

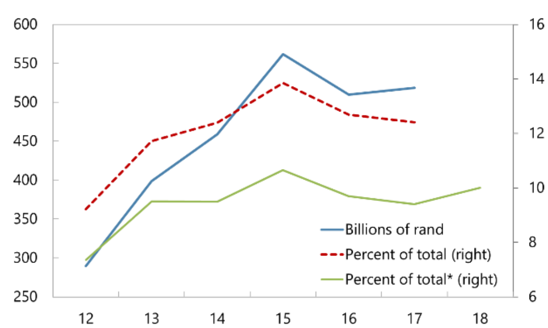
Presence of Large South Africa Banks in Sub-Saharan Africa

(Percent of host country GDP, using total assets, 2016)



...and their operations in the region remained relatively stable.

Large South African Banks' Assets in Rest of Africa

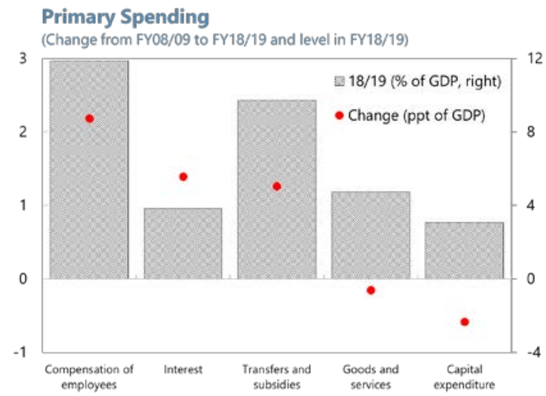


Note: Aggregating data for 3 of 4 largest banks. " * " for two banks.

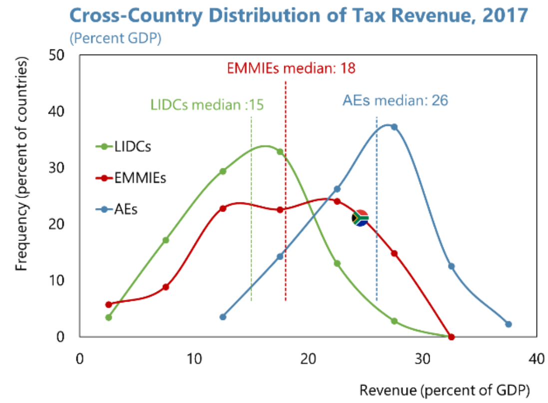
Sources: Fitchconnect, Haver, IMF Direction of Trade, and IMF staff calculations.

Figure 6. South Africa: Fiscal Developments

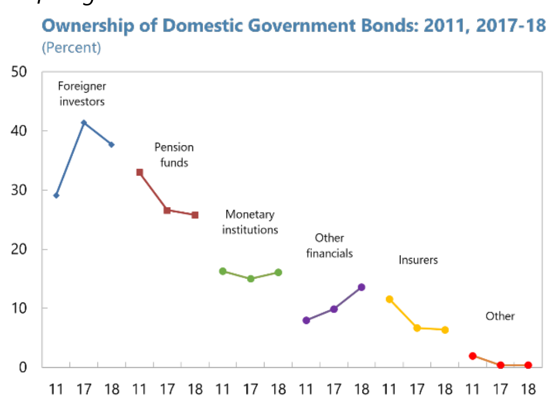
Expenditure rose due to wages, interest payments, and transfers over the past decade.



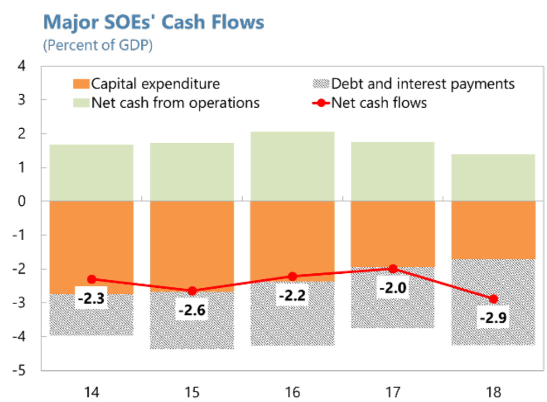
Tax revenue is higher than for peers as a share of GDP.



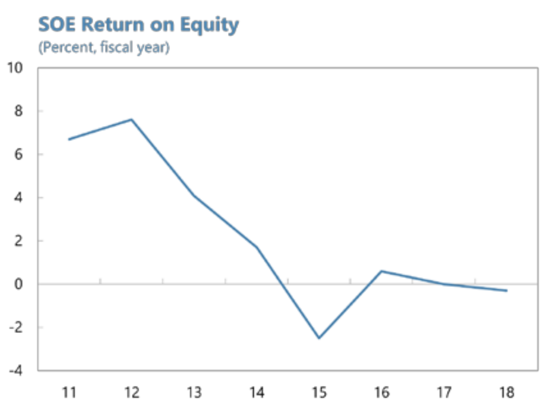
Other financials, such as mutual funds, increased holdings of government bonds as local institutional and foreign investors sold.



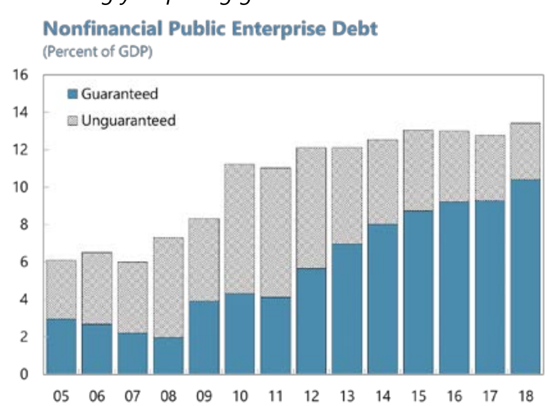
Major SOEs have faced severe cash flow issues…



…while profitability deteriorated…



…increasingly requiring guarantees to borrow.

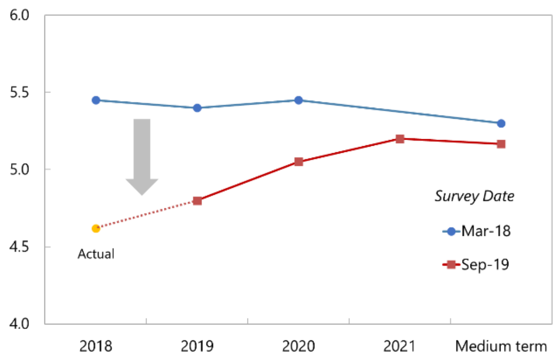


Sources: Bloomberg, Haver Analytics, IMF Fiscal Monitor April 2019, National Treasury 2019 Budget, and IMF staff calculations.

Figure 7. South Africa: Monetary Developments

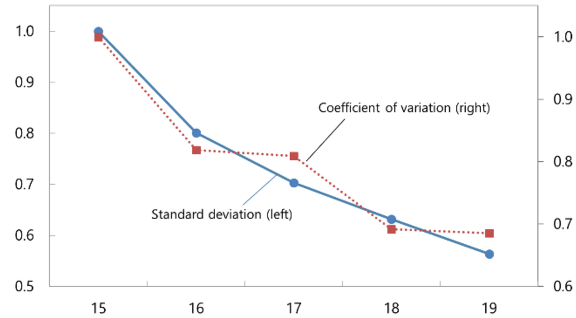
Businesses and trade unions' medium-term inflation expectations remained elevated.

Inflation Expectations of Businesses and Trade Unions
(Percent)



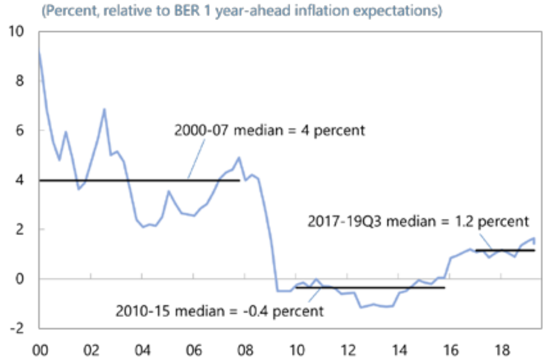
Analysts' inflation forecasts are less divergent, signaling greater central bank credibility.

Panelist Variation in Next-Year Inflation Forecasts
(Standard deviation and coefficient of variation of distance from panelist median, 2015=1, December data)



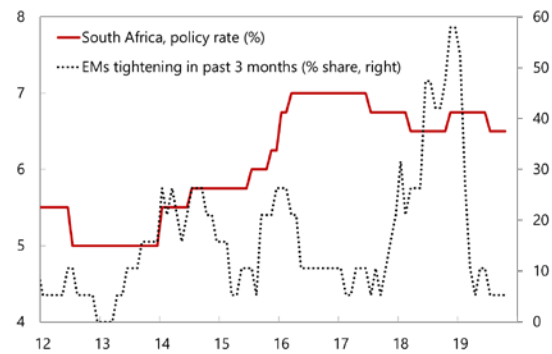
The real policy rate rose but remains below the 2000–07 norm amid a weaker economy.

Real Policy Rate
(Percent, relative to BER 1 year-ahead inflation expectations)



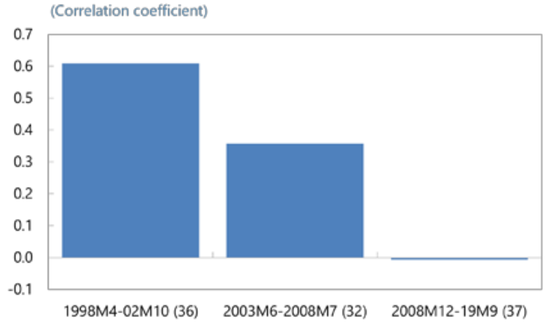
The July easing took place amid an EM-wide dovish environment.

Rate Action in Selected Emerging Economies



Monetary policy transmission along the yield curve may have declined.

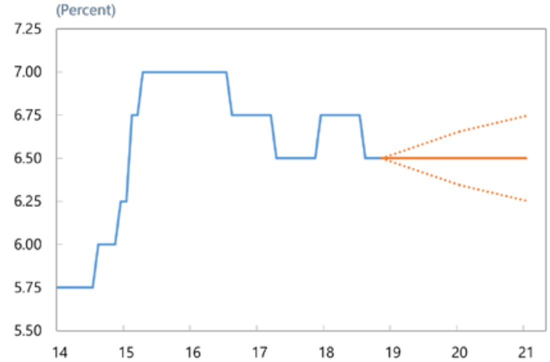
Policy Rate Correlation with Government Yields
(Correlation coefficient)



Note: Using monthly percentage point differences. Removing months with no policy rate change. Number of observations in parenthesis.

Analysts expect the policy rate to remain unchanged through end-2021.

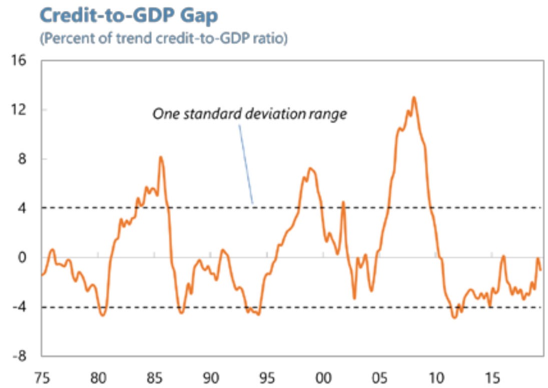
Policy Rate Consensus Forecasts Through End-2021
(Percent)



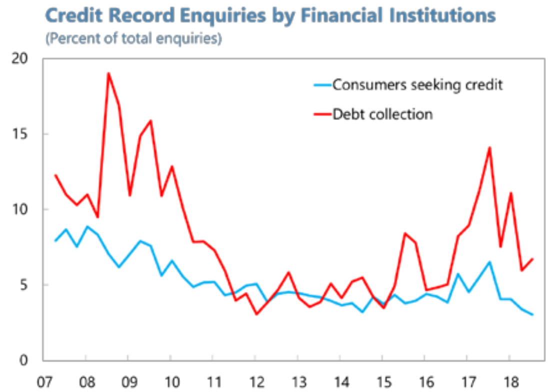
Sources: Bank for International Settlements, BER South Africa, Focus Economics Consensus Forecast, Haver Analytics, and IMF staff calculations.

Figure 8. South Africa: Credit Market Developments

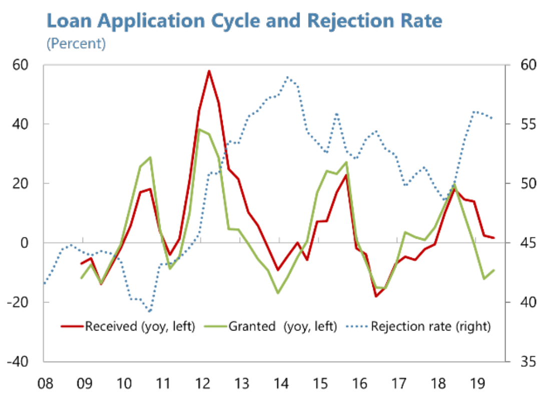
South Africa appears to have been at the bottom of the financial cycle for nearly a decade.



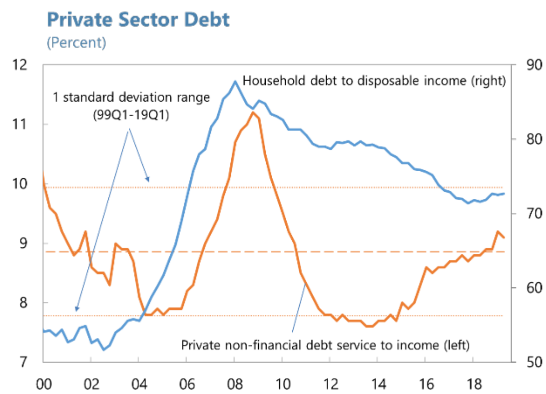
Credit standing of consumers appears weak as inquiries for debt collection remain relatively elevated.



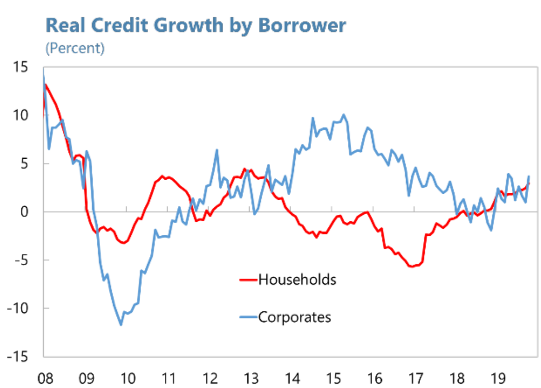
Credit application moderated after loan rejection increased.



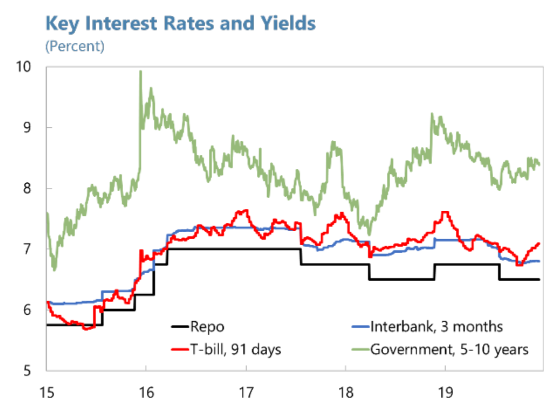
Debt burden of private non-financials exceeded historical average while household debt to income started to rise.



Real credit growth edged up but remains weak.



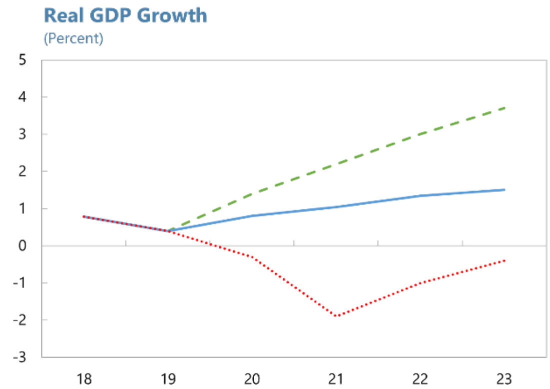
Short-term interest rates declined after the July policy rate cut but T-bill yields edged up more recently.



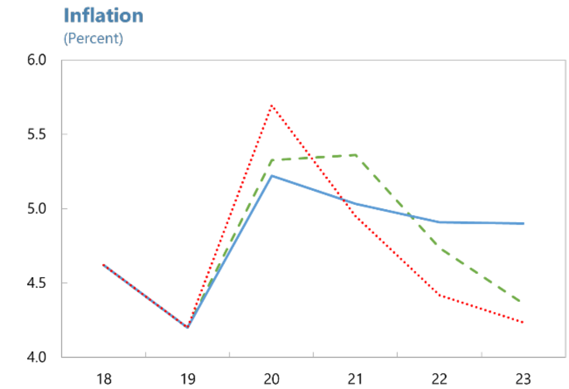
Sources: Bank for International Settlements, Haver Analytics, National Credit Regulator South Africa, and IMF staff calculations.

Figure 9. South Africa: Scenarios

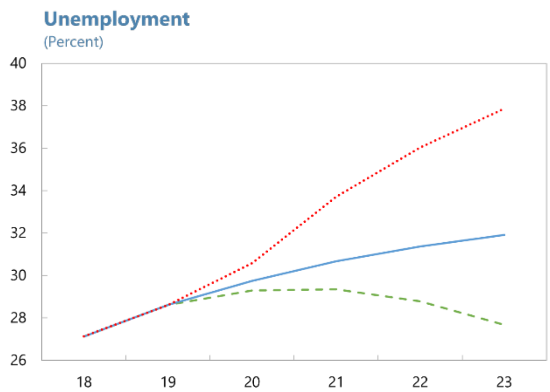
Real GDP growth would rise to 4 percent in the upside scenario, and fall to –2 percent in the downside one.



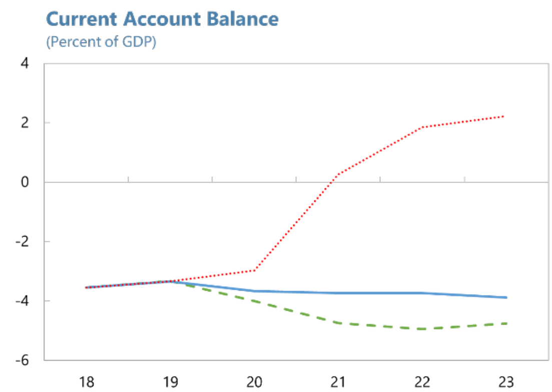
Inflation would rise on strong demand in the upside scenario and due to rand depreciation in the downside one.



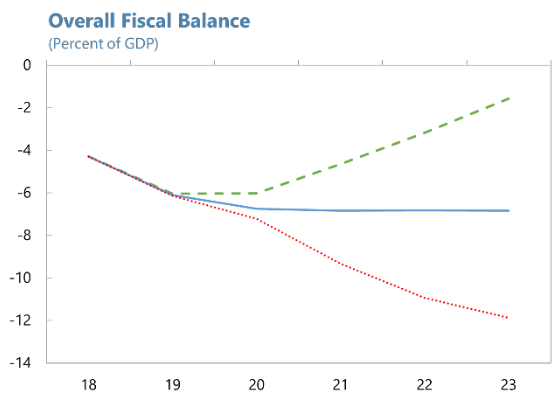
Unemployment would continue to fall in the upside; scenario; surge to 38 percent in the downside one.



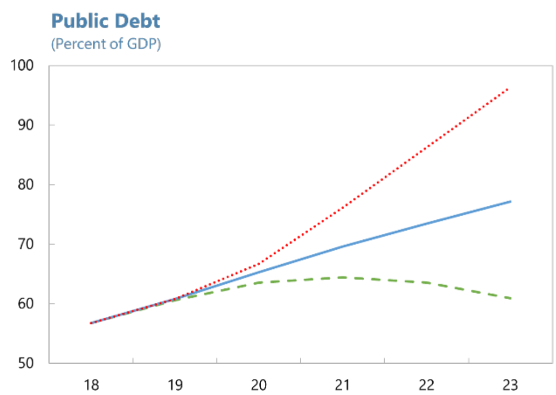
The CA deficit would widen on strong demand in the upside scenario; turn to a surplus on demand compression in the downside one.



Fiscal deficits would halve in the upside scenario; nearly double in the downside one.



Pubic debt would peak and start to decline in the upside scenario; become high and explosive in the downside one.

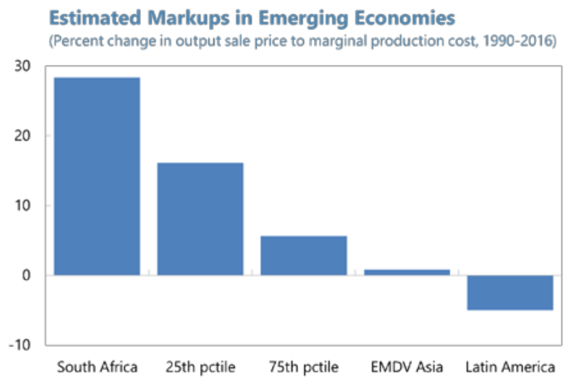


Upside Baseline Downside

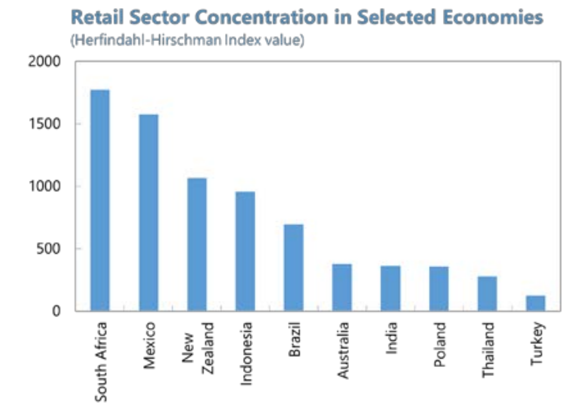
Source: IMF staff calculations.

Figure 10. South Africa: Structural Issues

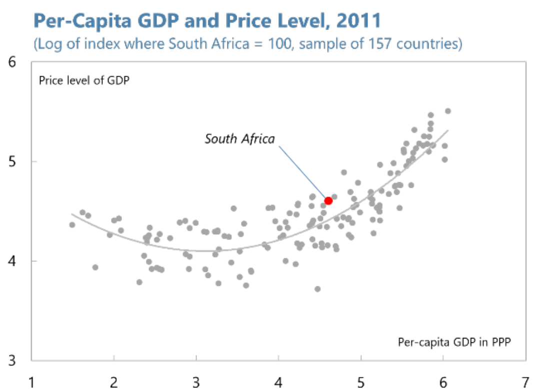
Markups in South Africa rose rapidly…



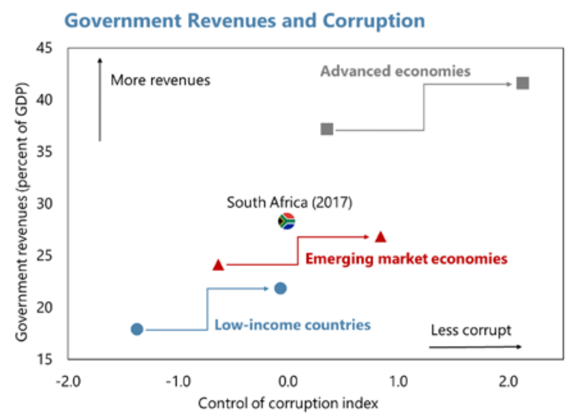
…likely reflecting the concentrated market structure…



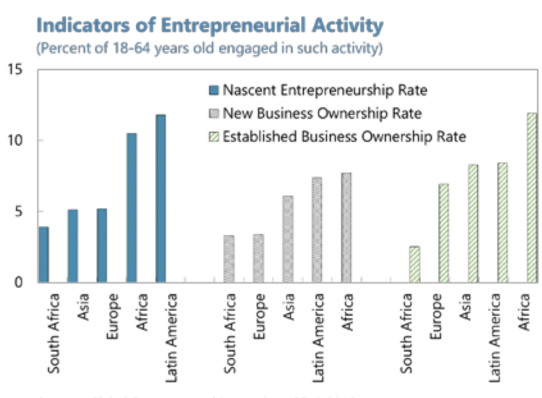
…leading to elevated price levels.



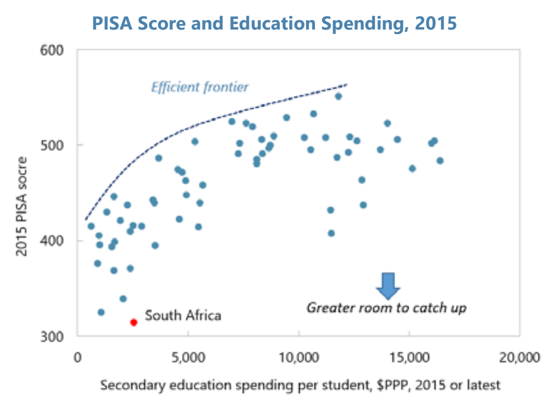
Better governance has multitude of benefits, including higher tax revenue.



From the demand side, unlocking the relatively low entrepreneurial activity would boost job creation.



From the supply side, there is much room to improve education attainment and skills.



Sources: Diez et al. 2018. "Global Market Power and its Macroeconomic Implications," IMF WP 18/137; Global Entrepreneurship Monitor (GEM) 2016; IMF Fiscal Monitor April 2019; Mlachila and Moeletsi. 2019. "Struggling to Make the Grade: A Review of the Causes and Consequences of the Weak Outcomes of South Africa's Education System," IMF WP 19/47; Orbis; World Bank World Development Indicators; Worldwide Governance Indicators; and IMF staff calculations.

Note: Point estimates of the Control of Corruption Index are subject to uncertainty.

Table 1. South Africa: Selected Economic Indicators, 2014–21

Social Indicators

GDP		**Poverty (percent of population)**	
Nominal GDP (2018, billions of US dollars)	368	Lower national poverty line (2015)	40
GDP per capita (2018, in US dollars)	6,354	Undernourishment (2016)	6
Population characteristics		**Inequality (income shares unless otherwise specified)**	
Total (2018, million)	58	Highest 10 percent of population	51
Urban population (2017, percent of total)	66	Lowest 20 percent of population	3
Life expectancy at birth (2017, number of years)	63	Gini coefficient (2015)	63

Economic Indicators

	2014	2015	2016	2017	2018	2019	2020	2021
							Proj.	
National income and prices (annual percentage change unless otherwise indicated)								
Real GDP	1.8	1.2	0.4	1.4	0.8	0.4	0.8	1.0
Real GDP per capita	0.3	-0.3	-1.1	-0.1	-0.7	-1.1	-0.7	-0.5
Real domestic demand	0.5	2.0	-0.9	1.9	0.9	0.7	0.8	1.1
GDP deflator	5.5	5.2	7.2	5.3	3.9	4.2	5.2	5.0
CPI (annual average)	6.1	4.6	6.3	5.3	4.6	4.2	5.2	5.0
CPI (end of period)	5.3	5.3	6.7	4.7	4.9	4.0	5.2	5.0
Labor market (annual percentage change unless otherwise indicated)								
Unemployment rate (percent of labor force, annual average)	25.1	25.4	26.7	27.5	27.1	28.6	29.8	30.7
Unit labor costs (formal nonagricultural)	5.2	5.4	5.5	5.1	4.6	4.2	5.2	5.0
Savings and Investment (percent of GDP)								
Gross national saving	15.4	16.3	16.3	16.3	14.4	14.2	13.8	13.8
Public (incl. public enterprises)	1.2	1.9	1.9	1.3	1.1	0.4	0.0	-0.1
Private	14.3	14.4	14.4	14.9	13.3	13.9	13.9	13.9
Investment (including inventories)	20.5	20.9	19.2	18.8	17.9	17.6	17.5	17.5
Public (incl. public enterprises)	6.9	7.3	6.9	6.3	5.7	5.9	5.9	6.1
Private	13.5	13.0	12.5	12.5	12.5	12.0	11.9	11.7
Fiscal position (percent of GDP unless otherwise indicated) 1/								
Revenue, including grants 2/	27.6	28.2	28.6	28.3	29.1	29.1	29.1	29.1
Expenditure and net lending	31.9	32.9	32.7	32.6	33.4	35.2	35.9	36.0
Overall balance	-4.3	-4.8	-4.1	-4.4	-4.3	-6.1	-6.7	-6.8
Primary balance	-1.2	-1.5	-0.6	-0.8	-0.5	-2.1	-2.4	-2.2
Structural balance (percent of potential GDP)	-4.1	-4.2	-3.8	-3.8	-3.6	-4.6	-4.9	-5.2
Gross government debt 3/	47.0	49.3	51.5	53.0	56.7	60.8	65.3	69.6
Government bond yield (10-year and over, percent)	8.0	9.7	8.9	9.2	9.4	9.0	...	...
Money and credit (annual percentage change unless otherwise indicated)								
Broad money	7.2	10.5	6.1	6.4	5.6	4.6	5.4	5.5
Credit to the private sector	7.2	8.0	4.7	4.3	5.5	3.1	3.7	3.7
Repo rate (percent, end-period)	5.8	6.3	7.0	6.8	6.8	6.5	...	...
3-month Treasury bill interest rate (percent)	5.8	6.1	7.2	7.3	7.2	7.1	...	...
Balance of payments (annual percentage change unless otherwise indicated)								
Current account balance (billions of U.S. dollars)	-17.8	-14.7	-8.5	-8.9	-13.1	-11.9	-13.4	-14.1
percent of GDP	-5.1	-4.6	-2.9	-2.5	-3.5	-3.3	-3.7	-3.7
Exports growth (volume)	3.6	2.9	0.4	-0.7	2.6	0.5	3.4	3.2
Imports growth (volume)	-0.6	5.4	-3.9	1.0	3.3	1.5	3.2	3.2
Terms of trade	-1.5	2.8	1.7	4.5	-2.6	1.4	-0.5	0.0
Overall balance (percent of GDP)	0.4	-0.3	0.9	0.5	0.2	0.6	-0.6	0.0
Gross reserves (billions of U.S. dollars)	49.1	45.8	47.4	50.7	51.6	53.8	51.5	51.7
Total external debt (percent of GDP)	41.3	39.1	48.2	49.6	46.8	51.1	51.0	51.2
Nominal effective exchange rate (period average)	-9.6	-5.2	-10.4	9.8	0.0	-5.2	...	...
Real effective exchange rate (period average) 4/	-6.1	-2.5	-6.3	12.7	1.8	-1.8	...	...
Exchange rate (Rand/U.S. dollar, end-period)	11.6	15.6	13.7	12.3	14.4	14.0	...	...

Sources: South African Reserve Bank, National Treasury, Haver, Bloomberg, World Bank, and Fund staff estimates and projections.

1/ Consolidated government as defined in the budget unless otherwise indicated.

2/ Revenue excludes "transactions in assets and liabilities" classified as part of revenue in budget documents. This item represents proceeds from the sales of assets, realized valuation gains from holding of foreign currency deposits, and other conceptually similar items, which are not classified as revenue by the IMF's Government Finance Statistics Manual 2010.

3/ Central government.

4/ January-October 2019 average.

Table 2. South Africa: Consolidated Government Operations, FY 2014/15–2022/23[1]

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20		2020/21		2021/22		2022/23	
						Auth.	Staff	Auth.	Staff	Auth.	Staff	Auth.	Staff
	(In billions of rand)												
Total revenue and grants	1,080.0	1,171.9	1,267.7	1,333.9	1,432.3	1,518.7	1,506.6	1,613.6	1,599.9	1,722.6	1,703.4	1,833.6	1,808.4
Tax revenue	934.6	1,019.0	1,104.6	1,160.5	1,239.4	1,319.4	1,306.9	1,397.5	1,386.3	1,493.5	1,476.5	1,593.5	1,568.1
Non-tax revenue 2/	15.6	13.9	15.0	16.3	22.2	20.6	20.6	23.5	23.5	25.1	25.1	26.7	26.7
Provinces, social security, and other entities	129.9	139.1	148.0	157.1	170.6	178.8	179.2	192.6	190.1	204.0	201.8	213.3	213.7
Total expenditure	1,235.0	1,366.3	1,443.0	1,543.8	1,652.8	1,844.1	1,845.1	1,978.7	1,969.8	2,097.5	2,095.9	2,214.9	2,221.2
Current expenditure	1,083.3	1,179.5	1,285.7	1,375.6	1,485.2	1,612.4	1,613.5	1,730.6	1,721.6	1,857.3	1,838.7	1,976.1	1,955.4
Wages and salaries	437.4	473.2	511.6	547.4	584.7	630.7	630.7	675.2	663.6	717.6	697.0	758.5	733.2
Other goods and services	186.0	197.9	218.9	227.5	233.4	252.2	252.2	264.3	264.3	284.9	284.9	297.3	297.3
Interest	121.4	138.5	154.4	169.8	188.5	211.0	212.0	241.4	244.1	273.1	275.0	308.0	312.7
Transfers	338.6	369.9	400.8	431.0	478.6	518.6	518.6	549.6	549.6	581.8	581.8	612.2	612.2
Capital expenditure	145.5	155.7	148.8	147.8	151.7	164.5	164.5	174.3	174.3	189.6	189.6	202.8	202.8
Payment for financial assets	6.2	31.1	8.5	20.3	15.9	67.1	67.1	67.9	67.9	44.6	61.6	30.0	57.0
Contingency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.0	6.0	6.0	6.0	6.0	6.0
Primary balance	-33.6	-55.9	-20.9	-40.1	-32.0	-114.4	-126.4	-123.7	-125.8	-101.9	-117.5	-73.3	-100.2
Overall balance	-155.0	-194.4	-175.3	-209.9	-220.6	-325.3	-338.4	-365.1	-369.9	-374.9	-392.5	-381.3	-412.8
Financing	155.0	194.4	175.3	209.9	220.6	325.3	338.4	365.1	369.9	374.9	392.5	381.3	412.8
Domestic Debt (net)	164.2	159.3	159.8	206.2	184.8	311.2	324.3	324.0	328.8	340.3	357.9	348.7	380.2
External Debt (net)	7.3	-3.9	35.4	29.8	23.3	25.7	25.7	32.8	32.8	42.0	42.0	38.7	38.7
Transactions in Assets and Liabilities	15.3	43.4	18.2	19.6	13.1	19.1	19.1	4.9	4.9	7.0	7.0	7.6	7.6
Use of cash and other balances	-31.8	-4.4	-39.6	-48.7	-0.7	-30.7	-30.7	3.4	3.4	-14.4	-14.4	-13.7	-13.7
Structural primary balance	-30.8	-41.6	-6.5	-14.3	1.2	...	-39.1	...	-38.0	...	-44.6	...	-40.3
Gross government debt	1,799	2,019	2,233	2,490	2,788	3,168	3,201	3,591	3,640	4,036	4,113	4,478	4,606
	(In percent of GDP)												
Total revenue and grants	27.9	28.4	28.7	28.4	29.1	29.1	29.1	29.2	29.2	29.2	29.2	29.2	29.2
Tax revenue	24.2	24.7	25.0	24.7	25.2	25.3	25.3	25.3	25.3	25.3	25.3	25.4	25.3
Non-tax revenue	0.4	0.3	0.3	0.3	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Provinces, social security, and other entities	3.4	3.4	3.3	3.3	3.5	3.4	3.5	3.5	3.5	3.5	3.5	3.4	3.4
Total expenditure	31.9	33.1	32.6	32.8	33.6	35.4	35.7	35.8	35.9	35.6	36.0	35.3	35.8
Current expenditure	28.0	28.6	29.1	29.3	30.2	30.9	31.2	31.3	31.4	31.5	31.6	31.5	31.6
Wages and salaries	11.3	11.5	11.6	11.6	11.9	12.1	12.2	12.2	12.1	12.2	12.0	12.1	11.8
Other goods and services	4.8	4.8	5.0	4.8	4.7	4.8	4.9	4.8	4.8	4.8	4.9	4.7	4.8
Interest	3.1	3.4	3.5	3.6	3.8	4.0	4.1	4.4	4.4	4.6	4.7	4.9	5.0
Transfers	8.8	9.0	9.1	9.2	9.7	10.0	10.0	9.9	10.0	9.9	10.0	9.7	9.9
Capital expenditure	3.8	3.8	3.4	3.1	3.1	3.2	3.2	3.2	3.2	3.2	3.3	3.2	3.3
Payment for financial assets	0.2	0.8	0.2	0.4	0.3	1.3	1.3	1.2	1.2	0.8	1.1	0.5	0.9
Contingency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Primary balance	-0.9	-1.4	-0.5	-0.9	-0.7	-2.2	-2.4	-2.2	-2.3	-1.7	-2.0	-1.2	-1.6
Overall balance	-4.0	-4.7	-4.0	-4.5	-4.5	-6.2	-6.5	-6.6	-6.7	-6.4	-6.7	-6.1	-6.7
Financing	4.0	4.7	4.0	4.5	4.5	6.2	6.5	6.6	6.7	6.4	6.7	6.1	6.7
Domestic Debt (net)	4.2	3.9	3.6	4.4	3.8	6.0	6.3	5.9	6.0	5.8	6.1	5.6	6.1
External Debt (net)	0.2	-0.1	0.8	0.6	0.5	0.5	0.5	0.6	0.6	0.7	0.7	0.6	0.6
Transactions in Assets and Liabilities	0.4	1.1	0.4	0.4	0.3	0.4	0.4	0.1	0.1	0.1	0.1	0.1	0.1
Use of cash and other balances	-0.8	-0.1	-0.9	-1.0	0.0	-0.6	-0.6	0.1	0.1	-0.2	-0.2	-0.2	-0.2
Structural primary balance (percent of potential GDP)	-0.8	-1.0	-0.1	-0.3	0.0	...	-0.8	...	-0.7	...	-0.8	...	-0.7
Gross government debt 3/	46.5	48.9	50.5	52.9	56.6	60.8	61.9	64.9	66.3	68.5	70.6	71.3	74.3
Memorandum items:													
National budget primary balance (percent of GDP)	-1.7	-2.0	-0.9	-1.4	-1.3	-2.7	-2.9	-2.7	-2.8	-2.1	-2.5	-1.6	-2.0
National budget overall balance (percent of GDP)	-4.7	-5.1	-4.2	-4.9	-5.0	-6.6	-6.9	-6.9	-7.0	-6.6	-7.0	-6.3	-6.9
SOE Debt Guarantees 4/	8.2	9.0	9.4	9.4	10.5	...	...	...	...	...	...	...	...
Fiscal year GDP (billions of rand)	3,866	4,127	4,420	4,702	4,925	5,211	5,173	5,530	5,487	5,893	5,826	6,283	6,196
Fiscal year real GDP growth (percent)	1.8	0.4	0.8	1.6	0.4	0.9	0.7	1.2	0.7	1.6	1.2	1.8	1.4
Fiscal year GDP Deflator growth (in percent)	5.2	6.3	6.2	4.8	4.3	4.9	4.3	4.9	5.4	4.9	4.9	4.7	4.9
Fiscal year nominal GDP growth (percent)	7.1	6.8	7.1	6.4	4.7	5.9	5.0	6.1	6.1	6.6	6.2	6.6	6.4

Sources: South African National Treasury and Fund staff estimates and projections.

1/ Data are on a fiscal year basis (April 1-March 31). Consolidated government corresponds to the national government, social security funds, provincial governments, and some public entities. Local governments are only partially captured through the transfers sent to them by the national government. The authorities' projections are based on the 2018 Budget Review.

2/ Non- tax revenue excludes transactions in financial assets and liabilities. These transactions are classified as a domestic financing item given that they involve primarily revenues associated with realized exchange rate valuation gains from the holding of foreign currency deposits and other conceptually similar smaller items.

3/ Covers only national government debt.

4/ Sourced from Table 11 of the Statistical Annex of the 2019 Budget Review.

Table 3. South Africa: Balance of Payments, 2014–24

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Proj.					
	(In billions of US dollars)										
Balance on current account	-17.8	-14.7	-8.5	-8.9	-13.1	-11.9	-13.4	-14.1	-14.7	-15.9	-17.0
Balance on goods and services	-5.3	-4.2	1.6	4.5	1.3	1.8	1.6	1.6	2.1	2.1	2.4
Exports of goods and services	110	96	91	104	110	112	114	118	124	130	137
Imports of goods and services	-116	-100	-89	-99	-109	-110	-113	-117	-122	-128	-134
Balance on income	-9.4	-7.9	-8.2	-10.5	-11.6	-11.3	-12.5	-13.2	-14.2	-15.2	-16.4
Income receipts	7.6	7.7	6.0	6.1	7.3	4.3	2.0	2.1	2.2	2.3	4.0
Income payments	-16.9	-15.6	-14.2	-16.6	-18.9	-15.6	-14.5	-15.3	-16.3	-17.5	-20.4
Balance on transfers	-3.2	-2.6	-1.9	-2.9	-2.7	-2.4	-2.4	-2.5	-2.6	-2.8	-2.9
Capital flows (including errors and omissions)	19.2	13.6	11.2	10.8	13.9	14.1	11.1	14.3	14.8	16.0	17.1
Balance on capital and financial account	24.3	15.3	11.7	10.2	11.6	14.1	11.1	14.3	14.8	16.0	17.1
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	24.3	15.3	11.7	10.2	11.6	14.1	11.1	14.3	14.8	16.0	17.1
Direct investment	-1.9	-4.0	-2.2	-5.4	0.8	1.0	1.1	1.2	1.2	1.2	1.2
Liabilities	5.8	1.7	2.2	2.0	5.3	5.5	5.6	5.9	6.0	6.3	6.5
Assets	-7.7	-5.7	-4.5	-7.4	-4.6	-4.4	-4.5	-4.7	-4.9	-5.1	-5.3
Portfolio investment	13.4	9.6	16.4	16.5	2.5	6.9	7.1	7.4	7.6	7.9	8.2
Liabilities	13.6	9.5	9.5	20.9	6.8	6.9	7.1	7.4	7.6	7.9	8.2
Assets	-0.1	0.1	6.8	-4.4	-4.3	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	1.5	0.4	-0.9	-0.3	0.5	0.5	0.5	0.6	0.6	0.6	0.6
Liabilities	-18.0	-25.2	-33.9	-17.1	-16.5	-16.1	-16.3	-16.7	-17.1	-17.5	-18.0
Assets	19.5	25.5	33.0	16.8	17.0	16.6	16.8	17.2	17.7	18.1	18.6
Other investment	11.2	9.3	-1.5	-0.6	7.7	5.7	2.4	5.1	5.5	6.3	7.0
Liabilities	13.7	5.7	-0.3	4.6	9.0	6.9	3.6	6.3	6.7	7.5	8.3
Assets	-2.4	3.7	-1.3	-5.3	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2
Errors and omissions	-5.1	-1.8	-0.4	0.6	2.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	1.4	-1.1	2.7	1.9	0.9	2.2	-2.3	0.2	0.1	0.1	0.1
Gross reserves (end of period)	49.1	45.8	47.4	50.7	51.6	53.8	51.5	51.7	51.8	51.9	52.1
	(In percent of GDP)										
Balance on current account	-5.1	-4.6	-2.9	-2.5	-3.5	-3.3	-3.7	-3.7	-3.7	-3.9	-4.0
Balance on goods and services	-1.5	-1.3	0.5	1.3	0.3	0.5	0.4	0.4	0.5	0.5	0.6
Balance on goods	-1.4	-1.2	0.7	1.4	0.5	0.6	0.4	0.4	0.5	0.5	0.5
Balance on services	-0.1	-0.1	-0.2	-0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.1
Exports of goods and services	31.5	30.2	30.6	29.6	29.9	31.3	31.2	31.3	31.6	31.9	32.1
Imports of goods and services	-33.0	-31.5	-30.1	-28.3	-29.6	-30.8	-30.8	-30.9	-31.1	-31.4	-31.6
Balance on income	-2.7	-2.5	-2.8	-3.0	-3.2	-3.2	-3.4	-3.5	-3.6	-3.7	-3.9
Balance on transfers	-0.9	-0.8	-0.6	-0.8	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Capital flows (including errors and omissions)	5.5	4.3	3.8	3.1	3.8	4.0	3.0	3.8	3.8	3.9	4.0
Balance on capital and financial account	6.9	4.8	3.9	2.9	3.2	4.0	3.0	3.8	3.8	3.9	4.0
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	6.9	4.8	3.9	2.9	3.1	3.9	3.0	3.8	3.8	3.9	4.0
Direct investment	-0.5	-1.3	-0.8	-1.5	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Portfolio investment	3.8	3.0	5.5	4.7	0.7	1.9	1.9	2.0	1.9	1.9	1.9
Financial derivatives	0.4	0.1	-0.3	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other investment	3.2	2.9	-0.5	-0.2	2.1	1.6	0.7	1.3	1.4	1.5	1.7
Errors and omissions	-1.5	-0.6	-0.2	0.2	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	0.4	-0.3	0.9	0.5	0.2	0.6	-0.6	0.0	0.0	0.0	0.0
Gross reserves (end of period)	14.0	14.4	16.0	14.5	14.0	15.1	14.1	13.6	13.2	12.7	12.2
Memorandum items:											
Total external debt	41.3	39.1	48.2	49.6	46.8	51.1	51.0	51.2	51.3	51.6	51.9
International investment position (net)	-7.9	15.7	7.0	7.6	11.3	...	...	...	...	...	...
GDP at current prices (US$ billion)	351	318	296	349	368	357	365	378	393	409	426

Sources: South African Reserve Bank and Fund staff estimates and projections.

Table 4. South Africa: Financial Corporations, 2014–24

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
								Proj.			
					(In billions of rand)						
Central Bank											
Net foreign assets	528	668	607	585	700	708	730	747	765	782	800
Net domestic assets	-323	-444	-367	-329	-431	-427	-433	-435	-435	-433	-429
Domestic claims	-306	-431	-352	-313	-399	-413	-380	-384	-387	-390	-394
Central government (net)	-353	-484	-418	-382	-474	-506	-474	-477	-481	-484	-487
State and local government	0.3	0.1	0.2	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Public nonfinancial corporations	1.4	1.4	1.3	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Private sector	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other depository corporations	45	51	59	62	68	87	87	87	87	87	87
Other financial corporations	0.0	0.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Other items net	-17.0	-13.2	-15.1	-15.4	-32.0	-14.0	-52.8	-51.0	-47.7	-42.4	-35.7
Monetary base	205	224	240	257	269	281	296	313	330	350	370
Other Depository Corporations											
Net foreign assets	72	117	96	113	60	114	115	106	120	119	110
Net domestic assets	2,673	2,971	3,123	3,393	3,667	3,811	3,978	4,158	4,368	4,609	4,873
Domestic claims	3,305	3,670	3,904	4,183	4,467	4,648	4,865	5,100	5,370	5,675	6,008
Central government (net)	245	284	361	433	484	530	579	636	700	768	838
State and local government	21.2	19.4	18.2	18.8	20.9	21.9	23.2	24.7	26.2	27.9	29.7
Public nonfinancial corporations	44.6	48.0	58.6	76.1	71.3	73.8	75.6	78.0	80.3	82.6	85.0
Private sector	2,552	2,764	2,903	3,051	3,204	3,303	3,424	3,552	3,702	3,880	4,080
of which loans and securities	2,500	2,699	2,826	2,948	3,111	3,207	3,325	3,449	3,594	3,767	3,961
Central Bank	121	126	139	145	147	153	163	173	184	196	208
Other financial corporations	322	428	424	459	541	566	600	637	677	721	768
Other items net	-632	-699	-781	-790	-800	-837	-888	-942	-1,001	-1,066	-1,135
Depository Corporations											
Net foreign assets	600	785	704	699	760	822	844	853	886	902	909
Net domestic assets	2,097	2,190	2,453	2,660	2,787	2,888	3,068	3,274	3,476	3,714	3,976
Domestic claims	2,834	3,062	3,354	3,662	3,853	3,995	4,235	4,457	4,712	5,003	5,320
Central government (net)	-108	-199	-57	50	10	23	105	158	220	284	351
State and local government	21.5	19.5	18.4	19.2	21.3	22.2	23.6	25.0	26.5	28.2	30.0
Public nonfinancial corporations	46.0	49.4	59.9	77.1	72.3	74.8	76.6	79	81	84	86
Private sector	2,552	2,764	2,904	3,052	3,204	3,304	3,425	3,553	3,703	3,881	4,080
of which loans and securities	2,500	2,699	2,826	2,948	3,111	3,207	3,325	3,449	3,594	3,767	3,961
Other financial corporations	322	428	429	464	546	571	605	642	682	726	773
Other items net	-737	-872	-901	-1,002	-1,066	-1,106	-1,168	-1,183	-1,236	-1,288	-1,344
Broad money	2,697	2,975	3,156	3,359	3,547	3,710	3,912	4,127	4,361	4,616	4,885

Sources: International Financial Statistics, South African Reserve Bank, and IMF staff estimates.

Table 4. South Africa: Financial Corporations: 2014–24 (concluded)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
								Proj.			
					(In billions of rand)						
Other Financial Corporations											
Net foreign assets	606	796	774	831	930	912	939	956	949	946	938
Net domestic assets	3,539	3,472	3,685	4,092	3,994	4,239	4,524	4,842	5,215	5,617	6,050
Domestic claims	5,406	5,490	5,837	6,372	6,320	6,696	7,167	7,679	8,229	8,825	9,457
Central government (net)	886	882	929	947	994	1,096	1,222	1,355	1,495	1,649	1,812
State and local government	14.3	13.7	16.0	15.1	17.2	18.0	19.1	20.2	21.5	22.9	24.4
Public nonfinancial corporations	438	407	439	420	415	462	496	541	585	630	674
Private sector	3,193	3,210	3,366	3,811	3,649	3,817	4,049	4,297	4,568	4,864	5,179
of which loans and securities	708	764	841	877	926	955	990	1,027	1,070	1,121	1,179
Central Bank	13.2	13.5	14.5	11.2	10.0	10.5	11.1	11.8	12.5	13.3	14.2
Other Depository Corporations	862	963	1,074	1,167	1,235	1,292	1,370	1,454	1,546	1,646	1,753
Other items net	-1,867	-2,018	-2,152	-2,280	-2,326	-2,457	-2,644	-2,837	-3,014	-3,208	-3,407
Non-liquid liabilities	4,145	4,268	4,459	4,923	4,924	5,151	5,463	5,798	6,164	6,563	6,988
Financial Corporations											
Net foreign assets	1,207	1,581	1,478	1,530	1,667	1,734	1,783	1,809	1,835	1,848	1,848
Net domestic assets	4,734	4,731	5,109	5,692	5,752	6,026	6,399	6,823	7,287	7,807	8,371
Domestic claims	7,042	7,147	7,674	8,392	8,431	8,817	9,416	10,028	10,700	11,442	12,237
Central government (net)	778	683	872	997	1,052	1,120	1,327	1,514	1,715	1,933	2,163
State and local government	35.7	33.2	34.4	34.3	38.5	40.2	42.6	45.2	48.1	51.1	54.4
Public nonfinancial corporations	484	457	499	498	487	537	573	620	667	713	760
Private sector	5,745	5,974	6,269	6,863	6,853	7,121	7,473	7,849	8,271	8,745	9,259
of which loans and securities	3,208	3,463	3,668	3,825	4,037	4,162	4,314	4,475	4,664	4,889	5,140
Other items net	-2,309	-2,416	-2,565	-2,700	-2,679	-2,791	-3,017	-3,206	-3,413	-3,635	-3,866
Liabilities	5,940	6,312	6,587	7,222	7,419	7,761	8,182	8,631	9,122	9,655	10,218
Liquid	1,689	1,876	2,009	2,166	2,315	2,422	2,553	2,693	2,846	3,013	3,189
Nonliquid	4,251	4,436	4,578	5,056	5,104	5,339	5,629	5,938	6,276	6,642	7,030
Memorandum items:											
Year-on-year growth (percent)											
Monetary base	7.3	9.0	7.3	7.0	4.6	4.6	5.4	5.5	5.7	5.8	5.8
Broad money	7.3	10.3	6.1	6.4	5.6	4.6	5.4	5.5	5.7	5.8	5.8
Claims on private sector											
Dep. Corp.	7.2	8.3	5.1	5.1	5.0	3.1	3.7	3.7	4.2	4.8	5.1
Dep. Corp., loans and securities	7.2	8.0	4.7	4.3	5.5	3.1	3.7	3.7	4.2	4.8	5.1
Fin. Corp., loans and securities	8.7	8.0	5.9	4.3	5.5	3.1	3.7	3.7	4.2	4.8	5.1
Broad money multiplier (ratio)	13.1	13.3	13.2	13.1	13.2	13.2	13.2	13.2	13.2	13.2	13.2

Sources: International Financial Statistics, South African Reserve Bank, and IMF staff estimates.

Table 5. South Africa: Soundness Indicators, 2014–19

	2014	2015	2016	2017	2018	2019[1/]
			(Percent)			
Capital adequacy						
Regulatory capital to risk weighted assets	14.8	14.2	15.9	16.3	16.1	16.4
of which Tier 1 capital	13.6	13.8	14.5	15.4	14.9	15.1
Capital to total assets	7.6	7.0	8.2	8.8	8.4	8.3
Asset quality						
Nonperforming loans to total of loans	3.2	3.1	2.9	2.8	3.7	3.8
Nonperforming loans net of provisions to capital	16.8	17.2	14.8	13.6	17.8	17.9
Earnings, profitability, and efficiency						
Return on assets	1.4	1.5	1.7	1.7	1.7	1.6
Return on equity	18.8	20.6	22.2	20.0	19.8	18.7
Interest margin to gross income	53.3	49.4	51.0	50.7	50.0	53.6
Trading income to total income	2.8	2.3	6.4	7.8	6.7	6.1
Non-interest expenses to gross income	53.5	47.7	53.3	54.9	52.8	65.7
Personnel expenses to non-interest expenses	50.7	42.2	46.0	48.1	51.9	49.8
Liquidity						
Liquid assets to total assets	17.6	17.8	16.0	15.1	15.6	15.9
Liquid assets to short-term liabilities	33.5	35.1	30.9	30.0	31.1	32.9
Customer deposits to total loans	53.5	54.3	54.5	55.9	55.7	55.3
Exposure to FX risk						
Net open FX position to capital	0.3	-0.3	1.0	0.1	0.7	0.8
Foreign-currency-denominated loans to total loans	10.1	11.2	10.0	8.9	9.4	8.6
Foreign-currency-denominated liabilities total liabilities	8.1	9.4	8.5	6.6	8.0	7.4
Sectoral distribution of loans and advances						
Residents	88.2	87.4	88.5	89.5	89.3	89.2
Central Bank and other financial corporations	12.2	13.8	13.7	13.5	15.7	15.0
General government	0.7	0.6	0.5	0.5	0.5	0.6
Nonfinancial corporations	32.2	32.4	34.7	35.4	34.0	34.3
Households	43.1	40.6	39.6	40.1	39.1	39.4
Nonresidents	11.9	12.6	11.5	10.5	10.7	10.8
Derivatives						
Gross asset position in financial derivatives to capital	64.5	113.7	51.6	60.2	41.9	57.4
Gross liability position in financial derivatives to capital	69.5	129.3	54.2	59.3	42.9	58.1
Real Estate Market						
Residential real estate price growth [2/]	7.7	6.2	5.6	4.3	3.8	3.6
Residential real estate loans to total loans	26.6	24.8	24.8	25.0	24.0	23.8
Commercial real estate loans to total loans	9.1	9.2	7.4	7.6	7.5	7.7
Household debt [3/]						
Household debt to GDP	45.8	45.1	43.5	42.3	43.3	43.3
Household debt to disposable income	77.8	75.9	73.4	71.2	72.7	72.7
Household debt service to disposable income	9.3	9.4	9.5	9.1	9.3	9.4

Sources: Financial Soundness Indicators Database, Haver, and IMF staff calculations.

[1/] As of August, 2019.

[2/] As of October, 2019.

[3/] As of June, 2019.

Table 6. South Africa: Medium-Term Macroeconomic Framework, 2014–24

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Proj.					
National income and prices (annual percentage change)											
Real GDP	1.8	1.2	0.4	1.4	0.8	0.4	0.8	1.0	1.3	1.5	1.5
CPI (annual average)	6.1	4.6	6.3	5.3	4.6	4.2	5.2	5.0	4.9	4.9	4.9
Output gap (percent of potential real GDP)	0.0	0.0	-0.6	-0.2	-0.3	-0.5	-0.4	-0.3	-0.2	0.0	0.0
Labor market (annual percentage change)											
Unemployment rate (percent of labor force, annual average)	25.1	25.4	26.7	27.5	27.1	28.6	29.7	30.7	31.4	31.9	32.5
Savings and Investment (percent of GDP)											
Gross national saving	15.4	16.3	16.3	16.3	14.4	14.2	13.8	13.8	13.8	13.8	13.8
Public (incl. public enterprises)	1.2	1.9	1.9	1.3	1.1	0.4	0.0	-0.1	-0.2	-0.4	-0.3
Private	14.3	14.4	14.4	14.9	13.3	13.9	13.9	13.9	14.0	14.1	14.1
Investment (including inventories)	20.5	20.9	19.2	18.8	17.9	17.6	17.5	17.5	17.5	17.6	17.8
Public (incl. public enterprises)	6.9	7.3	6.9	6.3	5.7	5.9	5.9	6.1	6.1	6.2	6.2
Private	13.5	13.0	12.5	12.5	12.5	12.0	11.9	11.7	11.7	11.8	11.8
Fiscal position (percent of GDP) 1/											
Revenue, including grants	27.6	28.2	28.6	28.3	29.1	29.1	29.1	29.1	29.2	29.2	29.3
Expenditure and net lending	31.9	32.9	32.7	32.6	33.4	35.2	35.9	36.0	36.0	36.0	36.0
Overall balance	-4.3	-4.8	-4.1	-4.4	-4.3	-6.1	-6.7	-6.8	-6.8	-6.8	-6.8
Primary balance	-1.2	-1.5	-0.6	-0.8	-0.5	-2.1	-2.4	-2.2	-1.8	-1.5	-1.1
Gross government debt 2/	47.0	49.3	51.5	53.0	56.7	60.8	65.3	69.6	73.5	77.1	80.6
Balance of payments (percent of GDP unless otherwise indicated)											
Exports of Goods and Services (volume, annual percentage change)	3.6	2.9	0.4	-0.7	2.6	0.5	3.4	3.2	3.5	3.5	3.7
Imports of Goods and Services (volume, annual percentage change)	-0.6	5.4	-3.9	1.0	3.3	1.5	3.2	3.2	3.5	3.6	3.6
Current account balance (billions of U.S. dollars)	-17.8	-14.7	-8.5	-8.9	-13.1	-11.9	-13.4	-14.1	-14.7	-15.9	-17.0
percent of GDP	-5.1	-4.6	-2.9	-2.5	-3.5	-3.3	-3.7	-3.7	-3.7	-3.9	-4.0
Overall balance	0.4	-0.3	0.9	0.5	0.2	0.6	-0.6	0.0	0.0	0.0	0.0
Gross reserves (billions of U.S. dollars)	49.1	45.8	47.4	50.7	51.6	53.8	51.5	51.7	51.8	51.9	52.1
percent of short-term debt (residual maturity)	100.5	106.9	118.3	93.7	89.2	87.5	88.9	89.6	86.9	88.4	85.0
Total external debt	41.3	39.1	48.2	49.6	46.8	51.1	51.0	51.2	51.3	51.6	51.9

Sources: Haver, South African National Treasury, World Bank, and Fund staff estimates and projections.

1/ Consolidated government unless otherwise indicated.

2/ National government.

Table 7. South Africa: Indicators of External Vulnerability, 2014–19

	2014	2015	2016	2017	2018	2019
Financial indicators						
Gross government debt (percent of GDP)	47.0	49.3	51.5	53.0	56.7	60.0
Broad money (annual percentage change)	7.2	10.5	6.1	6.8	4.7	5.1
Private sector credit (annual percentage change)	7.2	8.0	4.7	4.3	5.5	3.7
91 day Treasury bill yield (percent, end-period)	5.8	6.1	7.2	7.3	7.2	6.9
91 day Treasury bill yield (real, percent, end-period) 1/	-0.3	1.5	0.6	2.0	2.5	2.8
External indicators						
Exports (annual percentage change in U.S. dollars)	-3.3	-13.7	-5.5	15.0	7.4	3.2
Export volume (goods and services, annual percentage change)	3.6	2.9	0.4	-0.7	2.6	2.7
Imports (annual percentage change in U.S. dollars)	-5.2	-14.4	-12.1	11.7	11.5	2.2
Import volume (goods and services, annual percentage change)	-0.6	5.4	-3.9	1.0	3.3	2.8
Terms of trade (annual percentage change) 2/	-1.5	2.8	1.7	4.5	-2.6	1.3
Current account balance (percent of GDP)	-5.1	-4.6	-2.9	-2.5	-3.5	-3.1
Capital and financial account, excl. financial derivatives (percent of GDP)	6.5	4.7	4.3	3.0	3.0	2.7
of which: Net portfolio investment (debt and equity)	3.8	3.0	5.5	4.7	0.7	1.6
Other investment (loans, trade credits, etc.)	3.2	2.9	-0.5	-0.2	2.1	0.8
Net foreign direct investment	-0.5	-1.3	-0.8	-1.5	0.2	0.2
Gross international reserves (billions of U.S. dollars)	49.1	45.8	47.4	50.7	51.6	49.9
in months of prospective imports of goods and services	5.9	6.2	5.7	5.6	5.6	5.6
in percent of broad money	21.1	24.0	20.5	18.5	21.0	20.5
in percent of short-term debt, residual maturity	100.5	106.9	118.3	93.7	91.5	74.5
Net international reserves (billions of U.S. dollars)	42.7	40.7	40.8	42.9	43.1	44.2
Foreign currency forward position (billions of U.S. dollars)	2.0	1.4	1.8	1.2	0.1	0.2
Total external debt (percent of GDP)	41.3	39.1	48.2	49.6	46.8	47.7
percent of export earnings	131.4	129.6	157.6	167.4	156.6	149.8
External interest payments (percent of export earnings)	5.2	8.3	5.7	4.7	6.2	5.9
External amortization payments (percent of export earnings)	35.7	51.0	47.3	38.7	49.2	49.5
Exchange rate (Rand/U.S. dollar, period average)	10.8	12.8	14.7	13.3	13.2	15.1
Real effective exchange rate (annual percentage change, period average)	-6.1	-2.5	-6.3	12.8	1.7	85.2
Financial market indicators						
Stock market index (end-period)	49,771	50,694	50,654	59,505	52,737	55,260
Net purchases of bonds by nonresidents (billions of U.S. dollars)	-5.1	-2.3	-2.4	1.7	-6.7	-2.3
Net purchases of shares by nonresidents (billions of U.S. dollars)	1.2	-0.3	-8.2	-3.6	-4.0	-5.6

Sources: Haver and IMF staff calculations.

1/ Nominal yield deflated by current CPI inflation.
2/ The terms of trade include gold.

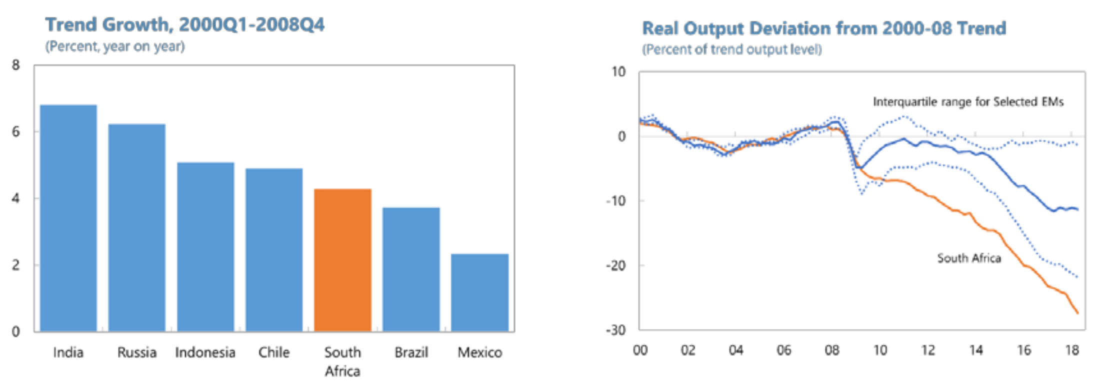
Annex I. Assessing Macro-Financial Linkages in South Africa: A Growth-at-Risk Approach

Growth has been low for a protracted period in the past decade, creating relatively large output losses in South Africa. An analysis of growth forecasts using a Growth-at-Risk approach suggests that credit shocks did not have as much potential to explain, or drive, economic growth in the past decade as in the previous decade. The results highlight the importance of revisiting the growth model. This could be done by addressing micro-level constraints to growth, such as the business environment, which worsened in the past decade.

Protracted Low Growth: The Context

1. **A pressing question for South Africa is how to boost its subdued economic growth.** Growth decelerated from the 2000s to the 2010s significantly and has been very low for a protracted period. While worse external conditions could have contributed to the deceleration, domestic factors have certainly played an important role, evidenced by the fact that growth started to diverge from its peers in the past decade. Such inflection is evident in a range of macroeconomic indicators, including the public debt-to-GDP ratio, which doubled in the past decade, the unemployment rate, which rose 8 points to 29 percent in the third quarter of 2019, and business confidence indicators, which after remaining structurally depressed, fell to very low levels in 2019. Moreover, the inflection coincides with the global financial crisis in 2008–09, which is often considered in the economic literature to represent a structural break.

Figure A1.1. Output Performance of South Africa and Selected Emerging Economies

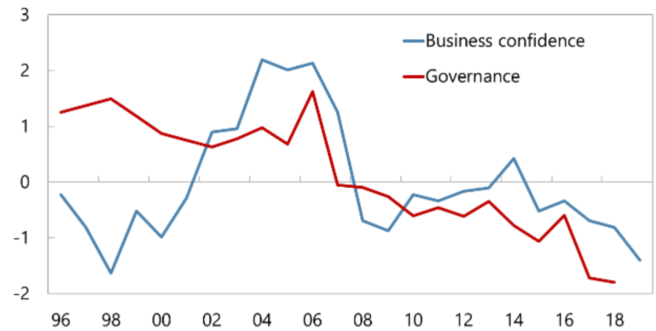


Sources: Haver and IMF staff calculations.

2. **South Africa's output losses after 2008, measured relative to the trajectory that extrapolates the pre-2008 trend, compare unfavorably to its peers** (Figure A1.1). Externally, favorable external conditions that buoyed global growth prior to 2008 dissipated. Domestically, the Commonly used indicators show that political uncertainty rose, government effectiveness declined, regulatory quality worsened, and control of business environment has become less favorable and related micro-level constraints have worsened. corruption weakened. This has likely depressed business confidence and private investment (Figure A1.2).

Figure A1.2. Indicators of Governance and Business Confidence in South Africa

(Distance from historical mean in number of historical standard deviation)



Note: Governance indicator is unweighted average of "estimate" variables for voice and accountability, political stability, government effectiveness, regulatory quality, role of law, and control of corruption.
Sources: BER South Africa, World Bank WWGI, and IMF staff calculations.

Approach and Data

3. **To shed some light on the question, South Africa's growth performance is analyzed using a Growth-At-Risk approach (GaR)**. GaR links current financial conditions to the distribution of future growth outcomes and has been extensively applied at the IMF (Adrian et al., 2018; IMF, 2017). The approach can be used to assess whether changes in financial conditions are macro-critical and may therefore put financial stability and future growth at risk.

4. **Two analyses are conducted**. First, to illustrate how the strength of macro-financial linkages may have changed from the pre-2008 to post-2008 periods, the sensitivity of growth forecasts one year ahead to shocks to macro and financial variables is analyzed. Second, the distributions of growth forecasts are generated for two sample periods, pre-2008 and post-2008 to help illustrate the extent of a potential structural slowdown in growth after 2008.

5. **These analyses employ standard indicators of domestic and external financial and macroeconomic conditions**. Domestic leverage is represented by the credit-to-GDP gap (deviations from the trend in credit-to-GDP ratio from the BIS) and credit growth. Domestic financial conditions are captured by interest rates (the term spread, or long yields minus short rates, and the policy rate), equity returns, inflation, currency volatility, and changes in the nominal effective exchange rate. External variables include global growth, the US Fed funds rate, and the VIX (implied volatility of US equity prices).

Results

6. **The impulse through macro-financial linkages may have weakened after 2008** (Table A1.1). Credit shock did not have as much potential to explain, or drive, economic growth in the past decade as in the previous decade. When credit growth prior to 2008 is shocked by one standard deviation (6.5 percentage points), growth one year ahead increases by 1.3 percentage points.

However, after 2008, in response to a one standard deviation increase in credit growth (1.9 percentage points) growth forecasts one year ahead change little. A similar message emerges when the VIX is shocked (indicating weaker risk sentiment), where the response of growth forecasts, when normalized by the size of the shock, moderates from -0.6 percentage point in pre-2008 to -0.1 percentage point in post 2008.[1] The decline in response to shocks could also be attributed to the potential change in the nature of shocks.

7. As a result, key macroeconomic and financial drivers of growth would lend limited support to economic activity in future. Figure A1.3 shows that GaR-based growth forecasts using the pre-2008 data are strong, likely buoyed by a range of factors, such as favorable commodity prices and global demand. They are also consistent with staff assessment of South Africa's growth potential (see IMF, 2018). By contrast, GaR-based growth forecasts using the post-2008 data point to further moderation in economic activity.

Table A1.1. South Africa: One-year Ahead GDP Growth Forecasts: Baseline and Scenarios

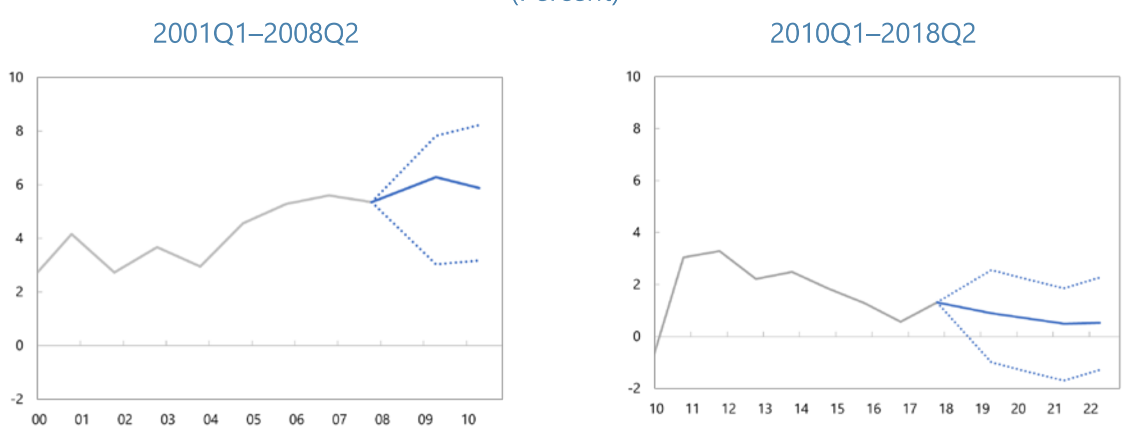
	Baseline	Scenario analysis			
	One-year ahead GDP growth	Shock variable	One standard deviation shock	Impact on one-year ahead GDP growth: Overall	Impact on one-year ahead GDP growth: Per 1 ppt shock
Model 1	5.7	Credit growth	6.5	1.3	0.2
Model 2	0.9		1.9	-0.1	0.0
Model 1	5.7	Equity returns	16.9	1.3	0.1
Model 2	0.9		7.7	0.5	0.1
Model 1	5.7	VIX	6.3	-3.6	-0.6
Model 2	0.9		4.8	-0.7	-0.1

Note: Model 1 = March 00-June 08. Model 2 = March 10-June 18

Source: IMF staff calculation.

Figure A1.3. GDP Growth Outturns and Forecasts Using Growth-at-Risk

(Percent)



Sources: Bloomberg, Haver, IMF October 2018 WEO, IMF G@R template and IMF staff calculations.
Note: Broken lines represent the 95 percent confidence interval for GaR forecasts.

[1] However, a shock to some other variables, such as equity price returns, yields similar response of growth forecasts in both pre and post-2008.

Conclusion

8. The results suggest the importance of addressing micro-level constraints. The analysis points to the need to revisit the growth model to avert further growth slowdown. One culprit is a less favorable business environment and related micro-level constraints that have worsened in the past decade. Left unaddressed, South Africa risks that the economy may not generate growth that can improve per-capita income and population welfare.

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Annex II. External Sector Assessment

Overall Assessment: *The external position in 2018 was moderately weaker than implied by fundamentals and desirable policies.*[1] In 2018, the current account gap remained broadly unchanged. Non-FDI flows continued to finance most of the relatively high current account deficit. REER depreciation in earlier years appears to have contributed little to CA adjustment due to unaddressed structural rigidities.

Potential Policy Responses: Reducing external gaps will require bold implementation of structural reforms to improve competitiveness and gradual fiscal consolidation while providing space for infrastructure and social spending (to improve education levels and skills). Efforts are also needed to improve the efficiency of key product markets (by encouraging private participation in power generation, transportation, and telecommunications) and the functioning of labor markets. These reforms will help attract durable foreign inflows such as FDI. Seizing opportunities to accumulate international reserves would strengthen the country's ability to deal with FX liquidity shocks.

Foreign Asset and Liability Position and Trajectory	**Background.** With large gross external assets and liabilities (respectively, 144 and 133 percent of GDP), South Africa is highly integrated into international capital markets. The NIIP improved markedly from -8 percent of GDP in 2014 to 16 percent of GDP in 2015, mainly on valuation changes, and declined to 11 percent of GDP in 2018. The NIIP is expected to continue moderating over the medium term as CA deficits are projected to remain relatively high. Gross external debt rose from 26 percent of GDP in 2008 to 47 percent of GDP in 2018 due mainly to public sector long-term debt. Short-term external debt (on a residual maturity basis) was slightly below 15 percent of GDP in 2018. **Assessment.** Risks from large gross external liabilities are mitigated by several factors, including South Africa's comfortable external asset position, as well as the fact that the bulk of the liabilities are in the form of equities and that about half of all external debt is rand-denominated.					
2018 (% GDP)	NIIP: 11.3	Gross Assets: 143.8	Debt Assets: 15.2	Gross Liabilities: 132.5	Debt Liabilities: 46.8	
Current Account	**Background**. The CA deficit narrowed from 5.8 percent of GDP in 2013 to 2.5 percent in 2017, but widened to 3.5 percent in 2018 as the terms of trade declined and the trade balance weakened. The CA deficit is projected at 4 percent of GDP in the medium term owing to an elevated deficit in the income account—projected to remain at about 4 percent of GDP. **Assessment**. Staff estimates a CA gap in the range of -0.8 to -2.8 percent of GDP in 2018, derived from a revised cyclically adjusted CA and an adjusted model-based norm. The revised cyclically adjusted CA (-2.4 percent of GDP) is obtained by subtracting 1.5 percentage points from the cyclically adjusted CA (-3.9 percent of GDP) for the statistical treatment of transfers and income accounts. The adjusted CA norm (-0.6 percent of GDP) is obtained by subtracting 1.1 percentage points from a surplus CA norm from the regression model (0.5 percent of GDP) to reflect the lower life expectancy at prime age relative to other countries in the regression sample.[2] The estimated CA gap is largely explained by structural factors outside the model.					
2018 (% GDP)	Predicted CA: -3.3 Actual CA: -3.5	Cycl. Adj. CA: -3.9	EBA CA Norm: 0.5	EBA CA Gap: -4.4	Staff Adj.: 2.6	Staff CA Gap: -1.8
Real Exchange Rate	**Background.** The CPI-REER depreciated during 2011–15 and recouped some of the losses through early 2018. In 2018, the REER strengthened about 2 percent after an earlier rally related to the appointment of the new president was unwound. **Assessment.** The two REER-based regressions (the REER approaches) point to undervaluation in a range of 1.8 percent (level approach) and 14 percent (index approach), but staff deems these results less reliable.[3] Staff assesses the REER to be overvalued by 2 to 12 percent, relying on the CA approach where the implied REER gap is estimated from the CA gaps.[4]					
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Net FDI flows turned positive in 2018 (0.2 percent of GDP). Net portfolio investment, at 0.7 percent of GDP, ceased to be the main source of financing the CA deficit, replaced by net other investment (2.1 percent of GDP). Gross external financing needs stood at 18 percent of GDP in 2018. **Assessment.** Risks from large reliance on non-FDI inflows and nonresident holdings of local financial assets are mitigated by a flexible exchange rate, a large share of local currency component in nonresident portfolio holdings, and a large domestic institutional investor base, which tends to reduce asset price volatility during periods of stress.					

FX Intervention and Reserves Level	**Background.** South Africa's exchange rate regime is classified as floating. Central bank intervention in the foreign exchange market is rare. International reserves were about 14 percent of GDP, 77 percent of gross external financing needs, and 5½ months of imports in 2018. Reserves stand below the IMF's composite adequacy metric (70 percent of the metric without considering existing capital flow management measures and 77 percent of the metric after considering them). **Assessment.** If conditions allow, reserve accumulation would be desirable to strengthen the external liquidity buffer, subject to maintaining the primacy of the inflation objective.

[1] The external position for 2019 based on staff projection is estimated to have remained moderately weaker than implied by fundamentals and desirable policies. In particular, staff estimates the CA gap for 2019 is -1.6 percent of GDP, similar to the CA gap for 2018 of -1.8 percent of GDP. Staff will update the ESA for 2019 when data become available.

[2] The final CA gap estimate results from the CA regression and staff's judgment.

i) As South Africa is among the few outlier countries regarding adult mortality rates, the demographic indicators are adjusted to account for the younger average prime-age and exit-age from the workforce. This results in an adjustor of -1.1 percent of GDP to the model-based CA norm.

ii) Net current transfers related to the Southern African Customs Union (SACU), assessed to have a net negative impact on the CA, are not accounted for in the regression model and warrant an adjustment to the cyclically adjusted CA. In addition, measurement issues pertaining the income balance are likely to contribute to an underestimation of the CA.

[3] Gauging the appropriate REER for South Africa is challenging. The weakening of average REER levels from pre-2000 to post-2000 would likely lead REER regression-based model results to indicate undervaluation, unless the model can sufficiently attribute the observed weakening in average REER to weaker fundamentals.

[4] Applying an estimated long-term elasticity of 0.27 would suggest a REER overvaluation of 2 to 12 percent.

Annex III. Collective Investment Schemes in South Africa

Collective investment schemes (CIS) in South Africa have been growing rapidly and are now relatively large compared to peers. Segments of CIS, such as funds invested in money market instruments, exhibit relatively high concentration, dominated by a small number of large players. CIS are interconnected directly with other parts of the domestic financial system and within themselves through funding and lending. With portfolio overlap, some CIS are interconnected indirectly among each other. Given the large degree of interconnectedness, CIS could amplify shocks travelling through the financial system, potentially increasing financial stability risks.

Characteristics

1. Collective investment schemes (CIS) in South Africa are asset management vehicles investing in a range of financial and real assets. About 90 percent of CIS are invested in local assets and classified as "South African funds". Among South African funds, multi-asset funds are the most important, representing around one half of the CIS space, followed by equity funds and money market funds, or MMF (19 percent and 16 percent, respectively). CIS invest mainly in money market products (49 percent), equity products (35 percent), and other CIS (12 percent). Institutional funds represent 63 percent of total assets under management and retail funds the remaining 37 percent. The overall CIS space, South African and foreign funds together, represents around 60 percent of the "Other Financial Institutions (OFI)" as defined by the Financial Stability Board.[1]

2. CIS have gained in importance over time. CIS' assets have grown rapidly, more than quadrupling, from 11 percent of GDP in 2000 to 46 percent in 2018, and 48 percent in March 2019 to reach R2.4 billion. Assets of CIS are around 40 percent of those of banks. Internationally, South Africa's OFI sector is large relative to the size of the economy (nearly 80 percent of GDP), comparable to peers. In Brazil, for instance, OFI account for 74 percent of GDP. OFI are larger in Korea and Australia (90–120 percent of GDP) but smaller in Chile and Russia (40–60 percent of GDP).

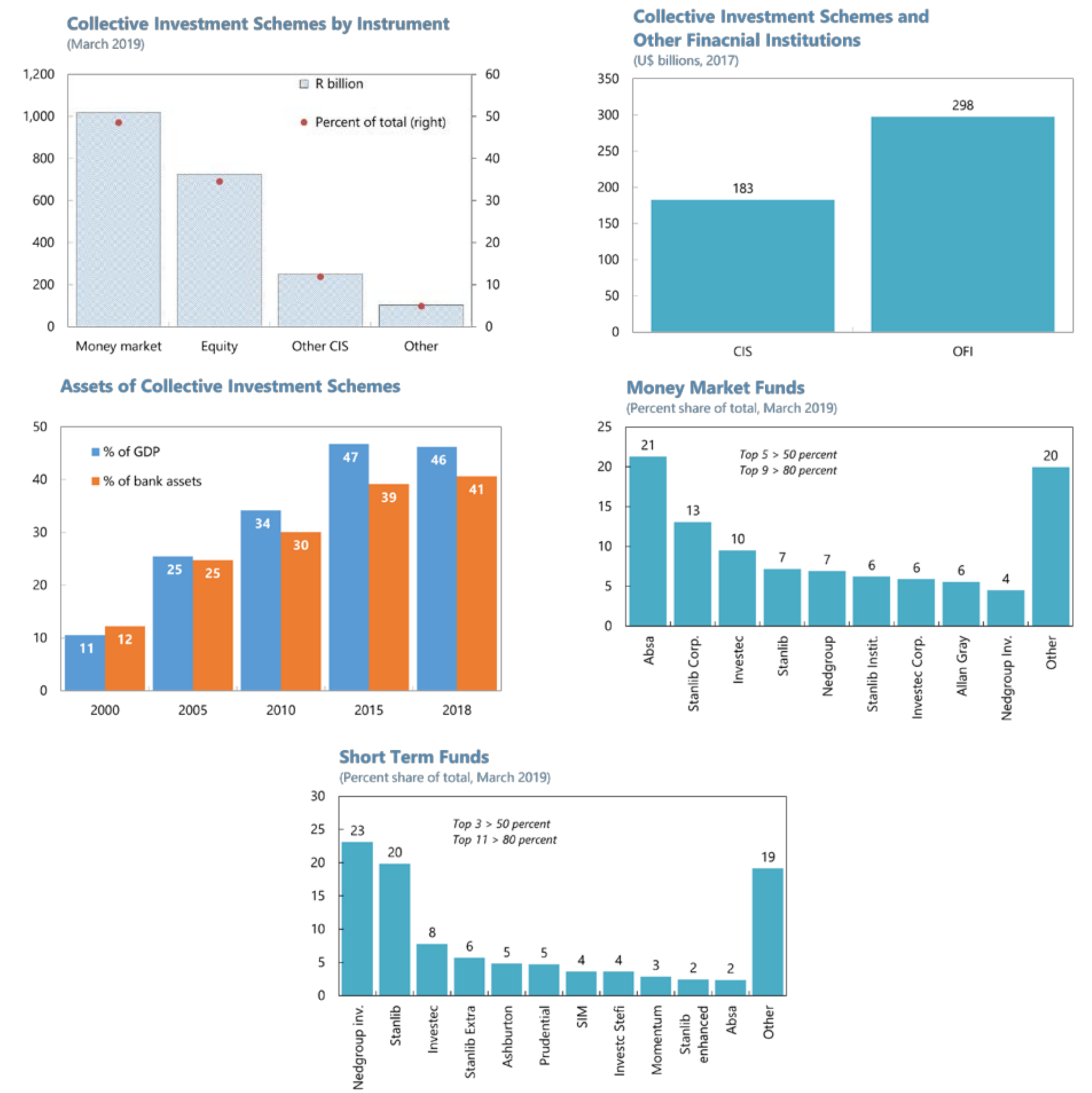
3. Some segments of CIS are relatively concentrated. Funds managing mainly MMF appear to have greater levels of concentration.[2] For instance, MMF, representing 16 percent of South African funds and invested mostly in money market instruments, are dominated by a handful of large entities. The largest MMF represents more than one fifth of the total, and the largest 5 funds account for more than a half. MMF belonging to two large financial groups—Standard Bank and

[1] The latest FSB data for OFI are for 2017, which are used for cross-country comparisons in the rest of the note. OFI includes all financial institutions that are not central banks, commercial banks, insurance corporations, pension funds, public financial institutions, or financial auxiliaries. They include a variety of nonbank financial entity types including investment funds, broker-dealers, and specialized financing vehicles. OFI include all financial institutions that are not central banks, banks, insurance corporations, pension funds, public financial institutions, or financial auxiliaries. They include a variety of nonbank financial entity types including investment funds, broker-dealers, and specialized financing vehicles.

[2] Multi asset income funds (about 10 percent of overall CIS) manage mainly money market products but exhibit a smaller degree of concentration—the top 7 funds represent 51 percent of the total and the top 53 funds 80 percent of the total.

Absa—together represent nearly one half of the total. A similar trend applies to short-term funds, which also manage mainly money market instruments and represent about one-tenth of the CIS space.

Figure A3.1. Characteristics of Collective Investment Schemes



Sources: ASISA, Financial Stability Board (FSB), Government Employees' Pension Fund (GEPF), Haver, SARB BA 900, and IMF staff calculations.

Note: See Annex Table 1 for more information on CIS composition.

Direct and Indirect Interconnectedness

4. **CISs are directly interconnected to the rest of the financial system thorough borrowing and lending.**[3] From the liability side, CIS borrow mainly from insurers, worth one-half of CIS assets. They also borrow from pension funds and other CIS, worth one-tenth of CIS assets each. Borrowing from retail customers, not included in Table A3.1, probably represents the bulk of the remaining funding, broadly proportional to the relative size of retail funds in the overall CIS space. From the asset side, CIS invest in financials and other CIS. (Table A3.1 focuses on money market instruments, excluding equity and other products).[4]

Table A3.1. South Africa: Financial System Cross Exposures

Lender	*Borrower*		
	Financial Institutions	CIS	Bank
Insurance company	...	1,248	95
Pension fund	...	244	68
Fund managers	...	...	633
CIS (MMkt instruments)	513	230	106
Bank	395	...	152
Total assets	...	2,384	5,652

Sources: ASISA, FSCA, GEPF, SARB BA 900, and IMF staff calculations. March 2019 for CIS and Bank data. Annual report 2018 for GIPF.

Note: Total assets include items that are not presented separately. "..." when data are unavailable.

5. **Internationally, the extent of direct interconnectedness created by OFI in South Africa is relatively high.** At more than 30 percent of total OFI assets, insurance companies' investment in OFI in South Africa is by far the largest among its peers. Pension funds' investment is less than 10 percent of OFI assets. OFI exposures to banks in South Africa are one of the largest, at around 20 percent of OFI assets (SARB data suggests the bulk of the funds come likely from fund managers). Bank lending to OFI is relatively small.

6. **Indirect interconnectedness among CISs stems from portfolio overlap.** For instance, the portfolios of Absa MMF and Stanlib MMF, the two largest MMFs in South Africa, are similarly concentrated in a few large banks. Even if the two funds are not directly lending to each other and are not directly interconnected, a shock emanating from a common borrower would affect both funds (see next paragraph).

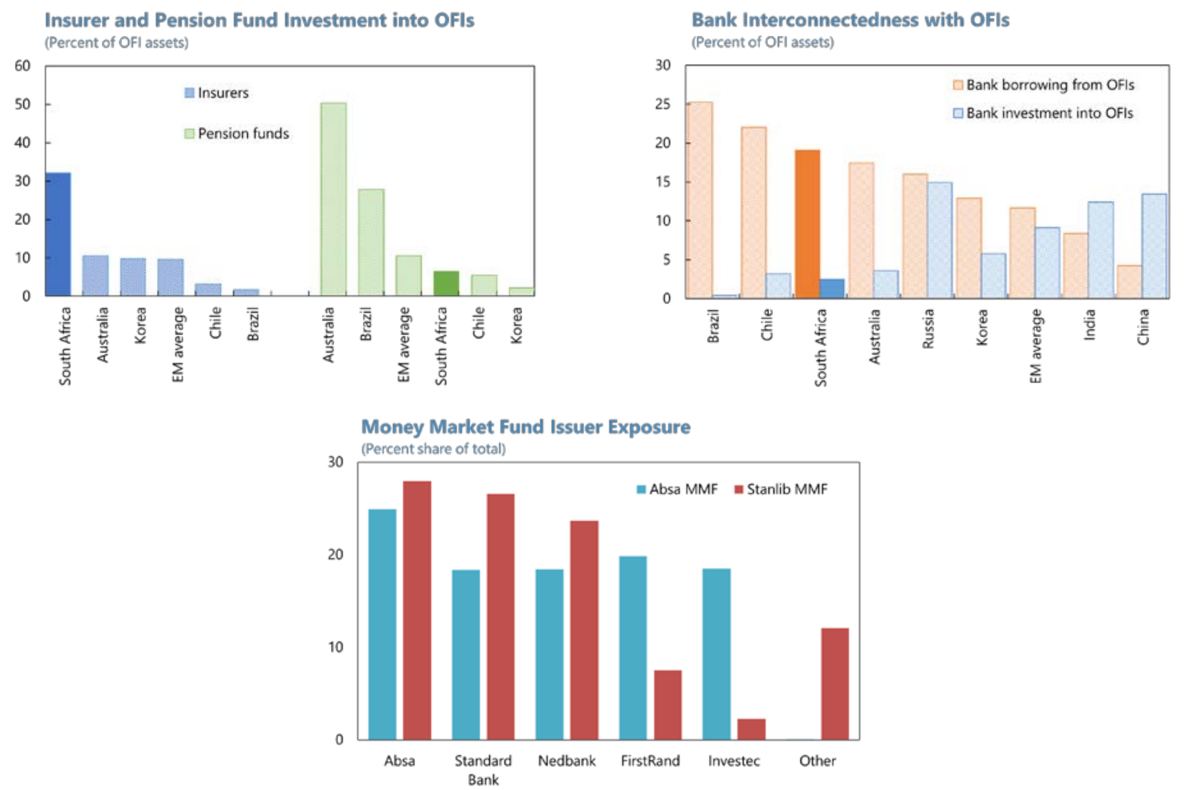
7. **Such interconnectedness brings about both strengths and vulnerabilities.** An interconnected financial system could be robust to shocks through substitution of lenders and buyers. At the same time, a strong and long transmission channel implies that a large shock in one

[3] This issue will be analyzed to a greater extent by the upcoming Financial Sector Assessment Program (FSAP) for South Africa.

[4] Consistency of CIS data across different sources (particularly ASISA and SARB) will be checked during the mission.

part of the financial system could travel through the system widely. Lenders, such as MMFs, absent direct connection through balance sheets, could be affected at the same time by a shock stemming from a common borrower, increasing the potential for indirect contagion during periods of elevated stress through, for example fire sales.[5] African Bank's default led all affected money-market funds to "break the buck" and triggered large redemptions.[6]

Figure A3.2. Direct and Indirect Interconnectedness



Sources: Financial Stability Board (FSB), MMF public disclosures, and IMF staff calculations.

[5] Financial Stability Board. 2019. “Global Monitoring Report on Non-Bank Financial Intermediation 2018.” https://www.fsb.org/2019/02/global-monitoring-report-on-non-bank-financial-intermediation-2018/

[6] Havemann, Roy. 2018. “Can creditor bail-in trigger contagion? The experience of an emerging market,” Review of Finance, 1–26.

Table A3.2. South Africa: Collective Investment Scheme by Fund Type and Instrument
(Billions of rand)

Fund Type		Instrument					
		Money market products	Equity	Other CIS	Other products	Total	*Percent share*
	Multi Asset Funds	415	353	230	40	1,037	*49*
	Interest Bearing Funds	596	-	-	-	596	*28*
	Money Market Funds	344	-	-	0	344	*16*
	Short Term Funds	181	-	-	0	181	*9*
	Variable Term Funds	71	-	-	(0)	71	*3*
	Equity Funds	7	370	20	4	401	*19*
	Real Estate Funds	2	2	0	60	65	*3*
	Total	1,020	725	250	103	2,099	*100*
	Percent share	*49*	*35*	*12*	*5*	*100*	

Sources: ASISA and IMF staff. Data for March 2019.

Annex IV. Public Debt Sustainability Analysis[1]

South Africa's government debt trajectory has severely and quickly worsened due to the continued deterioration in the growth outlook and the materialization of contingent liabilities from SOEs. Debt levels and gross financing needs are projected to exceed 70 and 15 percent of GDP, respectively, and contingent liabilities are expected to continue to grow as the financial situation of SOEs remains weak. The debt outlook is based on plans to support the largest SOE, Eskom; and staff assumptions that consolidation of the government and SOEs and implementation of growth-enhancing reforms would take time. Given its relatively high sensitivity to shocks, the debt trajectory could deteriorate beyond the baseline projections. Risks to the outlook are mitigated by the large rand denomination and long maturities of government debt and the deep local institutional investor base.

Context

1. **Public debt has doubled and gross financing needs (GFNs) have risen sharply in the last decade.** While revenue has recovered, expenditure has drifted up permanently, generating large government deficits (averaging 4.9 percent of GDP in FY10/11–FY18/19) and pushing public debt up to 57 percent of GDP in FY18/19. In parallel, GFNs increased from about 2 percent of GDP in FY07/08 to 12 percent in FY18/19. Mitigating factors are the debt composition and maturity, with low shares in foreign currency (10 percent), short term instruments (13 percent), and a term to maturity of about 13 years.

2. **Contingent liabilities have also grown significantly due to increasing government guarantees to SOE loans.** Total contingent liabilities increased from 8 percent of GDP in FY07/08 to 18 percent in FY18/19. Almost 80 percent of the increase is explained by SOE loan guarantees, reflecting their persistent cash deficits and their inability to borrow on the strength of their balance sheets. Guarantees to SOEs account for 10.5 percent of GDP. The remaining contingent liabilities are claims against public-private partnerships, the road accident fund, and post-retirement medical assistance for employees.

Baseline Projections

3. **Under staff's baseline calculations, the debt-to-GDP ratio is projected to rise sharply.** The debt trajectory has severely deteriorated since the previous DSA due to the materialization of contingent liabilities, especially from Eskom, and the continued deterioration in the growth outlook. As discussed in Box 1, staff assumes lackluster medium-term growth, limited fiscal consolidation, and strong transfers to SOEs, leading public debt to exceed the 70 percent high-risk threshold by 2022 and continue to increase over the medium term (Figure A6.3). Such high debt levels—in a

[1] For methodology, see: "Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries", IMF Policy Paper, May 6, 2013 and "Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis", SM/11/211.

context of spending rigidities, a borderline investment grade, and already high borrowing costs for the sovereign—leave no buffers for fiscal policy in response to any future adverse shocks.

4. Gross financing needs (GFNs) are projected to surpass the high-risk threshold during the projection period. GFNs are anticipated to exceed 15 percent of GDP in 2020 and beyond despite the favorable maturity and currency structure of the debt (Figure A6.3) and would increasingly be met from domestic financing sources, primarily non-bank financial institutions. In combination with the rapidly growing debt level, high GFNs highlight the increasing vulnerabilities, notably if some of the downside risks to the outlook materialize (see below).

Box A4.1. Staff Assumptions Underlying the Debt Sustainability Analysis

Data Coverage

Consistent with the debt coverage used by the authorities, calculations are based on the national government's main budget (central government). While this methodology excludes provincial governments, social security funds, and extra-budgetary institutions, these entities are not allowed to incur debt. Even though municipalities can borrow, most provincial and municipal expenditure is funded through transfers from the national government, and thus is already captured to a considerable extent. However, the DSA also excludes SOEs, whose indebtedness has increased rapidly in recent years.

Macroeconomic Assumptions

Real GDP growth is projected to weaken to 0.4 percent in 2019 (0.8 percent in 2018) as the impact of delayed reforms on electricity provision and mining activity have hampered a recovery of confidence and deterred the needed pick up in private investment. Over the medium term, growth is projected at 1.5 percent, slightly below population growth. The GDP deflator is expected to average 4.9 percent in 2019–24, consistent with the projected CPI inflation.

Fiscal Assumptions

Debt projections include stock-flow adjustments to capture discounts on new issuance of existing benchmark bonds as well as valuation effects on inflation-linked and foreign currency denominated bonds. The primary deficit is expected to improve over the longer term but remain above 1.5 percentage points of GDP. Factors that explain this performance are (i) a reduction in the financial assistance to SOEs as a share of GDP starting in FY 21/22 following some action to improve their financial situation; (ii) the impact of some announced fiscal measures; and (iii) a gradual recovery of growth to its projected medium-term level. Expenditure is projected to keep its current trend in the medium term. Projections assume contingency reserves averaging about0.1 percent of GDP a year.

5. The baseline scenario is subject to a variety of risks:

- ***Growth.*** Possible over-projections of growth pose an upside risk to the debt-to-GDP forecasts (Figure A6.2). Between 2010–18, the median real GDP forecast error was -1.2 percentage points (largely within the forecast error distribution of a sample including 132 surveillance countries countries). The scenarios below address this risk.
- ***Primary balance.*** Upward pressure on the primary balance could stem from lower-than-anticipated revenue collection because of growth deterioration or tax administration issues, or/and from higher-than-expected spending including that related to pressures for subsidies

and public wages (negotiations for the next three years are due in 2020). Primary balance projections have not been systematically biased (Figure A6.2).

- ***Interest rates.*** Higher borrowing costs may arise from a tightening of global financial conditions or higher than expected risk perceptions by investors.

- ***Contingent liabilities.*** Weak SOE balance sheets could trigger further government support or lead to calls of guarantees on loans.

Scenario Analysis

6. The analysis illustrates the sensitivity with which an individual or a combination of shocks can affect the projected paths of public debt and GFNs on the downside and the upside (Figures A6.4, A6.5 and A6.6).

- ***Persistent low growth scenario.*** If growth were permanently lower than in the baseline by 1 percentage point on average during 2020–24, the debt-to-GDP ratio would reach about 96 percent of GDP in 2024. This scenario factors in the adverse impact of lower tax revenue elasticities and higher interest rates as well as the denominator effects of lower GDP.

- ***Primary balance shock scenario.*** If the primary balance improved more gradually than in the baseline, deviating by a cumulative 1.4 percent of GDP during the medium term, the projected debt level would surpass 80 percent of GDP in 2024. The debt-to-GDP ratio would almost reach 85 percent if a temporary shock to growth with a magnitude of one-standard-deviation were to materialize in 2020 and 2021.

- ***Combined macro-fiscal shocks scenario***. A combination of standard shocks to growth and interest rates—a primary balance shock (temporary deterioration equivalent to one half of the 10-year historical standard deviation), and an exchange rate shock (consistent with the maximum movement over the past 10 years and an exchange rate pass-through of 0.25)—would result in an increase in the debt-to-GDP ratio to more than 90 percent by 2024 and higher gross financing needs by about 3.5 percentage points of GDP by 2024.

- ***Contingent liability shock scenario.*** Should all remaining SOE loan guarantees (excluding those already realized during the projection period for Eskom) be called and contingent liabilities of the road accident fund materialize, public debt would rise to 96 percent of GDP by 2024. This scenario underscores both the direct risks posed by contingent liabilities to the fiscal outlook and the indirect risks posed by the impact on investor confidence and borrowing costs.

- ***Faster implementation of structural reforms and reduction in SOE transfer.*** This scenario assumes that growth becomes permanently higher than in the baseline by 1 percentage point on average during 2020–24 due to more rapid implementation of structural reforms, and transfers to SOEs are halved in 2020 and stop in that year. In such case, the debt-t-GDP ratio and gross financing needs would return to below the high risk thresholds at 66 percent of GDP and 10 percent of GDP respectively in 2024. This scenario factors in the favorable impact of higher tax revenue elasticities and lower interest rates as well as the denominator effects of higher GDP.

7. The heat map summarizes the risk assessment of South Africa's debt and GFNs (Figure A6.1).[2] All shock scenarios for the debt level and gross financing needs flash red given the already weak projections in the baseline. Mitigating factors are the large domestic institutional investor base, the low share of foreign currency, and the short-term nature of the debt. However, South Africa's high bond spreads (above 300 bps, see Figure A4.3), its significant external financing requirements (18 percent of GDP), and the relatively high share of debt held by non-residents add to the risks.

8. The fan charts highlight the importance of adopting policies to reduce downside risks and the probability of debt distress (Figure A6.1, middle panel). Under a scenario in which downside shocks are predominant, debt-to-GDP ratio reaches 90 percent of GDP by 2024 (using the upper end of the 75th–90th percentile fan chart).[3] Conversely, under a scenario in which shocks are symmetric to both up and downsides, which could be triggered for example by somewhat faster progress in structural reforms, the probability of the debt exceeding the same high level is reduced and the probability of better than baseline outcomes increases significantly.

[2] The framework uses indicative thresholds of 70 percent of GDP for debt and 15 percent of GDP for gross financing needs, benchmarks beyond which a country is reported as high risk leading to a yellow color in the heat map if they are exceeded in a stress scenario and a red color if they are exceeded in the baseline. The benchmarks are based on a cross-country early-warning exercise of EMs that have experienced episodes of debt distress. Debt distress events are defined as default to commercial or official creditors, restructuring and rescheduling events, or IMF financing.

[3] The fan charts are generated using historical information and thus consider the downside scenario presented in the main text as an extreme event as it would involve a full downgrade to below investment grade, a deep recession generated by domestic reasons, and an extremely poor financial situation at Eskom which do not have historical precedents.

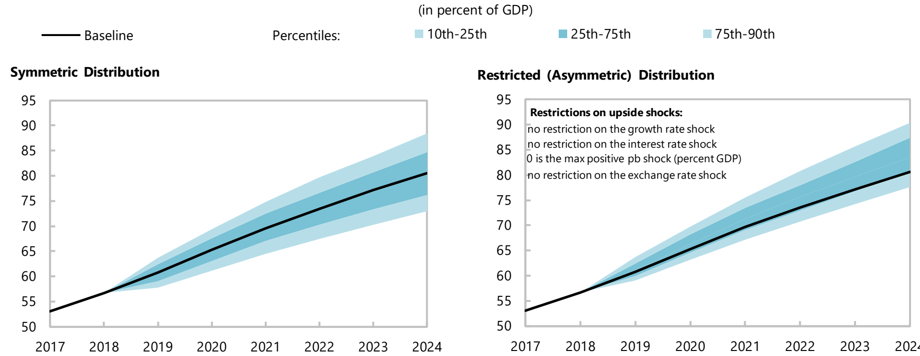
Figure A4.1. Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock /6	Persistently Low Growth
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock /6	Persistently Low Growth
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt	

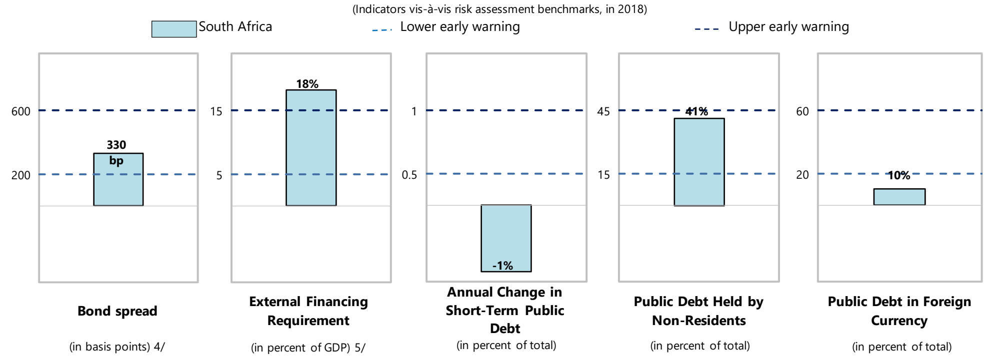
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

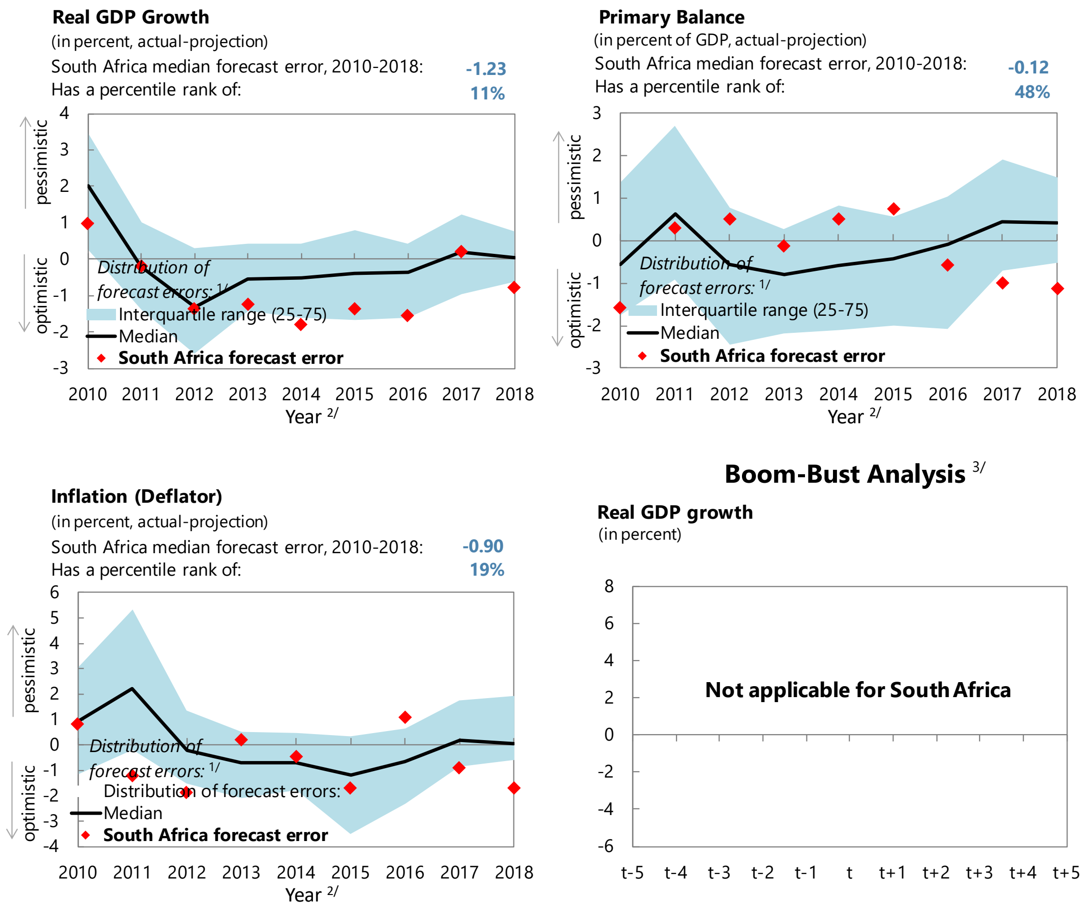
4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 10-Sep-19 through 09-Dec-19.

5/ The external financing requirement is defined for the economy as a whole (including the private sector). More specifically, it is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

6/ The contingent liability shock scenario included in the heat map entails the calling of all remaining SOE loan guarantees plus the contingent liabilities of the road accident fund. The standard financial sector contingent liability shock usually in the heat map is not triggered in the case of South Africa because the three year cumulative increase of the credit-to-GDP or loan-to-deposit ratio do not exceed the corresponding thresholds (i.e. 15 percent of GDP for the credit to GDP ratio and 1.5 loan-to-deposit ratio).

Figure A4.2. Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus all countries



Source : IMF staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries

2/ Projections made in the spring WEO vintage of the preceding year

3/ Not applicable for South Africa, as it meets neither the positive output gap criterion nor the private credit growth criterion.

Figure A4.3. Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

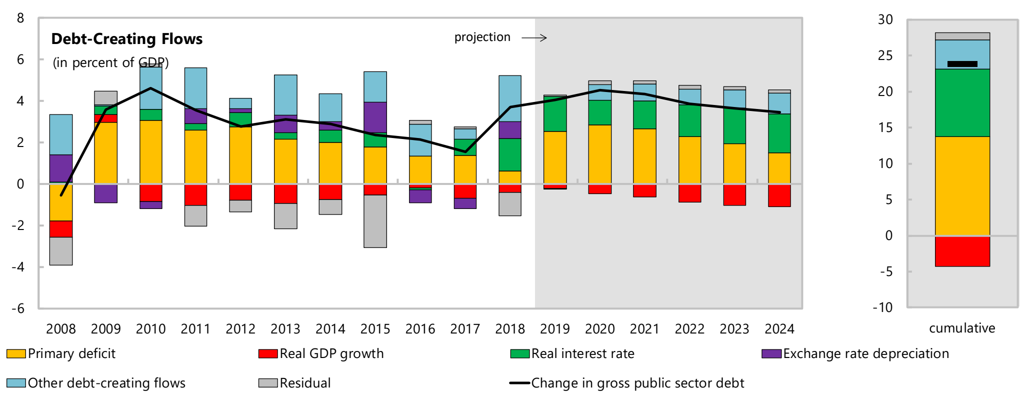
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	40.3	53.0	56.7	60.8	65.3	69.6	73.5	77.1	80.6
Public gross financing needs	9.8	12.1	11.6	14.9	15.5	15.8	17.0	17.1	16.5
Real GDP growth (in percent)	1.8	1.4	0.8	0.4	0.8	1.0	1.3	1.5	1.5
Inflation (GDP deflator, in percent)	6.5	5.3	3.9	4.2	5.2	5.0	4.9	4.9	4.9
Nominal GDP growth (in percent)	8.4	6.8	4.7	4.6	6.1	6.1	6.3	6.5	6.5
Effective interest rate (in percent) [4/]	7.8	7.0	7.0	7.3	7.3	7.3	7.3	7.5	7.6

As of December 09, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		349
5Y CDS (bp)		186
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	BB	BB+
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.7	1.6	3.7	4.0	4.5	4.3	3.9	3.6	3.4	23.8	
Identified debt-creating flows	3.4	1.5	4.8	4.0	4.3	4.2	3.7	3.5	3.3	22.9	
Primary deficit	1.9	1.4	0.6	2.5	2.9	2.6	2.3	1.9	1.5	13.7	1.8
Primary (noninterest) revenue and grants	24.2	24.9	25.6	25.7	25.6	25.7	25.7	25.7	25.8	154.2	
Primary (noninterest) expenditure	26.1	26.3	26.3	28.2	28.5	28.3	28.0	27.7	27.3	168.0	
Automatic debt dynamics [5/]	0.1	-0.4	2.0	1.5	0.7	0.7	0.7	0.7	0.8	5.0	
Interest rate/growth differential [6/]	-0.2	0.1	1.2	1.5	0.7	0.7	0.7	0.7	0.8	5.0	
Of which: real interest rate	0.4	0.8	1.6	1.7	1.2	1.3	1.5	1.7	1.9	9.3	
Of which: real GDP growth	-0.6	-0.7	-0.4	-0.2	-0.5	-0.6	-0.9	-1.0	-1.1	-4.3	
Exchange rate depreciation [7/]	0.3	-0.5	0.8	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.4	0.5	2.2	0.0	0.7	0.8	0.7	0.9	1.0	4.1	
Privatization/Drawdown of Deposits	0.5	0.0	0.5	0.0	-0.2	-0.1	-0.1	0.0	0.0	-0.5	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Stock-Flow adjustment	0.9	0.5	1.7	0.0	1.0	0.9	0.9	0.9	1.0	4.6	
Residual, including asset changes [8/]	-0.7	0.1	-1.1	0.1	0.2	0.2	0.2	0.2	0.2	1.0	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

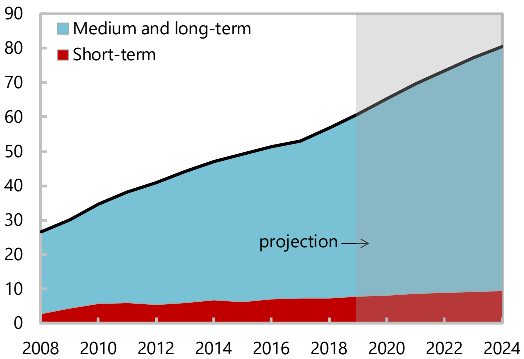
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

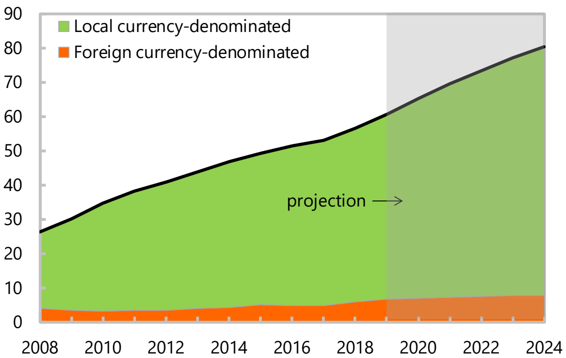
Figure A4.4. Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



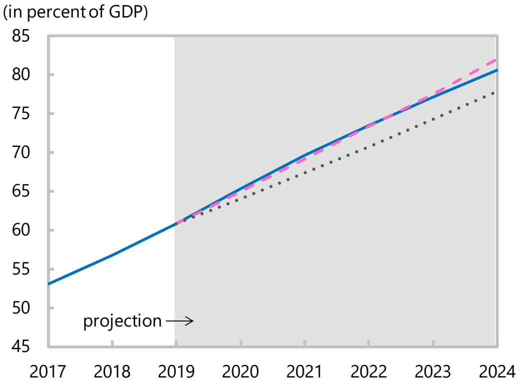
By Currency
(in percent of GDP)



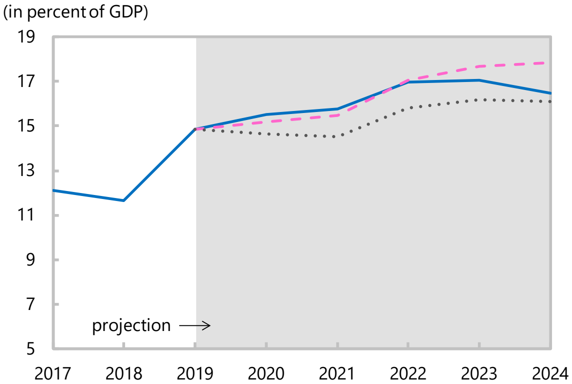
Alternative Scenarios

Baseline — Historical — Constant Primary Balance

Gross Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

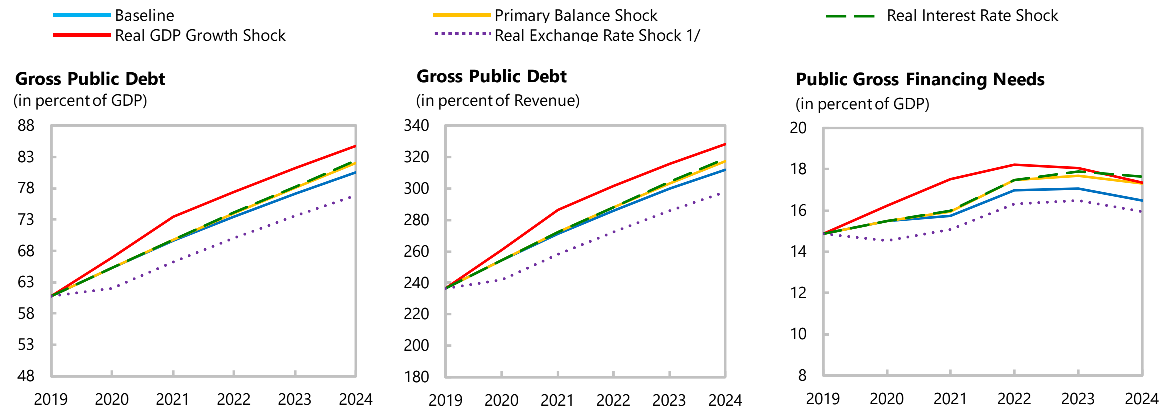
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	0.4	0.8	1.0	1.3	1.5	1.5
Inflation	4.2	5.2	5.0	4.9	4.9	4.9
Primary Balance	-2.5	-2.9	-2.6	-2.3	-1.9	-1.5
Effective interest rate	7.3	7.3	7.3	7.3	7.5	7.6
Constant Primary Balance Scenario						
Real GDP growth	0.4	0.8	1.0	1.3	1.5	1.5
Inflation	4.2	5.2	5.0	4.9	4.9	4.9
Primary Balance	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5
Effective interest rate	7.3	7.3	7.3	7.3	7.4	7.6

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	0.4	1.5	1.5	1.5	1.5	1.5
Inflation	4.2	5.2	5.0	4.9	4.9	4.9
Primary Balance	-2.5	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	7.3	7.3	7.1	7.1	7.1	7.2

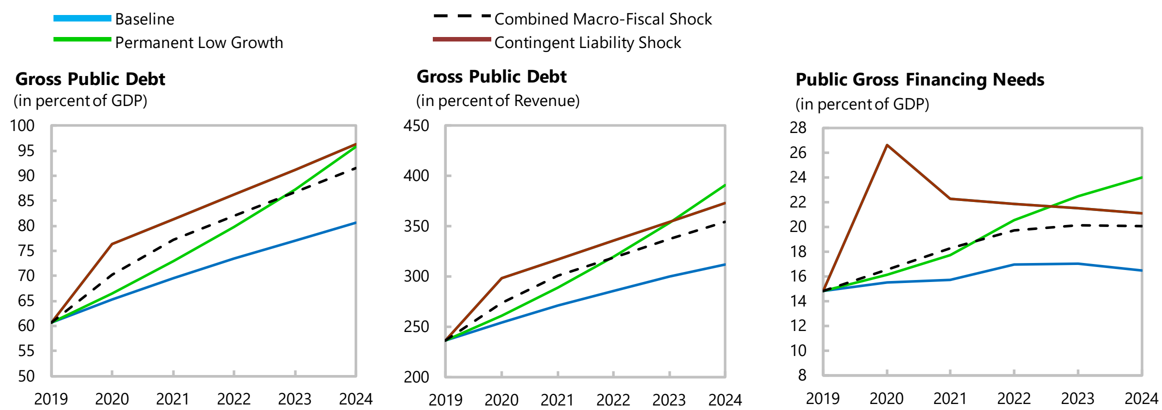
Source: IMF staff.

Figure A4.5. Public DSA – Stress Tests-Downside

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

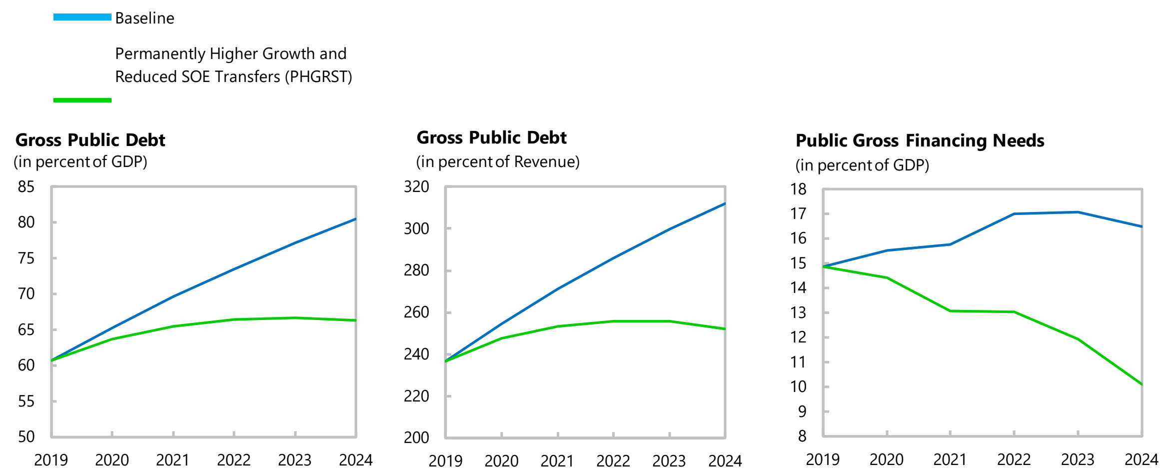
Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	0.4	0.8	1.0	1.3	1.5	1.5
Inflation	4.2	5.2	5.0	4.9	4.9	4.9
Primary balance	-2.5	-2.9	-2.9	-2.6	-2.3	-1.9
Effective interest rate	7.3	7.3	7.3	7.3	7.5	7.6
Real Interest Rate Shock						
Real GDP growth	0.4	0.8	1.0	1.3	1.5	1.5
Inflation	4.2	5.2	5.0	4.9	4.9	4.9
Primary balance	-2.5	-2.9	-2.6	-2.3	-1.9	-1.5
Effective interest rate	7.3	7.3	7.6	7.9	8.2	8.5
Combined Shock						
Real GDP growth	0.4	-0.6	-0.4	1.3	1.5	1.5
Inflation	4.2	4.9	4.7	4.9	4.9	4.9
Primary balance	-2.5	-3.4	-3.7	-2.6	-2.3	-1.9
Effective interest rate	7.3	7.7	7.6	7.9	8.2	8.5

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	0.4	-0.6	-0.4	1.3	1.5	1.5
Inflation	4.2	4.9	4.7	4.9	4.9	4.9
Primary balance	-2.5	-3.4	-3.7	-2.3	-1.9	-1.5
Effective interest rate	7.3	7.3	7.3	7.4	7.5	7.6
Real Exchange Rate Shock						
Real GDP growth	0.4	0.8	1.0	1.3	1.5	1.5
Inflation	4.2	16.8	5.0	4.9	4.9	4.9
Primary balance	-2.5	-2.9	-2.6	-2.3	-1.9	-1.5
Effective interest rate	7.3	7.7	7.2	7.3	7.5	7.6
Contingent Liability Shock						
Real GDP growth	0.4	0.8	1.0	1.3	1.5	1.5
Inflation	4.2	5.2	5.0	4.9	4.9	4.9
Primary balance	-2.5	-14.0	-2.6	-2.3	-1.9	-1.5
Effective interest rate	7.3	7.3	7.9	8.5	8.9	9.3

Source: IMF staff.

Figure A4.6. Public DSA – Stress Tests–Upside

Additional Stress Tests



Underlying Assumptions

(in percent)

Baseline	2019	2020	2021	2022	2023	2024
Real GDP growth	0.4	0.8	1.0	1.3	1.5	1.5
Inflation	4.2	5.2	5.0	4.9	4.9	4.9
Primary balance	-2.5	-2.9	-2.6	-2.3	-1.9	-1.5
Effective interest rate	7.3	7.3	7.3	7.3	7.5	7.6

PHGRST	2019	2020	2021	2022	2023	2024
Real GDP growth	0.4	1.8	2.0	2.3	2.5	2.5
Inflation	4.2	5.2	5.0	4.9	4.9	4.9
Primary balance	-2.5	-1.9	-0.8	-0.2	0.4	1.2
Effective interest rate	7.3	7.3	7.1	7.1	7.1	7.1

Source: IMF staff.

Annex V. External Debt Sustainability Analysis

South Africa's external financing is reliant on non-FDI flows, which raises external debt and gross external financing needs to relatively high levels. A significant share of total external debt is denominated in local currency, reflecting large nonresident participation in local sovereign bond markets. External debt is projected to remain slightly above 50 percent of GDP over the medium term and is vulnerable to a currency shock but less affected by a deceleration in economic activity or higher interest rates.

1. Net portfolio inflows, traditionally the main source of financing current account deficits, declined markedly in 2018, to 0.7 percent of GDP. Nonresident investors continued to sell debt instruments, possibly as expectations that the pace of reform implementation may accelerate dissipated. The decline was counterbalanced by increases in net inflows of FDI (which turned positive, to 0.2 percent of GDP) and other investment (2.1 percent of GDP, mainly cross-border bank lending and repatriation by locals).

2. As a result, external debt declined slightly in 2018. From below 20 percent of GDP in the mid-2000s, external debt peaked at 49.6 percent of GDP in 2017. The debt ratio subsequently declined to 46.8 percent of GDP in 2018 (Figure A4.1). A marginal increase in foreign currency-denominated external debt was more than counterbalanced by a decline in local currency-denominated external debt, with the latter remaining at around 50 percent of the total external debt (Figure A4.2).

3. However, gross external financing needs (GEFNs) increased to 18 percent of GDP in 2018, from 14 percent in 2017. GEFNs increased as the current account deficit widened (by 1.0 percentage point of GDP) and short-term external debt rose (by 3.2 percentage points of GDP). The majority of GEFNs still was short-term external debt on a remaining maturity basis (14.7 percent of GDP).

4. On current policies, financing of the current account deficit is projected to continue to come from non-FDI inflows. Net FDI inflows are anticipated to remain low or negative over the forecast horizon hampered by slow progress in structural reform implementation. Thus, non-FDI investment is expected to continue to provide the bulk of financing. As a result, GEFNs are projected to fluctuate around 20 percent of GDP during 2019–24, with short-term debt accounting for about 80 percent of the total. Overall external debt is projected to stay above 50 percent of GDP over the forecast horizon.

5. Sizable GEFNs would keep South Africa's external vulnerabilities elevated. Results from the external debt sustainability analysis indicate that a 30 percent currency depreciation could push external debt above 65 percent of GDP, despite rand-denominated external debt representing half of the total. However, other standard shocks simulated—such as a widening of the non-interest current account deficit, a deceleration in real GDP growth, and a rise in interest rates—would lead to only moderate increases in external debt.

Figure A5.1. Breakdown of External Debt by Sector

(% GDP)

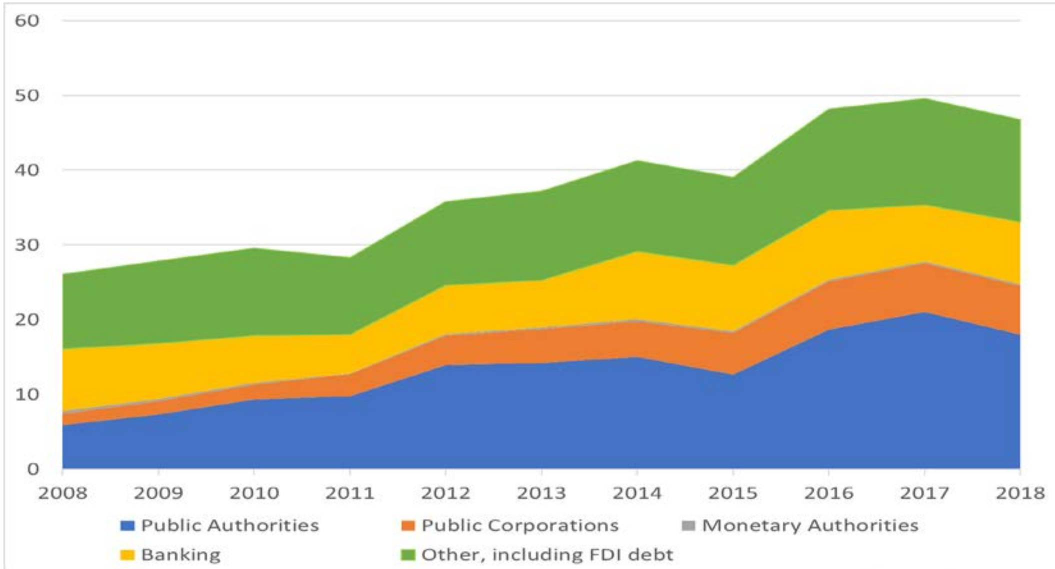


Figure A5.2. External Debt by Currency

(% GDP)

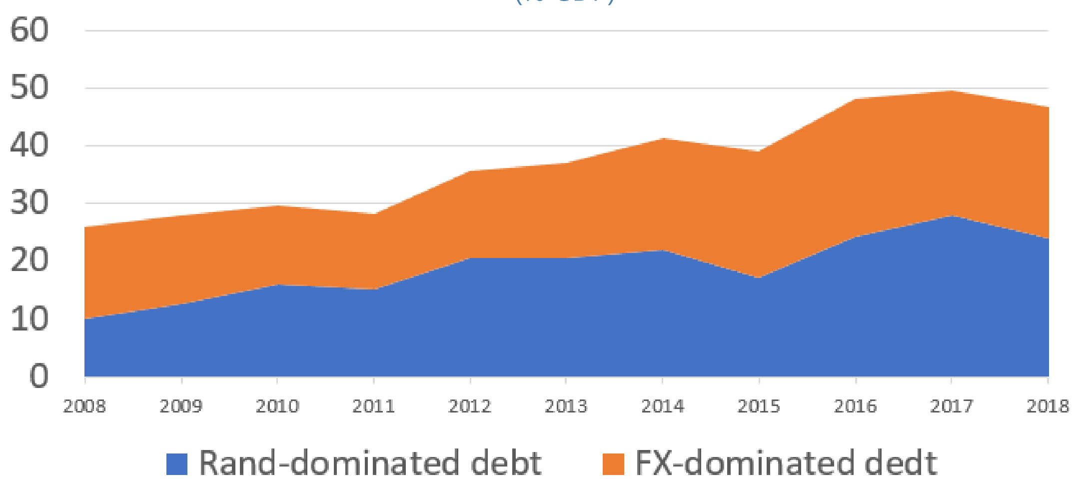


Table A5.1. South Africa: External Debt Sustainability Framework, 2015–2024

(In percent of GDP, unless otherwise indicated)

		Actual				Projections							
		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024		Debt-stabilizing non-interest current account 6/
1	**Baseline: External debt**	39.1	48.2	49.6	46.8	**51.1**	**51.0**	**51.2**	**51.3**	**51.6**	**51.9**		**-2.1**
2	Change in external debt	-2.3	9.1	1.4	-2.8	4.3	-0.2	0.2	0.2	0.2	0.3	0.0	
3	Identified external debt-creating flows (4+8+9)	2.7	2.4	-4.7	0.2	2.2	2.3	2.2	2.1	2.1	2.2	0.0	
4	Current account deficit, excluding interest payments	2.6	1.5	1.4	2.0	1.8	2.1	2.2	2.2	2.3	2.4	2.1	
5	Deficit in balance of goods and services	1.3	-0.5	-1.3	-0.3	-0.5	-0.4	-0.4	-0.5	-0.5	-0.6		
6	Exports	30.2	30.6	29.6	29.9	31.3	31.2	31.3	31.6	31.9	32.1		
7	Imports	31.5	30.1	28.3	29.6	30.8	30.8	30.9	31.1	31.4	31.6		
8	Net non-debt creating capital inflows (negative)	-2.5	-0.7	-2.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	
9	Automatic debt dynamics 1/	2.5	1.7	-4.0	-0.9	1.3	1.2	1.0	0.9	0.8	0.8	-1.1	
10	Contribution from nominal interest rate	2.0	1.4	1.1	1.5	1.5	1.6	1.6	1.6	1.6	1.6	1.6	
11	Contribution from real GDP growth	-0.5	-0.2	-0.6	-0.4	-0.2	-0.4	-0.5	-0.7	-0.7	-0.7	-0.7	
12	Contribution from price and exchange rate changes 2/	1.1	0.4	-4.5	-2.0	...	...	...	...	...	...	-1.9	
13	Residual, incl. change in gross foreign assets (2-3) 3/	-4.9	6.7	6.1	-3.0	2.1	-2.4	-2.0	-1.9	-1.9	-1.9	0.0	
	External debt-to-exports ratio (in percent)	129.6	157.6	167.4	156.6	163.4	163.1	163.5	162.2	161.8	161.5		
	Gross external financing need (in billions of US dollars) 4/	63.5	51.3	48.9	67.2	69.8	74.9	72.1	72.4	75.4	75.7		
	in percent of GDP	20.0	17.3	14.0	18.3	19.5	20.5	19.0	18.4	18.5	17.8		
	Scenario with key variables at their historical averages 5/					**51.1**	**49.9**	**49.7**	**49.5**	**49.4**	**49.3**		**-2.4**
	Key Macroeconomic Assumptions Underlying Baseline											For debt stabilization	
	Real GDP growth (in percent)	1.2	0.4	1.4	0.8	0.4	0.8	1.0	1.3	1.5	1.5	1.5	
	GDP deflator in US dollars (change in percent)	-10.6	-7.1	16.3	4.5	-3.3	1.5	2.5	2.4	2.5	2.7	2.7	
	Nominal external interest rate (in percent)	4.4	3.4	2.8	3.2	3.1	3.2	3.2	3.2	3.2	3.2	3.2	
	Growth of exports (US dollar terms, in percent)	-13.3	-5.4	14.3	6.3	1.5	2.1	3.7	5.0	4.8	5.0		
	Growth of imports (US dollar terms, in percent)	-13.6	-10.9	11.2	9.9	1.0	2.4	3.7	4.6	4.9	4.9		
	Current account balance, excluding interest payments	-2.6	-1.5	-1.4	-2.0	-1.8	-2.1	-2.2	-2.2	-2.3	-2.4		
	Net non-debt creating capital inflows	2.5	0.7	2.1	1.0	1.0	1.0	1.0	1.0	1.0	1.0		

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

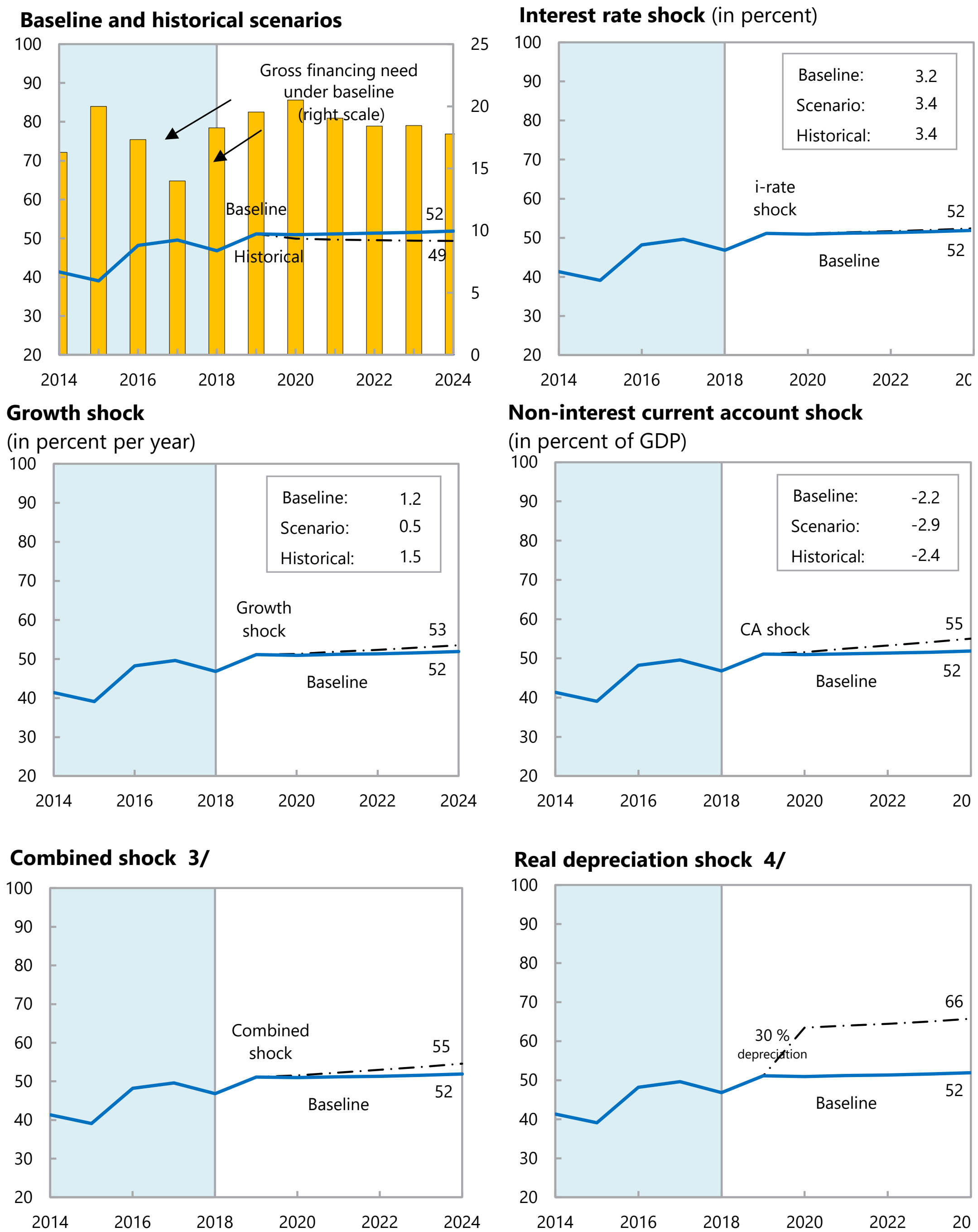
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure A5.3 External Debt Sustainability: Bound Tests 1/ 2/



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

Annex VI. Risk Assessment Matrix[1]

Nature/Source of Threat	Likelihood	Time Horizon	Expected Impact on Economy	Policy Responses
Global risks				
Rising protectionism and retreat from multilateralism.	*High*	*ST, MT*	***H***/***M***. Impact on the external accounts and growth would depend on the extent to which trade flows are disrupted.	Structural measures to promote growth domestically and regional integration initiatives, along with support for multilateralism and the global trading system. Fiscal consolidation to ensure medium-term debt stabilization.
Sharp rise in risk premia. An abrupt change in global risk leading to sudden, sharp increases in interest rates and associated tightening of financial conditions.	*High*	*ST*	***H***/***M***. Capital flow reversals (including prompted by rating downgrades) would affect the external and fiscal positions. Spillovers to the financial system likely.	Monetary policy tightening if currency depreciation pushes inflation expectations above the target range. Foreign exchange liquidity provision in disorderly market conditions. If fiscal financing becomes problematic, tighten fiscal policy. Measures to address capital flow reversals (see below).
Weaker-than-expected global growth.				
• U.S.	*Medium*	*ST-MT*	***M***. Protracted period of lower growth and worse twin deficits, especially if accompanied by lower commodity prices.	Structural measures to promote growth domestically. Fiscal consolidation to ensure debt stabilization over the medium term while protecting the poor.
• Europe.	*High*	*ST-MT*	***H***/***M***. Deterioration in growth, employment, and worsening of twin deficits, especially if accompanied by lower commodity prices. Potential capital flow reversal.	Structural measures to promote growth domestically. If external financing is reduced, tighten monetary and fiscal policies. Foreign exchange liquidity provision in disorderly market conditions.
• China.	*High*	*ST-MT*		
Domestic risks				
Protracted domestic policy uncertainty because of governance setbacks or delays in reform implementation.	*Medium*	*ST-MT*	***H***. Low growth, larger fiscal deficits, higher public debt, a ratings downgrade triggering capital outflows. Potentially, destabilizing financial conditions.	Greater consistency in policy statements, and structural measures to strengthen governance in SOEs. Increase competition in product markets and increase labor market flexibility. Anti-corruption and anti-money laundering measures to boost confidence.
Eskom's inability to pay debt.	*High*	*ST-MT*	***H***. Eskom being macro-critical (95 percent of domestic electricity production and 16 percent of GDP in size), major adverse consequences for the economy.	Measures to stabilize Eskom finances in the short run and overhaul the business model over the medium term to create space for greater private sector participation. Strict enforcement of structural conditionality for fiscal support.
Excessive budget deficits or other policy missteps that reduce market confidence.	*High*	*ST-MT*	***H***. Increases in interest rates, sovereign credit rating downgrades to speculative grade, capital outflows, financial instability.	Measures to reduce fiscal deficit, especially the fiscal cost of bailing out Eskom and other SOEs, while protecting social outlays. Ameliorating governance and improving spending efficiency. Measures to address financial risks (see below).
Deterioration in banks' asset quality and liquidity conditions owing to protracted low growth.	*Medium*	*MT*	***H***. Lower lending to households and corporates as bank balance sheet conditions weaken, with adverse impact on growth, fiscal outlook, and financial and external stability.	Asset quality reviews and adjustment to provisioning. Enhancement to risk analysis and action to mitigate risks. Foreign exchange liquidity provision in disorderly market conditions.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

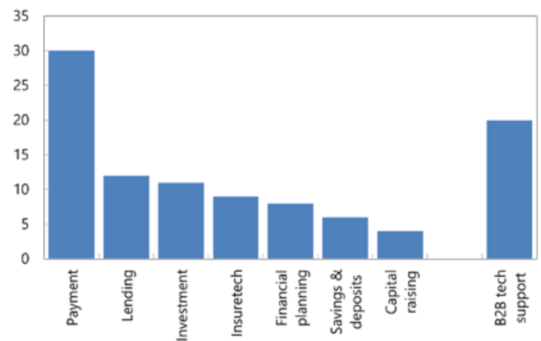
Annex VII. FinTech and Financial Inclusion in South Africa[1]

The Fintech industry, including many start-ups, provide a wide range of services, particularly in payments. Payment activities are supported by an evolving regulatory environment, conducive to Fintech emergence and growth. Fintech services have likely positive effects on financial inclusion, but their impact is yet to be measured. To deepen Fintech potential, financial literacy and trust in financial products need to be improved, and more needs to be done to better understand local social dynamics.

1. **Fintech start-ups are emerging across a wide range of services in South Africa, with payment-related services being the most popular.** While established financial institutions now provide Fintech services, many other emerging firms are of the type that the Financial Stability Board defines as "disruptive"—innovation in financial services that results in new business models materially disrupting existing products and services. Out of 220 active and operational firms, most cater to individuals and some provide services to businesses. As in other economies, payment-related services (nearly 70 firms) have attracted most of the activity, representing 30 percent of the total.

Figure A7.1. Fintech Firms by Segment

(Percent share)



Sources: Genesis, National Treasury South Africa, SECO, World Bank. *forthcoming.* "Fintech Scoping in South Africa."

2. **South Africa's Fintech space, particularly in payment-related services, appears to perform well relative to other emerging economies (EMs)**. Services, including real-time clearing, contactless cards, and an interoperable card-payment system were introduced relatively early compared to other EMs and have been widely used. The Fintech Data Hub—currently work in progress—will, when established, support compilation of rich data on Fintech activity.[2] A concrete and explicit country-level strategy for private sector-led innovation could further South Africa's potential to become a nation powered by a digital revolution, similar to the one ongoing in Singapore (Smart Nation Policy) or India (Digital India).[3]

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[1] This annex draws on the discussion with the SARB's FinTech Unit and a preliminary version of "Fintech Scoping in South Africa" by National Treasury, Genesis, SECO, and the World Bank.

[2] The Hub aims at harmonizing the data approach. Data will be collected through a singular platform. Raw data and analysis will meet all legal requirements including on privacy and will be used across regulators. Where appropriate, exchanges, academia, and industries will have access.

[3] A Presidential Commission on the Fourth Industrial Revolution will help leverage the digital revolution in South Africa. Platforms provided under the Smart Nation Singapore initiative aim at enabling citizens to provide solutions instead of relying on the government. India's Digital Campaign makes government services available electronically, including plans to connect rural areas with high-speed internet networks. It aims at developing secure digital infrastructure and achieving universal digital literacy.

3. The emergence of Fintech has been supported by policymakers and regulators. Fintech activity, particularly products outside of payment services, may require a regulatory review to ensure regulations are commensurate with emerging innovations. The regulators—Financial Intelligence Center (FIC), Financial Sector Conduct Authority (FSCA), National Credit Regulator (NCR), National Treasury, and South African Reserve Bank (SARB) —are working together to align regulation and oversight of all innovative financial products with the pace of innovation, including with a view to subjecting virtual asses service providers to AML/CFT requirements. The Inter-Governmental FinTech Working Group (IFWG), a cross cutting, cross government body, is being formalized through revised terms of reference and memoranda of understanding. The FSCA and SARB will lead the establishment of a joint innovation hub for the regulation of fintech firms or innovative financial products in the first half of 2020.[4]

4. Further improvements in Fintech regulation is underway. For instance, a regulatory sandbox will be deployed to assess whether mobile payments like Kenya's would work. The law and respective regulations need to ensure that mobile payments can operate within sandbox environments. Fintech firms' accessibility to the regulators is expected to be enhanced as the joint innovation hub turns operational. Regulators are experimenting with new technology in collaboration with the private sector—the Project Khokha piloted a distributed ledger technology (DLT)-based real time gross settlement system, and the technology is set to be applied to another pilot involving SARB debenture issuance**.**

5. Fintech has the potential to enhance financial inclusion. South Africa moderately underperforms its peers (upper middle-income economies) in bank account access and notably in the usage of financial products. Usage of financial products is lower among the young, female, and unemployed. To the extent that the unit costs of financial services, such as payments, savings, and lending are relatively high in South Africa, competition from new service providers, particularly those targeting low income consumers, is welcome.

6. Fintech firms appear to be gradually moving low income individuals away from cash. According to local industry experts, cash remains an important medium of transactions. Wizzit, a provider of basic banking services for the un-and under-banked, struggled to get consumers on board sustainably. M-Pesa, the cellphone-based money transfer, financing and microfinancing service was successful in Kenya but did not take-off in South Africa.[5] Meanwhile, Yoco, South Africa's largest mobile point of sales (MPOS) payment provider (which allows SMEs to accept card payments) has acquired 50,000 merchants since its launch in 2015.[6] Also, nearly three years after

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[4] They provide innovators with direct support and guidance, through access to regulatory personnel, as to how best to interpret regulations applicable to their product or service.

[5] A *TimesLive* article (June 5, 2016) argues M-Pesa took off in Kenya because it was the right product introduced at the right time. M-Pesa was introduced when banks closed for days, preventing customers from remitting funds. Also, the Kenyan government used the platform to pay pensions and social welfare grants. Consumers in South Africa did not trust the mobile operator as much as banks. M-Pesa was asked by the regulator to work with a bank in South Africa, but the collaboration did not work well.

[6] Such provides also help grow SMEs' businesses by assisting management of information, such as sales data.

withdrawing operations in South Africa, MTN plans to relaunch mobile money services, targeting the rural and peri-urban poor, who are largely reliant on cash payments. Bank Zero, an app-based mutual bank, will start providing financial services at low fees, along with financial education to its customers in 2020.

7. Several key issues emerge for Fintech to have a greater impact on financial inclusion.

- From *the demand side*, South Africa has a good experience with the viability of financial schemes supported by trust, as demonstrated by the *Stokvels* saving schemes.[7] Based on this experience, consumer awareness of the benefits of using technology to access financial services could be improved, including by emphasizing the difference between regulated and unregulated financial service providers. Technological innovations and increased financial literacy need to go hand in hand. To help reduce the mistrust of financial service providers, regulators should continue to deter criminal schemes that falsely position themselves as financial service providers.

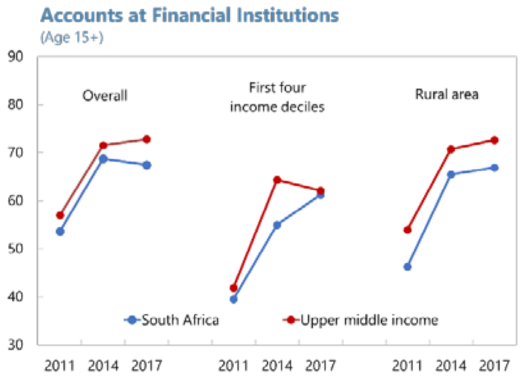
- From *the supply side*, products need to be catered better to local social dynamics. For instance, anecdotal evidence suggests that some of the remittances among low income users represent money transfers to self for security reasons (reflecting fear of robbery when carrying cash during transit). Low income users are cash-based and very sensitive to service fees.[8] Past experience indicates that introducing products that may have worked in other markets might not be suitable for the South African consumer. To this end, there is room for Fintech firms to understand better the local needs.

[7] These are by invitation-only clubs of twelve or more people serving as rotating credit unions or saving schemes where members contribute fixed sums of money to a central fund on a weekly, fortnightly or monthly basis.

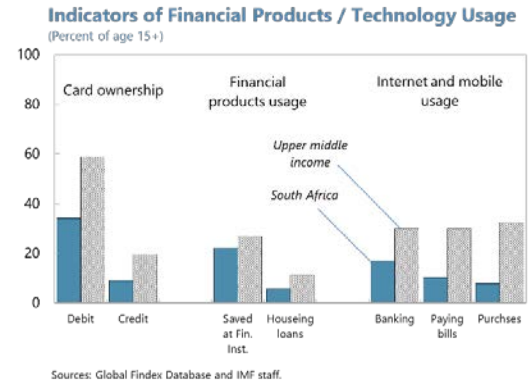
[8] A large share of grant recipients cash out grants in one go without using the accounts for other banking transactions.

Figure A7.2. Financial Inclusion

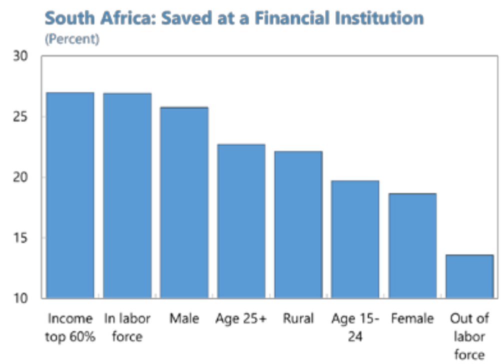
South Africa moderately underperforms the country group peers in account access…



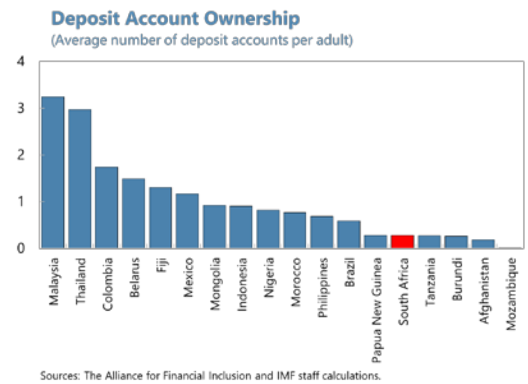
…and more significantly so in the usage of financial products and technology.



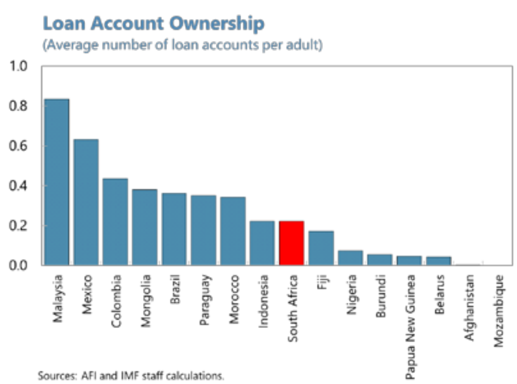
Usage of financial products is lower among the young, female, and unemployed.



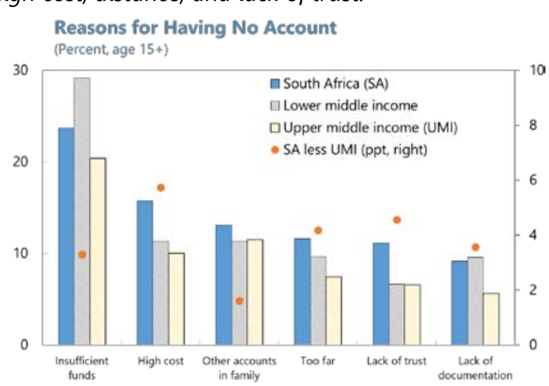
Data by a consortium of central banks and regulators suggest low usage of deposits and…



…loans in South Africa.



Lack of account access in South Africa is due mainly to high cost, distance, and lack of trust.



Sources: Alliance for Financial Inclusion, Global Findex, and IMF staff calculations.

Annex VIII. Progress in the Fight Against State Capture

Several steps have been taken to address state capture and corruption over the past two years. Priority has been given to strengthening criminal justice institutions to enable the state to deal more effectively with corruption, setting up several commissions of inquiry in charge of restoring the integrity of key state institutions, and establishing the causes behind the deterioration in their governance. Nonetheless, given the depth and breadth of state capture, sustained efforts—especially establishment of credible deterrence mechanisms—will be required to credibly combat corruption and improve governance.

1. **Efforts to fight state capture were significantly stepped up since 2018.** Several initiatives were outlined in the anti-corruption drive, including reforming the criminal justice system and state institutions, and establishing commissions of inquiry into corruption and impropriety at SOEs and public sector institutions. In this respect, some positive reforms have been advanced. For example, several boards of key state institutions have been replaced, and new heads of the National Prosecuting Authority (NPA) and the South African Revenue Services (SARS) have been appointed. Some ministers allegedly implicated in state capture have been replaced, although progress in prosecuting those involved in corrupt activities has been slow.

2. **The government has prioritized strengthening criminal justice institutions to enable the state to deal more effectively with corruption.** Over the years, investigative institutions such as the South Africa Police Service (SAPS) and the NPA had ended up becoming vectors of state capture. However, some headway has been made recently at the NPA through the appointment of a new National Director of Public Prosecutions, and the establishment of a new Special Investigating Unit (SIU) to investigate corrupt activities of SOEs and other state entities. Moreover, a new Directorate within the NPA was established to investigate complex high-profile corruption cases and cases emanating from the commissions of inquiry. Progress has been made by the NPA, including the conviction of more than 350 individuals over the last 12 months.[1] The recent establishment of a SIU Special Tribunal is expected to complement criminal justice efforts in recovering ill-gotten assets. There have also been calls to strengthen the protection of whistleblowers.

3. **The government has instituted several commissions of inquiry in the past 1½ years to investigate the expansion of corrupt activities in state institutions.**

- *The Judicial Commission of Inquiry into Allegations of State Capture*, headed by the deputy chief justice, is the most important one as it is investigating wide-ranging allegations of state capture, corruption, and fraud in the public sector, including organs of state.

- *The Commission of Inquiry into Allegations of Impropriety regarding the Public Investment Corporation (PIC)* has investigated whether employees misused their positions for personal gain; whether legislation regarding the protection of whistle blowers were complied with;

[1] National Prosecution Authority Annual Report 2018/19.

and whether discriminatory practices were followed regarding the remuneration of PIC employees.

- *The Commission of Inquiry into the National Prosecuting Authority (NPA)* investigated whether suspended senior officials were fit to hold office.

- *The Parliamentary Inquiry into Governance, Procurement and the Financial Sustainability of Eskom* investigated the appointments of board members and executive management; the early retirement and reappointment of the former CEO; alleged procurement irregularities; allegations of impropriety by the former acting CEO; and allegations of state capture relating to the department of public enterprises and other state-owned institutions.

- *The Commission of Inquiry into Tax Administration and Governance by South African Revenue Service (SARS)* investigated whether any politically connected persons linked to SARS' top management as well as private service providers benefitted from changes to its policy.

4. These inquiries are part of the process of restoring the integrity of key state institutions, and establishing the causes behind the deterioration in their governance. The NPA has taken a lead in investigating cases emanating from these inquiries. Furthermore, the new NPA head has assigned top prosecutors to follow evidence from the state capture inquiry to fast-track cases against those implicated. Table A10.1 summarizes the key findings and recommendations of the various commissions, and actions taken so far.

5. SOEs had become a major instrument of state capture, mainly because of easy access to procurement contracts and weak governance structures. SOEs play a significant role in the economy and have large annual procurement budgets. They are dominant in network industries, providing services such as energy, water, electricity, and transportation. Key SOEs include Eskom, state airline South African Airways (SAA), state aerospace and military technology company Denel, transport and logistics company Transnet, and public broadcaster SABC. Many of these SOEs have been experiencing severe financial and operational challenges, with corruption and weak accountability at the heart of these systemic failures. The initial findings also show how endemic corruption had become—reputable international audit firms, consultancies, and service providers actively benefited from corrupt activities.

6. The government has taken initial steps to restore the integrity and capacity of SOEs. New boards and management have been appointed at Eskom, Denel, Transnet, SAA and SABC, among others. The new boards have been mandated with improving governance and restoring financial sustainability. A Presidential SOE Council has been established to provide political oversight and strategic management in the reform, repositioning and revitalization of SOEs. Furthermore, several SOEs, namely Eskom, national oil company Petro SA, the Passenger Rail Agency of South Africa (PRASA), the South African National Roads Agency (SANRAL), among others, are undergoing forensic investigations. In November 2019, the NPA announced that more than R2.8 billion (about US$189 million) has been recovered in the past financial year from the proceeds of corruption, money laundering, cyber and environmental crimes through the NPA's Asset Forfeiture Unit. To facilitate the rebuilding of capacity, the government allocated additional financial resources in late 2019—R1.3 billion for the NPA and R1 billion for SARS.

7. Despite government's efforts in governance reforms, there has been slow progress in implementation. So far, there have been relatively few high-profile prosecutions of individuals accused of corruption, although the NPA has recently ratcheted up investigations and is likely to launch some major prosecutions in the coming months. In the meantime, several of the above-mentioned SOEs continue to face major operational and financial challenges. Moreover, several prominent SOE CEOs resigned in 2019, often citing excessive political interference and insufficient government support. Given the depth and breadth of state capture and corruption, sustained efforts over time—especially the establishment of credible deterrence mechanisms—will be needed to address the challenges.

Table A8.1. South Africa: Status of Governance Reforms		
Key Findings	**Recommendations**	**Action Taken so Far**
Parliament Inquiry into Governance, Procurement and the Financial Sustainability of Eskom[1]		
Systematic flouting of governance rules, which rendered Eskom financially unsustainable.	Law enforcement agencies to pursue investigations and prosecution of those implicated.	A new board and senior executives were appointed.
Eskom allowed irregular procurement practices to serve the interests of private businesses and individuals, including staff members.	Evidence to be further investigated by the State Capture Inquiry.	Executives are pursuing investigations into fraud, corruption and other crimes at the power utility.
International and domestic audit firms and consultancies were co-opted to facilitate corrupt practices.		Global consultancy McKinsey paid back R1 billion to Eskom for dubious contracts. The power utility is in a process to recover millions from the Gupta family-linked asset management company, Trillian.
Commission of inquiry into tax administration and governance by SARS[2]		
Massive failure of integrity and governance" under the leadership of the former commissioner.	Removal of the former SARS Commissioner.	The former Commissioner was removed, and several senior staff were forced to resign.
Failure of governance was made possible by weaknesses in the governing legislation for the revenue authority, which did not entrench governance structures in the organization.	Criminal prosecution for the awarding of a contract to Bain & Co for the restructuring of SARS.	A new commissioner was been appointed through a transparent selection process.
	National Treasury to review the procurement processes of SARS projects to prevent abuse.	The Large Business Center was re-established, and an illicit economy unit—with special focus on tobacco smuggling—has been established.
	Re-establishment of the Large Business Centre, the Compliance Unit and the establishment of a high-level Integrity Unit.	A separate division at SARS has been established, that will focus solely on the impact to the fiscus following the outcome of the commissions of inquiry into state capture.
	Appointment of a deputy commissioner.	
	Amendment of the SARS Act to require the preparation of an annual business plan by SARS to be approved by the Finance Minister.	
Commission of Inquiry into the NPA		
Two senior officials from the NPA are not fit and proper to hold their respective offices, having failed in their duties to uphold the NPA Act and brought the NPA into disrepute.	Two senior officials at the NPA to be removed from their positions.	The two officials were removed in April 2019 pending a parliamentary process.
Judicial Commission of Inquiry into Allegations of State Capture		
The commission is ongoing and is expected to continue at least into 2020.	Pending	
Commission of inquiry into allegations of impropriety regarding the PIC		
The commission is expected to complete its work in late 2019.	Pending	The PIC has fired its investment manager linked to a R4.3 billion deal done with Ayo Technology Solutions.

[1] Final report of the portfolio Committee on Public Enterprises on the inquiry into Governance, Procurement and the Financial sustainability of Eskom, November 28, 2018.

[2] Final report of the Commission of inquiry into tax administration and governance by SARS, December 11, 2018.

Annex IX. Summary of Capacity Development Strategy

1. Capacity development (CD) strategy. The main areas of CD the Fund can support over the next fiscal year and the medium term remain broadly unchanged from the previous vintage of the CD Strategy Note. Priorities include enhancing the role of the medium-term fiscal framework to stabilize debt, strengthening tax administration, maintaining financial stability while supporting financial inclusion, and upgrading national accounts statistics. These areas relate strongly to the main surveillance topics: reviving economic growth by implementing structural reforms, consolidating the government and SOEs positions, and maintaining credible monetary and financial sector policies.

Key Overall CD Priorities Going Forward

Priorities	Objectives
Fiscal Risk Management	Introduce a public debt ceiling as a fiscal anchor to complement the expenditure ceiling. Quantify and set risk limits for SOEs' contingent liabilities.
Tax Administration	Conduct a TADAT assessment following SARS's capacity erosion in recent years. Restore a large tax-payers unit and make it fully operational. Reduce tax base erosion and profit shifting, especially by multinational companies. Update customs legislation.
Financial Stability and Inclusion	Carry out an FSAP in 2020 to help enhance the financial stability framework and explore opportunities for greater financial inclusion. Assist the authorities in developing a capital account liberalization strategy in line with the IMF's *Institutional View* which should facilitate the adherence to the OECD Codes of Liberalization.
Statistics	Upgrade national accounts statistics, including seasonal adjustment, to enhance monitoring of economic activity.

2. Main risks and mitigation. Given the overall strength of economic institutions, Fund CD is highly focused on specific initiatives the authorities deem important. Since the support is demand driven, the authorities have shown a very high degree of commitment in preparing for TA missions and implementing recommendations. Significant buy-in and support limit risks.

Authorities' Views

3. The authorities plan to leverage Fund capacity development (CD) as needed. The SARS is looking to rebuild capacity and its particular needs will be guided by the outcome of a Tax Administration Diagnostic Assessment using the TADAT methodology. The SARB sees the forthcoming FSAP as an opportunity to strengthen its regulatory and supervisory framework. STATS SA appreciated CD to improve seasonal adjustment and is expected to request further CD to assess their progress in this area. The National Treasury is looking for assistance on how to set overall risk limits on SOE contingent liabilities, which could potentially be assisted by IMF CD.

Annex X. Status of Key Recommendations from the 2018 Article IV Consultation

	Recommendation	Status
Fiscal Policy	Stabilize debt at more comfortable levels with gradual fiscal adjustment. Streamline expenditure (especially the wage bill), enhance spending efficiency, and bolster tax administration. Introduce a debt ceiling in addition to the existing nominal expenditure ceiling.	Debt dynamics have continued to deteriorate, as weak growth, an increasing interest bill, and spending pressures from SOEs, particularly Eskom, widened the deficit. Limited consolidation measures were introduced, including early retirement, attrition, and savings in goods and services. Excise and "sin" taxes were increased. A new revenue authority commissioner was appointed, and progress has been made to rebuild capacity and boost the role of the large business center. Significant scope remains to improve public spending efficiency and harden SOE budget constraints. No debt ceiling was introduced.
State-Owned Enterprises	Improve Eskom's balance sheet conditions to secure funding at reasonable terms. Cut wage bill and procurement costs. Increase transparency of tariff setting for Eskom; collect arrears. Address outdated business models of key enterprises (unbundle and privatize). Optimize Eskom's energy mix. Address inefficiencies in national airlines, post office, and other enterprises.	Eskom's finances remain under severe pressure, requiring large transfers from the Treasury. Efforts are underway to cut procurement costs through improved governance and renegotiation of certain contracts. The tariff-setting process remains uncertain due to different interpretations of the pricing formula, which is being reviewed in court. Eskom Roadmap and Integrated Resource Plan have put forward long-term plans on restructuring of energy sector. Government had to provide budget transfers to several public entities but intends to stabilize the finances of other SOEs under pressure.

Monetary and Financial Policy	Anchor inflation expectations closer to the mid-point of the official band. Address pockets of vulnerability in the banking system (e.g., small and medium-sized banks). Enhance financial inclusion partly by improving the intermediation role of large banks in the economy Increase foreign exchange reserves as opportunities arise	The SARB started to emphasize its preference to durably reduce inflation and inflation expectations to 4.5 percent. The transition to the Twin Peaks approach to financial sector supervision and regulation has progressed. The SARB's stress-testing framework is being upgraded The authorities have continued to work on a regulatory framework conducive to developing fintech, with many products already present, albeit still at a small scale. Unfavorable capital flow developments left few opportunities to increase foreign exchange reserves.
Structural Reforms	Continue to strengthen governance and fight corruption. Enhance product market competition, including by seeking strategic equity partnerships with the private sector. Improve labor market flexibility by reviewing centralized bargaining. Enhance the provision of education services to address skills mismatches. Promote further digitalization of the economy to improve financial inclusion and service delivery.	Various commissions of inquiry are ongoing or have completed investigations into state capture and its damaging effects on institutions. Reforms are ongoing to rebuild capacity in key institutions (such as SARS and NPA). There have been initial steps for spectrum auctions, measures to facilitate visas for tourists and business registration, and increased powers for the Competition Commission. Little progress has occurred on labor market reforms and quality of education. Digitalization efforts are being accelerated to support financial inclusion.
Social	Improve payment mechanism of social grants to maximize impact. Reconsider poorly targeted tertiary education subsidies. Improve efficiency of education and health expenditure. Facilitate migration; transportation of workers to economic centers.	Grants are now paid through the post office. No change on education subsidies. No change on expenditure and health expenditure policies to improve efficiency. A policy proposal was put forward in National Treasury's policy paper.

Annex XI. Implementation of 2014 FSAP Recommendations

Key Recommendations	Progress
Finalized in most areas or near completion	
Twin Peaks Reform: Define clear and comprehensive institutional, governance, and accountability arrangements for prudential and market conduct regulation.	The Financial Sector Regulation (FSR) Act, which came into effect in April 2018, established the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA). The FSR requires collaboration between the financial sector regulators and the South African Reserve Bank (SARB), and prescribes a memorandum of understanding between them.
Publish a roadmap for regulatory reform, with adequate resource allocation, monitoring, and evaluation, to carefully implement the move to twin peaks and minimize transition risks.	The PA's regulatory strategy on how to achieve its objectives and perform its regulatory and supervisory functions has been published online.
Substantial progress	
Microprudential: Strengthen group-wide supervision of financial conglomerates, focusing on interconnectedness by monitoring intra-group transactions and aggregate exposures, and conducting joint on-site visits.	The PA and the FSCA continue to cooperate. The PA is set to release draft prudential standards for financial conglomerates for public consultation in 2020. A Conglomerate Supervision Department has been established within the PA.
Clarify objectives and strengthen the operational independence of all financial sector supervisors in the relevant legislation in line with international standards.	The FSR Act provides for the previously identified weaknesses.
Enhance regulatory requirements of Collective Investment Schemes (CIS). Introduce variable net asset valuation. Strengthen the supervision of CIS managers.	A revised draft of the Net Asset Valuation (NAV) Standard was submitted to the National Treasury in August 2019 for tabling in Parliament. The NAV Standard will be supported by a Guidance Notice currently under development by the FSCA.
Fully implement the Solvency Assessment and Management (SAM) regime and Treating Customers Fairly Initiative (TCF); give high priority in legislation to protecting policyholder rights and entitlements.	The SAM framework was fully implemented on 1 July 2018. TCF conduct matters are already being implemented by the FSCA. The Conduct of Financial Institutions Bill (CoFI Bill) is set to be tabled in Parliament during 2019.
Macroprudential: Continue building a top-down stress test framework for banks and insurers. Give the SARB more resources for data collection and analysis.	The current stress test framework is focused on banks and that for insurers is being developed. The SARB has approved additional resources in this area to assist with data collection and analysis.
Financial Safety Nets: Introduce a resolution regime compliant with the Key Attributes, or the core elements for an effective resolution regime. Make the SARB the resolution authority of all banks and systematically important financial institutions (SIFIs).	The National Treasury is preparing the Financial Sector Laws Amendment Bill for tabling in Parliament. Once promulgated, the SARB will be the resolution authority and the Corporation for Deposit Insurance will be established.

Key Recommendations	Progress
Adopt depositor preference and introduce an ex-ante funded deposit insurance scheme, with a back-up credit line from the National Treasury. Remove constraints to early intervention powers and improve legal protection for resolution officials.	The SARB and the National Treasury published a policy paper in May 2017 proposing the establishment of a deposit insurance scheme (DIS) for South Africa.
OTC Derivatives Market: Improve data collection and enhance surveillance of the over the counter (OTC) derivatives market.	The amendments to the Financial Markets Act create a framework for the licensing, regulation, and supervision of a CCP.
Consider establishing a local central clearing counterparty (CCP)—with credit lines to the central bank and securities collateral placed at a central securities depository—to reduce dependency on local banks.	There is currently no licensed trade repository in South Africa. The regulatory framework is in place and the FSCA is in the process of assessing license applications.
Some progress	
Competition: Adopt the international best practices on provision and disclosure of market information to retail customers and to potential entrants into the payments and clearance systems.	CPMI-IOSCO Principles for Financial Market Infrastructures (PFMIs) have not been formally adopted into domestic law.
Adopt a rules-based entry and exit framework, and lower entry hurdles to the financial system.	The National Payment System (NPS) Department is reviewing the NPS Act to address entry/exit frameworks in line with PFMIs and international standards.

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

January 9, 2020

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	The African Department (in collaboration with other departments and the World Bank)

CONTENTS

RELATIONS WITH THE IMF

As of November 30, 2019

Membership Status

Joined: December 27, 1945

Accepted the obligations of Article VIII Sections 2, 3, and 4 of the IMF's Articles of Agreement on September 15, 1973.

General Resources Account	**SDR Million**	**%Quota**
Quota	3,051.20	100.00
IMF holdings of currency	2,389.19	78.30
Reserve tranche position	673.03	22.06
Lending to the Fund		
New arrangements to borrow	22.10	

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	1,785.42	100.00
Holdings	1,496.43	83.81

Outstanding Purchases and Loans	None	

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	Nov 03, 1982	Dec 31, 1983	364.00	159.00
Stand-By	Aug 06, 1976	Aug 05, 1977	152.00	152.00
Stand-By	Jan 21, 1976	Aug 06, 1976	80.00	80.00

Projected Payments to the IMF

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2019	2020	2021	2022	2023
Principal					
Charges/interest		2.31	2.31	2.31	2.31
Total		2.31	2.31	2.31	2.31

Exchange Rate Arrangement

The rand floats against other currencies and South Africa maintains an exchange system consistent with obligations under Article VIII of the IMF's Articles of Agreement.[1] South Africa's de-jure exchange rate arrangement is free floating and the de-facto arrangement is floating. Its exchange system is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions. South Africa has continued to gradually liberalize the system of exchange controls in place since the apartheid regime.

With the abolition of the financial rand in 1995, all exchange controls on nonresidents were eliminated. Nonresidents are free to purchase shares, bonds, and other assets, and to repatriate dividends, interest receipts, and current and capital profits, as well as the original investment capital. Foreign companies, African governments, and institutions may list equity and debt instruments on South Africa's securities exchanges.

Exchange controls on capital transactions by residents have been gradually relaxed. The authorities' main objective has been to move toward a system based on prudential limits and supervision, and away from a rigid system of quantitative controls.

Article IV Consultation

The 2018 Article IV consultation was concluded by the Executive Board on July 25, 2018. South Africa is on the standard 12-month Article IV consultation cycle.

Technical Assistance

Fiscal Affairs Department (FAD) technical assistance (TA) missions

TA missions to support the authorities in the establishment of a new Parliamentary Budget Office (PBO), discuss options for the National Treasury to strengthen its performance management systems, and conduct a joint workshopmwith the National Treasury took place in 2013. Missions provided advice on expenditure reviews andoptions for further strengthening the PBO, and developed a pilot of the Tax Administration Diagnostic Assessment Tool (TADAT) in 2014. As part of the technical support for the Davis Tax Committee, an FAD mission on VAT gaps visited in late 2014 and early 2015, and missions on natural resource taxation took place in early 2015 and 2016. Missions on public sector balance sheets, wage bill management and PBO analysis occurred in 2015. Missions followed up on the review of mining and petroleum fiscal regimes in 2016, and assessed SARS' capacity in the administration of transfer pricing programs in 2017. An FAD mission assisted the National Treasury in developing a fiscal stress testing framework in June 2018. Subsequent capacity development (CD) support and training has been provided via AFRITAC South (AFS) in 2018 and 2019.

[1] South Africa accepted the Article VIII, Section 2(a), 3, and 4 obligations in 1973.

Monetary and Capital Markets Department (MCM) technical assistance (TA) missions

An MCM mission provided training to the South African Reserve Bank (SARB) on banking sector stress test in May 2014, and AFS on modernization of monetary frameworks in 2014. Other missions assisted the SARB in enhancing its stress testing framework in 2017 and 2018. AFS held a National PFMI workshop in late 2017 and early 2019. East AFRITAC (AFE) held a joint workshop on FX spot & Swap market simulation for regional central banks in June 2018. AFS convened a national workshop on risk-focused supervision of cross-border transactions in July 2018, and a seminar on risk-focused approach to supervision of cross-border transactions in July 2019.

Legal Department (LEG) technical assistance (TA) missions

In 2015, a LEG mission provided technical assistance on fiscal law of the extractive industries in conjunction with FAD's mission on national taxation.

Statistics Department (STA) technical assistance (TA) missions

An STA mission assisted Statistics South Africa (SSA) in assessing the potential for developing an official residential property price index in 2018. An AFRITAC South mission assisted SSA in assessing the coherence between quarterly national accounts estimates and the short-term estimates, particularly for household final consumption expenditure and monthly retail sales, in September 2019. Other series reviewed included the import and export price series, and the monthly mining series. The mission reviewed in detail the approach taken by SSA for the parameters set as part of the seasonal adjustment for those series. Jointly with the SARB Academy and the South African Development Community (SADC) Committee of Central Bank Governors (GCCB), STA conducted an introductory course on monetary and financial statistics (MFS) in October 2019. The course familiarized participants with the recommended methodology for compiling MFS and promoted the use of standardized report forms (SRFs) as an input to monetary policy formulation and analysis.

THE JMAP WORLD BANK IMF MATRIX

The IMF South Africa team led by Ms. Ana Lucía Coronel (mission chief) met with the World Bank South Africa team led by Ms. Marie-Françoise Marie-Nelly in November 2019, to discuss macrocritical structural issues.

The teams agreed that South Africa's economic challenges include maintaining macroeconomic stability and boosting growth and making it more inclusive to promote job creation and social cohesion.

The teams have the following requests for information from their counterparts:

- The IMF team asks to be kept informed of progress in the macrocritical structural reform areas under the World Bank's purview (product and labor markets and governance). Timing: when milestones are reached or in the context of missions (and at least semiannually).

- The World Bank team asks to be kept informed of progress in the areas of macroeconoomic stability (fiscal, monetary, and financial sector policies) and macrocritical structural reforms. Timing: when milestones are reached (and at least semiannually).

Table 1 lists the teams' separate and joint work programs during May 2019–April 2020.

Table 1. South Africa: Bank and IMF Planned Activities in Macro-Critical Reform Areas, May 2019-April 2020

Title	Products
1. World Bank Work Program[1]	• Legislative and governance reforms for State Owned Entities (SOEs). Produce a green paper as the basis for the SOE Act focused on institutional arrangements for centralized oversight; appointment procedures for SOE board members; performance management framework; and procurement. • Support program on townships economies for metropolitan cities. • Strategies/policies on financial stability, financial inclusion, fintech and cooperative banking. • Technical assistance on infrastructure finance and capital markets. • Diagnostic paper on digital economy for Africa (in-depth reviews of infrastructure, digital financial services, skills, and entrepreneurship). • Broad developmental issues. • Statistical capacity building.
2. IMF Analytical Work Program	The IMF will continue to conduct analytical work on topics related to: • Macro-financial linkages. • Monetary policy transmission. • Exchange rate volatility and its macroeconomic impact. • Growth diagnostics. • Drivers of fiscal expansion and public debt accumulation. • SOEs .

	• Product and labor market reforms. • Corruption and governance. • Buffers and vulnerabilities. • Digitalization. • Financial Inclusion. • Education.
3. Joint Products in the Next 12 Months	• Coordination on structural reform advice. • An FSAP.
[1] Missions are ad hoc, but generally occur twice a year. An ongoing lending project provides credit lines for agricultural financing. Most of the current engagement is on nonlending activities.	

STATISTICAL ISSUES

(As of January 10, 2020)

I. Assessment of Data Adequacy for Surveillance
General: Data provided to the IMF are adequate for surveillance.
National Accounts: Reporting of real sector data for International Financial Statistics (IFS) is timely. Statistics South Africa (SSA), which is responsible for compiling GDP data by production, has now also taken over the compilation of GDP data by expenditure from the South African Reserve Bank (SARB). GDP data are compiled according to SNA2008, with a base year of 2010. Quarterly labor market statistics are published one month after the end of the quarter. Given the seriousness of the unemployment problem, labor market analysis and policy design would benefit from better and more frequent labor market data. A new Quarterly Labor Force Survey (QLFS) was launched in January 2008 based on major revisions to an old survey in existence since 2000. Since 2015, a new Master Sample has been introduced based on the 2011 census data. The new Master Sample should improve the level of precision in the estimates produced.
Price Statistics: The consumer price index (CPI) covers all households living in metropolitan and urban areas,. The current CPI weights are based on data gathered by SSA in the Living Conditions Survey (LCS) 2014/15, supplemented by a range of other data sources, including SSA surveys and regulatory and industry reports. Indices in the CPI are based to 100 at December 2016.
Government Finance Statistics: To move toward fiscal analysis based on the Government Finance Statistics (GFS) framework in compliance with the GFS Manual 2014, fiscal data provided for surveillance by the National Treasury and data reported to IMF's Statistics Department (STA) for the GFS database need to be fully reconciled. National Treasury's fiscal data covers a part of the general government and does not include the corresponding balance sheet data. Data reported for the GFS database, compiled by the South African Reserve Bank (SARB), cover all the general government subsectors and include the balance sheet data.
Monetary and Financial Statistics: Monetary statistics compiled by the SARB are consistent with the methodology of the *Monetary and Financial Statistics Manual*. South Africa reports regular and good quality monetary statistics for publication in the *IFS*, although there is room for improving the timeliness of the data on other financial corporations.
Financial Ssector Surveillance: South Africa reports Financial Soundness Indicators (FSIs) to the Fund—published on the IMF's FSI website. All core FSIs, ten encouraged FSIs for deposit takers and two encouraged FSIs for the real estate sector are reported on a monthly basis. Two encouraged FSI for deposit takers, and two encouraged FSI for households are reported with a quarterly frequency. The encouraged residential real estate price index ceased to be reported to STA in 2016. South Africa reports data on some key series and indicators to the Financial Access Survey (FAS), including two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) related to the U.N. Sustainable Development Goals.
External Sector Statistics: Balance of payments and international investment position data are reported quarterly and are broadly consistent with the sixth edition of the *Balance of Payments*

and International Investment Position Manual (BPM6). The authorities improved the coverage of trade flows within the Southern African Customs Union (SACU) in 2013. Work is needed to improve the reliability and accuracy of balance of payments data with the aim of reducing errors and omissions. Data on the international reserves position are disseminated in line with the requirements of the IMF's *Data Template on International Reserves and Foreign Currency Liquidity*. South Africa also participates in the IMF's Coordinated Portfolio Investment Survey (CPIS) and Coordinated Direct Investment Survey (CDIS).	
II. Data Standards and Quality	
South Africa subscribed to the Special Data Dissemination Standard (SDDS) on August 2, 1996, and is in observance of the specifications for coverage, periodicity, and timeliness of data.	A Report on Observance of Standards and Codes—Data Module, Response by the Authorities, and Detailed Assessments Using the Data Quality Assessment Framework (DQAF) was published on October 16, 2001.
III. Reporting	
See Table 2.	

Table 2. South Africa: Table of Common Indicators Required for Surveillance
(As of January 10, 2020)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange rates	1/9/2020	1/9/2020	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	12/31/2019	1/6/2020	M	M	M
Reserve/base money	12/31/2019	1/6/2020	M	M	M
Broad money	11/31/2019	1/6/2020	M	M	M
Central bank balance sheet	12/31/2019	1/6/2020	M	M	M
Consolidated balance sheet of the banking system	11/31/2019	1/6/2020	M	M	M
Interest rates[2]	1/9/2020	1/10/2020	D	D	D
Consumer Price Index	11/30/2019	12/11/2019	M	M	M
Revenue, expenditure, balance and composition of financing[3] – general government[4]	9/30/2019	12/30/2019	Q	Q	Q
Revenue, expenditure, balance and composition of financing[3]–central government	11/30/2019	12/31/2019	M	M	M
Stocks of central government debt[5]	11/30/2019	12/31/2019	M	Q	Q
Stock of central government guaranteed debt	3/31/2018	2/20/2019	A	A	A
External current account balance	Q3 2019	12/06/2019	Q	Q	Q
Exports and imports of goods and services [6]	11/30/2019	12/30/2019	M	M	M
GDP/GNP	Q3 2019	12/03/2019	Q	Q	Q
Gross external debt	Q3 2019	12/30/2019	Q	Q	Q
International investment position	Q3 2019	12/30/2019	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Monthly data for goods. Goods and services are published quarterly on the same schedule as the rest of the balance of payments.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

Statement by Mr. Dumisani Hebert Mahlinza, Executive Director and Ms. Mmatshepo Maidi, Senior Advisor on South Africa
January 24, 2020

The South African authorities thank staff and management for the candid and fruitful engagements during the 2019 Article IV Consultation and appreciate the Fund's advice on policies required to support economic growth.

South Africa's economy continues to face a combination of constraints, including slow growth, structural challenges, rising debt and a deterioration in the financial position of state-owned enterprises. This notwithstanding, the economy continues to adhere to sound macroeconomic policies, supported by a flexible exchange rate. In addition, the deep and liquid domestic capital markets, large, well-established and capitalized banking system and a favourable public debt composition have provided buffers. That said, the authorities acknowledge the difficult juncture South Africa is in and remain committed to a well-designed reform agenda.

The authorities have initiated reform programs aimed at transforming the economy by promoting competitiveness and achieving sustainable and inclusive growth. These reforms include, among other things, modernizing network industries, improving export competitiveness, easing the cost of doing business and promoting agriculture. At the same time, discussions on a few policies are still ongoing, namely land expropriation without compensation and the nationalization of the South African Reserve Bank (SARB). Against this background, the authorities are concerned with how these issues are reflected in the Staff Report, as they have not yet been adopted as government policy.

Recent Economic Developments and Outlook

Economic performance remained sluggish in 2019, with growth estimated at 0.5 percent. GDP growth was weighed down by declines in activity in the mining, manufacturing and transport sectors which outweighed positive growth registered in the trade, government services and finance sectors. Going forward, the authorities expect growth to improve to 1.2 per cent in 2020, 1.6 per cent in 2021 and 1.7 per cent in 2022, due to a gradual recovery in confidence and investment. Meanwhile, the unemployment rate increased to 29.1 percent in the third quarter of 2019.

Headline CPI inflation averaged 4.7 percent in 2018 and inflation outcomes continued to moderate alongside inflation expectations during 2019. Subsequent to the IMF mission team's visit, inflation outcomes declined below forecasts, with headline CPI averaging 3.6 percent in November 2019. Food price inflation continued to surprise on the downside, and the currency has strengthened, contributing to the SARB revising down its January 2020 inflation forecasts. Headline CPI is expected to average 4.7 percent in 2020, 4.6 percent in 2021 and 4.5 percent in 2022.

The current account deficit narrowed from 3.5 percent of GDP in 2018 to 3.3 percent in 2019 on account of low imports. Foreign exchange reserves increased from $51.6 billion in 2018 to $55.1 billion at the end of December 2019, representing 5 months of import cover. Over the medium term, the current account is expected to widen somewhat as investor confidence recovers.

Fiscal Policy

The authorities broadly agree with staff's assessment of the fiscal position. They remain committed to prudent fiscal policy and fiscal sustainability while creating the required space for large infrastructural projects. Consequently, they place strong emphasis on achieving a low primary balance, excluding Eskom provisions, by 2022/23. While the fiscal deficit is projected to increase to an average of 6.2 percent over the next three years from 4.3 percent in 2018, the authorities are committed to the continuation of fiscal consolidation and containing debt accumulation. To this end, the authorities plan to stabilize and improve the fiscal position through several measures, including reducing the public sector wage bill and additional revenue measures.

Slower than expected growth in revenues, along with slow nominal GDP growth, are placing pressure on the fiscal framework. Thus, the authorities attach great importance to strengthening revenue mobilization and prudent expenditure execution, while protecting priority pro-poor spending. Government has made significant strides in improving the capacity of the South African Revenue Services, including through the re-establishment of the Large Business Centre to improve tax compliance by the largest tax payers.

Further, the authorities recognize that improving the efficiency of expenditures also contributes to increasing fiscal space and arresting the accumulation of debt and protecting the poor. Complementary reforms are underway to enhance the governance and efficiency of public spending. In this regard, the authorities have already reviewed the procurement regulatory framework and developed a Public Procurement Bill for submission to Parliament in 2020.

Debt Management and SOE reforms

The authorities have put forward recommendations to achieve both fiscal consolidation and reprioritization of expenditure in order to ensure stabilization of debt by 2025/26. However, implementation of the proposed wage bill measures and economic reforms require politically difficult decisions. Without these decisions, debt is likely to continue rising over the medium term and beyond. According to the authorities, total gross loan debt is expected to remain slightly above 70 percent of GDP at 71.3 percent in the medium term. They remain cognizant of the fiscal risks that SOEs, particularly the electricity utility - Eskom, present to the fiscal framework. Mindful of the current burden, the authorities will provide financial support to Eskom over the medium-term to secure energy supply and mitigate risks to the economy and the fiscus.

To mitigate risks from SOEs, the authorities have instituted a series of measures to strengthen SOE governance and finances. They have stepped up efforts to restructure the electricity sector, as outlined in the reformed Electricity Supply Industry paper (Eskom Roadmap). Once implemented, these measures would reduce the need for government to continue to support Eskom. Furthermore, the Eskom Roadmap also sets out a plan for expanding renewable energy output and cutting fuel costs. In this regard, the authorities have promulgated the new Integrated Resources Plan (IPP) which will guide the expansion and diversification of electricity supply over time.

In the transport sector, the authorities remain committed to resolving the challenges facing South African Airways (SAA). They have since placed the airline under voluntary business rescue to improve its financial position. This was preceded by extensive consultations between government and the creditors on the financing modalities.

Monetary Policy

Consistent with the IMF's analysis, the SARB has made progress in shifting inflation closer to the middle of the 3–6% target range. The disinflation effort is not complete, however, as inflation expectations – while lower – remain in the upper half of the target range.

At its recent meeting, the Monetary Policy Committee (MPC) of the SARB revised down its inflation forecasts. Both surveyed and market-based expectations have continued to moderate gradually. The MPC reduced rates by 25 basis points as of 16 January 2020. The authorities concur that interest rates are not the right tool for fixing South Africa's growth challenges, which are primarily structural in nature. Domestic macroeconomic fundamentals are also a significant source of vulnerability, posing a significant upside risk to the inflation outlook. Nonetheless, in the context of lower inflation and an improved risk profile, monetary policy can provide a degree of support to borrowers, without jeopardizing the central objective of delivering inflation well within the target range.

Financial Sector Policy

The South African financial sector has remained resilient in the face of challenging macroeconomic conditions. This has been underpinned by sizable capital and liquidity buffers as well as a robust regulatory and financial infrastructure. South Africa's deep and sophisticated capital markets complement traditional bank credit and have contributed to the relatively low reliance on foreign currency funding in the economy.

The promulgation of the Financial Sector Regulation Act in 2018 introduced a "twin peaks" model of financial regulation, which provides a delineation of responsibility between market conduct regulation (under the Financial Sector Conduct Authority (FSCA)) and prudential regulation (under the Prudential Authority (PA)) for the sector at large. Furthermore, this legislation assigns an explicit responsibility to the SARB to enhance and monitor financial stability. As part of these powers the SARB recently designated six financial institutions as systemically important, providing the ability to impose macroprudential requirements on these institutions, should the need arise.

The Financial Sector Laws Amendment Bill (FSLAB) was published for comment in September 2018 and is expected to be introduced during the calendar year 2020. The FSLAB will introduce a resolution framework for designated financial institutions, thereby strengthening the ability of the SARB to wind down or resolve failing institutions with the least possible disruption to the economy. The Bill will also establish an explicit deposit insurance scheme.

The establishment of three new banks, with a specific focus on digital channels, is expected to support competition and expand financial inclusion. Significant growth in the number of fintech firms (especially in the payments space) has further contributed to the dynamism of the financial sector. In this regard, the Intergovernmental Fintech Working Group (IFWG) has been established to develop a common understanding, among regulators, of fintech developments and their policy implications.

The authorities have announced their intention to reform the framework for cross-border flows by making it simpler and more transparent. This is expected to improve the ease of doing business and support the attractiveness of South Africa as an investment destination. Additional measures to combat illicit financial flows are also being developed.

The authorities continue to make steady progress in the reform of key interest rate benchmarks, that play a fundamental role in the domestic financial system. This reform will align South Africa with international best practice, while also enhancing the transparency and efficiency of domestic money markets. It is also expected to improve both the implementation of monetary policy and the monitoring of risk in the domestic financial system.

Structural and Governance Reforms

The authorities remain committed to implementing structural reforms to boost overall growth. Amongst others, they have made progress on the easing of the visa regime to support tourism, demarcation of new special economic zones, and releasing a policy directive for licensing the auctioning of high demand broadband spectrum. Further, the authorities are planning to implement reforms in transport, water, telecommunications, industrial, trade and competition policy to address microeconomic binding constraints, as outlined in the "Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa" discussion paper that was published in October 2019.

To address governance and corruption challenges, the authorities have strengthened the capacity of the National Prosecuting Authority. The judicial commission of inquiry into the state-run asset manager of the Public Investment Corporation has been completed and the final report was submitted to the President and the judicial commission of inquiry into allegations of state capture is proceeding.

Conclusion

The authorities recognize the mounting pressures and remain steadfast in addressing the macroeconomic challenges and ensuring fiscal sustainability in order to set the economy on a firm and accelerated growth trajectory. To this end, they remain committed to fiscal consolidation and expediting the much-needed structural reforms to support fiscal adjustments and achieve inclusive growth that will create jobs, reduce poverty, and inequality. They look forward to continued engagement with the Fund, including through technical support.