INTERNATIONAL MONETARY FUND

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SOUTH AFRICA

February 2022

2021 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 2021 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 February 7, 2022 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 February 7, 2022, following discussions that ended on November 17–December 7, 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 21, 2022.
- 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

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR22/31

IMF Executive Board Concludes 2021 Article IV Consultation with South Africa

FOR IMMEDIATE RELEASE

Washington, DC – **February 11, 2022:** On February 7, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with South Africa.

The recovery has been faster than anticipated but its durability is uncertain. Despite the authorities' strong policy response to the pandemic, real output contracted by 6.4 percent in 2020. As the mobility restrictions were phased out and terms of trade improved, real output is estimated to have rebounded by 4.6 percent in 2021.The rapid pace of recovery, despite the earlier surge in infections amid low vaccination rates and international travel bans brought by the *Omicron* variant, could be a source of optimism. However, the economic recovery is deemed fragile, as it was accompanied by worsening unemployment (34.9 percent), weak bank lending to the private sector, and anemic private investment. Despite the growth rebound, poverty and inequality did not show signs of improvement.

Against this backdrop, macroeconomic fundamentals have weakened, and vulnerabilities have increased. The fiscal position deteriorated following the introduction of COVID-19-related measures and the transfers to state-owned enterprises (SOEs), whose operational and financial performance deteriorated further. As a result, the fiscal deficit soared to 9.7 percent of GDP in 2020, before declining to an estimated 8.4 percent in 2021. Public debt is estimated to have reached almost 70 percent of GDP in 2021. The external current account balance turned into extraordinary surpluses as the pandemic compressed import volumes while favorable commodity prices, deemed temporary, boosted exports. Gross fiscal and external financing needs remained elevated. Inflation was well-anchored within the 3–6 percent target range during the pandemic, but rising inflation risks prompted the South African Reserve Bank to start unwinding monetary accommodation in late-2021. Bank soundness indicators, including profitability, solvency, and liquidity, remained solid.

The outlook points to some growth recovery in the near term but lackluster medium-term performance. Growth is projected at 1.9 percent in 2022, before easing to 1.4 percent in the medium term, capped by structural constraints to investment, prevailing policy uncertainty, and elevated public debt, which hinders job creation. Inflation would converge to the midpoint of the 3–6 percent target range. The fiscal deficit is projected to continue to narrow on recovering revenue and phasing out of COVID-19-related measures, but over the medium term, the growing interest bill and demands from SOEs and public servants will keep the fiscal deficit high, above 7 percent of GDP. The debt ratio is expected to continue rising. The external current account is projected to return to a deficit from 2022.

[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.

700 19th Street NW
Washington, DC 20431
USA

Executive Board Assessment[2]

Directors noted that COVID 19 has exacerbated already low growth, high unemployment and inequality, and elevated public debt. Directors commended the authorities' strong policy response to the pandemic, which has been supported by anchored inflation expectations, a sound financial system, and a flexible exchange rate. They underscored the need to address longstanding challenges through sound fiscal policy and reforms to support sustainable, green, and inclusive growth.

Directors recommended ambitious fiscal consolidation to reduce public debt, while protecting the most vulnerable. This consolidation should be mainly focused on the expenditure side and complemented by revenue administration enhancements and a credible public debt anchor. They viewed the upcoming February budget as an opportunity to define concrete measures, including containing public sector compensation, rationalizing transfers to state owned enterprises (SOEs), streamlining tax expenditures, and better targeting education subsidies. Directors highlighted the need for well targeted social spending to reduce poverty and inequality. Noting the deteriorating performance of SOEs, Directors urged prompt action to strengthen their operations and finances and advance anti-corruption efforts in procurement and administration. They noted that restructuring the national electricity company is critical to ensure energy security, reduce fiscal risks, and transition away from coal powered energy.

Directors welcomed the South African Reserve Bank's plan to gradually unwind accommodative monetary policy amid rising inflation risks. They recognized its commitment to price stability and focus on strengthening monetary policy transmission to support market functioning. Directors saw merit in reducing the inflation target when conditions allow.

Directors welcomed the financial sector's resilience to the pandemic while calling for enhanced supervision and regulation and continued monitoring of the deepening bank sovereign nexus. They stressed that greater use of fintech to enhance financial inclusion should be complemented by adequate oversight. Directors encouraged swift completion of the bank resolution framework and the deposit insurance scheme, and measures to strengthen the AML/CFT framework.

Directors stressed the importance of improving economic efficiency and facilitating the green transition through increased competition in product markets and flexibility in labor markets. They emphasized that measures to reduce regulatory barriers and modernize labor markets would support greater private sector participation. These efforts are essential for boosting investment, creating employment, and strengthening the external position. Directors encouraged further actions to strengthen governance and fight widespread corruption, including by safeguarding pandemic related funds.

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[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.

South Africa: Selected Economic Indicators, 2018–2023

Social Indicators

GDP		**Poverty (percent of population)**	
Nominal GDP (2020, billions of US dollars)	335	Lower national poverty line (2015)	40
GDP per capita (2020, in US dollars)	5,637	Undernourishment (2019)	7
Population characteristics		**Inequality (income shares unless otherwise specified)**	
Total (2021, million)	60	Highest 10 percent of population (2015)	53
Urban population (2017, percent of total)	67	Lowest 40 percent of population (2015)	7
Life expectancy at birth (2017, number of years)	62	Gini coefficient (2015)	65

Economic Indicators

	2018	2019	2020	2021	2022	2023
			Est.		Proj.	
National income and prices (annual percentage change unless otherwise indicated)						
Real GDP	1.5	0.1	-6.4	4.6	1.9	1.4
Real GDP per capita 8/	0.0	-1.3	-7.8	3.7	0.3	-0.1
Real domestic demand	1.6	1.1	-8.0	4.0	3.0	1.9
GDP deflator	4.0	4.5	5.3	4.7	1.7	4.7
CPI (annual average)	4.6	4.1	3.3	4.4	4.5	4.5
CPI (end of period)	4.9	3.7	3.2	5.0	4.5	4.5
Labor market (annual percentage change unless otherwise indicated)						
Unemployment rate (percent of labor force, annual average)	27.1	28.7	29.2	34.2	35.3	37.0
Unit labor costs (formal nonagricultural)	4.0	4.7	2.9	0.2	4.5	4.5
Savings and Investment (percent of GDP)						
Gross national saving	13.6	13.4	14.7	15.3	11.8	11.3
Public (incl. public enterprises) 6/	1.0	0.0	-6.1	-5.3	-4.3	-3.9
Private	12.6	13.5	20.8	20.6	16.1	15.2
Investment (including inventories)	16.5	16.0	12.7	12.2	13.1	13.2
Public (incl. public enterprises excl. inventories) 7/	4.8	4.3	3.9	3.7	3.9	4.0
Private	11.0	11.1	9.8	9.7	9.8	9.8
Fiscal position (percent of GDP unless otherwise indicated) 1/						
Revenue, including grants 2/	26.4	26.9	25.3	25.9	27.0	26.5
Expenditure and net lending	30.2	31.7	35.0	34.3	34.5	33.6
Overall balance	-3.7	-4.8	-9.7	-8.4	-7.5	-7.1
Primary balance	-0.3	-1.1	-5.5	-3.9	-2.6	-1.8
Structural balance (percent of potential GDP)	-3.5	-3.9	-4.8	-4.8	-5.0	-5.5
Gross government debt 3/	51.6	56.3	69.4	69.9	74.5	77.7
Government bond yield (10-year and over, percent) 4/	9.4	9.0	9.7	9.9	9.9	...
Money and credit (annual percentage change unless otherwise indicated)						
Broad money	5.6	6.1	9.4	6.4	5.8	5.7
Credit to the private sector 5/	5.5	5.5	1.0	2.1	2.7	4.1
Repo rate (percent, end of period) 4/	6.8	6.5	3.5	3.8	3.8	...
3-month Treasury bill interest rate (percent) 4/	7.6	7.2	3.9	3.9	3.9	...
Balance of payments (annual percentage change unless otherwise indicated)						
Current account balance (billions of U.S. dollars)	-12.0	-10.0	6.7	12.8	-5.2	-8.6
percent of GDP	-3.0	-2.6	2.0	3.1	-1.2	-2.0
Exports growth (volume)	2.8	-3.4	-12.0	13.5	7.0	3.0
Imports growth (volume)	3.2	0.5	-17.4	10.8	11.2	4.7
Terms of trade	-2.1	4.2	9.4	1.8	-9.7	0.5
Overall balance (percent of GDP)	0.2	0.5	-1.0	0.5	0.1	-0.2
Gross reserves (billions of U.S. dollars)	51.6	55.1	55.5	57.6	58.0	57.3
in percent of ARA (w/o CFMs)	72.0	74.2	78.1	81.0	81.6	80.5
in percent of ARA (w/ CFMs)	78.8	81.6	86.6	89.8	90.5	89.3
Total external debt (percent of GDP)	42.6	47.8	50.8	39.5	42.9	43.4
Nominal effective exchange rate (period average) 4/	-0.6	-5.2	-11.6	7.6	-2.2	...
Real effective exchange rate (period average) 4/	1.7	-3.3	-10.1	9.5	2.0	...
Exchange rate (Rand/U.S. dollar, end of period) 4/	14.4	14.0	14.7	15.9	15.6	...

Sources: Bloomberg, Haver, National Treasury, South African Reserve Bank, 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 2014.
3/ Central government.
4/ January 11, 2022.
5/ Other depository institutions' "loans and securities" in all currencies.
6/ Public savings are the sum of public corporations and general government gross savings, using SARB financial accounts data. This allows to obtain a private sector savings estimate that excludes SOEs (SOEs are included in the National Accounts), derived as the difference between the National Accounts gross national savings and the public savings.
7/ Inventories data are volatile and excluded from the investment breakdown to help clarify fixed capital formation developments.
8/ Per-capita GDP figures are computed using STATS SA mid-year population estimates.

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

January 21, 2022

KEY ISSUES

Context: South Africa's subpar economic performance over the last decade has weakened its macroeconomic fundamentals and social indicators. In response to formidable COVID-19-related challenges, government expenditure surged, and, amid declining revenue, the budget deficit widened significantly. The South African Reserve Bank (SARB) and the Prudential Authority (PA) preserved adequate liquidity conditions and financial-sector stability. The cyclical recovery from the deep contraction has been faster than expected but its strength is unlikely to be sustained. Benign global market conditions have supported asset performance, although term premia are elevated due to fiscal risks. Bank soundness indicators remain solid, but a deepening bank-sovereign nexus raises some concerns.

Outlook and Risks: The outlook points to some growth recovery in the near term and lackluster medium-term performance capped by structural constraints, weak confidence, and less-favorable terms of trade. Growth is estimated at 4.6 percent in 2021 and projected at 1.9 percent in 2022 and an average of 1.4 percent thereafter. Main downside risks include further delays in adjustment and reform, deteriorating health and travel conditions from prospective COVID-19 waves, and tightening global liquidity conditions. Eskom's operational and debt problems raise macro-critical challenges. Existing sources of strength (a flexible exchange rate, anchored inflation expectations, and a sophisticated financial system) help support the recovery. However, structural reform implementation and public debt reduction are vital.

Staff Advice: Sustaining efforts to mitigate the pandemic's impact, notably accelerating vaccination, is a key priority. Since policy support must be withdrawn amid heightened vulnerabilities, reigniting growth is more challenging and requires urgently advancing long-standing reforms. Fostering private investment is crucial for improving the economy's productivity and competitiveness, including by continuing to address governance and corruption vulnerabilities. Taking additional fiscal measures to reverse the concerning upward trend in public debt is imperative. Mitigating the impact of fiscal consolidation on the most vulnerable groups amid elevated unemployment requires increasing the efficiency of government and SOE spending. The SARB should continue to unwind the accommodative monetary policy stance. Stepped-up supervision, enhanced macroprudential policy, and a stronger financial safety net will help maintain the financial sector's strength amid weak macroeconomic conditions.

Approved By
Abebe Selassie (AFR)
Bjoern Rother (SPR)

An IMF team comprising Ana Lucía Coronel (head, AFR), Max Alier (resident representative), Heiko Hesse (SPR), Ken Miyajima, Haonan Qu, Alejandro Simone (AFR), Sébastien Walker (FAD), and Nasha Mavee (local office) held virtual discussions with Finance Minister Enoch Godongwana, Public Enterprises Minister Pravin Gordhan, Reserve Bank Governor Lesetja Kganyago, and other senior government officials during November 17–December 7, 2021. Ita Mannathoko and Mmatshepo Maidi (OED) attended key discussions. Tiana Wang, Zhangrui Wang (AFR), and Hermine Ilunga (local office) provided research support. Hatem Alsokhebr, Cecilia Prado (AFR), and Sandra du Plessis (local office) supported the preparation of the report.

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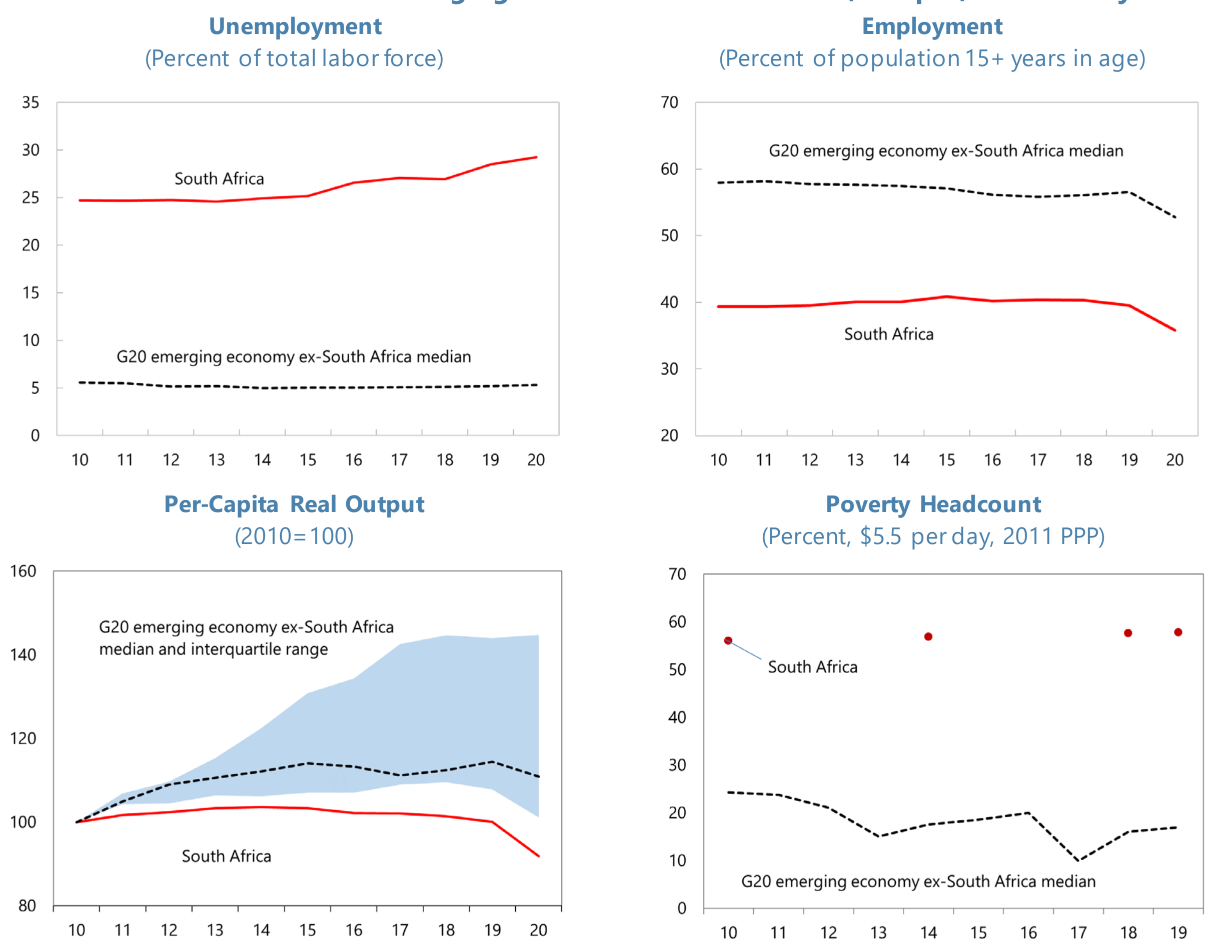
THE CONTEXT

1. **South Africa's subpar economic performance over the last decade has significantly eroded living standards and macroeconomic fundamentals**. As economic policies failed to adapt to the end of the commodity price boom of the 2000s, productivity deteriorated, and business confidence faltered. The impact of adverse shocks was exacerbated by widespread corruption, state capture, and difficulties to muster political support to implement much-needed reforms. Growth disappointed, with per-capita real output stagnating in the decade preceding the pandemic as private investment lost dynamism and the contribution of total factor productivity turned negative. Subdued growth eroded fiscal and external buffers, aggravated unemployment, and kept a large share of the population in poverty. The economy slowed to a standstill in 2019. South Africa remains one of the most unequal societies in the world despite its formidable growth potential.

South Africa and G20 Emerging Economies: Labor Market, Output, and Poverty



Sources: IMF World Economic Outlook, Statistics South Africa, World Development Indicators, and staff calculations.

2. **Amid long-standing structural obstacles, persistently high fiscal expenditure was ineffective in igniting growth**. Before the onset of the pandemic, fiscal deficits averaged 4 percent of GDP in the decade through FY19/20 (ending March 2020) in a bid to stimulate growth. However, considerable structural weaknesses, including rigid labor markets, lack of competition in product

markets, governance deficiencies, and inefficient public-sector operations constrained these efforts, and growth remained low despite repeated fiscal stimuli. Marred by high market concentration, excessive regulation, weak education outcomes, and ageing infrastructure, South Africa has been unable to grow at the pace necessary to reduce poverty, while public debt spiraled. The private sector, notably small and medium-sized enterprises (SMEs), lacks a business environment conducive to investment and employment creation.

South Africa and G20 Emerging Economies: Selected Vulnerability Indicators

Sources: IMF Vulnerability Indicator Database and staff calculations.

Notes: Interest coverage ratio is earnings before interest and taxes in percent of interest payments due. RWA = risk-weighted assets.

3. With subdued growth, economic vulnerabilities had already reached high levels before the pandemic emerged. Amid increasing fiscal financing needs, public debt rose to 57 percent of GDP in FY19/20. The current account balance sustained deficits of 3 percent of GDP on average in 2015–19. Foreign direct investment remained subdued, and the country continued to rely on volatile portfolio inflows to meet external financing needs. By early-2020, all three main rating agencies had downgraded South Africa's sovereign credit rating to below investment grade.

4. **On the positive side, key economic strengths acted as mitigating factors**. A flexible exchange rate regime alleviated the negative impact of structural rigidities. A sound inflation-targeting framework, underpinned by strong central bank credibility, helped keep inflation outturns and expectations anchored. Deep domestic financial markets and healthy banks (partly thanks to the timely implementation of Basel III) with relatively low exposure to the sovereign allowed the government to place its increasing debt mainly in local currency and with relatively long maturities. Finally, well-targeted social grants supported a large vulnerable segment of the population and arguably limited social discontent, albeit at a large fiscal cost (Annex I. Social Assistance).

THE COVID-19 CRISIS AND IMMEDIATE POLICY RESPONSE

5. **South Africa has faced formidable challenges created by the COVID-19 pandemic**. A nationwide lockdown, among the most stringent by international standards, was enacted in March 2020, reducing activity in mining and industry and bringing the tourism, entertainment, and transport sectors to a near standstill. The associated uncertainty and global market turmoil led to large capital outflows and asset selloffs. The rand weakened to an all-time low against the dollar in April 2020 and stock prices tumbled. Domestic yields surged and interbank market liquidity conditions tightened. The first wave of the pandemic and related lockdown led to a severe contraction. Additional waves continued to impact lives and jobs especially, among the most vulnerable.

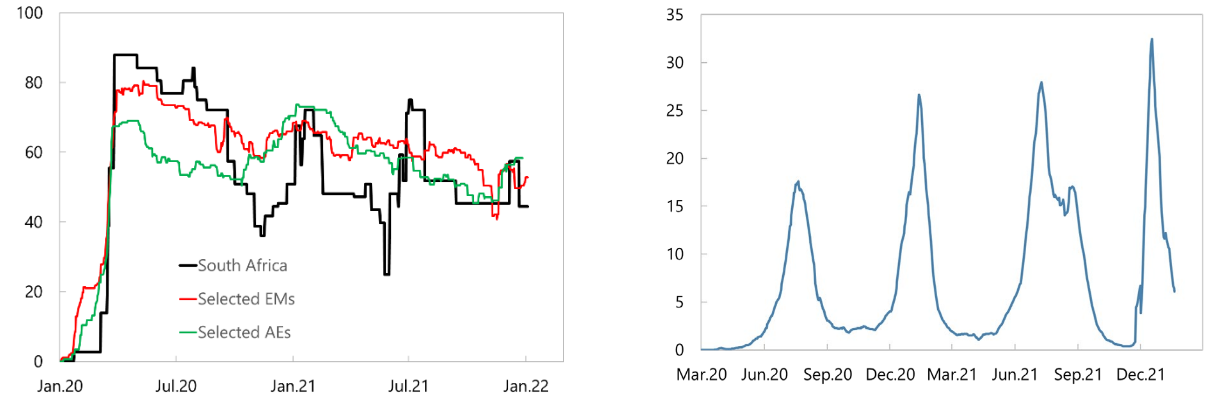
6. **More recently, the *Omicron* variant caused additional health and economic distress amid relatively low vaccination rates**. Mobility restrictions, which have been adjusted as conditions changed, are now at the lowest level. However, international travel restrictions and a surge in infections weighed on economic activity, notably on business and tourism during the high summer season. Vaccination efforts initially suffered from supply constraints and, while these have eased, vaccine hesitancy and distribution challenges continue to hinder the rollout (about one-fourth of the population was fully vaccinated by end-2021). Ongoing work to boost vaccine production in South Africa will also benefit other countries in the region.

7. **Some key macroeconomic indicators moved to concerning levels**. Unemployment worsened from already high levels, reaching 32.5 percent in the fourth quarter of 2020, as jobs were lost amid an unprecedented real output contraction of 6.4 percent in 2020. Inflation fell through the lower end of the 3–6 percent target range amid the decline in demand. The fiscal deficit soared to 10.6 percent of GDP in FY20/21 and public debt climbed to 71 percent of GDP, while the current account balance in 2020 turned into an extraordinary surplus after imports plummeted and higher commodity prices boosted exports. External financing needs remained elevated.

Indicators of Economic Restrictions and COVID-19 Infections

Policy Stringency Index | **Confirmed COVID-19 Cases in South Africa**

(Index, higher value indicates greater stringency) | ('000 persons, 5 business day rolling average)

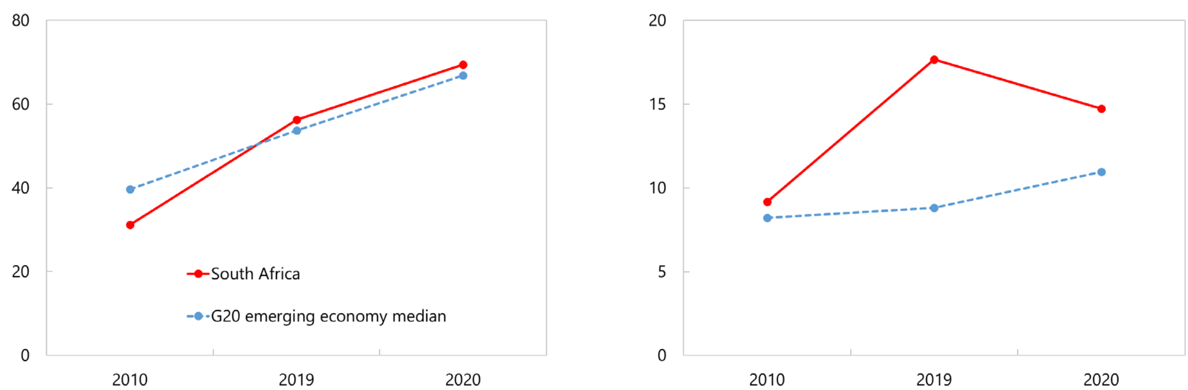


Sources: IMF World Economic Outlook, Oxford COVID-19 Government Response Tracker, Statistics South Africa, World Development Indicators, World Health Organization, and IMF staff calculations.

South Africa and G20 Emerging Economies: Selected Vulnerability Indicators

(Percent of GDP)

Government gross debt | **Gross external financing needs**



Sources: IMF Vulnerability Indicator Database and staff calculations.

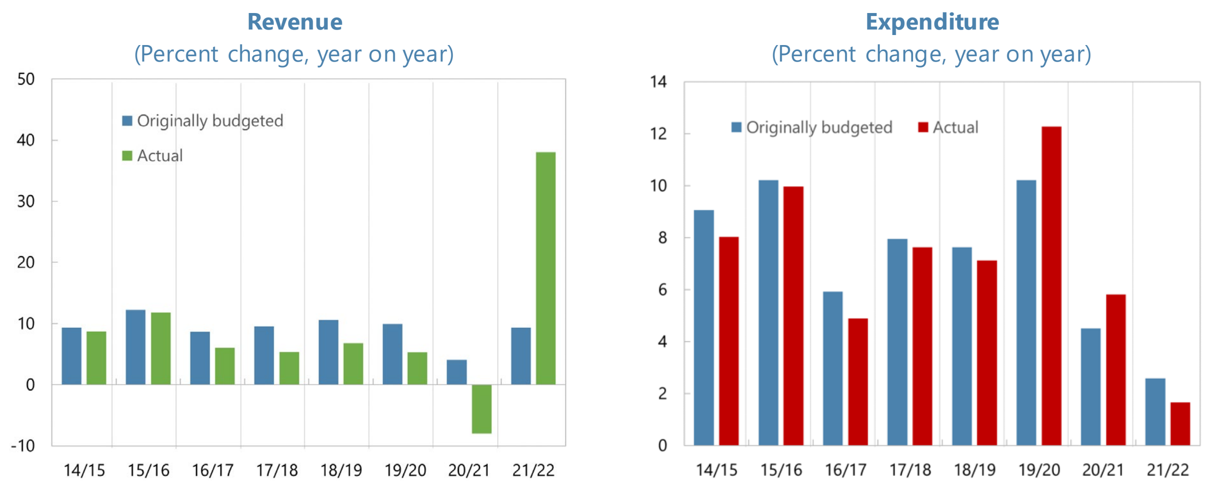
8. **The crisis prompted a strong policy response**. (Text Figure, Annex II. Key Fiscal, Monetary, and Financial Sector Policy Measures During the COVID-19 Pandemic).

- A fiscal package that was larger than in other emerging market economies (EMEs) was announced but not fully executed––the loan guarantee scheme was underutilized reflecting limited businesses' appetite for additional debt and banks' low propensity to lend in an uncertain environment. Nevertheless, some elements of the package, intended to be temporary, were extended when lapsing, including the COVID-19 grant for vulnerable individuals and the Unemployment Insurance Fund (UIF) wage protection.

- The SARB and PA took measures to safeguard price and financial-sector stability by easing liquidity conditions and supporting bank lending. Temporary regulatory flexibility was broadly aligned with best practice and supported banks' efforts to restructure loans. Relative to other EMEs, the extent of rate cuts was large, even more so than during the 2008-09 global financial crisis. By contrast, government bond purchases were relatively limited.

9. **Government expenditure rose sharply to mitigate the impact of COVID-19 and, amid declining revenue, increased the deficit significantly**. Part of the pandemic-related package was accommodated by expenditure re-prioritization––social grants and UIF benefits were partially offset by cuts in the acquisition of goods and services and delays in investment projects. However, compared to FY19/20, total expenditure rose by 3.7 percentage points of GDP, reflecting increases in the wage and interest bills, grants to the vulnerable population, and transfers to state-owned enterprises (SOEs). Moreover, overall revenue fell by 1.5 percentage points of GDP. Financing needs increased significantly (partly met by unprecedented IFI financing, including a RFI from the IMF) and the composition of financing shifted toward domestic sources and shorter maturities, as nonresidents reduced their bond holdings and long-term financing costs increased.

Selected National Government Fiscal Indicators

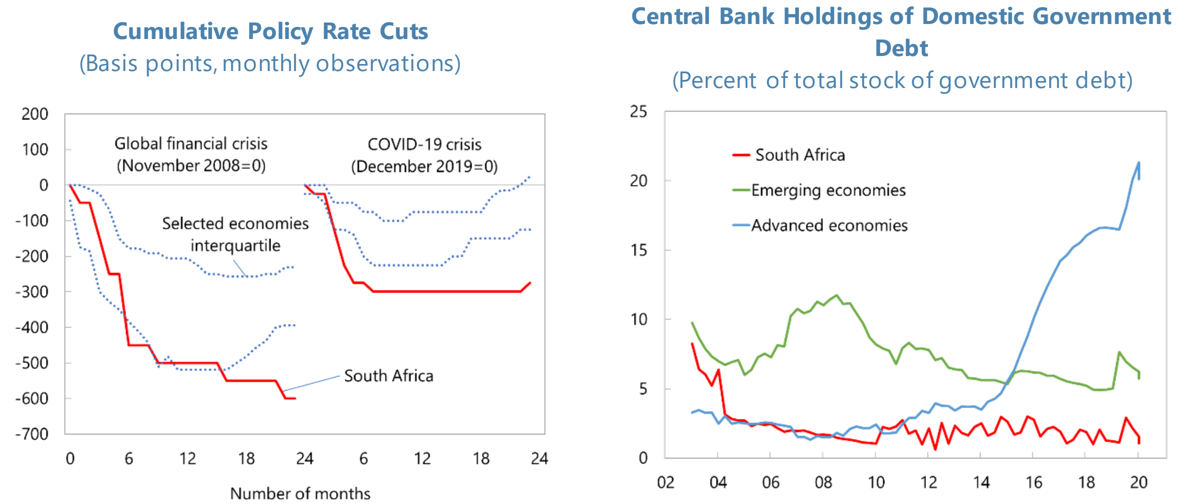


Sources: Haver, National Treasury, SARB, SARS, and IMF staff calculations.

Note: 2021/22 actual data are based on April-October.

10. **The SARB and PA's policy response provided a substantial cushion to the financial system and capital markets**. The repo rate was cut, helping limit the rise in debt service payments by corporates and households affected by lower incomes (Annex III. Household Debt). Repo operations helped stabilize funding market conditions. Bank loan restructuring provided borrowers with temporary cash flow relief, although interest and fees continued to accumulate. Restructured loans fell significantly in 2021. Nonperforming loans (NPLs) rose in early-2020 but remained steady at around 5 percent before moderating in the third quarter of 2021.

Indicators of Monetary and Financial Measures in Selected Economies



Sources: Bank for International Settlements, Haver Analytics, IMF Sovereign Debt Investor Base, and IMF staff calculations.

11. The COVID-19 crisis further raised South Africa's vulnerabilities. The fiscal and debt positions worsened further with the government's COVID-19-related measures and transfers to SOEs. Expansionary monetary policy supported growth but was constrained by fiscal risks and attendant currency depreciation. Employment and private-sector investment activity remain depressed, with material adverse social implications. Addressing these challenges will be critical to achieve higher, sustainable, and inclusive growth.[1]

RECENT ECONOMIC AND FINANCIAL INDICATORS

12. The recovery from the deep contraction has been relatively rapid, but its durability is uncertain. Following the large output contraction in 2020, growth recovered faster than anticipated in 2021, despite frequent power outages, as lockdowns were phased out and terms of trade further improved.[2] The mining sector was supported by high commodity prices and businesses (manufacturing and some services) benefitted from a relatively strong rebound in consumption. While the pace of recovery could be a source of optimism, several factors point to its fragility, including worsening unemployment (34.9 percent overall and a staggering 49 percent for 15-to-34-year-olds in the third quarter of 2021) amid low business confidence; weak bank lending to the private sector (contracting in real terms the past year through October 2021); and anemic private investment (10 percent of GDP).

13. Despite the rebound, social conditions do not show signs of improvement. In July 2021, during the third COVID-19 infection wave, severe and unprecedented civil unrest erupted. Close to 350 lives were lost, and economic damages have reportedly reached almost 1 percent

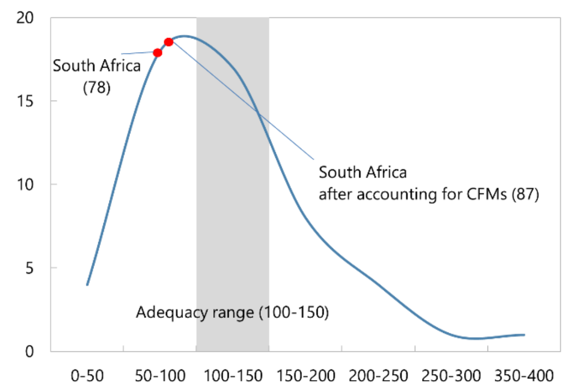
[1] Appendix I summarizes the status of key recommendations from the 2019 Article IV Consultation.

[2] The national accounts were revised using upgraded statistical measurements. Nominal GDP's level rose by about 10 percent on average relative to the previous series. However, the path of real GDP growth changed little.

of GDP.[3] The unrest was prompted by political tensions but also likely reflected the population's discontent with the worsening economic and social situation. The under-employment created by the pandemic disproportionately affected disadvantaged groups, including the youth. Recent indicators point to a pandemic-related deterioration of poverty and inequality from already high levels (Annex IV. Differential Mobility Response to the COVID-19 Crisis Across Income).

14. The external position temporarily improved from historical deficits. The pandemic compressed domestic demand and import volumes while favorable commodity prices, deemed temporary, boosted exports (Box 1). Most of the improvement in the current account is assessed to result from temporary factors, especially terms of trade gains. As these factors unwind from 2022, the current account is projected to revert to its structural deficit. Staff continues to consider the external position as moderately weaker than implied by medium-term fundamentals and desirable policies (the real effective exchange rate was assessed as moderately overvalued in 2021; Annex V. External Sector Assessment). The level of official foreign exchange reserves remains below adequate, according to the IMF's composite adequacy metric.

Distribution of Reserve Adequacy, 2020
(Frequency, 53 emerging and other economies)



Source: IMF staff calculations.

Note: ARA is the Assessing Reserve Adequacy metric.

Box 1. Recent External Sector Developments

- ***The external current account*** turned positive in 2020 (2 percent of GDP) and remained so through 2021Q3 (after nearly two decades of structural deficits), reflecting strong commodity prices, low imports, rand depreciation, and lower dividend outflows.
- ***On the capital account,*** the pandemic triggered nonresident outflows, some asset repatriation, and funding from overseas parent companies.
- ***The net international investment position*** (NIIP) increased by 20 percentage points of GDP to 30 percent of GDP in 2020, with external debt rising to 51 percent of GDP (Annex VI. External DSA) and gross external financing needs at around 15 percent of GDP.
- ***The August 2021 SDR allocation*** ($4.2 billion) increased official reserves by as much and is expected to be used to repay maturing debt obligations in the medium term.

15. In the November Medium-Term Budget Policy Statement (MTBPS), the authorities foresaw a gradual decline in the deficit, with debt peaking at 78 percent of GDP in FY25/26. These projections compare favorably to both the ones presented earlier in the 2021 budget, where debt peaked at 81 percent of GDP, and staff's. The improvement mainly reflects better-than-anticipated revenue from mining companies and financial institutions and higher nominal GDP

[3] The state-owned insurer, SASRIA, the sole provider of insurance against public unrest of the nature in July, received R15 billion in government transfers to support the prompt payment of insurance claims.

numbers following the national accounts' revision. Expenditure is expected to moderate with the phasing out of one-off outlays, but some offsetting increases were made in response to the July unrest and pay negotiations. The MTBPS assumed that non-pensionable *'gratuities'* paid to public servants in non-managerial positions in FY21/22 would be temporary, while maintaining the decision to freeze cost-of-living adjustments (COLA) for employees until FY23/24.[4] The MTBPS did not envisage further support to SOEs beyond the transfers in the 2021 budget.

16. The already-weak performance of several SOEs has deteriorated further. Reflecting unclear objectives and mandates, widespread corruption in procurement and administration, serious institutional governance deficiencies, weaknesses in oversight, and unsustainable business models, several SOEs have continued to resort to government bailouts. Notably, Eskom's low productivity and quality of service delivery has translated into rising tariffs and repeated power outages despite subdued demand during the pandemic.

17. Inflation remained well-anchored within the 3–6 percent target band even though money market liquidity conditions were looser than targeted. The COVID-19-related negative demand shock dampened headline inflation to 3.3 percent in 2020—unprecedently undershooting the lower end of the target range in May and June. Core inflation was also low (3.3 percent in 2020) as depressed earnings and employment weakened the rental market and the rand appreciated (Box 2). However, in 2021 headline inflation climbed above the midpoint of the target range due to fuel prices and global supply-chain disruptions, and upside risks to inflation emerged. Accordingly, the SARB increased the repo rate by 25 basis points in November. A long-standing plan to upgrade the monetary policy implementation framework (MPIF) is under public consultation.[5]

Box 2. Recent Financial Market Performance

- ***Exchange rate and local equity performance.*** Following the sharp COVID-19-related depreciation through April 2020, the rand rebounded through June 2021 to the strongest level in over two years, while equity prices reached an all-time high in early-2021. Both have weakened since then, particularly after *Omicron* shook markets in late-2021.
- ***Local fixed income performance.*** Global and domestic risk sentiment soured as US Treasury yields rose on inflation fears in early-2021. Local currency government yields surged by around one percentage point. Much of the increases unwound thanks to benign global financial conditions, before rising again amid the reemergence of inflationary pressures and market nervousness.
- ***Public debt issuance.*** Shorter-dated issuance rose in FY20/21 to finance the higher deficit, taking advantage of investor demand and lower funding costs. With local currency government yields still above pre-pandemic levels and short-term interest rates at long-term lows, the yield curve is steep.
- ***Local investor base.*** Most of the demand for local currency government bonds stemmed from unit trusts and hedge funds, as insurers, pension funds, and nonresident investors stayed on the sidelines while purchases by banks stabilized after a sizable uptake in 2020.

[4] The agreement provides for continued payment of gratuities in FY22/23 unless a new agreement is reached with unions.

[5] The SARB is considering changing the MPIF from the current shortage system to a tiered floor system.

18. Bank soundness indicators remain solid. Banks' profitability continued to be positive during the worst of the pandemic and has recovered (return-on-equity of 12.6 percent in October 2021). The banking sector is well capitalized (total capital adequacy ratio close to 19 percent) and liquid (liquidity coverage ratio 140 percent), albeit with considerable heterogeneity across banks. Banks stepped in to absorb domestic government bonds in the early part of the pandemic after selling by nonresident investors and greater issuance in shorter tenors. Bank holdings of government bonds have generally stabilized.

19. The government has stressed the need for structural reforms and private-sector participation in its development plan and '*Operation Vulindlela,'* but progress has been slow.[6] The October 2020 Economic Reconstruction and Recovery Plan (ERRP) contemplates (i) an infrastructure drive to stimulate investment through a review of the procurement and public-private partnership frameworks; (ii) energy-sector reform to enhance private-sector participation and efficiency, notably by unbundling Eskom into separate entities for generation, transmission, and distribution; and (iii) fast-tracking of reforms in mining, tourism, and network industries to promote competition and inclusion. Similarly, a government-wide initiative, '*Operation Vulindlela*', was introduced as a coordination mechanism to facilitate reform implementation. While some steps have been taken (e.g., easing regulations in the energy sector) the bulk of the agenda remains outstanding.

OUTLOOK AND RISKS

20. The outlook points to some growth recovery in the near term but lackluster medium-term performance.

- Growth is estimated at 4.6 percent in 2021 and projected at 1.9 percent in 2022 led by private consumption—real output would rebound to its 2019 level by 2022. Private investment would gradually pick up as pandemic-related uncertainty eventually moderates. In the medium term, growth is projected to ease to 1.4 percent, capped by structural constraints to investment, prevailing policy uncertainty, and elevated public debt, which will hinder job creation.

- Inflation would converge to the midpoint of the 3–6 percent target range as the real policy rate approaches its estimated neutral level. Private-sector credit growth is anticipated to remain sluggish amid weak economic activity and increased financial institutions' holdings of government debt.

- As activity recovers and imports rebound, the current account is expected to return to a deficit in 2022 and would gradually widen to around 3 percent of GDP. External financing would increasingly come from sources other than historically important nonresident portfolio flows, as these would remain volatile and dampened by weaker investors' appetite as global financing conditions tighten.

[6] "Vulindlela" means "make way" in Xhosa/Zulu.

Baseline Scenario

	2020	2021	2022	2023	2024	2025	Unit
		Est.	Proj.				
Real output growth	-6.4	4.6	1.9	1.4	1.4	1.4	(percent)
Per-capita real output growth	-7.8	3.7	0.3	-0.1	-0.1	-0.1	(percent)
Inflation	3.3	4.4	4.5	4.5	4.5	4.5	(percent)
Private sector credit growth	1.0	2.1	2.7	4.1	4.4	4.9	(percent)
Fiscal deficit	-9.7	-8.4	-7.5	-7.1	-7.1	-7.4	(percent of GDP)
Public debt	69.4	69.9	74.5	77.7	80.9	84.3	(percent of GDP)
Current account balance	2.0	3.1	-1.2	-2.0	-2.5	-2.8	(percent of GDP)

Source: IMF staff calculations.

21. Staff projects the fiscal deficit to continue to narrow from pandemic-related levels but remain significantly larger than before the pandemic in the medium term. Recovering revenue and phasing out of COVID-19-related measures are the main factors underlying the projected improvement in the 2022 deficit to 7.5 percent of GDP. A further deficit reduction is expected in the next two years, as revenue gradually returns to pre-COVID-19 levels and the primary expenditure-to-GDP ratio falls somewhat with further withdrawal of exceptional measures and some slowdown of compensation increases. However, over the medium term, staff projects that the growing interest bill and demands from SOEs and public servants will keep the fiscal deficit high—above 7 percent of GDP. Financing of the fiscal deficit is set to come mainly from domestic sources of shorter maturities than in the past. The debt ratio is expected to rise to 84 percent of GDP in 2025 without stabilizing.

22. Main risks to the baseline scenario relate to the pace of adjustment and reform and to evolving global liquidity conditions (Annex VII. Risk Assessment Matrix).

- ***Domestically***. Additional COVID-19 outbreaks amid slow vaccination uptake and slower-than-expected progress in or reversals of policies and reforms would weigh on investor sentiment and growth. Eskom creates macro-critical challenges, and a worsening of its operational weaknesses and debt problems would have considerable adverse consequences. Bailouts of SOEs, wage bill overruns, and pressures to increase grants could also lead to higher budget deficits, raising the country's risk premium. More incidents of social unrest would further damage confidence. The deepening bank-sovereign nexus could amplify a shock to the financial system and the real economy. On the upside, faster reform implementation would lift confidence, accelerate private investment, and boost growth.

- ***Externally***. South Africa's appeal as an investment and tourism destination could be further weakened by COVID-19 local outbreaks. Growth could be hurt by weak economic performance in trading partners. Nonresident investor appetite for South African assets could be discouraged by developments such as a de-anchoring of inflation expectations in advanced economies and/or increases in core yields and risk premia. By contrast, terms of trade could remain favorable for a longer period, continue to support exports, and prolong a faster pace of output growth.

23. Materialization of downside risks would inflict substantial macro-financial costs. Significant policy delays or reversals and a worsening of macroeconomic fundamentals, amid a deterioration of the external environment, would lead to a recession. Public debt would surge, threatening market confidence, and liquidity conditions would tighten while bank capital and profitability erode. Some small- and medium-sized banks with relatively high NPLs would be under particular strain. Persistent and accelerating capital outflows, a large rand depreciation, increasing demand for social spending, and inflation pressures would present increasing challenges. Fiscal and external financing would become scarce, and foreign exchange reserves would help close financing gaps with negative spillovers to the financial system and the rest of the region. Debt sustainability concerns would be amplified by disappointing fiscal and growth outcomes. (Annex VIII. Public DSA).

24. Weak economic activity in South Africa would have negative spillovers to other countries in the region. Channels of transmission include FDI, remittances, and trade. Transfers to the Southern African Customs Union (SACU) economies, the largest revenue source for most of them, could fall. Economies with currency pegs to the rand would be hurt by adverse monetary and exchange rate developments.

Downside Scenario

	2020	2021	2022	2023	2024	2025	Unit
Real output growth	-6.4	4.6	0.9	-1.5	-0.9	-0.5	(percent)
Per-capita real output growt	-7.8	3.7	-0.6	-3.0	-2.4	-2.0	(percent)
Inflation	3.3	4.4	5.0	4.4	4.0	3.8	(percent)
Private sector credit growth	1.0	2.1	0.1	-1.7	-2.2	-2.7	(percent)
Fiscal deficit	-9.7	-8.4	-7.9	-8.5	-9.8	-11.2	(percent of GDP)
Public debt	69.4	70.0	74.2	80.8	88.9	98.5	(percent of GDP)
Current account balance	2.0	3.1	2.0	2.9	3.2	2.6	(percent of GDP)

Source: IMF staff calculations.

Note: Scenario analysis starts from 2022. Calendar year-based fiscal data for 2021 differ slightly from baseline values as the underlying fiscal year-based values are affected by 2022Q1 inflation.

Authorities' Views on Outlook and Risks

25. The authorities are somewhat more optimistic than staff on the medium-term growth and fiscal outlook but agree that the economy is subject to significant risks. The Finance Minister is committed to resisting expenditure pressures and taking the lead in the implementation of the reforms outlined in *Operation Vulindlela* without further delay but acknowledges that some negotiations will be challenging. The authorities' medium-term projections point to growth of 2 percent, a reduction in the fiscal deficit to pre-pandemic levels, and a smaller increase in debt than expected by staff (to 78 percent of GDP) before it starts to decline. They are aware of potential risks from policy delays and stressed those coming from global market conditions and insufficient international collaboration to defeat the pandemic. SARB officials agreed with staff's outlook on inflation, reiterating their commitment to price stability. The authorities agreed that the external position in 2021 remained moderately weaker than implied by medium-term fundamentals and desirable policies.

PUTTING PUBLIC DEBT ON A SUSTAINABLE PATH

26. The government's medium-term fiscal consolidation plan faces expenditure pressures that would push the deficit beyond the MTBPS projections. These pressures relate to the three issues below, where staff see MTBPS projections subject to risks. On the other hand, the MTBPS allowance for capital expenditures—generous by historical standards—could be under-executed, offsetting in part such pressures but further worsening the composition of expenditure.

- **Wage bill.** The National Treasury (NT) established a ceiling implying that any compensation overruns would be offset through headcount reductions. Comparisons with other countries and the private sector show that the high wage bill arises primarily from elevated average compensation (Annex IX. South Africa's Wage Bill and Cross-Country Experience).[7] At a cost of 0.3 percent of GDP, the non-pensionable gratuities were part of a compromise with unions given the three-year COLA freeze. However, according to the agreement, gratuities constitute a de facto floor for further adjustments.[8] Given the track record of negotiations with unions and the downward inflexibility of nominal salaries, it is unlikely that gratuities will be discontinued.

- **SOEs.** The NT's support is likely to be higher than planned, given that SOE cost reductions have not proceeded as hoped. Of particular concern is the financial situation of Eskom, which received on average close to 1 percent of GDP in transfers while registering net losses of about 0.4 percent of GDP per year in FY19/20 and FY20/21. The company also benefits from a government loan guarantee facility of about 6 percent of GDP. Despite the improved financial performance in the first half of FY21/22, driven by the tariff increase and demand recovery, Eskom still relied on budget support to service its debt. While some progress has been made on separating Eskom's transmission division, the company's planned unbundling will require complementary legislative action and a decision on how to address the company's unsustainable debt level. Options being discussed include an upfront assumption by the government of part or all of the debt (not in the MTBPS) or continued annual transfers, which staff estimates would be higher than stated in the MTBPS.

- **Grants.** The MTBPS assumed that those related to COVID-19 would be phased out by the end of FY21/22. However, given the ongoing fourth COVID-19 wave and the relatively low vaccination rate, staff expects an additional one-year extension at a cost of 0.6 percent of GDP in FY 22/23. Demands for a Basic Income Grant (BIG), a form of universal basic income, have been growing, but the authorities agree with staff that there is no fiscal space to accommodate this grant (Annex I. Social Assistance).

27. The February 2022 budget for FY22/23 is an opportunity to present concrete measures to support a credible consolidation to stabilize debt and set it on a declining path. The public

[7] See Chapter 1 of the Selected Issues Paper accompanying the 2018 Article IV Report.

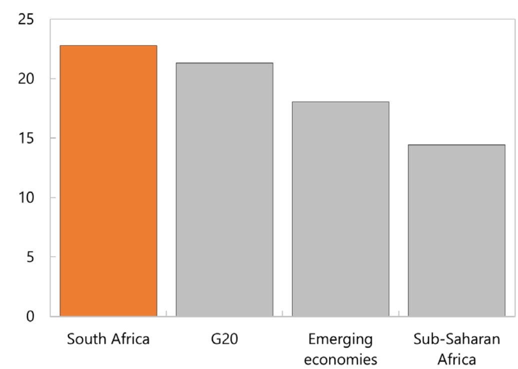
[8] The gratuities are worth between R1,220 and R1,695 per month on a sliding scale to ensure that all eligible employees receive R1,000 per month after tax. According to the agreement, gratuities will continue in FY22/23 absent a different agreement with unions.

debt-to-GDP ratio is already above the EME average and set to continue rising on current policies, creating significant risks and leaving no fiscal space to respond to domestic or external shocks that could force an abrupt fiscal tightening with adverse growth and social consequences.[9] Stabilizing debt at current levels with the aim of gradually reducing it thereafter is crucial and would require significant fiscal consolidation over the next three years.

28. The medium-term consolidation effort will need to be largely expenditure-based while protecting well-targeted social spending and investment. An evenly spread and permanent adjustment of 4.5 percentage points of GDP over the next three years (as compared with staff's baseline scenario) would be needed if accompanied by the implementation of structural reforms to boost growth.[10] On compensation, staff advised below-inflation COLAs, reform of allowances and pay progression, and the introduction of an evidence-based approach to pay-setting to achieve overall cost savings of 2 percent of GDP. Savings of 1.5 percent of GDP could be achieved by limiting SOE operating costs so that transfers from the NT could be reduced. Subjecting any support to SOEs to measurable performance improvements in procurement and compensation costs is crucial. The rest of the adjustment (1 percent of GDP) could come from improving expenditure efficiency and limiting tertiary education subsidies to only vulnerable households. The government should also exercise caution with its social assistance program, by fully offsetting any increases with credible cuts in other budget areas.

Tax Revenue

(Percent of GDP, 2015–19 average)



Sources: WEO, IMF Internal World Revenue Longitudinal Database (WORLD), and IMF staff calculations.

29. Revenue measures should aim at limiting tax expenditures, addressing tax evasion, and reducing carbon emissions. While South Africa's tax revenue relative to GDP is already among the largest in EMEs, the authorities are encouraged to broaden the tax base, notably by removing exemptions related to selected sectors and special economic zones that add little value to production. Further strengthening tax administration by limiting base erosion and profit shifting would also add to tax collection. Tax administration could be reinforced by improving the integrity of the registration database, addressing shortcomings in the compliance risk management approach, and eliminating fragmentation of organizational roles and responsibilities by type of tax. The carbon and excise tax rates could be increased, which would also help reduce emissions to meet

[9] To keep the ratio of public debt to GDP unchanged from that in 2021, the primary balance would need to be in surplus of 2.1 percent of GDP compared to a deficit of 2.1 percent of GDP projected for FY21/22.

[10] Staff estimates that the fiscal deficit will need to decline by 6 percentage points of GDP over the next three years for the debt ratio to start to reverse its upward trajectory. To this end a permanent adjustment of 4.5 percent of GDP would be needed. Increased tax buoyancy, but primarily lower interest payments, would achieve the remaining 1.5 percentage points of GDP worth of deficit reduction.

international commitments (paragraph 49). These revenue measures, if taken, would facilitate the consolidation.

30. A well-designed public debt ceiling could usefully complement the existing nominal primary expenditure ceiling in the medium-term fiscal framework. While the primary expenditure ceiling has helped reduce pro-cyclicality, it has not adjusted to revenue and growth shortfalls, thus contributing to debt accumulation amid a prolonged period of weak economic growth. The debt ceiling should be set at levels that facilitate a gradual decline of the debt-to-GDP ratio over the medium term while maintaining space to enable fiscal policy to respond to adverse shocks—including the growing materialization of contingent liabilities from SOEs—without jeopardizing debt sustainability.[11]

31. Ongoing reforms to improve planning, selection, budgeting, procurement, and execution of public investment should be well-integrated into the budget process. Staff cautioned against the creation of special off-budget funds or institutions to make public investment decisions at the risk of fragmenting budget operations and complicating cash and debt management. Staff advised streamlining the number of institutions involved in public investment and fully integrating all spending in the budget process. Undertaking a Public Investment Management Assessment (PIMA) could help achieve these goals.

Authorities' Views on Fiscal Issues

32. The authorities indicated that fiscal policy had to balance supporting the economic recovery with rebuilding public finances:

- *Concrete measures* to support the MTBPS objectives will be part of the February 2022 budget and the State of the Nation Address by the President. While a debt ceiling could help guide consolidation efforts, the authorities prefer to introduce it once there is more certainty about the evolution of public finances to ensure its credibility.

- *On the revenue side,* the allowances on the carbon tax will be reduced over time, but cutting some tax expenditures (e.g., on the production of motor vehicles) will be challenging.

- *Spending pressures have proliferated* as the pandemic persists, and some have become difficult to avoid. Demands for extending COVID-19-related grants are increasing as infection waves recur.

- *Granting gratuities* to government employees was a necessary compromise to avoid a strike while maintaining the COLA freeze and reducing the wage bill-to-GDP ratio. The authorities are confident about the one-off nature of the gratuities.

[11] Other essential characteristics of debt ceiling design include well-defined escape clauses, correction mechanisms, and credible enforcement.

- *The financial deterioration of SOEs* is already exerting pressure on the budget and demands for additional support is possible, but the NT will reinforce efforts to minimize them.

MAINTAINING PRICE STABILITY AND FINANCIAL-SECTOR SOUNDNESS

33. **Having supported the economy while keeping inflation under control, the SARB should continue to monitor inflation risks cautiously**. The accommodative monetary policy stance, with the real policy rate remaining negative and significantly below the estimated neutral real interest rate, is appropriate; so is the SARB's plan gradually to unwind it over the next few years, as inflationary pressures have emerged and global financing conditions are set to tighten. Large fiscal risks constrain further monetary easing. However, the prevailing data-dependent approach will allow the SARB to act in either direction to keep inflation outturns and expectations anchored. Other upside risks to inflation stem from administered prices, pay increases, and exchange rate depreciation attendant on weaker risk appetite. Downside risks to inflation include faster-than-expected reform implementation, which would increase competition and reduce costs.

34. **When circumstances allow in the future, staff sees merits in reducing the inflation target range**. Low inflation outturns and expectations at the height of the pandemic motivated a debate on the benefits of reducing the inflation target range. Lower inflation would be more aligned with that of trading partners, help domestic interest rates stay predictably low, and boost the economy's competitiveness. Moreover, with lower inflation, enhanced monetary policy credibility would support capital inflows to bolster much-needed private investment that would help create jobs and, amid high income inequality, the poor would particularly benefit. Such a move should be transparently communicated with due attention to risks and readiness to tighten or loosen monetary policy as needed. In particular, if there is a need to tighten, the SARB should clearly communicate the plan to re-anchor inflation outturns and expectations. Importantly, sound public compensation policies, and more competitive and flexible product and labor markets would lead to lower production costs and support the shift to lower inflation.

35. **The planned revision of the monetary policy implementation and external sector policy frameworks should be consistent with the objective of improving economic efficiency**. The new MPIF (currently under public consultation), based on a tiered floor system, should be focused on strengthening monetary policy transmission and the SARB's ability to support market functioning. The authorities' plans to gradually modernize exchange controls should facilitate adherence to the OECD Codes of Liberalization over time. The flexibility of the rand, which has greatly helped insulate the economy from external shocks, should be maintained. Further accumulating international reserves is advisable once growth-enhancing reforms boost exports and durably attract capital inflows.

36. **The PA should monitor the deepening bank-sovereign nexus to maintain banks' strength and prevent an eventual spillback to the sovereign's credit quality**. Relative to assets, government bond holdings by financial institutions are comparable to cross-country "norms"

(Selected Issues Paper. The Financial Sector-Sovereign Nexus).[12] The large domestic investor base could help keep sovereign bond yields and other benchmarked interest rates relatively stable. However, a continued increase of sovereign exposures could further crowd out lending to the private sector and cap private investment. As fiscal risks increase, such exposures could weaken bank balance sheets. While fiscal consolidation is the first line of defense to reduce this risk, the implementation of the Financial Sector Laws Amendment Bill (FSLAB), which seeks to reduce fiscal costs of bank resolution, should also be accelerated. Carefully calibrated risk-mitigating regulatory measures could be considered while bolstering the strength of the domestic financial system through more intrusive supervision, broadening of the macroprudential toolkit, and a stronger financial safety net (Annex X. 2021 FSAP Key Recommendations).

37. Greater use of fintech to enhance financial inclusion should be complemented by adequate oversight to manage associated risks.[13] Banks continue to use fintech to maintain and enhance financial access during the pandemic. Nonbank players started to provide payment services (clearing) and work is ongoing for them also to provide settlement services. The SARB has begun to investigate the feasibility and appropriateness of a central bank digital currency (CBDC) as electronic legal tender for general-purpose retail use, complementary to cash, but its launch will take several years. A first study considered a variety of factors, including policy, regulatory, security, and risk management implications. More recently, the SARB took part in a global project to test the use of CBDCs for international settlements. To adequately manage risks associated with new technologies and services, fintech oversight should be enhanced.

38. The effectiveness of anti-money laundering and combating the financing of terrorism (AML/CFT) measures should be enhanced in line with the recent Fund assessment. The assessment found that the legal framework for AML/CFT is solid, but implementation needs improvements. Making better use of financial intelligence, proactively seeking international cooperation, detecting and seizing illicit cash flows, and improving both the availability of beneficial ownership information and the application of a risk-based approach are all necessary actions.[14] The authorities should make sufficient progress by October 2022 to avoid being subject to the Financial Action Task Force's (FATF) enhanced monitoring process ("gray listing") and its potential negative impact on South Africa's access to the international financial markets.

Authorities' Views on Monetary and Financial Sector Issues

39. The authorities highlighted the importance of maintaining price and financial-sector stability:

[12] Relative to the stock outstanding, domestic government bond holdings by domestic nonbanks and nonresidents appear relatively high in South Africa.

[13] Earlier examples include Project Khokha launched in 2018, which focused on the settlement of high-value transactions between commercial banks and other stakeholders at the wholesale level using distributed ledger technology.

[14] The assessment has been adopted as South Africa's Mutual Evaluation Report by the Financial Action Task Force and the Eastern and Southern Africa Anti-Money Laundering Group.

- *The SARB is committed to preserving low and stable inflation.* Lower inflation would benefit the fiscus, the poor, and the broader economy. Although the economic recovery is fragile, the Monetary Policy Committee raised the policy rate (by 25 basis points) in November as upside risks to inflation had emerged. The SARB remains data dependent and envisages to gradually remove much of the accommodation over the next three years.

- *The PA is monitoring the financial sector's linkage with sovereign risk*, particularly for smaller banks, through close supervision, while assessing policy options to address potential financial stability risks. The establishment of a deposit insurance scheme is moving forward—now with a dedicated unit to manage it. The authorities intend to implement the necessary measures to avoid inclusion in the FATF gray list. Work is ongoing to identify risks from climate change.

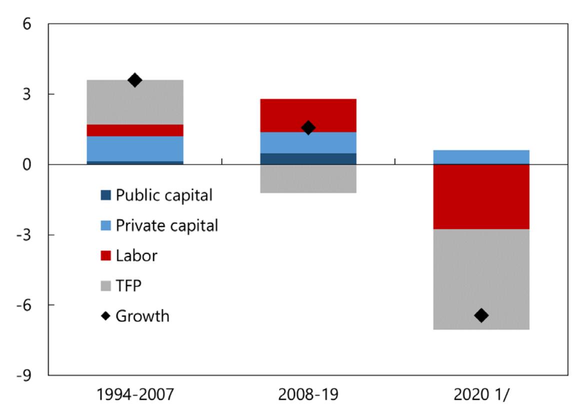
- *On financial inclusion,* competition among banks has increased, led by medium-sized banks, significantly compressing bank service fees. The authorities' financial inclusion strategy is under discussion, including a framework to monitor progress.

- *On external sector policies,* engagement with the OECD on exchange controls is nearing completion, with the implementation of the updated framework expected by early-2022.

REDUCING STRUCTURAL IMPEDIMENTS TO GROWTH

40. Staff analysis has highlighted the structural nature of South Africa's growth weakness. The anemic growth over the past decade was driven by a significant drop in the contributions of total factor productivity and private investment, partly reflecting the deteriorating allocative efficiency of resources. The pandemic has further exacerbated this situation by hampering human and physical capital accumulation, two crucial elements that typically support productivity growth. Therefore, a credible commitment to reform and a multipronged set of coherent actions that address these issues are needed. Reform implementation will lift productivity levels and growth potential by attracting investment in both human and physical capital, which will ultimately lead to a reduction of poverty and inequality.

Contributions to Real GDP Growth
(Percent)



Sources: IMF World Economic Outlook, Penn World Table 100, UN Human Development Report, South African Reserve Bank, and IMF staff calculations.

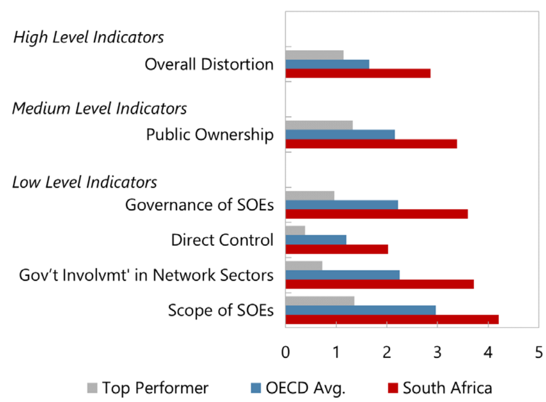
1/ Estimates for 2020 reflect the idiosyncrasy of the unprecedented pandemic's impact on the economy and should be treated with caution when comparing to the earlier years.

A. Enhancing Productivity and Allocative Efficiency

41. Insufficient progress in advancing reforms to boost private investment, partly explained by the necessary focus on easing the pandemic's impact, weighs on the recovery. To mitigate electricity shortages, the government launched an emergency energy procurement process and a long-overdue bidding round for renewable energy projects; started to ease the regulatory burden in the energy sector; and advanced the functional separation of Eskom for the planned unbundling of the company. The recent resolution of disputes around the mining charter that governs ownership in the sector should help alleviate regulatory and policy uncertainty. There were also ongoing regulatory efforts to broaden private-sector access to infrastructure in the transportation sector. While these steps are welcome, the bulk of reform implementation (e.g., decisively reforming the highly concentrated network industries and streamlining the regulatory environment) remains outstanding.

42. Addressing the large footprint of SOEs in the economy and their deteriorating performance is imperative. Both are major obstacles to economic efficiency and growth of productive firms. Actions could include undertaking a comprehensive SOE inventory and developing a triage of existing SOEs to decide whether to divest, liquidate, or keep them as SOEs after being restructured. SOEs that are retained as such should have clearly defined mandates and governance and oversight structures, operate in competitive markets with proper autonomy and regulation, and face the right incentives (Selected Issues Paper. The Role of SOEs in South Africa: Issues and Policy Options).

Distortions Induced by the State, 2018
(Product market regulation indicators)



Sources: OECD 2018 PMR database and IMF staff calculations.

Note: A higher value indicates greater regulatory barriers. Top performer = average of top 5 performing OECD countries.

43. Reforms in product markets, particularly in network industries, should focus on reducing the influence of SOEs while lowering entry barriers and abolishing regulatory constraints to expand access to new players:

- ***Energy.*** Eskom should abandon its outdated business model, reduce its footprint in the sector, and compete on a level playing field with private participants, including the producers of renewable energy. Urgent steps to be taken by the company include improved procurement processes to reduce costs, better service delivery through enhanced operational efficiency, faster collection of arrears from municipalities, and continued rationalization of its wage bill. Importantly, any government support should be conditional on achieving key milestones in these areas, and any solution to Eskom's debt problem should avoid undermining reform incentives.

- ***Mining.*** Several mining companies are planning significant investment in generating their own electricity as energy generation licensing requirements have been eased, but there is a need to expedite the authorization process to accelerate these investments. Moreover, continued efforts to reduce regulatory hurdles and tackle the long backlog of mining licensing applications are important to attract investment in the sector.

- ***Transportation.*** The planned reforms of the state monopoly, Transnet, including the corporatization of the National Ports Authority, should address logistical inefficiencies of the ports and rail network and enable private-sector access to the existing infrastructure, which would ultimately improve competitiveness and boost exports.[15]

- ***Telecommunications.*** Efforts should focus on completing the digital migration and expediting the spectrum allocation process, to enable its competitive use by private-sector participants and facilitate the digital transformation of the economy.

44. A streamlined and transparent regulatory environment that encourages competition and entrepreneurship is essential to unlocking private investment. The high market concentration and regulatory burden raise input costs and dent investment returns. The role of SMEs and micro-enterprises is low and declining, underutilizing their significant job-creation potential.[16] A streamlined regulatory environment would better support businesses to start, grow, and compete on a level playing field. Policy uncertainty, another drag on the business environment that saps confidence and impedes the creation of new companies, should be addressed by establishing clear, fair, and stable rules. Staff called for resisting protectionism and localization policies while deepening regional integration to reverse the declining productivity. Industrial policies should be consistent with international obligations, including under the WTO. The African Continental Free Trade Area (AfCFTA) agreement provides an opportunity to improve competitiveness and further boost exports.

Authorities' Views on Product Market Reforms

45. The authorities favor reforms to restructure SOEs, attract private investment, and increase competition to boost growth and job creation:

- *Some SOE consolidation, informed by an assessment of their strategic relevance, is envisaged*. Notwithstanding the planed unbundling, Eskom is expected to remain a relevant player in the energy market. It will continue to receive government support in the coming years, and a solution to Eskom's unsustainable debt burden is under discussion.

- *Efforts to streamline the regulatory burden are underway.* The recent easing of regulation in the energy sector was well received by the private sector and has the potential to result in a strong uptake of generation projects, improving business sentiment and medium-term

[15] The corporatization refers to the government's plan to make the National Ports Authority, the owner of the port infrastructure, an independent subsidiary of Transnet to enable third-party operators in the port service sector.

[16] See Thakoor (2020).

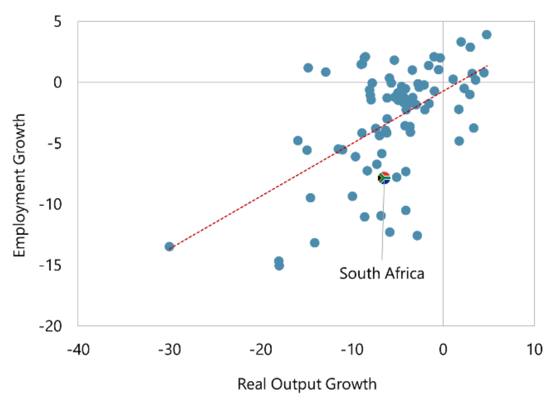
growth prospects. The uncertainty around the mining charter dispute has been mitigated somewhat. The mining licensing framework will continue to promote active participation of historically disadvantaged South Africans to ensure inclusive development and the future sustainability of the sector.

- *On localization policies*, views from different parts of the government are not uniform and an internal discussion is ongoing. The ERRP, for instance, emphasizes the importance of localization based on business models that combine import substitution and regional trade. Officials of the Department of Trade Industry and Competition argued that enhancing production capacity and trade within the continent through localization would help business communities build resilience against disruptions to the global value chains in the post-COVID-19 world. Other parts of the government see ambitious localization targets as likely hitting capacity constraints and raising production costs.

B. Building A Dynamic Labor Market

46. The COVID-19 crisis highlighted the limited labor market resilience, which reflects a structural mismatch between labor supply and demand. Unemployment in South Africa is more susceptible to the business cycle than in other EMEs, including because labor market institutions are not conducive to employment-stabilizing adjustments in pay and working hours. The COVID-19 shock exacerbated these structural weaknesses, and employment fell drastically. Several labor market institutional shortcomings contributed to this outcome, including the country's collective bargaining system, which lacks representativeness of bargaining parties and firm-level flexibility, and the slow and burdensome enforcement of employment protection legislation (EPL).

EMDEs: Real Output and Employment Growth, 2020
(Percent)



Source: IMF World Economic Outlook.
Note: EMDEs = Emerging market and developing economies.

47. A bold labor market reform strategy will aid the economy to benefit from a rising labor force. The ongoing review of the skilled immigration framework should help, but additional measures are needed. Employers need greater workforce management ability and workers better job opportunities. Both require greater representation and firm-level flexibility in the collective bargaining system, balanced national minimum wage setting, streamlined EPL enforcement, and improved active labor market policies (Annex XI. Labor Market Reform Options). Furthermore, efforts are needed to improve employability by easing restrictions for skilled immigrants and improving the quality of education (Annex XII. Public Spending on Education). Effective apprenticeship and vocational training programs would also support the growing labor force in acquiring the skills demanded by employers.

Authorities Views on Labor Market Reforms

48. The authorities have considered taking actions to remove labor market impediments, and noted that implementation will be challenging and results will take time to materialize:

- *Addressing the public health threat* by boosting COVID-19 vaccination efforts is crucial for a full recovery of the labor market. Measures during the COVID-19 pandemic have provided incentives for employment retention in the short run, but social assistance cannot replace the function of a robust and flexible labor market in the medium term.

- *Some interventions to fix skill mismatches and remove rigidities* in the labor market are of a longer-term nature and their effect will be only felt over time.

C. Contributing to a Green and Digital Transition

49. The authorities are advancing their climate agenda, and continued efforts will be needed to achieve their objectives. South Africa's climate challenges include both the likely increase in the frequency and severity of extreme weather events and the high carbon-intensity of the economy due to its dependence on coal, particularly in the energy sector. To achieve carbon-neutrality by 2050, the government has developed a climate policy framework overseen by the Presidential Climate Commission (PCC) (Selected Issues Paper. How Can Structural Reforms Support the Climate Ambition of South Africa?). A stable macroeconomic environment and a coherent set of actions to encourage private-sector participation and develop green finance will help build a climate-resilient economy.

50. The transition toward a green economy in the digital age hinges on the removal of structural obstacles. A more efficient reallocation of resources would ease the transition costs. The government's commitment to attaining carbon-neutrality by mid-century is commendable, and the achievement of decarbonization while ensuring a just transition hinges crucially on more dynamic product and labor markets and strong institutional credibility. An increase in investment, enabled by the reforms, would also facilitate the expansion of the digital economy by providing critical infrastructure to improve access, reduce costs, and foster technology adoption and innovation. Training and education reforms would further help build up the needed human capital to fully reap the benefits of digitalization.

Authorities' Views on a Green and Digital Transition

51. The authorities consider climate change a significant threat to both the country and its socio-economic development and remain committed to the Paris Agreement:

- *Reflecting strong political will*, the PCC is leading the necessary work to translate climate ambition into a coherent set of concrete actions.

- *International financial support* in aiding the decarbonization transition is crucial as is the need to mobilize funding from the private sector. The authorities welcomed the financial support pledged to South Africa's green transition at the COP26 climate summit.

- *To advance the digital transition*, the migration of broadcasting signals from analogue to digital is to be completed by March 2022, paving the way for a speedy release of high-demand spectrum to facilitate investment in the telecommunications sector.

D. Combating Corruption and Strengthening Governance

52. Continued efforts to fight corruption and improve governance, in parallel to other reform measures, are necessary for securing a boost to productivity and economic growth.

- **Important progress has been made**, including through special audits of the financial management of COVID-19 initiatives by the Auditor General and publication of information on procurement contract awardees, including corporate directors (Annex XIII. Progress in the Fight Against Corruption). The first of three parts of a report on state capture, led by Acting Chief Justice Zondo, was published in early-January 2022. The report presents evidence of widespread corruption and governance weaknesses at state entities, resulting in misappropriation of public resources and long-lasting institutional damage.

- **Further efforts are nevertheless needed.** The establishment of independent anti-corruption agencies (a key recommendation of the Zondo Commission report) is crucial, as is enhancing criminal prosecution and establishing credible deterrence mechanisms. Implementing the recommendations from the AML/CFT assessment (paragraph 38) will help improve the detection, investigation, and prosecution of corruption cases, as well as the transparency of beneficial ownership in procurement contract awardees beyond directors. Approval and enactment of new procurement legislation is critical to reducing widespread corruption and promoting public investment efficiency. Implementing measures to combat corruption in SOEs, including approval of a shareholder management bill that follows international standards and best practices, is crucial for enhancing SOE governance.

- **Accelerating governance reforms** will help channel talent, investment, and technology toward their best use, foster public trust, and facilitate progress in other key reform areas, thereby contributing to reducing poverty and inequality.

Authorities' Views on Governance

53. The authorities see improving governance and fighting corruption as essential components of the growth-enhancing reforms:

- *Efforts to address corruption and state capture* have been made in the last three years, including by implementing the recommendations of the various commissions of enquiry.

- *The systematic undermining of key institutions has been stemmed* and efforts are ongoing to undo the damage to these institutions.
- *Remaining weaknesses* in legislation and its enforcement need to be addressed.

THE BENEFITS OF ADJUSTMENT AND REFORM

54. **Comprehensive reform implementation would significantly boost growth and economic strength**. If a strong package of reforms and fiscal adjustment along the lines of the above recommendations is implemented, staff projects the public debt ratio to start declining in 2023 while financing costs fall and bank lending rises, creating virtuous macro-financial feedback loops and further financial deepening. Potential growth would be raised by an improved business environment and lower costs of key inputs. Higher growth would meaningfully reduce unemployment and poverty. Inflation outturns and expectations would fall as the disinflationary impact of higher competition and an exchange rate appreciation counterbalances the inflationary effects of robust demand. The current account deficit would widen as investment-related imports expand, before starting to moderate in the outer years as higher competitiveness boosts exports.

Upside Scenario

	2020	2021	2022	2023	2024	2025	Unit
Real output growth	-6.4	4.6	2.3	2.8	3.1	3.6	(percent)
Per-capita real output growt	-7.8	3.7	0.8	1.3	1.6	2.0	(percent)
Inflation	3.3	4.4	4.6	4.9	4.3	4.0	(percent)
Private sector credit growth	1.0	2.1	3.3	7.3	7.9	8.5	(percent)
Fiscal deficit	-9.7	-8.3	-6.3	-4.4	-2.7	-1.8	(percent of GDP)
Public debt	69.4	69.7	71.6	70.4	67.8	64.6	(percent of GDP)
Current account balance	2.0	3.1	-1.7	-2.7	-3.1	-2.8	(percent of GDP)

Source: IMF staff calculations.

Note: Scenario analysis starts from 2022. Calendar year-based fiscal data for 2021 differ slightly from baseline values as the underlying fiscal year-based values are affected by 2022Q1 inflation.

55. **Achieving this scenario would require well-sequenced structural reforms adopted in coordination with fiscal consolidation**. Given the broad reform agenda, reaping the gains in the upside scenario would require a particularly swift, deep, and comprehensive reform package cutting across all key areas. However, the economy would benefit from prioritizing product market reforms, as they are estimated to deliver substantial growth gains in a shorter period and at a lower cost than others.[17] Successful implementation of product market reforms would generate buy-in for reform in other areas, including the labor market. Governance improvements should be accelerated in parallel.

[17] Staff analysis shows that product market reforms have the largest impact on per-capita growth with possibly the least difficulty of implementation. See IMF 2019 South Africa Article IV Selected Issues for a more detailed discussion.

RFI AND POST-FINANCING ASSESSMENT

56. **The IMF RFI purchase supported the authorities' efforts in addressing the challenging health situation and severe economic impact of the COVID-19 shock**. The RFI, in an amount equivalent to 100 percent of quota, helped fill the urgent BOP need originating from the fiscal pressures posed by the pandemic, limit regional spillovers, and catalyze additional financing from other international financial institutions (African Development Bank and BRICS New Development Bank). It complemented the authorities' strong policy response to the crisis.

57. **Some progress has been made in meeting the governance and transparency commitments accompanying the RFI request, but there are delays**. The NT published a dashboard with information on procurement contracts and allocation, but the database is yet to be completed.[18] The NT also produced a report—not publicly available—covering COVID-19-related spending for parliamentary consideration. The Auditor General has published three special audit reports on the COVID-19 relief package, which found some irregularities.[19] Corrective actions were put in place and some fraudulent transactions were reversed. Draft legislation, aimed at consolidating rules and management of the public procurement system, is facing procedural delays, and is expected to be presented to parliament in 2022.

58. **A first-time safeguards assessment of the SARB is substantially complete**. It found that overall, the SARB has a strong safeguards framework. The Board and its Audit Committee are actively engaged in oversight, and a collegial executive management team is in place. Audit mechanisms and financial reporting practices conform to international standards, and the control culture is anchored on a well-developed risk management function. Nonetheless, the SARB Act's provisions on autonomy could be further strengthened.

59. **South Africa's capacity to repay the Fund under the RFI is adequate under both the staff baseline and adverse scenarios**.[20] All key capacity to repay indicators, such as outstanding debt to the IMF relative to foreign exchange reserves, fiscal revenues, and exports are adequate under the baseline scenario (Table 9). The RFI amortization will not increase debt service obligations in a substantial way, and the authorities plan on using the SDRs allocated in August 2021 to service maturing debt obligations. Even under the adverse scenario, which assumes that the main external and domestic risks materialize (paragraphs 22–23, Annex VII. Risk Assessment Matrix, and Annex VIII. Public DSA), the capacity to repay the Fund would not materially weaken, as the country would rely on existing resources and adopt policy measures to meet its obligations.

[18] Some government departments failed to report relevant information to the NT. The names of the awarded companies and their directors (rather than beneficial owners per RFI commitment) are listed on the NT's website. See the dashboard.

[19] See Reports 1 and 2, and Report 3.

[20] South Africa is undergoing a PFA, as its total GRA credit outstanding of SDR3.1 billion is above the threshold of SDR1.5 billion.

Authorities' Views on PFA

60. **The authorities expressed once again their appreciation for the timely RFI disbursement and reiterated they have used the resources transparently**. Nonetheless, they explained that they have faced challenges to adequately capture, record, and report COVID-19-related expenditures in the public financial management system. Difficulties arose from the overlap between regular and COVID-19-related spending, and the lack of timely access to information on expenditure execution by decentralized entities. They acknowledged that the publication of the reports covering COVID-19-related spending other than procurement of goods and services have not yet been done. However, they are in the process of addressing the stated challenges and will produce a report in this regard. Finally, the authorities agreed that the country's capacity to repay the Fund under the RFI is adequate under both the staff baseline and adverse scenarios.

TECHNICAL COOPERATION

61. **Technical cooperation has been demand-driven, aligned to policy and reform priorities, and welcomed by the authorities**. Activities have focused on revenue administration, (including a TADAT assessment); public financial management (zero-based and gender-responsive budgeting); expenditure policy (wage bill reform); banking supervision and regulation; capital account liberalization; AML/CFT; national and sectoral accounts statistics; and residential property price statistics. The authorities saw the FSAP as a key undertaking that helped shape the financial sector reform process. Future cooperation will be guided by the authorities' interest in improving the medium-term fiscal framework; further strengthening tax administration; conducting a PIMA; maintaining financial stability while supporting financial inclusion; and upgrading national account statistics (Annex XIV. Technical Cooperation).

STAFF APPRAISAL

62. **The COVID-19 pandemic aggravated South Africa's low growth, elevated unemployment, high public debt, and weak social conditions**. COVID-19 has taken a heavy toll on lives and prompted one of the largest output contractions among EMEs, raising unemployment to record levels. The crisis has disproportionally affected the youth, women, and black Africans in a society that is deeply unequal. Economic sources of strength, including anchored inflation expectations, a sophisticated financial system, and a flexible exchange rate have somewhat contained the economic fallout. However, the necessary government response to the pandemic has added to debt accumulation and deepened the bank-sovereign nexus. Overcoming the COVID-19 pandemic by accelerating vaccination, preventing further infections, and continuing to support the most vulnerable remains the near-term priority.

63. **Turning the ongoing economic rebound into sustained and inclusive growth is a challenging but essential goal**. The cyclical rebound, supported by the phasing out of COVID-19-related mobility restrictions and improvements in terms of trade and global financing conditions, has not been accompanied by job creation and credit recovery. The medium-term outlook remains lackluster, marred by increasing public debt and deep-seated structural rigidities. Downside risks

include prospective COVID-19 waves and travel restrictions, a drop in commodity prices, tightening of external financing conditions, delays or reversals in reform implementation, and social instability. On the upside, the economy's formidable potential could sustain strong and inclusive growth should the necessary reforms and adjustment take place.

64. The structural rigidities need to be timely addressed to improve productivity and competitiveness and reduce poverty and inequality. Fostering private investment will require urgent reforms to (i) raise the efficiency of the economy, particularly in network industries to ensure energy security and facilitate the digital transition; (ii) reduce regulatory barriers that impede competition, including by avoiding misuse of localization and industrial policies that could hurt competitiveness and contravene international trade obligations; and (iii) make the labor market more flexible to boost job opportunities, facilitate workforce management, and attain the demographic dividend. Intensified efforts to decisively address governance deficiencies need to proceed in parallel with measures to secure the economic gains from other reforms.

65. An inventory of SOEs should be carried out to decide those that should be divested or liquidated and those that should remain as such. In doing so, action must be taken to dismantle corrupt practices in procurement and administration. The restructuring of Eskom will be costly and must be accompanied by a substantial downsizing and transformation of its operations, notably through a meaningful reduction of procurement and personnel costs. With a lower footprint of Eskom in the sector, private investment should help finance the energy transition away from coal, contributing to the climate objectives. The unbundled Eskom subsidiaries should operate without resorting to budgetary funds, and maintain sound governance and financial frameworks to guarantee their commercial viability. Efforts to address the country's logistical bottlenecks should be accelerated, notably by reforming Transnet and enabling private-sector participation in the port and railway sectors.

66. Maximizing the growth dividend from structural reforms requires firm and decisive action to put public debt on a sustainable path. The need to withdraw policy support amid heightened vulnerabilities leaves only limited scope for demand-side policies to foster growth and highlights the benefits of adopting a credible public debt anchor to bolster investor and consumer confidence. An ambitious and growth-friendly fiscal consolidation over the next three years is necessary to reverse the risky upward trend in the debt ratio and reduce high financing costs, while protecting well-targeted social expenditures and investment. The adjustment needs to be centered on tackling compensation costs, better targeting tertiary education subsidies, and streamlining tax expenditures. There is also an urgent need to reduce subsidies to SOEs and make them conditional on measurable performance improvements. The credibility of the MTBPS critically hinges on the government as a whole uniting behind reform implementation. The February budget represents the opportunity to define concrete measures that support the announced consolidation.

67. Accommodative monetary policy has helped mitigate the pandemic's impact and the SARB needs to remain vigilant about rising inflation risks. The recent increase in the policy rate was consistent with the planned gradual withdrawal of monetary support and the SARB's commitment to price stability. With inflation still above that of main trading partners and other

EMEs, the authorities are encouraged to lower the inflation target when circumstances allow in the future. Reducing fiscal financing needs would help safeguard monetary policy credibility. The planned shift in the monetary policy implementation framework should be focused on strengthening monetary policy transmission and the SARB's ability to support market functioning.

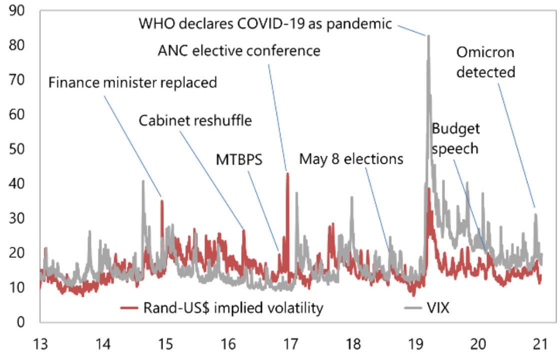
68. Although the financial sector has weathered the pandemic well, the financial safety net and supervision need to be strengthened further. Robust prudential regulation, closely aligned with international standards, and a commitment to independent supervision helped equip the financial sector with a moderate risk profile going into the COVID-19 crisis. However, close monitoring of the increasing financial sector-sovereign nexus is warranted, together with stepped-up supervision, swift completion of the bank resolution framework, finalization of the deposit insurance scheme, and strengthening of both AML/CFT efforts and pension fund oversight. Development of fintech, which could enhance financial access and inclusion, should be accompanied by adequate oversight.

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

Figure 1. South Africa: Financial Market Developments

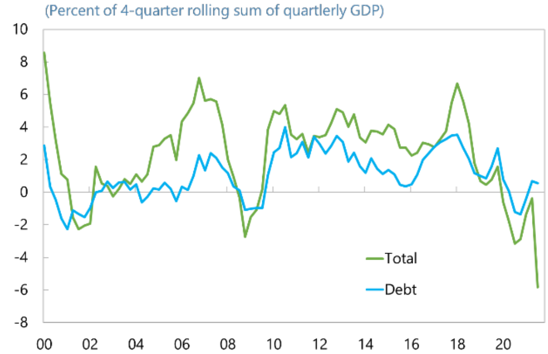
An indicator of local risk sentiment worsened but proportionally less than in its global comparators.

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



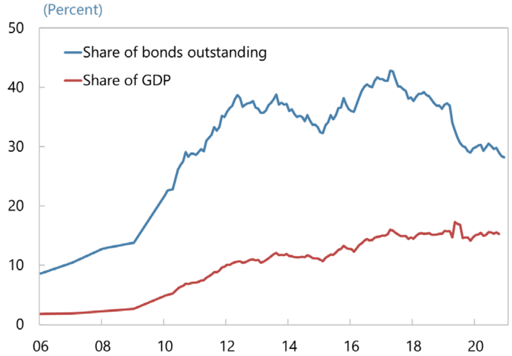
Nonresidents have sold record amounts of portfolio assets during the worst of the COVID-19 turmoil…

Net Nonresident Portfolio Investment
(Percent of 4-quarter rolling sum of quartlerly GDP)



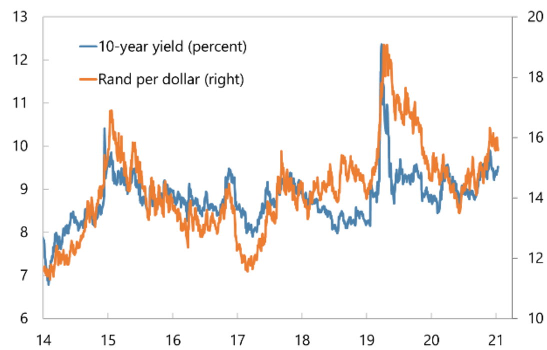
…reducing their holdings of local currency government bonds to a decade low.

Nonresident Holdings of Local Government Bonds
(Percent)



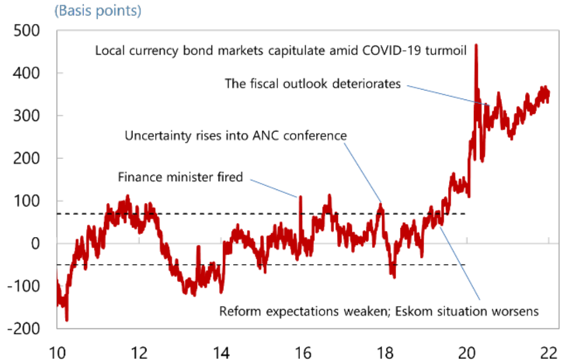
The 10-year local currency government yield and the rand recouped earlier large losses despite having lately been under some pressure.

Local Government Yield and Currency Performance



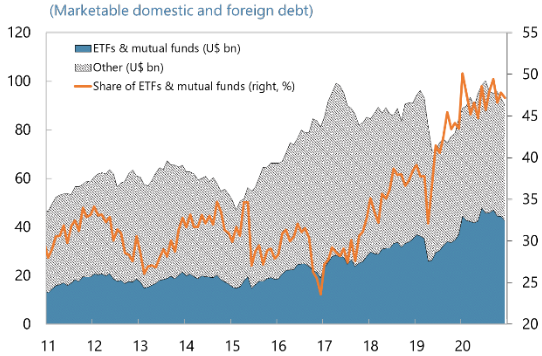
However, an indicator of local currency government credit risk remains elevated.

Local Currency Sovereign Yield Differential to Implied
(Basis points)



ETFs and mutual funds have continued to increase their importance in nonresident government debt holdings.

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

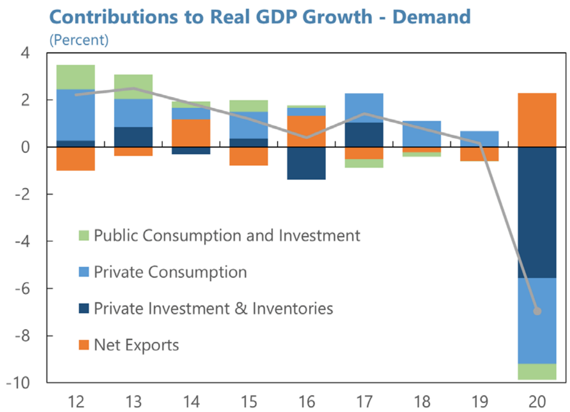


Sources: Bloomberg, EPFR, Haver Analytics, IIF, and IMF staff calculations.

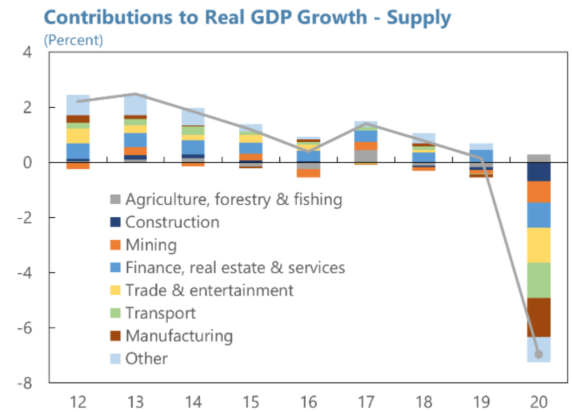
Note: Large nonresident portfolio outflows in 2021Q3 mainly reflect share transactions where Prosus acquired about 45 percent of Naspers from the existing Naspers shareholders.

Figure 2. South Africa: Real Sector Developments

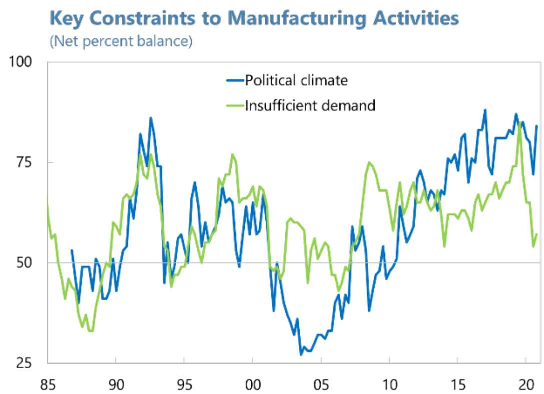
GDP contracted as private-sector activity weakened substantially...



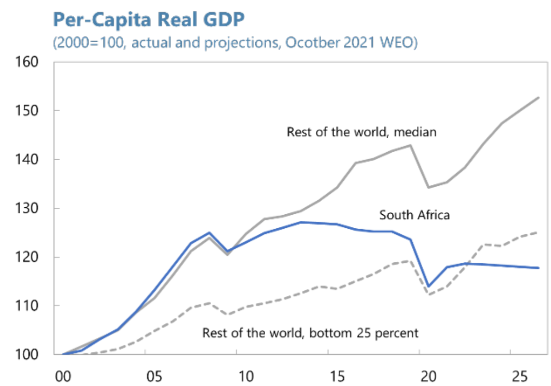
...across different sectors.



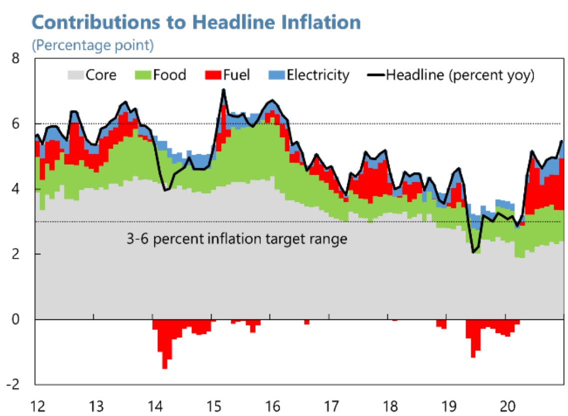
The political climate remains a key constraint to manufacturing



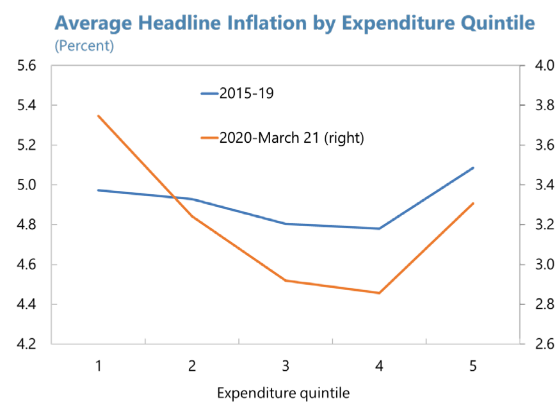
Per-capita output is set to underperform the rest of the world.



Inflation has risen due mainly to fuel prices.



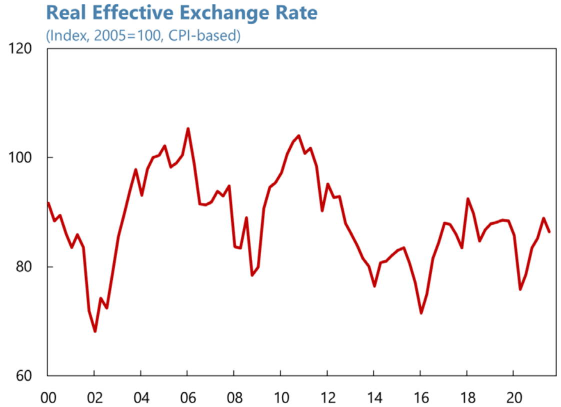
Individuals with lower expenditure benefited less from the disinflation in 2020 and early-2021.



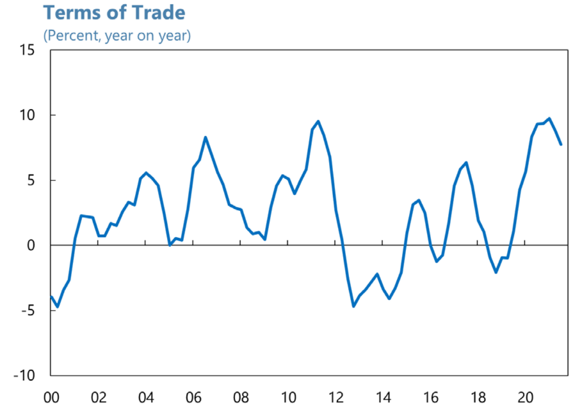
Sources: BER South Africa, IMF WEO, Haver Analytics, and IMF staff calculations.

Figure 3. South Africa: External Sector Developments

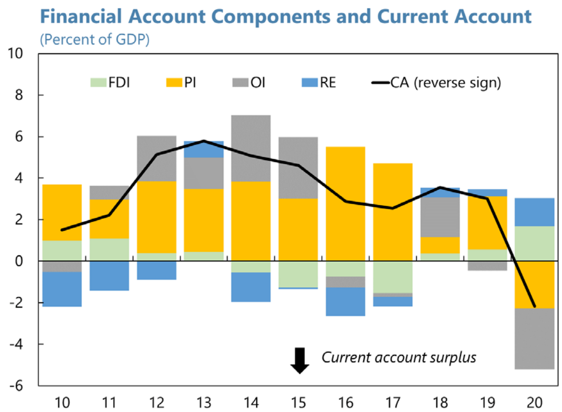
The real effective exchange rate has returned to pre-COVID-19 pandemic levels...



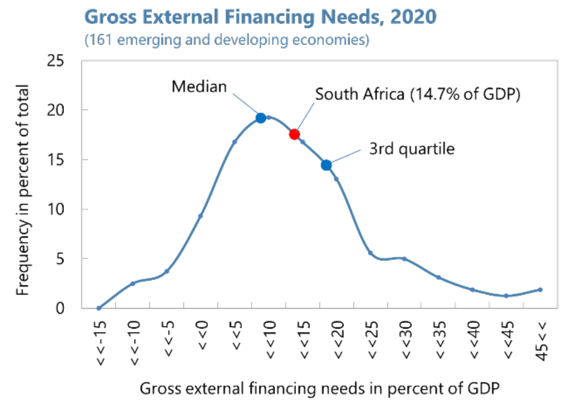
...while terms of trade have improved significantly...



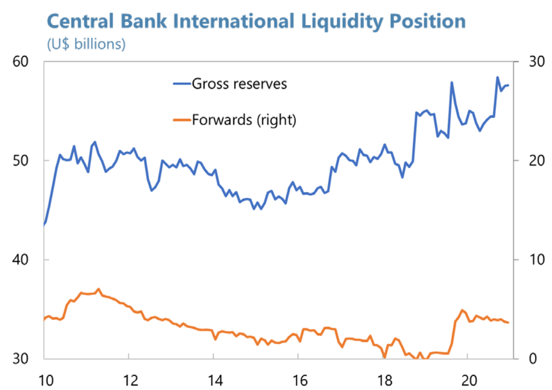
A current account surplus in 2020 was accompanied by portfolio and other investment outflows.



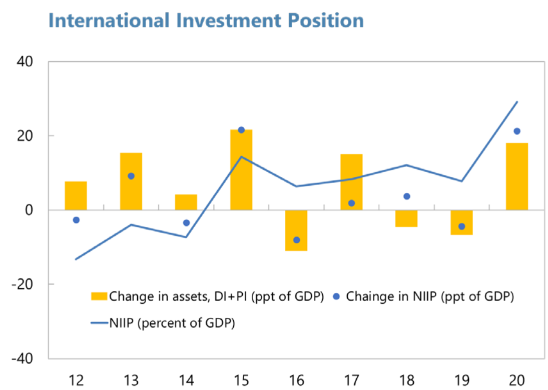
Gross external financing needs in 2020 were somewhat above the emerging and developing economy median.



RFI inflows were converted into rand (FX forwards were used to sterilize) while SDRs boosted gross reserves.



NIIP jumped as foreign assets appreciated.

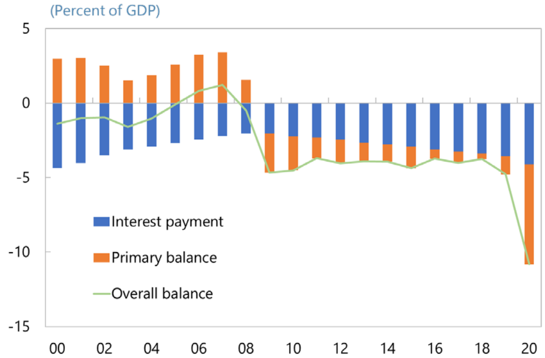


Sources: Haver Analytics, IMF WEO, and IMF staff calculations.

Figure 4. South Africa: Fiscal Sector Developments

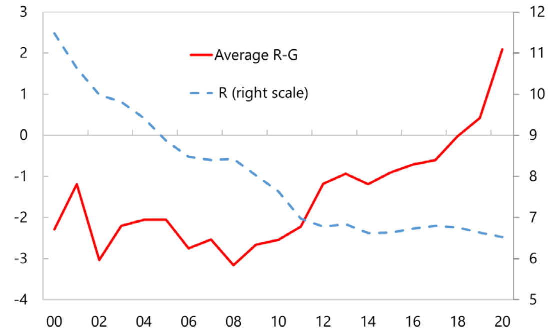
The primary balance worsened significantly while interest payments kept rising.

Fiscal Balance
(Percent of GDP)



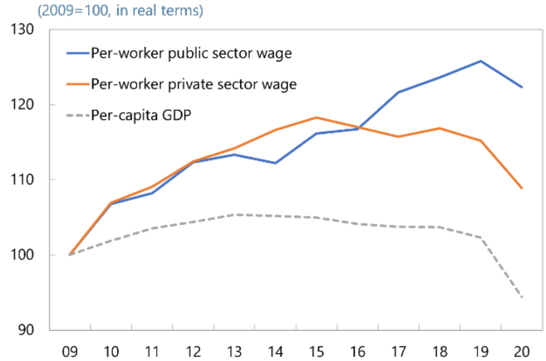
The interest rate-growth differential continued to increase into positive territory.

Sovereign Effective Interest Rate Differential to Growth
(Percent, October 2021 WEO)



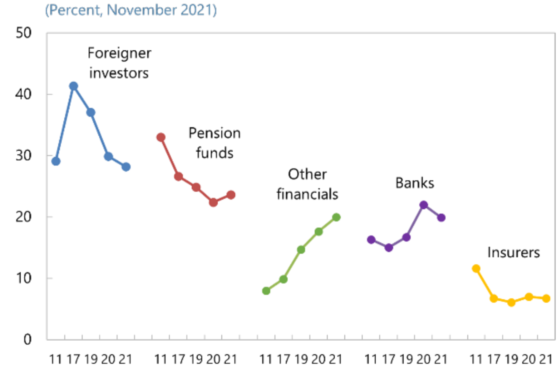
Public-sector wages diverged from private-sector wages and per-capita output.

Per-Worker Wage and Per-Capita GDP Levels
(2009=100, in real terms)



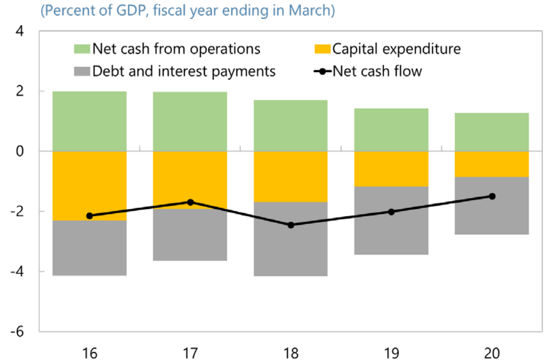
Banks and OFIs (mutual funds and others) increased their government bond holdings as nonresidents sold.

Ownership of Domestic Government Bonds: 2011, 17, 19-21
(Percent, November 2021)



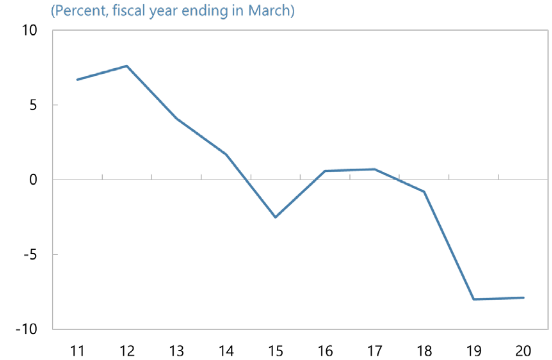
SOEs' cash flow remains under pressure from debt service despite having reduced capital expenditure...

Major SOEs' Cash Flow
(Percent of GDP, fiscal year ending in March)



...while profitability deteriorated.

SOE Return on Equity
(Percent, fiscal year ending in March)



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

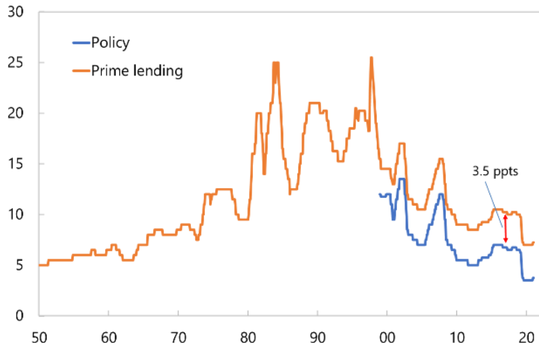
Note: In the upper right panel, *R* is the nominal effective interest rate on government debt, calculated as the primary balance in *t* less the overall balance in *t* as a share of average debt in *t* and *t-1*. Average *R-G* is *R* less nominal GDP growth. Showing 5-year moving averages from 2004 and averages since 2000 for earlier years.

Figure 5. South Africa: Monetary Policy Developments

The policy rate has been reduced to a multi-decade low in nominal terms….

…sending real rates into negative territory.

Policy and Prime Lending Rates
(Percent)

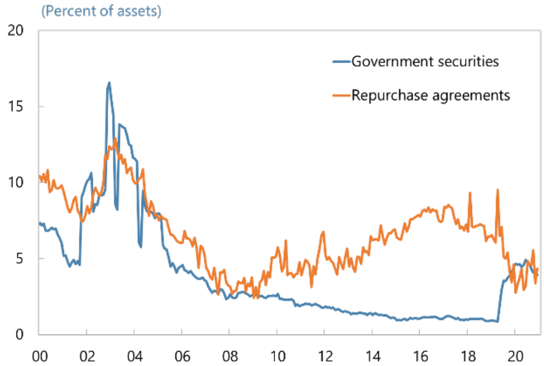


Real Policy Rate
(Percent, relative to BER 1 year-ahead inflation expectations)

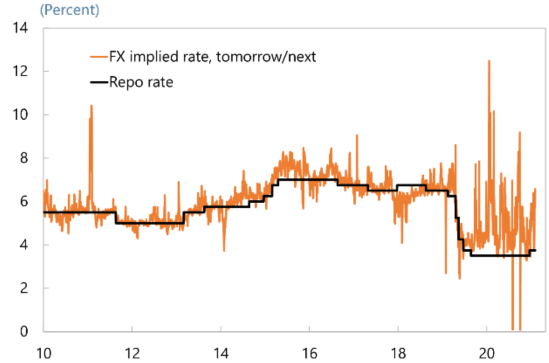
The SARB bought government bonds in the secondary market and provided liquidity to the financial system.

FX-implied short-term interest rates rose.

South African Reserve Bank Balance Sheet Items
(Percent of assets)



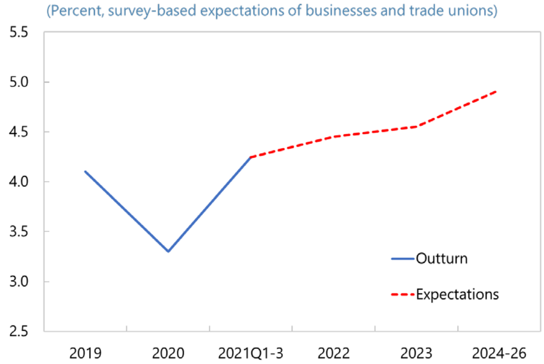
Repo and FX-Implied Rates
(Percent)



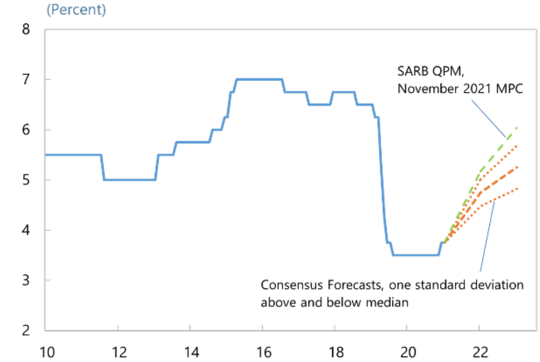
Inflation expectations are anchored around the 4.5 percent midpoint of the 3–6 percent target range.

Analysts expect the policy rate to rise gradually.

Inflation Outturn and Expectations
(Percent, survey-based expectations of businesses and trade unions)



Policy Rate Outturn and Forecasts
(Percent)

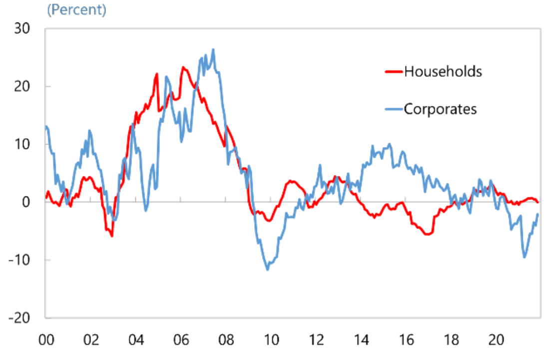


Sources: Bank for International Settlements, BER South Africa, Focus Economics Consensus Forecast, Haver Analytics, and IMF staff calculations.

Figure 6. South Africa: Credit and Financial Sector Developments

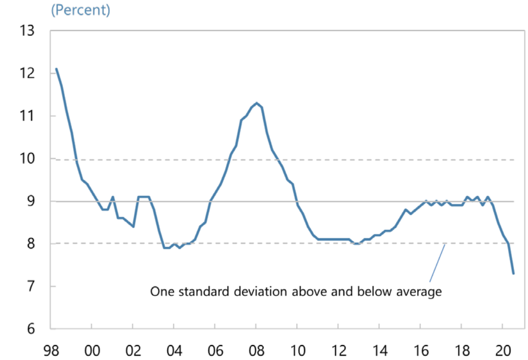
Real credit growth remained around zero for households and turned negative for corporates.

Private Sector Real Credit Growth by Borrower
(Percent)



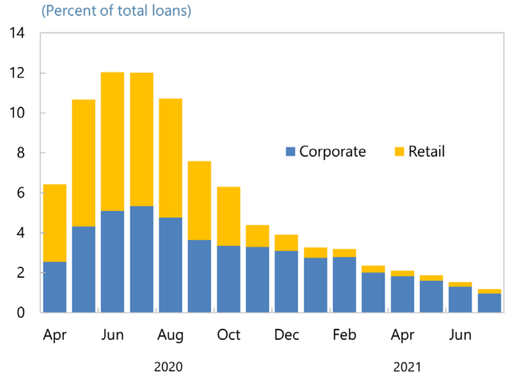
Debt service burden for private nonfinancial institutions declined.

Private Nonfinancial Sector Debt Service to Income
(Percent)



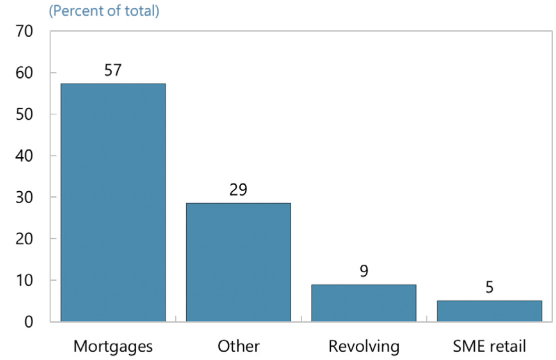
Bank restructured credit continued to decline for both retail and corporate borrowers...

Restructured Bank Loans
(Percent of total loans)



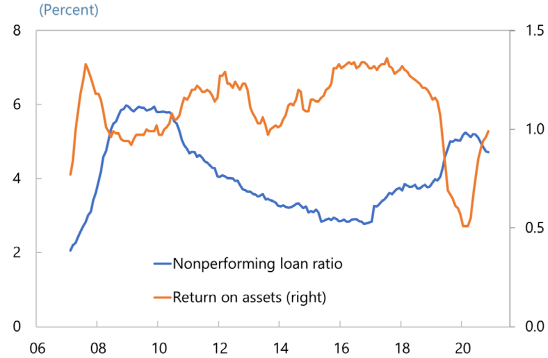
...where mortgages represented the bulk of retail restructured credit.

Composition of Retail Restructured Credit, Dec 2020
(Percent of total)



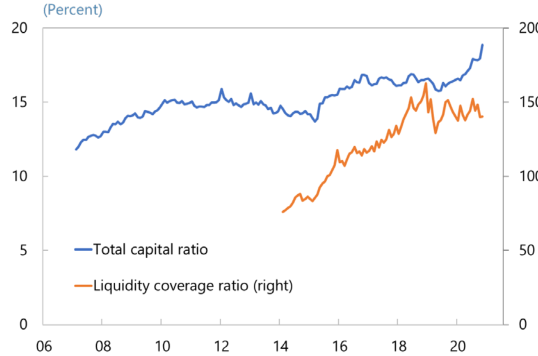
Bank asset quality worsened and profitability tumbled.

Bank Asset Quality and Profitability
(Percent)



But capital and liquidity ratios remained relatively high.

Bank Solvency and Liquidity Ratios
(Percent)

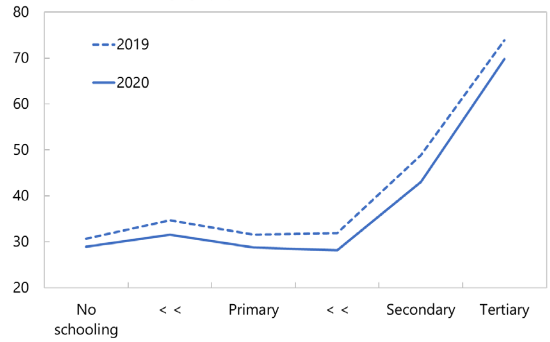


Sources: Bank for International Settlements, Haver Analytics, National Credit Regulator South Africa, and IMF staff calculations.

Figure 7. South Africa: Labor/Product Market and Climate Issues

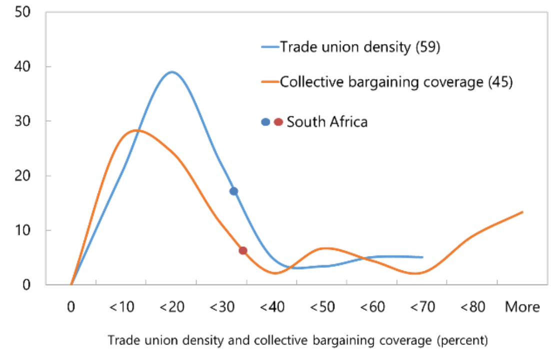
Employment is uneven across the spectrum of education attainment.

Employment by Educational Attainment
(Percent of working age population)



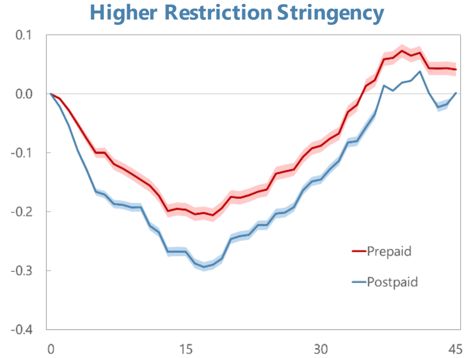
South Africa has relatively high trade union density and collective bargaining coverage.

Distribution of Collective Bargaining Coverage
(Percent of total, number of countries in parenthesis, 2015)



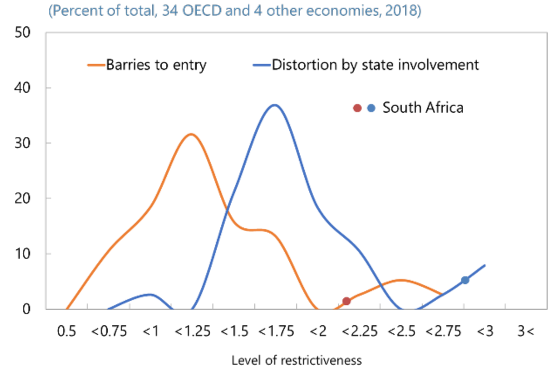
Poorer individuals (proxied by prepaid mobile phone owners) tended to stay home less in response to tightening of COVID-19 economic restrictions.

Estimated Decline in Time Out of Home in Response to Higher Restriction Stringency



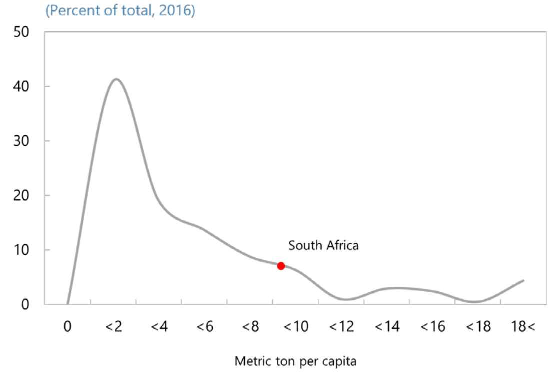
Product market regulations are tight in South Africa relative to OECD and other countries.

Indicators of Product Market Regulations
(Percent of total, 34 OECD and 4 other economies, 2018)



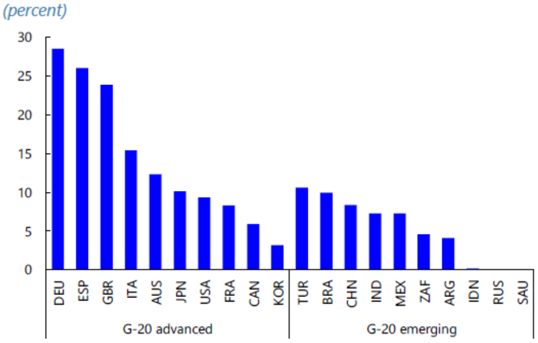
South Africa emits relatively large amounts of CO_2...

Global Distribution of CO2 Emissions
(Percent of total, 2016)



...reflecting its low share of renewables in total electricity generation.

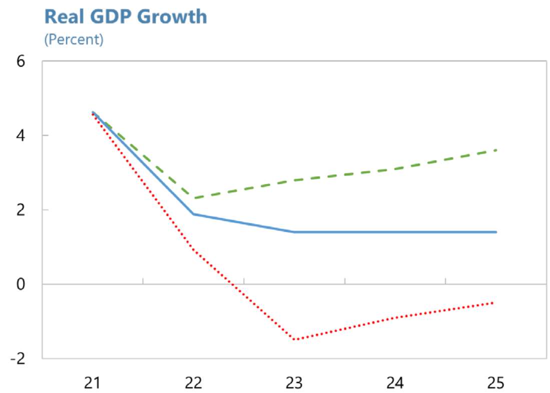
Share of renewable energy in electricity generation 1/
(percent)



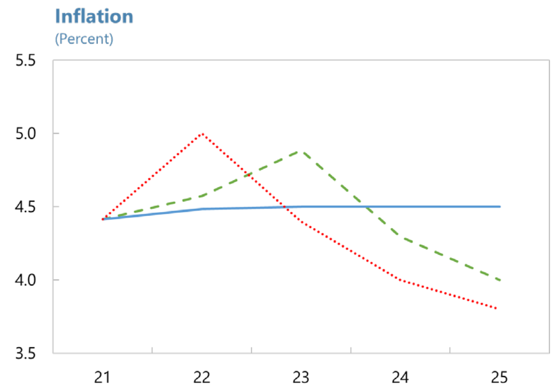
Sources: ILOSTAT, OECD, QLFS South Africa, World Development Indicators, and IMF staff calculations.

Figure 8. South Africa: Scenarios

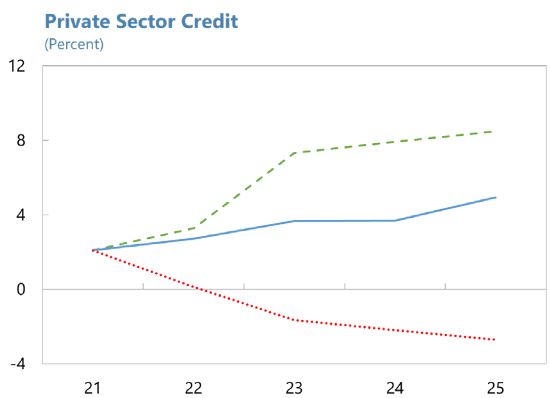
Real GDP growth would exceed 3 percent in the upside scenario; fall to –1½ percent in the downside one.



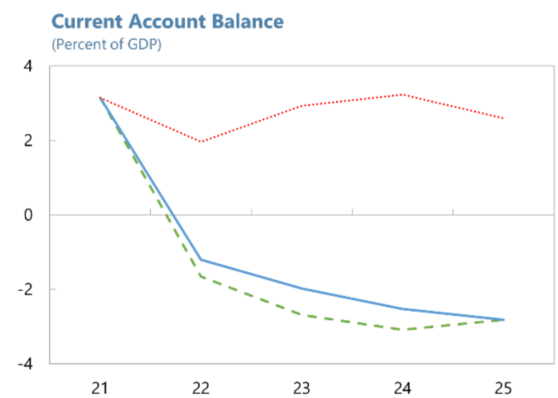
Inflation would rise on strong demand in the upside scenario and due to rand depreciation in the downside one.



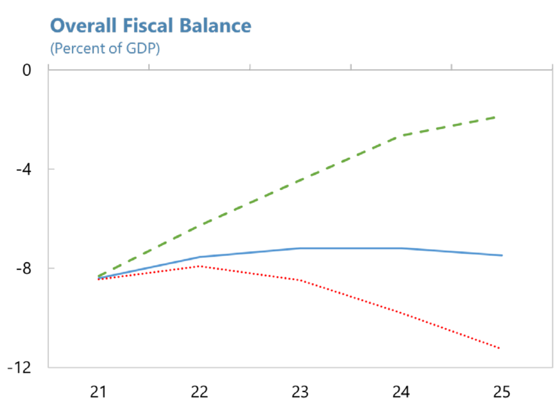
Private-sector credit would rebound in the upside scenario; contract in the downside one.



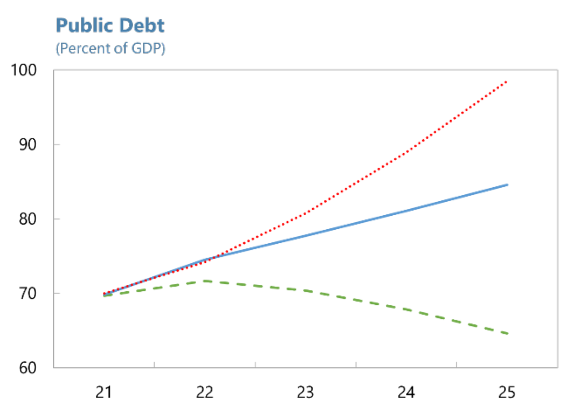
The CA deficit would widen on strong demand in the upside scenario; turn to a surplus on demand compression in the downside one.



Fiscal deficits would narrow significantly in the upside scenario; widen in the downside one.



Public 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.

Table 1. South Africa: Selected Economic Indicators, 2018–23

Social Indicators

GDP		**Poverty (percent of population)**	
Nominal GDP (2020, billions of US dollars)	335	Lower national poverty line (2015)	40
GDP per capita (2020, in US dollars)	5,637	Undernourishment (2019)	7
Population characteristics		**Inequality (income shares unless otherwise specified)**	
Total (2021, million)	60	Highest 10 percent of population (2015)	53
Urban population (2020, percent of total)	67	Lowest 40 percent of population (2015)	7
Life expectancy at birth (2021, number of years)	62	Gini coefficient (2015)	65

Economic Indicators

	2018	2019	2020	2021	2022	2023
				Est.	Proj.	
National income and prices (annual percentage change unless otherwise indicated)						
Real GDP	1.5	0.1	-6.4	4.6	1.9	1.4
Real GDP per capita 8/	0.0	-1.3	-7.8	3.7	0.3	-0.1
Real domestic demand	1.6	1.1	-8.0	4.0	3.0	1.9
GDP deflator	4.0	4.5	5.3	4.7	1.7	4.7
CPI (annual average)	4.6	4.1	3.3	4.4	4.5	4.5
CPI (end of period)	4.9	3.7	3.2	5.0	4.5	4.5
Labor market (annual percentage change unless otherwise indicated)						
Unemployment rate (percent of labor force, annual average)	27.1	28.7	29.2	34.2	35.3	37.0
Unit labor costs (formal nonagricultural)	4.0	4.7	2.9	0.2	4.5	4.5
Savings and Investment (percent of GDP)						
Gross national saving	13.6	13.4	14.7	15.3	11.8	11.3
Public (incl. public enterprises) 6/	1.0	0.0	-6.1	-5.3	-4.3	-3.9
Private	12.6	13.5	20.8	20.6	16.1	15.2
Investment (including inventories)	16.5	16.0	12.7	12.2	13.1	13.2
Public (incl. public enterprises excl. inventories) 7/	4.8	4.3	3.9	3.7	3.9	4.0
Private (excl. inventories)	11.0	11.1	9.8	9.7	9.8	9.8
Fiscal position (percent of GDP unless otherwise indicated) 1/						
Revenue, including grants 2/	26.4	26.9	25.3	25.9	27.0	26.5
Expenditure and net lending	30.2	31.7	35.0	34.3	34.5	33.6
Overall balance	-3.7	-4.8	-9.7	-8.4	-7.5	-7.1
Primary balance	-0.3	-1.1	-5.5	-3.9	-2.6	-1.8
Structural balance (percent of potential GDP)	-3.5	-3.9	-4.8	-4.8	-5.0	-5.5
Gross government debt 3/	51.6	56.3	69.4	69.9	74.5	77.7
Government bond yield (10-year and over, percent) 4/	9.4	9.0	9.7	9.9	9.9	...
Money and credit (annual percentage change unless otherwise indicated)						
Broad money	5.6	6.1	9.4	6.4	5.8	5.7
Credit to the private sector 5/	5.5	5.5	1.0	2.1	2.7	4.1
Repo rate (percent, end-period) 4/	6.8	6.5	3.5	3.8	3.8	...
3-month Treasury bill interest rate (percent) 4/	7.6	7.2	3.9	3.9	3.9	...
Balance of payments (annual percentage change unless otherwise indicated)						
Current account balance (billions of U.S. dollars)	-12.0	-10.0	6.7	12.8	-5.2	-8.6
percent of GDP	-3.0	-2.6	2.0	3.1	-1.2	-2.0
Exports growth (volume)	2.8	-3.4	-12.0	13.5	7.0	3.0
Imports growth (volume)	3.2	0.5	-17.4	10.8	11.2	4.7
Terms of trade	-2.1	4.2	9.4	1.8	-9.7	0.5
Overall balance (percent of GDP)	0.2	0.5	-1.0	0.5	0.1	-0.2
Gross reserves (billions of U.S. dollars)	51.6	55.1	55.5	57.6	58.0	57.3
in percent of ARA (w/o CFMs)	72.0	74.2	78.1	81.0	81.6	80.5
in percent of ARA (w/ CFMs)	78.8	81.6	86.6	89.8	90.5	89.3
Total external debt (percent of GDP)	42.6	47.8	50.8	39.5	42.9	43.4
Nominal effective exchange rate (period average) 4/	-0.6	-5.2	-11.6	7.6	-2.2	...
Real effective exchange rate (period average) 4/	1.7	-3.3	-10.1	9.5	2.0	...
Exchange rate (Rand/U.S. dollar, end-period) 4/	14.4	14.0	14.7	15.9	15.6	...

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 2014.

3/ Central government.

4/ January 11, 2022.

5/ Other depository institutions' "loans and securities" in all currencies.

6/ Public savings are the sum of public corporations and general government gross savings, using SARB financial accounts data. This allows to obtain a private sector savings estimate that excludes SOEs (SOEs are included in the National Accounts), derived as the difference between the National Accounts gross national savings and the public savings.

7/ Inventories data are volatile and excluded from the investment breakdown to help clarify fixed capital formation developments.

8/ Per-capita GDP figures are computed using STATS SA mid-year population estimates.

Table 2. South Africa: Consolidated Government Operations, FY 2017/18–2025/26[1]

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
							Proj.		
					(In billions of rand)				
Total revenue and grants	1,331	1,433	1,515	1,388	1,643	1,707	1,783	1,902	2,020
Tax revenue	1,161	1,239	1,305	1,186	1,441	1,497	1,556	1,661	1,766
Non-tax revenue 2/	16.3	21.4	24.6	25.6	36.4	32.1	35.9	37.3	37.8
Provinces, social security, and other entities	154	173	185	176	166	178	190	203	216
Total expenditure	1,541	1,644	1,822	1,972	2,109	2,171	2,259	2,412	2,588
Current expenditure	1,371	1,485	1,619	1,755	1,884	1,933	1,993	2,128	2,291
Wages and salaries	548	584	624	635	666	687	711	744	778
Other goods and services	221	234	253	246	290	303	317	331	346
Interest	173	192	214	240	278	318	365	425	503
Transfers	429	475	528	634	649	624	600	628	664
Capital expenditure	150	143	137	126	154	160	186	196	208
Payment for financial assets	20.3	15.7	66.1	90.9	71.4	72.5	75.1	82.9	84.5
Contingency	0.0	0.0	0.0	0.0	0.0	5.0	5.0	5.0	5.0
Primary balance	-37.3	-18.2	-93.9	-344.0	-187.1	-145.3	-111.7	-85.6	-65.4
Overall balance	-210	-210	-308	-584	-466	-463	-477	-511	-568
Financing	210	210	308	584	466	463	477	511	568
Local Currency Debt (net)	212	195	330	579	203	421	434	461	515
Foreign Currency Debt (net)	31.4	26.3	24.7	77.5	73.7	31.3	39.7	64.8	64.8
Official Creditors	0.0	0.0	0.0	85.5	33.3	0.0	-16.6	-34.1	-17.5
Commercial Creditors	31.4	26.3	24.7	-8.0	40.4	31.3	39.7	64.8	64.8
Transactions in Assets and Liabilities	19.5	14.5	15.8	26.5	7.3	1.7	2.0	2.2	2.3
Use of cash and other balances	-52.3	-25.5	-63.6	-99.0	182.0	9.5	17.5	17.1	3.7
Structural primary balance	-20.0	-1.4	-32.2	45.9	-52.6	-44.1	-25.3	-14.0	-12.5
Gross government debt	2,490	2,788	3,261	3,936	4,319	4,787	5,293	5,837	6,454
					(In percent of GDP)				
Total revenue and grants	25.9	26.5	26.6	25.1	26.9	26.7	26.5	26.6	26.7
Tax revenue	22.6	22.9	22.9	21.5	23.6	23.4	23.1	23.2	23.3
Non-tax revenue	0.3	0.4	0.4	0.5	0.6	0.5	0.5	0.5	0.5
Provinces, social security, and other entities	3.0	3.2	3.2	3.2	2.7	2.8	2.8	2.8	2.9
Total expenditure	30.0	30.3	32.0	35.7	34.5	34.0	33.5	33.7	34.2
Current expenditure	26.6	27.4	28.5	31.7	30.9	30.3	29.6	29.7	30.3
Wages and salaries	10.7	10.8	11.0	11.5	10.9	10.8	10.6	10.4	10.3
Other goods and services	4.3	4.3	4.5	4.4	4.8	4.7	4.7	4.6	4.6
Interest	3.4	3.5	3.8	4.3	4.6	5.0	5.4	5.9	6.6
Transfers	8.3	8.8	9.3	11.5	10.6	9.8	8.9	8.8	8.8
Capital expenditure	2.9	2.6	2.4	2.3	2.5	2.5	2.8	2.7	2.7
Payment for financial assets	0.4	0.3	1.2	1.6	1.2	1.1	1.1	1.2	1.1
Contingency	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Primary balance	-0.7	-0.3	-1.6	-6.2	-3.1	-2.3	-1.7	-1.2	-0.9
Overall balance	-4.1	-3.9	-5.4	-10.6	-7.6	-7.3	-7.1	-7.1	-7.5
Financing	4.1	3.9	5.4	10.6	7.6	7.3	7.1	7.1	7.5
Local Currency Debt (net)	4.1	3.6	5.8	10.5	3.3	6.6	6.4	6.4	6.8
Foreign Currency Debt (net)	0.6	0.5	0.4	1.4	1.2	0.5	0.6	0.9	0.9
Official Creditors	0.0	0.0	0.0	1.5	0.5	0.0	-0.2	-0.5	-0.2
Commercial Creditors	0.6	0.5	0.4	-0.1	0.7	0.5	0.6	0.9	0.9
Transactions in Assets and Liabilities	0.4	0.3	0.3	0.5	0.1	0.0	0.0	0.0	0.0
Use of cash and other balances	-1.0	-0.5	-1.1	-1.8	3.0	0.1	0.3	0.2	0.0
Structural primary balance (percent of potential GDP)	-0.4	0.0	-0.6	0.8	-0.9	-0.7	-0.4	-0.2	-0.2
Gross government debt 3/	48.4	51.5	57.3	71.2	70.7	75.0	78.6	81.5	85.2
Memorandum items:									
National budget primary balance (percent of GDP)	-1.3	-1.2	-2.7	-6.2	-2.1	-2.5	-1.9	-1.5	-1.2
National budget overall balance (percent of GDP)	-4.4	-4.5	-6.3	-10.4	-6.5	-7.3	-7.1	-7.1	-7.5
Fiscal year GDP (billions of rand)	5,144	5,417	5,689	5,529	6,107	6,386	6,735	7,161	7,573
Fiscal year real GDP growth (percent)	1.4	1.2	0.2	-7.2	5.7	2.1	1.2	1.5	1.3
Fiscal year GDP Deflator growth (in percent)	5.0	4.1	4.8	4.8	4.5	2.4	4.3	4.7	4.4
Fiscal year nominal GDP growth (percent)	6.4	5.3	5.0	-2.8	10.4	4.6	5.5	6.3	5.8
Contingent Liabilities (percent of GDP) 4/	14.3	15.3	18.6	20.3	…	…	…	…	…

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

1/ Data are on a fiscall year basis (April 1-March 31) and are based on the October 2021 Medium Term Budget Policy Statement. 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 national government.

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/ Contingent Liabilities are sourced from Table 11 of the Statistical Annex of the 2021 *Budget Review*. For FY 2020/21, it also includes disbursements of loan guarantees provided in the context of the COVID-19 fiscal support package of 0.3 percent of GDP.

Table 3. South Africa: Balance of Payments, 2018–26

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.			Proj.		
				(In billions of US dollars)					
Balance on current account	-12.0	-10.0	6.7	12.8	-5.2	-8.6	-11.3	-13.2	-15.1
Balance on goods and services	1.9	2.1	14.9	24.3	9.1	8.0	6.8	6.0	5.8
Exports of goods and services	111	106	93	126	127	133	138	145	153
Imports of goods and services	-109	-104	-78	-102	-118	-125	-132	-139	-147
Balance on income	-11.3	-9.7	-5.6	-8.7	-10.8	-12.2	-13.2	-14.0	-15.3
Income receipts	7.9	8.5	7.8	4.3	6.3	12.3	15.9	18.9	19.7
Income payments	-19.2	-18.2	-13.4	-13.0	-17.2	-24.5	-29.0	-32.9	-34.9
Balance on transfers	-2.6	-2.4	-2.6	-2.9	-3.5	-4.4	-5.0	-5.3	-5.6
Capital flows (including errors and omissions)	12.9	11.8	-10.0	-10.8	5.6	7.9	10.3	12.1	14.0
Balance on capital and financial account	11.9	9.0	-11.3	-10.8	5.6	7.9	10.3	12.1	14.0
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	11.8	9.0	-11.3	-10.8	5.6	7.8	10.3	12.1	14.0
Direct investment	1.4	2.0	5.1	0.4	1.0	1.9	2.1	2.2	2.4
Liabilities	5.4	5.1	3.1	4.0	4.7	5.7	6.1	6.4	6.9
Assets	-4.1	-3.1	2.0	-3.6	-3.6	-3.8	-4.0	-4.1	-4.5
Portfolio investment	2.9	9.0	-6.8	5.5	8.5	9.7	10.6	11.0	11.9
Liabilities	7.2	6.1	-9.7	5.5	8.5	9.7	10.6	11.0	11.9
Assets	-4.3	2.9	2.8	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.5	-0.4	-0.7	-0.8	-0.8	-0.9	-0.9	-0.9	-1.0
Liabilities	-16.5	-11.6	-20.4	-23.8	-25.0	-25.8	-26.6	-27.4	-29.5
Assets	17.0	11.3	19.7	23.0	24.2	25.0	25.8	26.5	28.5
Other investment	7.1	-1.6	-8.9	-15.9	-3.0	-3.0	-1.6	-0.2	0.6
Liabilities	8.7	-2.2	1.0	-5.9	6.9	7.0	8.4	9.7	10.5
Assets	-1.6	0.6	-9.9	-9.9	-9.9	-9.9	-9.9	-9.9	-9.9
Errors and omissions	1.0	2.7	1.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	0.9	1.8	-3.3	2.1	0.4	-0.8	-1.1	-1.1	-1.1
IFI disbursements			5.5						
FX reserves drawdown	-0.9	-1.8	-2.2	-2.1	-0.4	0.8	1.1	1.1	1.1
Gross reserves (end of period)	51.6	55.1	55.5	57.6	58.0	57.3	56.2	55.1	54.0
				(In percent of GDP)					
Balance on current account	-3.0	-2.6	2.0	3.1	-1.2	-2.0	-2.5	-2.8	-2.9
Balance on goods and services	0.5	0.5	4.4	6.0	2.1	1.8	1.5	1.3	1.1
Balance on goods	0.5	0.7	5.2	6.9	2.6	1.9	1.5	1.3	1.1
Balance on services	0.0	-0.2	-0.8	-0.9	-0.4	-0.1	0.0	0.0	0.0
Exports of goods and services	27.5	27.3	27.8	30.9	30.0	30.0	30.1	30.3	29.4
Imports of goods and services	-27.0	-26.8	-23.3	-24.9	-27.9	-28.2	-28.6	-29.1	-28.3
Balance on income	-2.8	-2.5	-1.7	-2.1	-2.6	-2.8	-2.9	-2.9	-2.9
Balance on transfers	-0.6	-0.6	-0.8	-0.7	-0.8	-1.0	-1.1	-1.1	-1.1
Capital flows (including errors and omissions)	3.2	3.0	-3.0	-2.6	1.3	1.8	2.2	2.5	2.7
Balance on capital and financial account	2.9	2.3	-3.4	-2.6	1.3	1.8	2.2	2.5	2.7
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	2.9	2.3	-3.4	-2.6	1.3	1.8	2.2	2.5	2.7
Direct investment	0.3	0.5	1.5	0.1	0.2	0.4	0.5	0.5	0.5
Portfolio investment	0.7	2.3	-2.0	1.4	2.0	2.2	2.3	2.3	2.3
Financial derivatives	0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other investment	1.7	-0.4	-2.7	-3.9	-0.7	-0.7	-0.3	0.0	0.1
Errors and omissions	0.2	0.7	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	0.2	0.5	-1.0	0.5	0.1	-0.2	-0.2	-0.2	-0.2
Gross reserves (end of period)	12.8	14.2	16.6	14.1	13.7	12.9	12.2	11.5	10.4
in months of next year's imports	6.0	8.4	6.6	5.9	5.6	5.2	4.9	4.5	4.2
Memorandum items:									
Total external debt	42.6	47.8	50.8	39.5	42.9	43.4	44.1	45.5	45.5
International investment position (net)	12.1	7.8	29.9	...	...	...	...	...	...
GDP at current prices (US$ billion)	405	388	335	408	424	442	460	478	520

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

Table 4. South Africa: Financial Corporations, 2018–26

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.			Proj.		
	(In billions of rand)								
Central Bank									
Net foreign assets	700	737	777	791	755	750	747	744	725
Net domestic assets	-431	-455	-477	-471	-413	-387	-362	-335	-292
Domestic claims	-399	-413	-435	-432	-377	-355	-333	-310	-270
Central government (net)	-474	-517	-505	-493	-438	-415	-393	-371	-331
State and local government	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Public nonfinancial corporations	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Private sector	0.3	1.1	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Other depository corporations	68	96	65	55	55	55	55	55	55
Other financial corporations	5.0	5.0	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Other items net	-31.6	-40.6	-42.7	-39.2	-35.7	-32.2	-28.7	-25.2	-21.7
Monetary base	269	282	299	320	342	363	385	409	434
Other Depository Corporations									
Net foreign assets	60	105	378	341	333	309	278	241	193
Net domestic assets	3,356	3,526	3,595	3,881	4,127	4,405	4,693	5,002	5,326
Domestic claims	4,467	4,749	4,906	5,231	5,497	5,805	6,127	6,473	6,837
Central government (net)	484	525	478	644	777	872	963	1,046	1,133
State and local government	20.9	23.0	22.8	24.9	25.8	27.4	29.1	30.8	32.6
Public nonfinancial corporations	71.3	77.1	70.3	71.3	71.5	71.6	71.8	71.9	72.1
Private sector	3,204	3,388	3,448	3,520	3,616	3,765	3,930	4,124	4,328
of which loans and securities	3,111	3,281	3,312	3,382	3,474	3,617	3,777	3,963	4,159
Central Bank	147	159	165	181	188	199	211	224	237
Other financial corporations	541	577	722	791	819	870	922	977	1,034
Other items net	-1,111	-1,224	-1,311	-1,350	-1,370	-1,401	-1,434	-1,471	-1,510
Depository Corporations									
Net foreign assets	760	841	1,155	1,133	1,088	1,058	1,025	984	919
Net domestic assets	2,787	2,922	2,963	3,249	3,546	3,842	4,148	4,475	4,835
Domestic claims	3,853	4,081	4,241	4,564	4,878	5,197	5,529	5,885	6,276
Central government (net)	10	9	-27	151	339	457	569	675	802
State and local government	21.3	23.3	23.1	25.3	26.2	27.8	29.4	31.1	33.0
Public nonfinancial corporations	72.3	78.1	71.3	72	73	73	73	73	73
Private sector	3,204	3,389	3,449	3,521	3,617	3,766	3,932	4,126	4,330
of which loans and securities	3,111	3,281	3,312	3,382	3,474	3,617	3,777	3,963	4,159
Other financial corporations	546	582	725	794	823	873	925	980	1,038
Other items net	-1,066	-1,159	-1,278	-1,315	-1,331	-1,355	-1,381	-1,410	-1,440
Broad money	3,547	3,764	4,118	4,381	4,635	4,901	5,173	5,460	5,754

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

Table 4. South Africa: Financial Corporations: 2018–26 (concluded)

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.			Proj.		
				(In billions of rand)					
Other Financial Corporations									
Net foreign assets	1,131	1,315	1,661	1,442	1,409	1,383	1,314	1,228	1,086
Net domestic assets	4,637	4,850	4,813	5,438	5,860	6,298	6,787	7,315	7,910
Domestic claims	5,725	5,974	5,930	6,624	7,111	7,619	8,179	8,781	9,451
Central government (net)	1,014	1,116	1,291	1,465	1,691	1,930	2,188	2,475	2,812
State and local government	42.6	44.8	45.6	48.5	51.3	54.2	57.1	60.2	63.4
Public nonfinancial corporations	455	482	501	520	523	526	529	531	534
Private sector	3,065	3,120	2,510	2,909	3,069	3,231	3,425	3,626	3,843
of which loans and securities	921	971	781	905	955	1,005	1,066	1,128	1,196
Central Bank	5.2	6.6	5.9	6.2	6.6	7.0	7.3	7.7	8.1
Other Depository Corporations	1,144	1,205	1,577	1,676	1,770	1,871	1,973	2,081	2,191
Other items net	-1,088	-1,124	-1,117	-1,186	-1,251	-1,321	-1,392	-1,466	-1,541
Non-liquid liabilities	5,768	6,165	6,473	6,881	7,269	7,681	8,101	8,543	8,996
Financial Corporations									
Net foreign assets	1,891	2,156	2,815	2,575	2,498	2,441	2,339	2,212	2,004
Net domestic assets	6,368	6,625	6,393	7,206	7,831	8,466	9,159	9,907	10,752
Domestic claims	7,884	8,261	7,863	8,712	9,389	10,065	10,802	11,598	12,490
Central government (net)	1,024	1,124	1,264	1,616	2,030	2,388	2,757	3,150	3,614
State and local government	63.8	68.1	68.8	73.8	77.4	81.9	86.5	91.4	96.4
Public nonfinancial corporations	527	560	572	592	596	599	601	604	607
Private sector	6,269	6,509	5,959	6,430	6,685	6,996	7,357	7,752	8,173
of which loans and securities	4,031	4,252	4,094	4,287	4,429	4,623	4,842	5,091	5,355
Other items net	-1,515	-1,637	-1,470	-1,505	-1,558	-1,599	-1,643	-1,690	-1,738
Liabilities	8,259	8,781	9,209	9,781	10,328	10,907	11,498	12,119	12,757
Liquid	2,320	2,470	2,596	2,762	2,920	3,087	3,258	3,437	3,622
Nonliquid	5,940	6,310	6,612	7,020	7,408	7,820	8,240	8,682	9,135
Memorandum items:									
Central Bank (billions of US dollar)									
Net foreign reserves	48.7	52.5	52.9	50.1	51.0	50.3	49.2	48.1	47.0
Central gov. FX deposits	8.7	10.1	6.7	7.8	8.3	7.5	6.4	5.3	4.2
Year-on-year growth (percent)									
Monetary base	4.6	4.9	6.1	7.0	6.9	6.1	6.1	6.1	6.1
Broad money	5.6	6.1	9.4	6.4	5.8	5.7	5.6	5.5	5.4
Claims on private sector									
Dep. Corp.	5.0	5.8	1.8	2.1	2.7	4.1	4.4	4.9	4.9
Dep. Corp., loans and securities	5.5	5.5	1.0	2.1	2.7	4.1	4.4	4.9	4.9
Fin. Corp.	-2.0	3.8	-8.5	7.9	4.0	4.7	5.2	5.4	5.4
Fin. Corp., loans and securities	5.5	5.5	-3.7	4.7	3.3	4.4	4.8	5.1	5.2
Broad money multiplier (ratio)	13.2	13.3	13.8	13.7	13.6	13.5	13.4	13.4	13.3
Claims on public sector (percent of total assets)									
Other Depository Corporations									
Central government	11.5	12.0	12.4	12.7	13.5	14.2	14.8	15.3	15.9
Public nonfinancials	1.3	1.3	1.0	1.0	1.0	1.0	0.9	0.9	0.9
Other Financial Corporations									
Central government	12.9	13.2	13.6	14.3	15.5	16.6	17.7	18.8	20.1
Public nonfinancials	4.6	4.5	4.4	4.3	4.1	3.9	3.8	3.6	3.4

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

Table 5. South Africa: Financial Soundness Indicators, 2018–21

	2018	2019	2020	2021 1/
		(Percent)		
Capital adequacy				
Regulatory capital to risk weighted assets	16.1	16.6	16.6	17.3
of which Tier 1 capital	14.9	15.6	15.7	16.4
Capital to total assets	8.4	8.5	7.9	8.3
Asset quality				
Nonperforming loans to total of loans	3.7	3.9	5.2	5.2
Nonperforming loans net of provisions to capital	17.8	18.1	25.6	23.3
Earnings, profitability, and efficiency				
Return on assets	1.7	1.5	0.6	0.9
Return on equity	19.8	17.6	7.7	11.8
Interest margin to gross income	50.0	52.8	52.0	55.3
Trading income to total income	6.7	5.4	6.1	8.1
Non-interest expenses to gross income	52.8	54.0	61.5	64.7
Personnel expenses to non-interest expenses	51.9	44.2	41.5	49.0
Liquidity				
Liquid assets to total assets	15.6	15.0	15.2	15.8
Liquid assets to short-term liabilities	31.1	30.2	28.6	28.8
Customer deposits to total loans	55.7	57.4	61.0	61.4
Exposure to FX risk				
Net open FX position to capital	0.7	0.9	0.7	0.8
Foreign-currency-denominated loans to total loans	9.4	8.3	8.7	7.5
Foreign-currency-denominated liabilities total liabilities	8.0	7.4	6.4	6.2
Sectoral distribution of loans and advances				
Residents	89.3	90.0	86.8	87.4
Central Bank and other financial corporations	15.7	15.1	15.8	15.2
General government	0.5	0.6	0.5	0.5
Nonfinancial corporations	34.0	34.0	31.5	31.8
Households	39.1	40.2	38.9	40.0
Nonresidents	10.7	10.0	13.2	12.6
Derivatives				
Gross asset position in financial derivatives to capital	41.9	51.2	104.2	74.9
Gross liability position in financial derivatives to capital	42.9	49.3	100.3	70.9
Real Estate Market				
Residential real estate price growth 2/	3.8	3.5	2.5	4.2
Residential real estate loans to total loans	24.0	24.2	23.6	24.5
Commercial real estate loans to total loans	7.5	8.0	8.0	8.1
Household debt 3/				
Household debt to GDP	43.3	43.8	44.3	45.0
Household debt to disposable income	72.7	73.2	75.4	75.3
Household debt service to disposable income	9.3	9.4	7.7	7.7

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

1/ As of May, 2021.

2/ As of October, 2021.

3/ As of March, 2021.

Table 6. South Africa: Medium-Term Macroeconomic Framework, 2018–26

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.			Proj.		
National income and prices (annual percentage change)									
Real GDP	1.5	0.1	-6.4	4.6	1.9	1.4	1.4	1.4	1.4
CPI (annual average)	4.6	4.1	3.3	4.4	4.5	4.5	4.5	4.5	4.5
Output gap (percent of potential real GDP)	-0.9	-2.1	-9.5	-6.1	-4.4	-3.3	-2.2	-1.4	-0.8
Labor market (annual percentage change)									
Unemployment rate (percent of labor force, annual average)	27.1	28.7	29.2	34.2	35.3	37.0	38.1	38.7	39.3
Savings and Investment (percent of GDP)									
Gross national saving	13.6	13.4	14.7	15.3	11.8	11.3	11.1	11.1	11.2
Public (incl. public enterprises) 1/	1.0	0.0	-6.1	-5.3	-4.3	-3.9	-3.8	-4.2	-4.7
Private	12.6	13.5	20.8	20.6	16.1	15.2	14.9	15.2	15.9
Investment (including inventories)	16.5	16.0	12.7	12.2	13.1	13.2	13.6	13.8	14.1
Public (incl. public enterprises) 2/	4.8	4.3	3.9	3.7	3.9	4.0	4.1	4.1	4.1
Private	11.0	11.1	9.8	9.7	9.8	9.8	10.1	10.3	10.6
Fiscal position (percent of GDP) 3/									
Revenue, including grants	26.4	26.9	25.3	25.9	27.0	26.5	26.6	26.6	26.7
Expenditure and net lending	30.2	31.7	35.0	34.3	34.5	33.6	33.7	34.1	34.7
Overall balance	-3.7	-4.8	-9.7	-8.4	-7.5	-7.1	-7.1	-7.4	-7.9
Primary balance	-0.3	-1.1	-5.5	-3.9	-2.6	-1.8	-1.3	-0.9	-0.7
Gross government debt 4/	51.6	56.3	69.4	69.9	74.5	77.7	80.9	84.3	88.1
Balance of payments (percent of GDP unless otherwise indicated)									
Exports of Goods and Services (volume, annual percentage change)	2.8	-3.4	-12.0	13.5	7.0	3.0	3.2	3.4	3.9
Imports of Goods and Services (volume, annual percentage change)	3.2	0.5	-17.4	10.8	11.2	4.7	4.0	3.6	3.6
Current account balance (billions of U.S. dollars)	-12.0	-10.0	6.7	12.8	-5.2	-8.6	-11.3	-13.2	-15.1
percent of GDP	-3.0	-2.6	2.0	3.1	-1.2	-2.0	-2.5	-2.8	-2.9
Overall balance	0.2	0.5	-1.0	0.5	0.1	-0.2	-0.2	-0.2	-0.2
Gross reserves (billions of U.S. dollars)	51.6	55.1	55.5	57.6	58.0	57.3	56.2	55.1	54.0
percent of short-term debt (residual maturity)	89.2	98.4	95.1	78.1	93.0	88.9	80.0	80.0	65.8
Total external debt	42.6	47.8	50.8	39.5	42.9	43.4	44.1	45.5	45.5

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

1/ Public savings are computed using SARB financial accounts data adding public corporations and general government gross savings. This allows to obtain a refined private sector savings estimate that excludes SOEs included as part of the private sector in the National Accounts. The refined private sector savings estimate is derived as the difference between the National Accounts gross national savings and the public savings.

2/ Noisy inventories data are excluded from the investment breakdown to highlight fixed capital formation developments.

3/ Consolidated government unless otherwise indicated.

4/ National government.

Table 7. South Africa: Indicators of External Vulnerability, 2016–21

	2016	2017	2018	2019	2020	2021
Financial indicators						
Gross government debt (percent of GDP)	47.1	48.6	51.6	56.3	69.4	68.8
Broad money (annual percentage change)	6.1	6.4	5.6	6.1	9.5	8.5
Private sector credit (annual percentage change)	4.7	4.3	5.5	5.5	1.0	6.2
91 day Treasury bill yield (percent, end-period)	7.2	7.3	7.2	7.1	4.5	3.9
91 day Treasury bill yield (real, percent, end-period) [1/ 2/]	0.6	2.0	2.5	2.8	1.3	-1.5
External indicators						
Exports (annual percentage change in U.S. dollars)	-5.5	15.0	7.4	-4.3	-6.1	31.7
Export volume (goods and services, annual percentage change)	0.4	-0.3	2.8	-3.4	-12.0	12.2
Imports (annual percentage change in U.S. dollars)	-12.1	11.7	11.5	-5.3	-22.9	26.2
Import volume (goods and services, annual percentage change)	-4.1	1.5	3.2	0.5	-17.4	15.1
Terms of trade (annual percentage change) [3/]	1.6	4.5	-2.1	4.2	10.1	7.6
Current account balance (percent of GDP)	-2.6	-2.3	-3.2	-2.7	2.0	2.9
Capital and financial account, excl. financial derivatives (percent of GDP)	3.9	2.8	2.8	2.4	-3.2	-1.6
of which: Net portfolio investment (debt and equity)	5.1	4.3	0.7	2.3	-2.0	1.4
Other investment (loans, trade credits, etc.)	-0.5	-0.2	1.7	-0.4	-2.7	-3.1
Net foreign direct investment	-0.7	-1.4	0.3	0.5	1.5	0.1
Gross international reserves (billions of U.S. dollars)	47.4	50.7	51.6	55.1	55.0	57.6
in months of prospective imports of goods and services	5.7	5.6	6.0	8.6	6.8	6.2
in percent of broad money	20.5	18.6	20.9	20.5	19.6	19.1
in percent of short-term debt, residual maturity	118.3	93.7	89.2	98.4	75.9	84.6
Net international reserves (billions of U.S. dollars)	40.8	42.9	43.1	44.9	52.1	55.3
Foreign currency forward position (billions of U.S. dollars)	1.8	1.2	0.1	-0.1	3.8	3.4
Total external debt (percent of GDP)	44.2	45.4	42.6	47.6	56.4	45.1
percent of export earnings	157.6	167.4	156.7	176.0	205.3	153.6
External interest payments (percent of export earnings)	5.7	4.7	6.2	5.8	7.1	5.5
External amortization payments (percent of export earnings)	47.3	38.7	49.2	55.2	60.8	59.4
Exchange rate (Rand/U.S. dollar, period average)	14.7	13.3	13.2	14.5	16.5	15.9
Real effective exchange rate (annual percentage change, period average) [4/]	-6.3	12.7	1.7	-3.2	-9.2	5.3
Financial market indicators						
Stock market index (end-period)	50,654	59,505	52,737	57,084	59,409	73,709
Net purchases of bonds by nonresidents (billions of U.S. dollars) [5/]	7.8	13.3	4.7	10.4	-4.5	-0.1
Net purchases of shares by nonresidents (billions of U.S. dollars) [5/]	1.7	7.7	2.4	-4.4	-5.1	-25.7

Sources: Haver and IMF staff calculations.

[1/] November 2021.

[2/] Nominal yield deflated by CPI inflation.

[3/] Terms of trade include gold.

[4/] October 2021.

[5/] 2021Q3.

Table 8. South Africa: Gross External Financing Requirements and Sources, 2017–23

	2017	2018	2019	2020	2021	2022	2023
	(In billions of US dollars)						
Gross external financing requirements	49.1	66.2	67.9	49.3	45.6	78.9	71.0
Current account deficit	9.0	12.0	10.0	-6.7	-12.8	5.2	8.6
Short-term debt at remaining maturity	40.0	54.2	57.9	56.0	58.4	73.7	62.4
Short-term debt at original maturity	37.2	40.9	47.9	44.5	37.1	48.1	55.7
MLT amortization	2.8	13.3	10.0	11.5	21.3	25.6	6.6
Sources of Financing	49.1	66.2	67.9	49.3	45.6	78.9	71.0
FX reserves drawdown	-1.9	-0.9	-1.8	-2.2	-2.1	-0.4	0.8
FDI (net)	-5.4	1.4	2.0	5.1	0.4	1.0	1.9
New borrowing and debt rollover	56.3	65.7	67.7	40.9	47.3	78.3	68.3
Short-term debt	40.9	47.9	44.5	37.1	48.1	55.7	58.8
Long-term debt	15.4	17.8	23.2	3.8	-0.8	22.6	9.5
Other sources (including IFI)	0.0	0.0	0.0	5.5	0.0	0.0	0.0
RFI	0.0	0.0	0.0	4.2	0.0	0.0	0.0
	(In percent of GDP)						
Gross external financing requirements	12.9	16.3	17.5	14.7	11.2	18.6	16.1
Current account deficit	2.4	3.0	2.6	-2.0	-3.1	1.2	2.0
Short-term debt at remaining maturity	10.5	13.4	14.9	16.7	14.3	17.4	14.1
Short-term debt at original maturity	9.8	10.1	12.3	13.3	9.1	11.4	12.6
MLT amortization	0.7	3.3	2.6	3.4	5.2	6.1	1.5
Sources of Financing	12.9	16.3	17.5	14.7	11.2	18.6	16.1
FX reserves drawdown	-0.5	-0.2	-0.5	-0.7	-0.5	-0.1	0.2
FDI (net)	-1.4	0.3	0.5	1.5	0.1	0.2	0.4
New borrowing and debt rollover	14.8	16.2	17.5	12.2	11.6	18.5	15.4
Short-term debt	10.7	11.8	11.5	11.1	11.8	13.2	13.3
Long-term debt	4.1	4.4	6.0	1.1	-0.2	5.3	2.1
Other sources (including IFI)	0.0	0.0	0.0	1.6	0.0	0.0	0.0
RFI	0.0	0.0	0.0	1.3	0.0	0.0	0.0

Source: SARB and Fund Staff Estimates.

Table 9. South Africa: Indicators of Capacity to Repay, 2020–26 /1

	2020	2021	2022	2023	2024	2025	2026
IMF obligations based on existing credit (in millions of SDRs)							
Principal	0.0	0.0	0.0	381.4	1525.6	1144.2	0.0
SDR Charges and Assessments	0.1	0.0	33.0	33.1	22.8	6.4	0.3
IMF obligations based on prospective credit (in millions of SDRs)							
Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	24.0	0.0	0.0	0.0	0.0	0.0	0.0
Total IMF obligations based on existing and prospective credit							
In millions of SDRs	24.1	0.0	33.0	414.5	1548.4	1150.6	0.3
In millions of U.S. dollars	17.6	0.0	22.9	284.2	1052.8	776.5	0.2
In percent of GDP	0.0	0.0	0.0	0.1	0.2	0.2	0.0
In percent of exports of goods and services	0.0	0.0	0.0	0.3	1.1	0.8	0.0
In percent of government revenue	0.0	0.0	0.0	0.2	0.8	0.6	0.0
In percent of gross international reserves	0.0	0.0	0.1	0.7	2.8	2.1	0.0
In percent of IMF quota	0.8	0.0	1.1	13.6	50.7	37.7	0.0
IMF credit outstanding (end of period)							
In millions of SDRs	3,051.2	3,051.2	3,051.2	2,669.8	1,144.2	0.0	0.0
In millions of U.S. dollars	4,176.7	4,366.1	4,405.1	3,894.6	1,682.8	0.0	0.0
In percent of GDP	1.2	1.1	1.0	0.9	0.4	0.0	0.0
In percent of exports of goods and services	4.5	3.5	3.5	2.9	1.2	0.0	0.0
In percent of government revenue	5.0	3.9	3.8	3.3	1.4	0.0	0.0
In percent of gross international reserves	5.5	5.3	5.3	4.7	2.0	0.0	0.0
In percent of IMF quota	100.0	100.0	100.0	87.5	37.5	0.0	0.0
Memorandum items (in millions of U.S. dollars, unless otherwise noted)							
Nominal GDP	335,344	408,462	423,599	442,146	460,050	478,233	519,501
Exports of goods and services	93,152	126,030	127,095	132,783	138,365	145,010	152,647
Government revenue	84,283	111,043	115,412	118,493	124,122	129,352	140,941
Gross international reserves	55,549	57,600	58,030	57,252	56,179	55,076	53,981
IMF quota	3051.2	3051.2	3051.2	3051.2	3051.2	3051.2	3051.2
SDR exchange rate (per U.S. dollar)	0.73	0.70	0.69	0.69	0.68	0.67	0.67

Sources: South African authorities, and IMF staff estimates and projections.

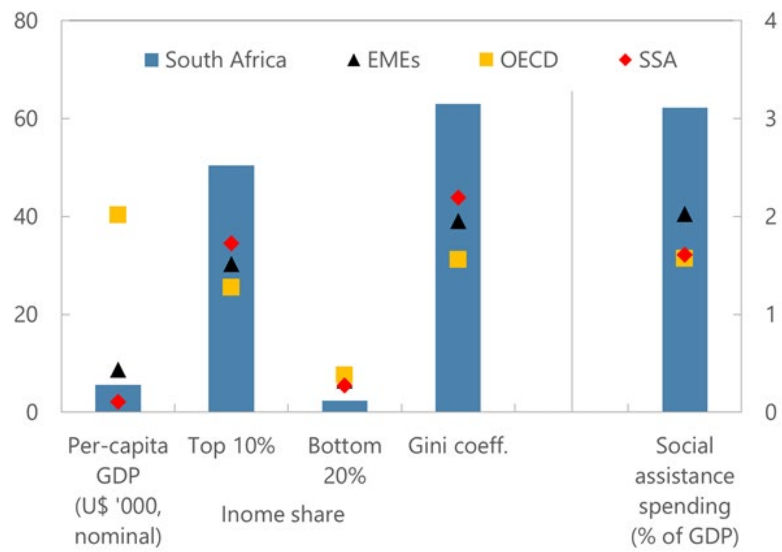
1/ Includes RFI disbursement approved by the Board in July 2020

Annex I. Social Assistance[1]

South Africa's high spending on social assistance appears commensurate with the country's vast inequality. However, further increases in social assistance, notably a Basic Income Grant (BIG), would require additional offsetting fiscal measures.

1. **The income distribution in South Africa is one of the most unequal in the world, whether judged by the income share of the richest/poorest or the Gini Coefficient.** The inequality indicators do not appear to be linked to the country's income level, as they are worse than those of the sub-Saharan Africa (SSA), emerging markets economies (EMEs), and OECD comparator groups even though South Africa's per-capita GDP is between the averages of those of SSA and EMEs (Figure A1.1).

Figure A1.1 Indicators of Income Distribution and Social Assistance
(Latest observations)



Sources: World Bank ASPIRE database and World Development Indicators, IMF World Economic Outlook, IMF FAD Expenditure Assessment Tool, and IMF staff calculations.
Note: South Africa data are for 2014, except per-capita GDP (2020) and social assistance spending (2016) and reflect new GDP data released in 2021. EMEs, SSA, and OECD are simple averages of countries for which observations are available.

2. **Social assistance spending is significantly higher than the average in comparator groups, and appropriately so commensurate with the country's high inequality** (Figure A1.1). This spending, at around 3 percent of GDP, mainly comprises social pensions and categorically targeted cash transfers. Social assistance has had an important impact in addressing poverty and inequality, which are in part a legacy of apartheid.[2] However, it will take deep reforms to tackle their

[1] Prepared by Sébastien Walker (FAD).

[2] IMF Country Report No. 18/247. South Africa: Selected Issues. "Inequality in South Africa: Trends and the Role of Fiscal Policy." July 2018.

other causes, namely a stagnant economy and dismal employment prospects for inexperienced workers and those with lower or no qualifications. Reforms to boost job creation are therefore all the more important to lessen the need for additional social assistance spending.

3. **However, there is no fiscal space for additional social assistance, especially a Basic Income Grant (BIG), absent additional offsetting measures.** The BIG, a form of universal basic income that is currently discussed, presents advantages for countries with a limited capacity to ensure that benefits reach the most vulnerable, which is not the case of South Africa.[3] The authorities estimate the cost of a universal grant at the level of the food poverty line to be about R233 billion per year (3.8 percent of staff's projected FY21/22 GDP), which would further strain South Africa's fiscal position. Smaller and more targeted increases in social assistance, such as an extension of the COVID-19 grants or a pared-down version of these grants, would only be feasible alongside a deeper reprioritization of spending over and above the fiscal consolidation that is needed to reduce public debt and stabilize it over time. Even if the BIG were limited to the existing budget envelope for grants, the widening of benefit eligibility would require reducing benefits to those who truly need them to meet basic needs. Ultimately, social assistance policy should be based on regular impact and poverty assessments and household budget surveys.

[3] IMF. 2017. *Fiscal Monitor—Tackling Inequality*. Washington, DC, October.

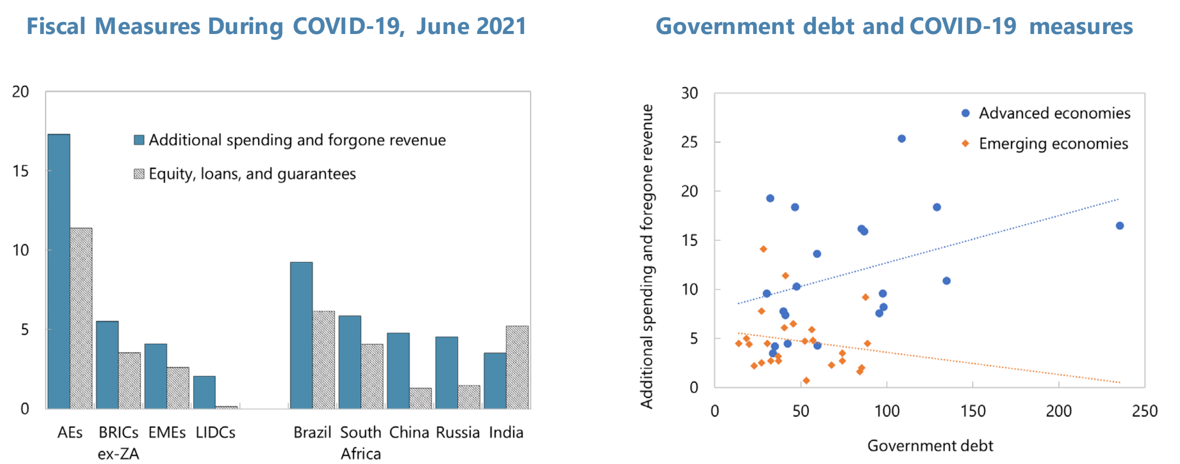
Annex II. Key Fiscal, Monetary, and Financial Sector Policy Measures During the COVID-19 Pandemic[1]

In response to the COVID-19 pandemic, the South African government as well as both the South African Reserve Bank and the Prudential Authority undertook a range of measures to mitigate the impact of the pandemic and safeguard price and financial-sector stability. The authorities have started withdrawing the temporary measures.

Fiscal Measures

1. **In response to the COVID-19 pandemic, the South African government announced a package of measures**. The size of the announced measures was larger than those in other emerging market economies (EMEs) and comparable to those in the other BRICS countries (Figure A2.1, left panel). However, the package was not fully executed––for instance, a loan guarantee scheme was under-executed on both weak demand and implementation issues. In general, it appears that the size of government debt has constrained the fiscal response to the pandemic more in EMEs than in advanced economies (Figure A2.1, right panel). South Africa has had access to capital markets and funds from international financial institutions to finance these extraordinary measures.

Figure A2.1. Fiscal Measures During COVID-19 as of June 2021



Sources: Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic, IMF WEO, and IMF staff calculations.

Note: The right panel shows government debt in 2019 and COVID-19 fiscal measures in the fiscal monitor database as of June 2021 (additional spending and forgone revenue). Results are similar with debt in 2020.

[1] Prepared by Ken Miyajima (AFR).

Key announced fiscal policy measures were the following:

- Support to informal businesses and SMEs under stress, mainly in the tourism and hospitality sectors, and to small-scale farmers.
- Tax deferrals and holidays and accelerated tax reimbursements.
- An expansion of social grants to vulnerable households and the creation of a special COVID-19 grant for individuals with no access to other grants (extended to March 2022).
- Funding for public work programs to provide poverty and income-loss relief through temporary work for the unemployed.
- Wage protection through the Unemployment Insurance Fund (UIF) to assist companies and workers in distress. UIF benefits were subsequently repeatedly extended through April 2021.
- A bank loan guarantee scheme to help SMEs finance their operating expenses. The National Treasury guaranteed up to R200 billion in loans and commercial banks assumed part of the risk. The scheme was extended through June 2021 but was only partially implemented.
- Vaccine procurement (albeit delayed) to cover at least two thirds of the population.

Monetary and Financial Measures

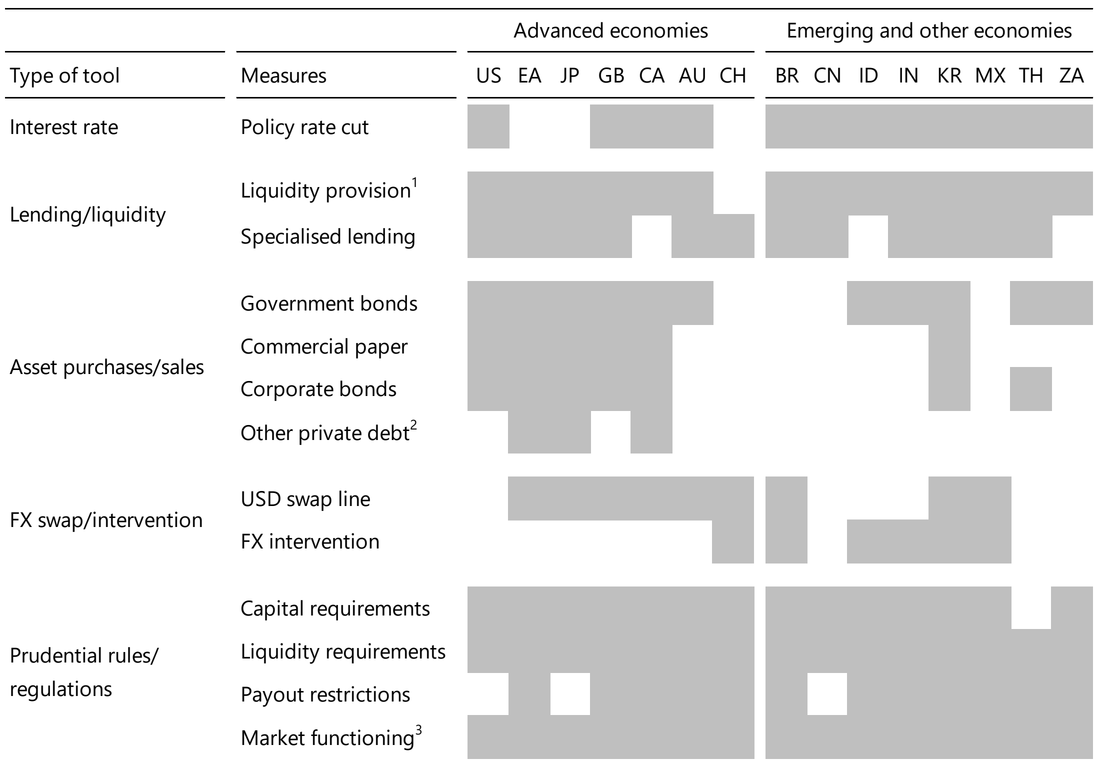
2. **The South African Reserve Bank (SARB) and Prudential Authority (PA) also undertook a range of measures**. These measures aimed to normalize market liquidity conditions and facilitate bank lending through refinancing operations. Relative to other EME central banks' measures, the extent of rate cuts was large, even more so than during the 2008-09 global financial crisis, and that of regulatory measures appears to have been as extensive. Government bond purchases were limited and foreign exchange-related measures were absent (Table A2.1.)

The main monetary and financial-sector policy measures were the following (Table A2.2):

- Reduction of the policy rate by 275 basis points in March-July 2020.
- Provision of liquidity to the banking sector to address strains in money markets through supplementary overnight repo operations, extension in the maturity of repo facilities, and a 100-basis point cut in standing facilities' interest rates.
- Purchases of local currency government bonds (on a small scale) in the secondary market in response to signs of market dysfunction.
- Reduction of capital requirements for banks by 1 percentage point of risk weighted assets on a temporary basis (the Pillar 2A buffer was reduced to zero percent, which is set to be normalized in early-2022) and of the liquidity coverage ratio requirement from 100 to 80 percent.

- Authorization by the PA that banks could use their capital conservation buffer (built up for periods of economic stress).
- Permission for banks not to hold additional capital against loans restructured because of COVID-19-related causes, provided there was a reasonable likelihood of repayment.
- Permission for banks to refrain from increasing provisioning of COVID-19-related restructured loans that can reasonably be expected to be repaid.
- Guidelines for banks on dividends on ordinary shares and cash bonuses in 2020.

Table A2.1. Central Bank Measures During COVID-19 Pandemic



Sources: "Central banks and the Covid-19 economic crisis". In *Monetary Policy and Central Banking in the Covid Era*. Chapter 18; and IMF staff.

[1] For example, repo and reverse repo operations, standing facilities, modified discount windows, and lower reserve requirement ratios.

[2] For example, asset- and mortgage-backed securities, covered bonds, and exchange-traded funds.

[3] For example, short-selling bans and circuit breakers.

3. The SARB and PA have started the process of gradually unwinding extraordinary regulatory measures.

- The SARB hiked the policy rate by 25 basis points in November 2021.
- Banks were required to reinstate the Pillar 2A capital buffer by January 2022.

- A gradual approach will be used for the withdrawal of temporary liquidity measures. Banks need to comply with the revised minimum LCR requirements: 90 percent in January 2022 and 100 percent in April 2022.

- The PA will start withdrawing the relief measure for restructured credit exposures from April 2022.

- Banks were required to comply with the capital conservation buffer requirement by January 2022.

- The PA revised its guidance for capital distributions back in February 2021.

Table A2.2. South Africa Reserve Bank COVID-19 Measures, March 2020–February 2021

	Repo rate		Secondary market bond purchases	Money and repo market	Other policy changes
	Change (bps)	level (%)			
March	100	5.75	Bond purchases begin	..	..
April	100	4.75	Bond purchases ramp up	Standing facilities borrowing rate reduced to repo less 200 bps Standing facilities lending rate reduced by 100 bps to repo rate Intraday repos initiated	Loan Guarantee Scheme Leverage coverage ratio reduced Pillar 2a reduced Restructured loans eased Dividends guidance Capital conservation buffer guidance
May	50	3.75	Bond purchases continue	3-month term repo facility introduced	..
July	25	3.50	Bond purchases ease sharply	..	..
August	..	3.50	Small bond purchases	Standing facilities rates return to standard levels (repo rate +/- 100 bps)	..
December-January	..	3.50	..	3-month term repo facility and intraday repos discontinued Month-end injections of rand liquidity in forward market	..
February	..	3.50	..	Wednesday repo auction amount reverts to normal level of R56 billion	..

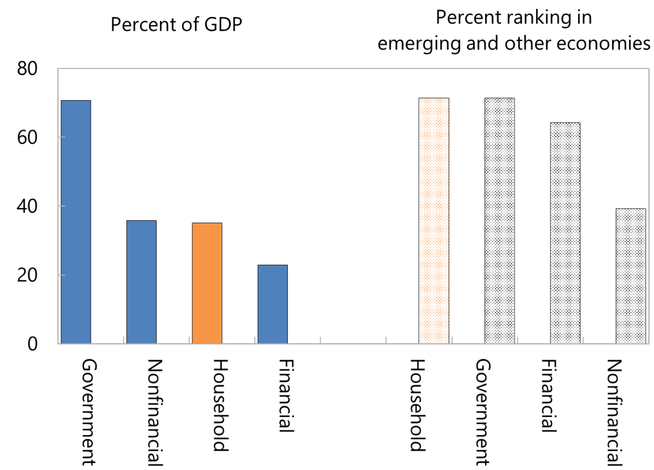
Sources: "Central banks and the Covid-19 economic crisis". In Monetary Policy and Central Banking in the Covid Era. Chapter 16; and IMF staff.

Annex III. Household Debt[1]

The household sector has strong buffers. The strength of the banking system and the extraordinary policy measures taken in response to COVID-19 have helped mitigate the negative economic effects of the pandemic on the economy, including on households. However, household debt is somewhat elevated relative to peer countries. Debt held by lower-income households, even though small in absolute terms, is large relative to their incomes, and warrants close monitoring. Developing a central credit register would help bolster the quality of financial stability analysis and the efficiency of financial intermediation.

1. **The household sector has strong buffers, but indebtedness is high among the poorest**. The household sector in aggregate held 220 percent of GDP in net wealth in 2019. Financial and nonfinancial assets, worth 172 and 92 percent of GDP, respectively, more than offset total debt of 45 percent of GDP. However, given significant wealth inequality, the aggregate picture may mask pockets of vulnerabilities. South Africa's household debt-to-GDP ratio is relatively low compared with other sectors in the economy after households deleveraged for more than a decade. Even so, the household debt ratio appears somewhat elevated relative to that in selected emerging and other economies (Figure A3.1). Within household debt, unsecured debt warrants close monitoring.[2] One medium-sized bank is specialized in unsecured household lending. For some smaller banks, unsecured credit is relatively large as a share of total lending to households, but not particularly so as a share of total assets (Table A3.1). For the largest banks, residential mortgages represent the bulk of overall household credit.[3]

Figure A3.1. South Africa: Sectoral Debt to GDP
(Q3 2021)



Sources: IIF Global Debt Monitor and IMF staff calculations.

Note: Emerging and other economies = Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Ghana, Hungary, India, Indonesia, Israel, Kenya, Korea, Malaysia, Mexico, Nigeria, Pakistan, Peru, the Philippines, Poland, Russia, Saudi Arabia, Thailand, Turkey, Ukraine, UAE, and Vietnam.

2. **The strength of the banking system and the robust policy response to COVID-19 have helped mitigate the negative economic effects of the pandemic**. Household debt soared relative to income, and in Q2 2020 reached a level close to the historical high. However, the debt burden (debt service relative to income) remained steady as the policy rate was cut progressively by

[1] Prepared by Ken Miyajima (AFR).

[2] The South African Reserve Bank Financial Stability Review, November 2019.

[3] Largest 4 (6) banks account for around 90 (98) percent of the system's household credit.

300 basis points since the end of 2019 (Figure A3.2, panels 1 and 2). In Q3 2020, the debt burden indicators improved as income rebounded. As part of the broad policy measures, the Prudential Authority eased regulatory requirements to help banks support borrowers (see next paragraph).[4] During the COVID-19 pandemic, banks maintained high levels of capital and strong liquidity positions (Panel 3).

Table A3.1. South Africa: Bank-Level Household Credit and Components, February 2021

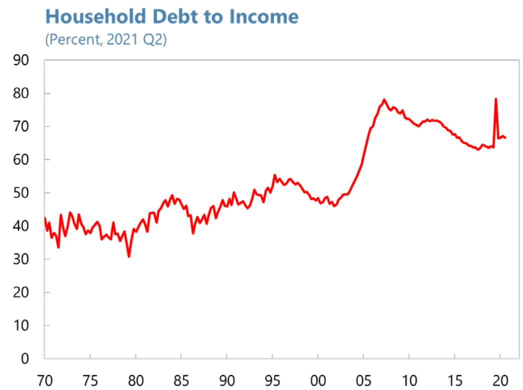
Bank	Assets	Household credit	Residential mortgages	Installment sale	Other loans	Credit cards	Commercial mortgages	Overdraft
	(% of system assets)	(% of assets)	(% of total household credit)					
1	23.81	30.9	74	9	8	7	0	2
2	21.24	27.6	55	21	14	8	1	2
3	20.09	28.7	63	18	7	9	1	2
4	16.92	29.4	45	35	8	5	6	1
5	7.79	16.3	84	4	2	2	9	0
6	2.40	42.9	4	0	86	9	0	0
7	1.32	0.0	…	…	…	…	…	…
8	1.23	0.0	…	…	…	…	…	…
9	0.91	0.0	…	…	…	…	…	…
10	0.75	0.0	100	0	0	0	0	0
11	0.59	0.0	…	…	…	…	…	…
12	0.39	106.8	0	0	86	14	0	0
13	0.34	0.0	…	…	…	…	…	…
14	0.26	0.0	…	…	…	…	…	…
15	0.19	30.7	0	0	0	99	0	1
16	0.19	0.3	87	0	4	0	0	9
17	0.19	4.7	7	93	0	0	0	0
18	0.19	0.0	57	40	3	0	0	0
19	0.13	30.6	75	25	0	0	0	0
20	0.13	2.1	0	100	0	0	0	0
21	0.10	2.1	0	0	84	0	0	16
22	0.09	11.7	0	0	100	0	0	0
23	0.04	22.9	81	2	1	0	15	1
24	0.04	0.1	0	0	100	0	0	0
25	0.04	17.2	56	0	8	0	35	0
26	0.03	30.7	64	2	2	0	32	0
27	0.02	11.8	0	0	100	0	0	0
28	0.02	1.6	0	0	68	0	0	32
29	0.01	0.0	…	…	…	…	…	…
30	0.01	0.0	…	…	…	…	…	…

Sources: SARB BA900 and IMF staff calculations.

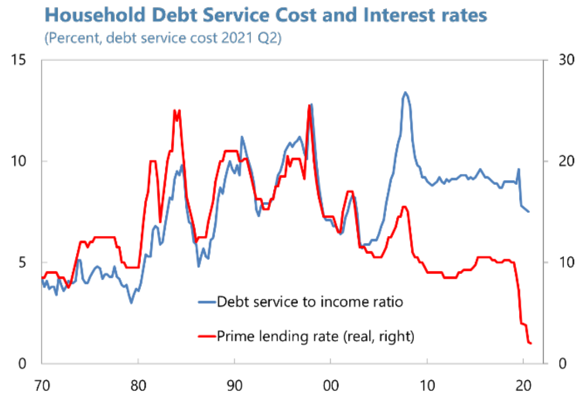
[4] Directive 3 of 2020 (D3/2020) issued in April 2020 provided guidance on the treatment of COVID-19-related restructured credit exposures and intended to provide temporary relief on the minimum capital requirements relating to corporate and retail credit exposures to enable and encourage banks, within their risk appetite, to continue to extend credit during the difficult times.

Figure A3.2. South Africa: Indicators of Household Debt

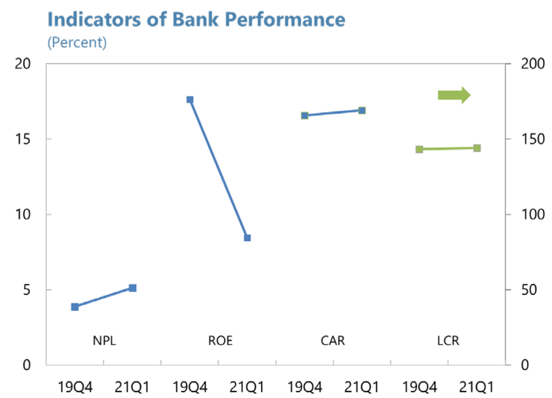
Debt jumped relative to income in Q2 but declined as income rebounded.



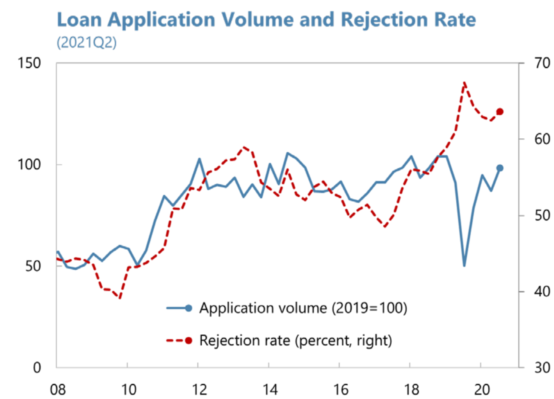
Large rate cuts helped contain household debt burden.



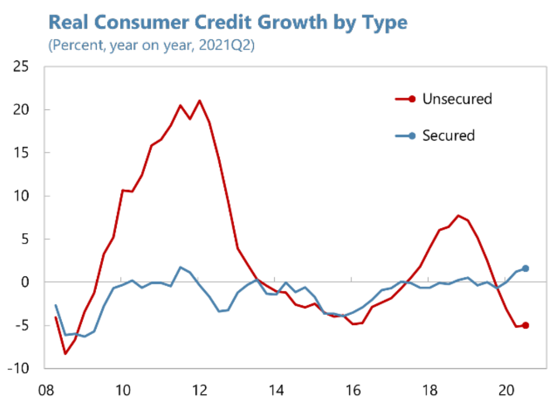
Asset quality and profitability worsened, but capital and liquidity ratios remain solid.



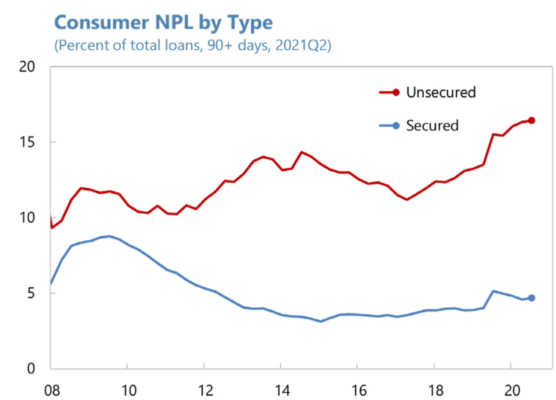
Loan application volumes recovered but the rejection rate remains elevated.



Unsecured credit growth is more volatile and has decelerated…



…and its NPL ratio rose to a high level.

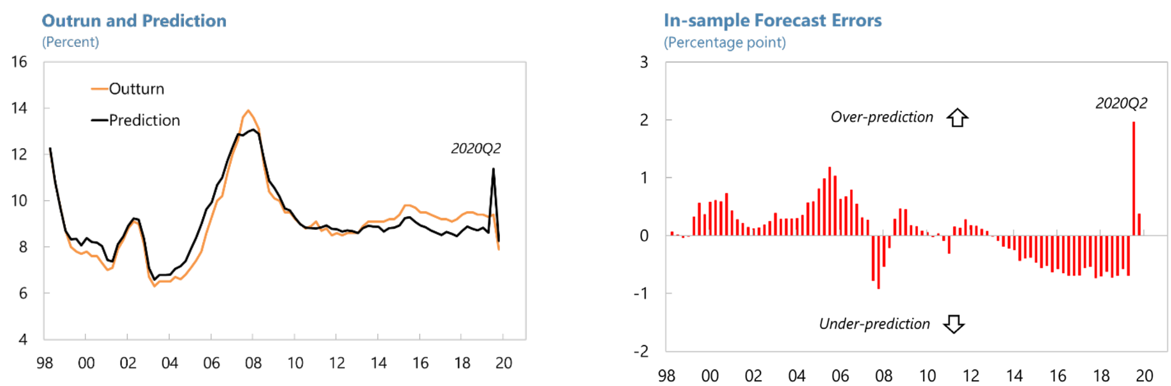


Sources: IMF FSI, Haver, National Credit Regulator, South African Reserve Bank, and IMF staff calculations.

Note: Household debt to income up to end 2009 does not reflect GDP revision and is estimated.

3. **Econometric results support the view that official measures provided significant support to households**. The household debt service-to-income ratio (*dsr*) would increase with interest rates and debt levels and decline as income rises. Thus, the *dsr* is modeled using the policy rate (*i*), real GDP growth (*g*), and household debt to income (*dti*).[5] The in-sample projection somewhat over-predicts in the run-up to the 2008–09 global financial crisis and under-predicts during 2015–19 when growth was particularly weak, probably as the policy rate does not capture the commensurate compression and widening of the risk premium reflected in the actual lending rates (Figure A3.3). The model notably over-predicts the *dsr* in Q2 2020 as it does not capture extraordinary official measures that helped counter the effects of a significant output contraction.

Figure A3.3. South Africa: Household Debt Service to Income, 1998Q1–2020Q3



Sources: Haver, SARB, and IMF staff calculations.

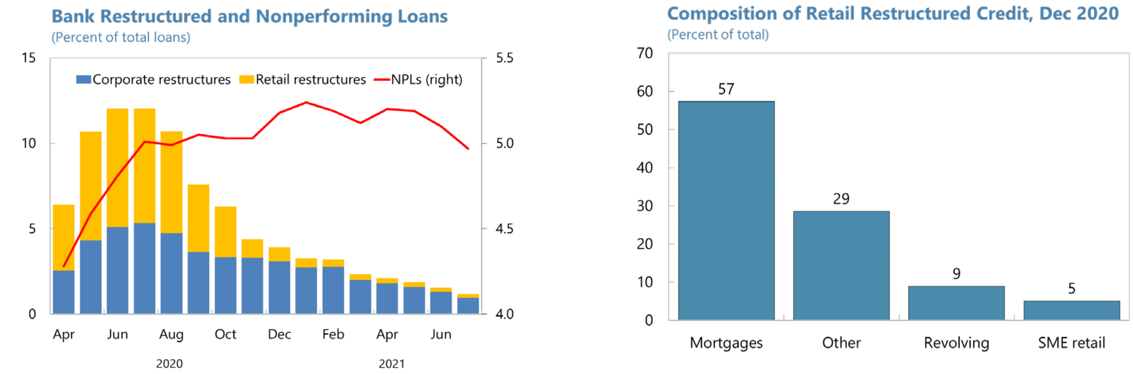
4. **Restructured bank loans have benefited from temporary regulatory relief.** As the COVID-19 pandemic started to inflict major economic effects, particularly during the stringent lockdown, banks voluntarily started to restructure loans of customers in good standing prior to the pandemic. The stock of active restructured retail credit rose from around 6 percent of total corporate and retail credit in April to 12 percent in June and July 2020 but declined to around 1 percent by July 2021 (Figure A3.4).[6] While restructured loans declined, the overall NPL ratio was little changed, suggesting that much of the loans likely became current. Of total retail restructured credit, residential mortgages represented around 60 percent, other retail credit 30 percent, and revolving credit including credit cards 9 percent, as of end-2020. Looking ahead, banks appear to be able to withstand a potential adverse impact from COVID-19 related restructured loans.[7]

[5] The equation is: $dsr_t = \alpha + \beta_1 i_t + \beta_2 g_t + \beta_3 dti_t + \epsilon_t$ where t is the time subscript.

[6] The ratios are approximations as the denominators may somewhat differ from the numerators.

[7] Results from the FSAP's simulation under the adverse scenario assuming that 1/3 of the stock of temporary restructured loans become impaired suggest the aggregate capital ratio would fall by an additional ½ percentage point.

Figure A3.4. South Africa: Active COVID-19 Restructured Credit



Sources: Haver, SARB, and IMF staff calculations.

5. **Nonetheless, household credit growth has remained weak due to both demand- and supply-side factors**. South Africa has been on a financial downcycle, with a commonly used indicator of the financial cycle (the credit-to-GDP gap) remaining very weak for years. Household debt in relation to GDP had generally declined for more than a decade.[8] Real household credit growth was weak and moderated further during the pandemic due likely to both demand- and supply-side factors. From the demand side, loan applications declined likely as individuals were reluctant to take on additional debt during times of elevated uncertainty (Figure A3.2, panel 4). From the supply side, the rejection rate jumped as banks turned more risk averse (which likely helped banks maintain their buffers), due partly to a general decline in the applicants' creditworthiness (Panel 4). Indeed, credit growth moderated particularly for the unsecured component as its NPL ratio rose to the highest level in over a decade (Figure A3.2, Panels 5 and 6).[9] Similarly, inquiries from those seeking credit declined (revealing weak demand) while those for debt collection purposes rose (indicating weak supply).

6. **Survey data warn about debt-related vulnerabilities for lower-income households**. This analysis relies on data from the National Income Dynamics Study (NIDS), the first national household panel study in South Africa, which describes the livelihoods of individuals and households over time and provides information on a wide range of topics. The debt variable does not specify the type of lender. For lower-income households, social grants represent an important source of overall income. Also, consumption, likely supported by debt, in some cases exceeds income (Figure A3.5, panels 1 and 2). Debt (from all sources) is largely incurred by higher-income households (mainly mortgages) in absolute terms, but indebtedness (debt to income) is highest among both the lowest- and highest-income households (Panels 3 and 4). Lower-income households rely more on unsecured loans, such as store cards and unsecured bank loans (Panel 5).[10]

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[8] The credit to GDP ratio differential to its long-term trend is commonly used as an early warning indicator of excess in credit supply.

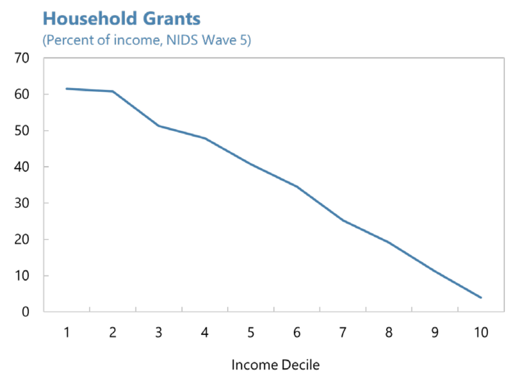
[9] Unsecured consumer credit represents around ¼ of the total.

[10] Mashonisa loans, often predatory, operating in informal settlements and townships, are anecdotally important but do not come out as such in the data.

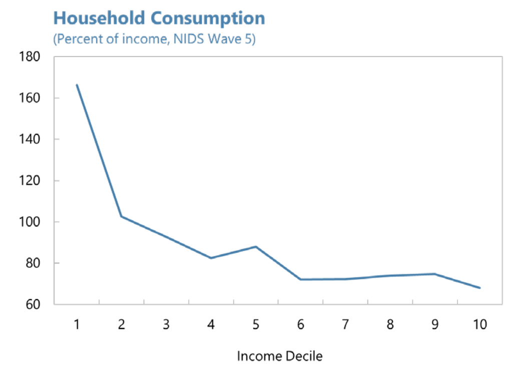
High indebtedness by lower-income households, particularly when unsecured, may create pockets of vulnerability in the otherwise strong financial system.

Figure A3.5. South Africa: Household Debt Characteristics from Survey Data

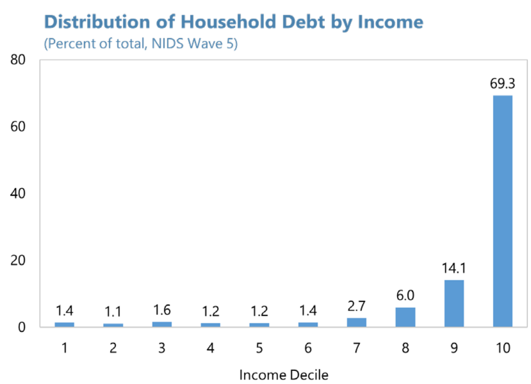
Grants represent large shares of income for lower-income households.



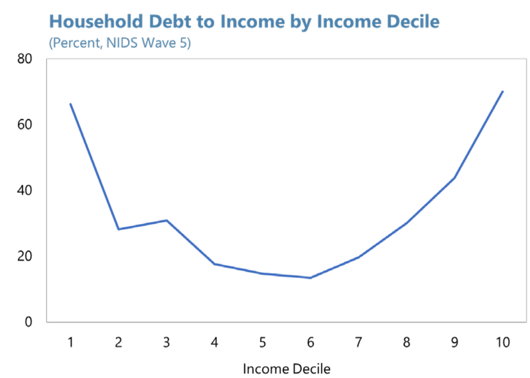
Consumption is large relative to income for lower-income households.



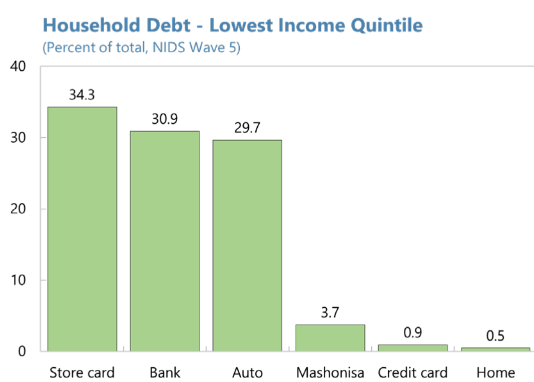
Debt was mostly incurred by higher-income households in absolute terms.



Lowest-income households are as indebted relative to income as the highest-income households.



Lower-income households mainly incur unsecured debt, including auto loans.



Sources: National Income Dynamic Study South Africa (NIDS) and IMF staff calculations.
Note: NIDS Wave 5 correspond to 2017.

7. Developing a central credit register will enhance financial stability analysis and financial intermediation. The survey data presented above lack lender information. Availability of credit register data would bridge this gap and be an important tool for policy evaluation and monitoring of credit standards across the sector.[11] Detailed individual loan-level information would allow the identification of systemic risks within the financial sector, benchmarking of credit institutions' loan characteristics, and evaluating the effect of macroprudential regulation. For micro-prudential supervision, credit register data would help supervisors narrow the focus on main risks when preparing inspections of credit institutions, thereby optimizing resource allocation. To this end, the authorities are encouraged to continue efforts to develop a national central credit register to facilitate risk analysis and calibration of macroprudential tools. Moreover, greater access to granular data would enhance both banks' capacity to assess the creditworthiness of potential borrowers and the efficiency of financial intermediation more broadly.

[11] For instance, see *Denmark's National Bank* conference on the use of credit register data for financial stability and credit risk analysis.

Annex IV. Differential Mobility Responses to the COVID-19 Crisis Across Income[1]

Unique mobility indicators based on anonymized data show that in response to lockdowns and rising COVID-19 infections, richer individuals' mobility tends to decline significantly more than poorer ones'. Those with fewer means and options to telework need to maintain mobility to earn a living while risking their health. The poorer also have significantly lower subjective risk perceptions compared to the richer. Differential effects on mobility may widen income inequality in the longer run.

1. **The impact of the COVID-19 pandemic on mobility has social implications that are particularly relevant for South Africa**. COVID-19 has drastically reduced people's mobility globally. Generally, individuals' mobility would fall for at least two reasons: in response to government's economic restrictions and voluntarily out of fear of being infected. However, the mobility response has differed considerably across income levels, with important socioeconomic and policy implications. This is particularly the case for South Africa, where socioeconomic inequalities are already high.

2. **Effects of the stringent lockdown during the first wave are analyzed by disentangling "bigdata" on individuals' mobility by income using two methodologies**. The first lockdown in March 2020 provides an opportunity to isolate behavioral changes in response to lockdowns from those in response to the spread of the virus, the risk of catching the virus was still perceived to be low.[2] Vodacom provides daily mobility indicators by income, demographic group, and location.[3] Pre-paid phone users (75 percent of total) represent "the poor" in this analysis as they generally belong to a lower income group. Post-paid phone users (25 percent) represent "the rich".[4] The analysis starts with a regression discontinuity approach (similar to the event study approach) to first test whether lockdowns have different effects across groups within a short period of time (i.e., the first nation-wide lockdown), assuming that other factors affecting mobility remain broadly unchanged around the events analyzed. Then, local projections are used to check robustness: the approach exploits the

[1] Prepared by Nan Li (AFR), based on a joint research project with Chris Papageorgiou, Antonio Spilimbergo, Junjie Wei (RES), and Pedro Rente Lourenco (Vodafone).

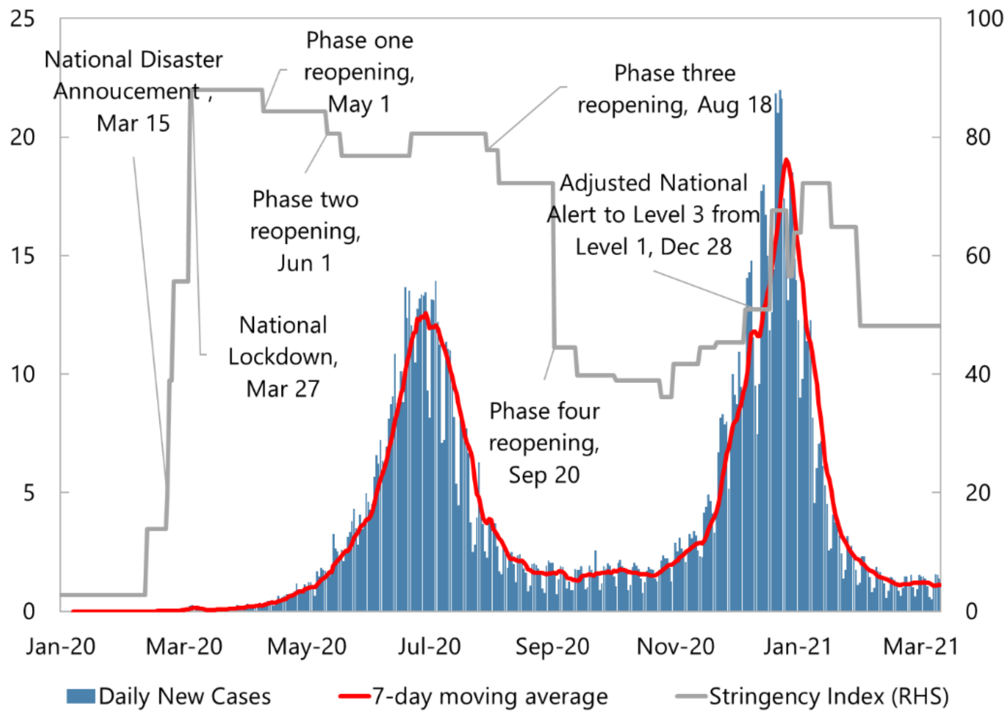
[2] The first known case of COVID-19 in South Africa was confirmed on March 5, 2020. Shortly afterwards on March 15, the government declared a national state of disaster and announced measures such as immediate travel restrictions and school closures. One week later, a national lockdown effective March 27 was instituted and lasted five weeks. The country then sequentially relaxed restrictions with multiple reopening phases.

[3] Vodacom South Africa analyzes connections to cell towers and their physical location. By monitoring connections during the night, Vodacom can identify the home location of each customer. Two measures of mobility are then constructed in each district and income/demographic group: (i) average percentage of time out of home, and (ii) percentage of people who leave home in a day. Since income information is not directly reported in the user data, payment types (pre-paid users and post-paid users) and pre-COVID phone bills are used to proxy purchasing power and categorize income groups. Information about individual gender and age is obtained from post-paid customer contracts and mobility indicators can be differentiated across age and gender.

[4] Pre-COVID phone bills are used as another proxy for purchasing power to separate individuals into income groups.

variation in the stringency of lockdowns over the entire period and traces how the responses vary over time (rather than just on impact) and allows the examination of the effect of fear on mobility.

Figure A4.1. South Africa: COVID-19 New Cases and Economic Restriction Stringency

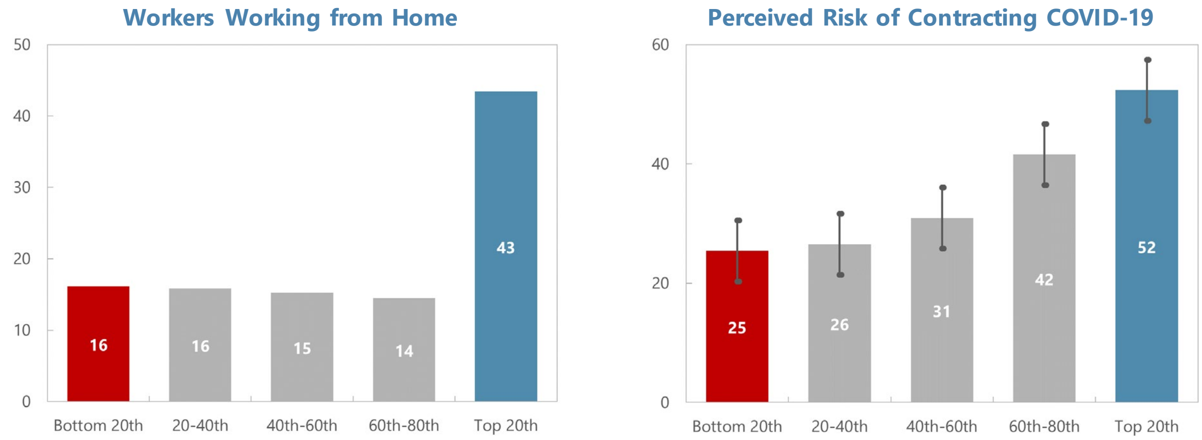


Sources: Johns Hopkins University, Oxford COVID-19 Government Response Tracker, and IMF staff calculations.
Note: Number of new cases in thousands.

3. **A priori, it was expected that the mobility of the rich would fall proportionally more as the rich are more capable of working from home than the poor.** According to the Coronavirus Rapid Mobile Survey (CRAM waves 1–2), those in the highest income quintile were nearly three times more likely to telework, compared to those in the rest of the sample (43 percent v.s. 15 percent). The poorer likely do not have as much job security nor savings to meet basic needs, and often need to go out to earn a living while risking their health. In addition, CRAM data also reveal that the richer and the more educated tend to perceive a greater health risk from COVID-19, probably as they have greater access to information while the poorer often report no information to rely on.[5]

[5] Women's mobility would fall more than men's as women tend to be more tied to home (greater responsibility for childcare when schools are closed and other unpaid care work) or lose jobs (mostly employed in sectors more severely impacted by the pandemic). The crisis also has uneven effects across age groups. On the one hand, the older would stay home more as they face greater health risks from COVID-19. On the other hand, the younger may do so as the lockdown has more severely affected their employment in contact-intensive businesses.

Figure A4.2. South Africa: Work Modality and Risk Perception by Income
(Percent)



Sources: Kollamparambil et al. (2020), South Africa National Income Dynamics Study, Coronavirus Rapid Mobile Survey Waves 1–2 (2020), and IMF staff calculations.

Note: The left panel shows response by employed workers (excluding self-employed) to question "Are you able to work from home". The right shows response to question "Do you think you are likely to get Coronavirus?". The vertical lines in the right-hand side panel are 95 percent confidence bands.

4. **An event study confirms that, after the stringent lockdown, the rich's mobility fell significantly more on impact.** Before the lockdown on March 27, the rich's mobility was above the poor's (the former spent more time out of home). The lockdown led to a broad-based decline in mobility, but the impact was more pronounced on the rich, keeping their mobility below that of the poor throughout the lockdown. As economic restrictions were loosened, mobility generally increased.

5. **A separate regression analysis confirms that the mobility response to economic restrictions and fear of infection differs persistently across income groups.** Results from the local projection method suggest that the rich reduced their mobility by almost 40 percent more than the rest, two weeks after economic restrictions were tightened.[6] In addition, an increase in the number of new cases (a proxy for the perceived infection risk) lowered the rich's mobility by 75 percent more than the rest in a week.[7] The difference in the mobility responses lasts for at least a month.

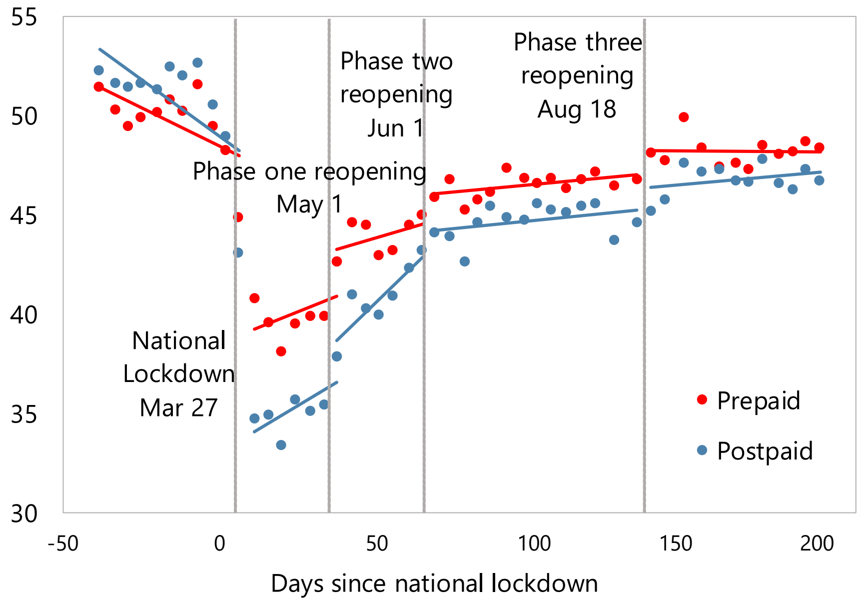
6. **These findings highlight the importance of pursuing policies to achieve inclusive growth.** The COVID-19 pandemic has worsened pre-existing inequlities. Moreover, poorer individuals tend to have weaker health conditions and lower access to heathcare. To this end, access to basic services, inclusive and efficient labor markets, and effective and well-targeted social safety nets are key to extend the ongoing cyclical economic recovery to a sustained and inclusive growth.

[6] It is also found that lockdown measures reduced the mobility of women and younger individuals more than that of men and older individuals, and this differential effect is long-lasting.

[7] When categorizing income groups according to users' pre-COVID Vodacom phone bills, the top quartile reduced mobility at peak by 115 percent more than the bottom quartile two weeks after a tightening of the restrictions. The response to the spread of the disease shows even higher differences between the rich and the poor: an increase in the case growth rate lowers the top quartile mobility by 150 percent more than the bottom quartile in a week.

Figure A4.3. South Africa: Time Out of Home by Type of Mobile Phone Owned

(Percent of time out of home)

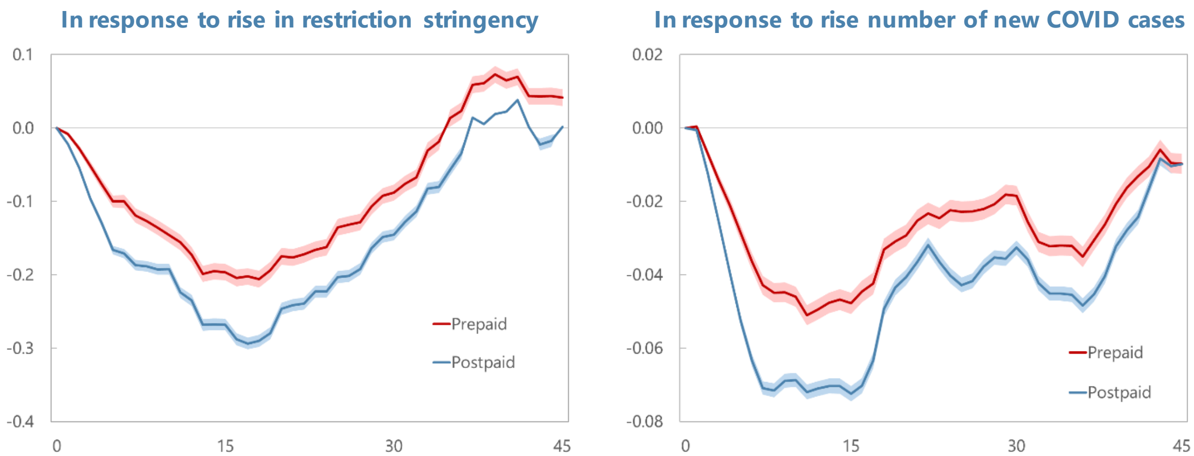


Sources: Vodacom South Africa and IMF staff calculations

Note: The figure shows results from a regression discontinuity method, controlling for location (municipality) and day-of-the-week fixed effects. Users are separated into two groups based on how fees on their mobile phones are paid—prepaid and postpaid—where incomes of postpaid users tend to be significantly higher than incomes of prepaid users.

Figure A4.4. South Africa: Response of Time Out of Home

(Estimated coefficients)



Sources: Oxford COVID-19 Government Response Tracker, Vodacom South Africa, and IMF staff estimates.

Note: The figure shows estimates of the share (0–1) of time out of home using a local projection method in response to a rise in the stringency index of containment measures (current and lagged variables) and the growth rate of the number of daily new COVID-19 cases, while controlling for location (municipality) and fixed effects for both day-of-the-week and income group. The x-axes denote the number of days. The lines denote the point estimates and the shaded areas 95 percent confidence intervals.

Annex V. External Sector Assessment

<table>
<tr><td colspan="7">Overall Assessment: The external position in 2021 was moderately weaker than the level implied by medium-term fundamentals and desirable policies. The exceptional current account (CA) surplus in 2021 (estimated at 3.1 percent of GDP) from the sharp increase in commodity prices and a number of pandemic-related factors is expected to be temporary.[1] Staff projects the CA to move back into negative territory in 2022, as commodity prices continue to level off from their peak and temporary COVID-19-related factors are unwound. This assessment is somewhat uncertain given the lack of full-year data for 2021 and the effects of the COVID-19 crisis. A complete analysis will be provided in the 2022 External Sector Report.
Potential Policy Responses: Tackling external imbalances will require a combination of bold implementation of structural reforms and gradual but substantial fiscal consolidation, while providing space for infrastructure and social spending to help reduce poverty and inequality. Reform efforts should focus on improving governance, the efficiency of key product markets to promote private sector participation), and the functioning of labor markets. These reforms are expected to help attract less volatile and longer-term capital inflows, such as FDI. Seizing opportunities to accumulate international reserves, should they arise, would strengthen the country's ability to deal with shocks.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="6">Background. With large gross external assets and liabilities (respectively, 134.8 and 111.9 percent of GDP in 2021 Q3), South Africa is highly integrated into international capital markets. The NIIP improved markedly from 7.8 percent of GDP in 2019 to 22.9 percent of GDP in 2021 Q3, mainly due to nonresident capital outflows and valuation adjustments from rand depreciation. The NIIP is expected to moderate over the medium term as the CA balance is projected to return to a deficit in 2022 and beyond. Gross external debt rose from 47.8 percent of GDP in 2019 to 50.8 percent of GDP in 2020 (as GDP contracted) and has been since declining to 40.5 percent of GDP by 2021 Q3 on the back of the GDP rebound. Short-term external debt (on a residual maturity basis) was around 13.7 percent of GDP at the end of 2020.
Assessment. Risks from large gross external liabilities are mitigated by a large external asset position and the liability composition (mostly in equities, and external debt is mostly in rand).</td></tr>
<tr><td>2021 Q3 (% GDP)</td><td>NIIP: 22.9</td><td colspan="2">Gross Assets: 134.8</td><td>Debt Assets: 20.1</td><td>Gross Liabilities: 111.9</td><td>Debt Liabilities: 40.5</td></tr>
<tr><td>Current Account</td><td colspan="6">Background. The CA deficit narrowed progressively from 5.3 percent of GDP in 2013 to 2.4 percent in 2017 but widened somewhat to 2.6 percent in 2019 as the trade balance weakened. The CA balance turned into a surplus for the first time in nearly two decades in 2020, reaching 2.0 percent of GDP, due to sharp and mainly pandemic-related changes in the trade balance amid unusually weak imports, strong commodity prices, some rand depreciation, and a favorable income balance. The CA surplus is estimated to have further increased to 3.1 percent of GDP in 2021, as continued buoyancy in terms of trade and commodity exports more than offsets the imports from the recovery in domestic demand and a weaker income and services' balance, as dividend payments picked up from 2020 and tourism remained subdued. The CA balance is projected to turn to a deficit of 1.2 percent of GDP in 2022. The CA deficit will gradually widen to around 2.5–3 percent of GDP over the medium term as the trade balance deteriorates.
Assessment. Staff estimates a preliminary CA gap in the range of -2.1 to -0.1 percent of GDP in 2021. The staff's cyclically adjusted CA is estimated at -0.5 percent of GDP in 2021 accounting for COVID-19-related adjustors of -2.9 percent of GDP to take account of the unique impact of the pandemic on gold and other minerals' exports, travel services including tourism, medical spending imports, and still lower dividend payments (compared to pre-pandemic levels)[2], as well as the statistical treatment of transfers and income accounts.[3] The adjusted CA norm (0.6 percent of GDP) for 2021 is obtained by subtracting 1 percentage point from the EBA CA norm (1.6 percent of GDP) to reflect lower life expectancy relative to other countries in the regression sample.[4]</td></tr>
<tr><td>2021 (% GDP)</td><td>CA: 3.1</td><td>Cycl. Adj. CA: 1.0</td><td>EBA Norm: 1.6</td><td>EBA gap: -0.6</td><td>COVID-19 Adj.: -2.9
Other Adj.: 2.4</td><td>Staff Gap: -1.1</td></tr>
</table>

Real Exchange Rate	**Background.** The CPI-REER depreciated during 2011–16, unwound some of it in 2017–18, and depreciated again during 2019–20. In particular, the REER depreciated by around 8.3 percent in 2020, mainly due to the nominal depreciation experienced during the pandemic. In 2021, the REER depreciated by around 1.4 percent through October relative to end-2020. **Assessment.** The staff preliminary CA gap implies an overvalued REER with a mid-point of 4.6 percent for 2021 (applying an estimated elasticity of 0.24). The two REER-based regressions point to undervaluation in a range of 0.6 percent (level approach) to 12.6 percent (index approach). Based on the CA approach, staff assesses the REER to be overvalued by 4.6 percent, with a range between -0.4 percent and 9.6 percent.
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Net FDI slightly increased in 2020 (from 0.5 percent of GDP in 2019 to 1.5 percent). Net portfolio investment turned negative in 2020 (-2.0 percent of GDP) on account of nonresident capital outflows during the pandemic. Gross external financing needs stood at 14.7 percent of GDP in 2020. **Assessment.** In 2021, COVID-19-related financial market volatility in emerging markets persisted despite overall favorable market sentiment and a search for yield. This followed large capital outflows and asset selloffs during the pandemic in Spring 2020 and the corresponding significant rand depreciation. As the CA is expected to return to a deficit in 2022, risks from large reliance on non-FDI inflows for external financing and sizeable nonresident holdings of local financial assets are mitigated by a flexible exchange rate, relatively small currency mismatches in the economy, and a large domestic institutional investor base. The latter tends to reduce asset price volatility during periods of market stress. The South African authorities obtained \$4.3 billion (100 percent of quota) under the IMF's RFI in July 2020 and \$4.2 billion as part of the IMF's SDR allocation in August 2021.
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 16.4 percent of GDP, 140.6 percent of gross external financing needs, and 6.0 months of imports in 2020. Reserves stand below the IMF's composite adequacy metric (78 percent of the metric without considering existing capital flow management measures and 87 percent of the metric after considering them). **Assessment.** If conditions allow, reserve accumulation would be desirable over the medium term to strengthen the external liquidity buffer, subject to maintaining the primacy of the inflation objective.

[1] This preliminary 2021 EBA assessment considers the temporary surge in mineral export prices and volumes and also the importance for South Africa of some mineral exports (for instance, rhodium or palladium), which are not included in the IMF EBA model (terms of trade adjustment). In addition, imports in 2021 were lower than expected due to weak investment, which the preliminary assessment for 2021 also accounts for.

[2] The South Africa-specific COVID-19 adjustors for 2021 of -2.9 percent of GDP comprise adjustments for: travel services including tourism exports (0.5 percent of GDP), medical spending imports (-0.1), consumption shift to tradable goods (0.4), gold and other mineral exports (-3.2), and an improved income balance (-0.5).

[3] Net current transfers related to the Southern African Customs Union (SACU) in 2021 are 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 by 0.7 percent of GDP. In addition, measurement issues pertaining to the income balance are likely to contribute to an underestimation of the CA by 0.7 percent of GDP in 2021 overall.

[4] Because South Africa is among the few countries with relatively high 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 percent of GDP to the model-based CA norm for 2021.

Annex VI. External Debt Sustainability Analysis[1]

South Africa's significant gross external financing needs are largely reliant on non-FDI flows, which have pushed external debt to relatively high levels. Against this backdrop, the onset of the pandemic witnessed sharp capital outflows and currency depreciation. A sizable share of total external debt is denominated in local currency, reflecting large nonresident holdings of such debt. External debt, at 51 percent of GDP in 2020, is projected to decline to around 45 percent of GDP over the medium term. The rand is relatively volatile, and staff's scenario analysis suggests that a large exchange rate depreciation could be a source of relatively large increases in total external debt, notwithstanding the large local currency debt component.

1. **Gross external financing needs (GEFNs) declined to 15 percent of GDP in 2020, from 18 percent in 2019, as the current account balance moved from a deficit into a surplus.** The current account, traditionally in deficit, turned into a surplus of 2 percent of GDP in 2020 (a change of close to 5 percentage points of GDP) while short-term external debt decreased slightly (by 0.4 percentage point of GDP). The majority of GEFNs still originated from short-term external debt on a remaining maturity basis. Net FDI inflows slightly increased to 1.5 percent of GDP in 2020.

2. **Overall net portfolio flows, traditionally the main source of financing current account deficits, turned negative.** Nonresident portfolio outflows amounted to around 2 percent of GDP. In particular, with market confidence deteriorating during the early phase of the pandemic, nonresident investors heavily sold debt and equity assets (more than in other EMEs), which was only partly offset by inflows from resident asset repatriation and parent company support. The exchange rate rapidly depreciated by over 30 percent against the US dollar between the onset of the pandemic and early-April 2020 before stabilizing. At the same time, interbank market liquidity tightened. South Africa received IMF emergency financing in July 2020 to help address urgent BOP needs from the pandemic.

3. **External debt increased in 2020 to 51 percent of GDP (from 48 percent in 2019) amid a historic output contraction.** From below 20 percent of GDP in the mid-2000s, external debt peaked at 45 percent of GDP in 2017 before subsequently declining to 43 percent of GDP in 2018 (Figure A6.1). External debt then continued its ascent in 2019 before jumping in 2020 amid the pandemic and the sharp GDP decline, while the increase in external debt from the time of the RFI disbursement was likely more than compensated for by the exodus of nonresident investors. In particular, the pace of increase in foreign currency-denominated external debt (mainly and unprecedently from IFIs) was larger than that in local currency-denominated external debt, which remained at around 50 percent of the total external debt (Figure A6.1, right panel).

4. **On current policies, financing of the current account deficit (expected from 2022 onwards) is projected to continue to come from non-FDI inflows.** The projected 4.6 percent GDP growth rate in 2021 and a forecast current surplus of 3.1 percent of GDP (historic high) are

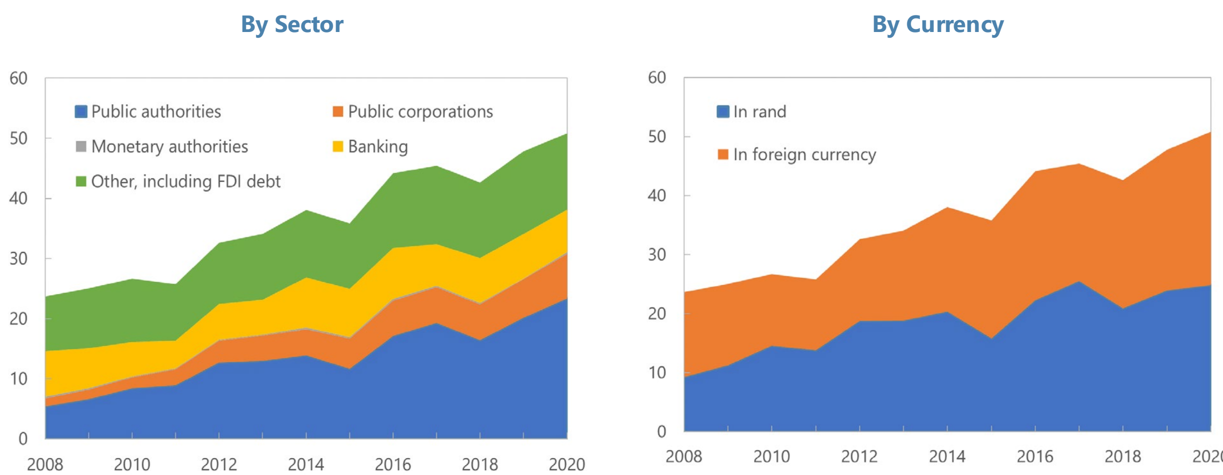
[1] Prepared by Heiko Hesse (SPR).

expected to lead to a sizable decline in external debt to around 40 percent of GDP in 2021. GEFNs are projected to fluctuate around 16–19 percent of GDP during 2022–26, with short-term debt redemptions accounting for over 80 percent of the total. Net FDI inflows are anticipated to remain low over the forecast horizon, hampered by slow progress in structural reform implementation and subdued private investment. Thus, non-FDI investment is expected to continue to provide the bulk of financing. External debt is projected to increase somewhat to above 45 percent of GDP over the forecast horizon from 2022 onwards.

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 increase external debt above 58 percent of GDP (compared to a baseline of around 45 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 small to moderate increases in external debt.

Figure A6.1 South Africa: External Debt

(Percent of GDP)



Sources: South African Reserve Bank, and IMF staff calculations.

Table A6.1. South Africa: External Debt Sustainability Framework, 2017–2026
(In percent of GDP, unless otherwise indicated)

	Actual				Projections							
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026		**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	45.4	42.6	47.8	50.8	**39.5**	**42.9**	**43.4**	**44.1**	**45.5**	**45.5**		**-1.0**
Change in external debt	1.3	-2.8	5.2	3.0	-11.3	3.4	0.5	0.7	1.4	0.0	0.0	
Identified external debt-creating flows (4+8+9)	-2.9	-0.5	3.2	2.1	-3.6	1.8	2.5	3.0	3.2	3.4	0.0	
Current account deficit, excluding interest payments	1.3	1.6	1.3	-3.3	-4.2	0.3	1.0	1.5	1.7	1.9	1.0	
Deficit in balance of goods and services	-1.1	-0.5	-0.5	-4.4	-6.0	-2.1	-1.8	-1.5	-1.3	-1.1		
Exports	27.3	27.5	27.3	27.8	30.9	30.0	30.0	30.1	30.3	29.4		
Imports	26.2	27.0	26.8	23.3	24.9	27.9	28.2	28.6	29.1	28.3		
Net non-debt creating capital inflows (negative)	-0.6	-0.9	0.6	0.0	1.4	1.3	1.1	1.1	1.1	1.1	1.1	
Automatic debt dynamics 1/	-3.6	-1.1	1.2	5.4	-0.9	0.2	0.4	0.4	0.4	0.4	-2.1	
Contribution from nominal interest rate	1.0	1.4	1.3	1.3	1.0	0.9	1.0	1.0	1.0	1.0	1.0	
Contribution from real GDP growth	-0.4	-0.6	-0.1	3.6	-1.9	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6	
Contribution from price and exchange rate changes 2/	-4.2	-1.8	0.0	0.5	...	...	...	...	...	...	-2.5	
Residual, incl. change in gross foreign assets (2-3) 3/	4.2	-2.4	2.0	1.0	-7.7	1.6	-2.0	-2.3	-1.9	-3.4	0.0	
External debt-to-exports ratio (in percent)	166.2	155.1	174.8	182.9	128.0	143.0	144.4	146.6	149.9	154.7		
Gross external financing need (in billions of US dollars) 4/	49.1	66.2	67.9	49.3	45.6	78.9	71.0	75.7	83.5	83.9		
in percent of GDP	12.9	16.3	17.5	14.7	11.2	18.6	16.1	16.5	17.5	16.2		
Scenario with key variables at their historical averages 5/					**39.5**	**44.8**	**47.0**	**48.9**	**51.3**	**54.2**		**2.5**
Key Macroeconomic Assumptions Underlying Baseline											For debt stabilization	
Real GDP growth (in percent)	1.2	1.5	0.1	-6.4	4.6	1.9	1.4	1.4	1.4	1.4	1.4	
GDP deflator in US dollars (change in percent)	16.5	4.6	-4.3	-7.6	16.4	1.8	2.9	2.6	2.5	7.1	7.1	
Nominal external interest rate (in percent)	2.8	3.2	2.8	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	
Growth of exports (US dollar terms, in percent)	14.5	6.7	-4.7	-12.2	35.3	0.8	4.5	4.2	4.8	5.3		
Growth of imports (US dollar terms, in percent)	11.5	9.5	-4.9	-24.7	29.9	16.1	5.7	5.4	5.7	5.7		
Current account balance, excluding interest payments	-1.3	-1.6	-1.3	3.3	4.2	-0.3	-1.0	-1.5	-1.7	-1.9		
Net non-debt creating capital inflows	0.6	0.9	-0.6	0.0	-1.4	-1.3	-1.1	-1.1	-1.1	-1.1		

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).

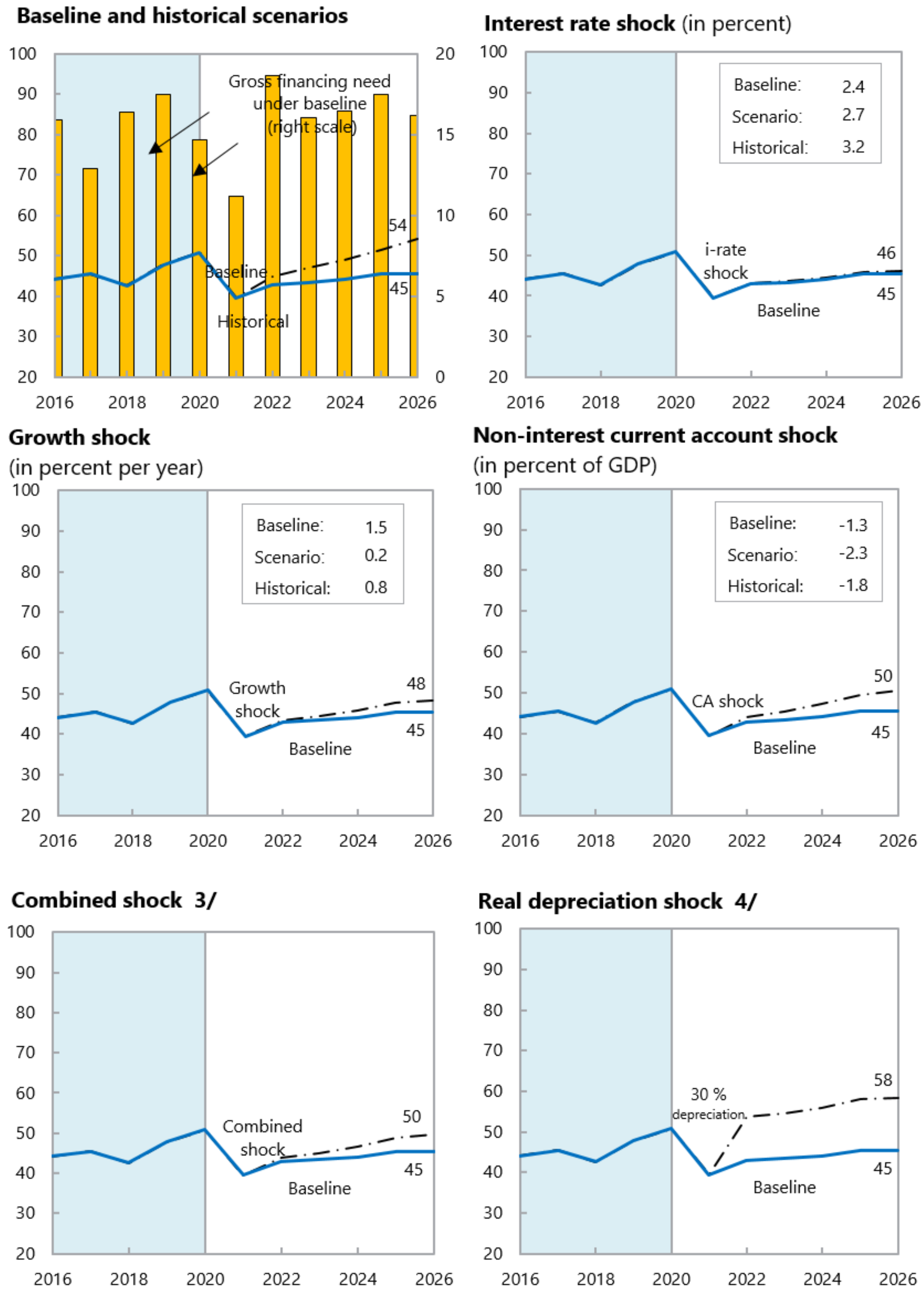
3/ For projection, line includes the impact of price and exchange rate changes.

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 A6.2 South Africa: 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 2022.

Annex VII. Risk Assessment Matrix[1]

Nature/Source of Threat	Likelihood	Time Horizon	Expected Impact on Economy	Policy Responses
Global risks				
Uncontrolled COVID-19 local outbreaks and subpar/volatile growth in affected countries. Outbreaks in slow-to-vaccinate countries force new lockdowns. Policy response to cushion the economic impact is constrained by lack of policy space, with some market access countries facing additional financial tightening as a reassessment of growth prospects triggers capital outflows, currency depreciations, and debt defaults.	*High*	*ST*	***H/M***. Impact on the economy would depend on the extent of the vaccination rollout and new lockdowns in new waves. Lack of fiscal space would make additional policy support difficult and thus a stringent lockdown rather unlikely. Either way, social conditions would deteriorate further. Tightening of funding conditions, capital outflows, and higher risk premia would be probable.	Speed up vaccination. Provide well-targeted support to the most vulnerable. Proceed with a gradual, credible, and growth-friendly fiscal consolidation, while preserving social spending, to ensure the debt-to-GDP ratio reverses its upward trend and stabilizes at a comfortable level. Implement bold structural reforms to facilitate private sector-led employment creation. Tighten monetary policy if currency depreciation pushes inflation expectations above the target range.
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia. A fast recovery in demand (supported by excess private savings and stimulus policies), combined with COVID-19-related supply constraints, leads to sustained above-target inflation readings and a de-anchoring of expectations. The Fed reacts by signaling a need to tighten earlier than expected.	*Medium*	*ST-MT*	***H/M***. Capital flow reversals would cause a sharp tightening of financial conditions and an increase in risk premia across asset classes, including potential sovereign rating downgrades, weakening the external and fiscal positions, and negatively affecting the domestic financial system amid a deepening bank-sovereign nexus.	Tighten monetary policy if large currency depreciation and a surge in general uncertainty de-anchor inflation expectations. Accelerate the envisaged fiscal tightening if budget financing becomes problematic. If market conditions turn disorderly, consider measures to stem capital flow reversals.
Widespread social discontent and political instability. Social tensions erupt as a withdrawal of pandemic-related policy support results in higher unemployment and, amid increasing prices of essentials, hurts vulnerable groups (often exacerbating pre-existing inequities).	*Medium*	*ST-MT*	***H/M***. Social tensions would disrupt key infrastructure and supply channels, and weaken confidence generally, dampening economic growth. Employment would deteriorate, fiscal deficits worsen, risk premia surge, and domestic financing conditions tighten.	Enact support measures to protect the poor while continuing gradual and credible fiscal consolidation to ensure debt stabilization. Implement structural measures that allow the private sector to invest and create jobs and promote inclusive growth. Tighten monetary policy in case of external financing shortfalls and/or higher inflation.
Domestic risks				
Inability to advance structural and governance reforms. Difficulties to attain consensus delay the implementation of the envisaged reforms.	*High*	*ST-MT*	***H***. Structural constraints to growth would continue to erode confidence, trigger capital outflows, and raise financing costs amid further sovereign rating downgrades. Poverty, inequality, and unemployment would worsen and dissatisfaction would become widespread.	Swiftly implement reforms to strengthen governance, notably in SOEs, enhance competition in product markets, and increase labor market flexibility. Advance anti-corruption and anti-money laundering measures to boost confidence.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood 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. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Nature/Source of Threat	Likelihood	Time Horizon	Expected Impact on Economy	Policy Responses
Eskom's worsening operational and financial problems. Eskom shows inability to decisively reform and to service its debt.	***High***	*ST-MT*	***H.*** Failure to address the macro-critical Eskom's vulnerabilities would have major adverse consequences for the economy and the fiscus, including frequent power outages and debt service difficulties.	Adopt measures to stabilize Eskom's finances in the short run (mainly by cutting costs). Overhaul the energy business model over the medium term to create space for greater private sector participation in procuring from more efficient and sustainable energy sources. Strictly enforce conditionality for any further fiscal support.
Higher-than-expected budget deficits and ballooning debt. The fiscal deficit is already high and threatened by continuous SOE bailouts, expansive compensation policy, and high current expenditures.	***High***	*ST-MT*	***H***. Perception that public debt is unsustainable would lead to capital outflows, amid deteriorating confidence, and challenging BOP financing. Financial sector soundness would be impaired by an entrenched bank-sovereign nexus and loss of appetite for sovereign credit.	Introduce revenue and expenditure measures to credibly reduce the fiscal deficit (while protecting social outlays) by adhering to the announced compensation policy, conditioning transfers to SOEs to meeting performance indicators, and eliminating inefficient subsidies. Support fiscal consolidation by decisively implementing long-standing structural reforms to boost market confidence.
Bank-sovereign nexus in vicious downward spiral from capital flow reversal. Exodus by nonresidents forces domestic banks to absorb the sovereign debt amid a sudden macro-financial deterioration.	***Medium***	*MT*	***H/M***. As risk premia surge, bank holdings of government bonds would lose value; risks of prescribed purchases of government paper and financial repression would worsen; and, as bank balance sheets weaken, lending to households and corporates would slow with adverse effects on growth, the fiscus, and financial and external stability.	Pursue fiscal consolidation to stabilize debt and structural reforms to boost market confidence. Provide temporary regulatory and monetary policy support to the banking system. Engage in clear communication and careful calibration of measures to reduce the bank-sovereign nexus once the initial acute phase has passed. Boost banks' buffers to withstand shocks (e.g., dividend payment restrictions), including by introducing some of the measures recommended by the FSAP as appropriate.

Annex VIII. Public Debt Sustainability Analysis[1]

Despite the fast rebound in output from the 2020 contraction, the government debt outlook remains challenging.[2] The pandemic significantly increased debt and debt service, exacerbating already unfavorable dynamics arising from persistent weak growth, high fiscal deficits, and a growing materialization of contingent liabilities from SOEs. On current policies, debt is projected at 88 percent of GDP by 2026 and not expected to stabilize during the projection period, while gross fiscal financing needs would average 17 percent of GDP in 2021–26. Risks to the debt outlook include the uncertain nature of the recovery, possible global financial tightening, additional spending pressures, and large SOE liabilities. While the currency and maturity composition of debt mitigate these risks, debt sustainability critically hinges on timely and credible policies to tackle the economy's fiscal and structural weaknesses.

Context

1. **Public debt and gross financing needs (GFNs) increased significantly in FY20/21 while contingent liabilities remained sizable.** With revenue falling by 1.5 percent of GDP due to the output contraction, and expenditure increasing by 2.7 percent of GDP to accommodate the COVID-19 package, transfers to SOEs, and an increasing interest bill, the national government fiscal deficit widened to 10.4 percent of GDP from 6.3 percent in FY19/20, adding 14 percentage points of GDP to public debt. In parallel, GFNs continued their expansion to 18.3 percent of GDP in FY20/21 (from 10.6 percent in FY15/16). The stock of contingent liabilities averaged 15.1 percent of GDP in the five years that preceded the pandemic and reached 20.3 percent in FY20/21, mainly due to persistent SOE cash deficits and difficulties in borrowing. However, growth in contingent liabilities in FY20/21 was lower than expected as the loan guarantee scheme set up to support firms during the pandemic was only partially used (0.3 percent of GDP compared to an announced 3.6 percent).

Baseline Projections

2. **The debt-to-GDP ratio is projected to rise to about 88 percent of GDP by 2026 driven by the anticipated fiscal deficit dynamics** (Figure A8.3). The winding down of one-off COVID-19-related measures combined with the expected growth rebound explain the relatively small increase in the debt-to-GDP level for 2021. The deficit is expected to somewhat decline thereafter, driven by some revenue recovery and cost containment but to remain elevated in the medium term, at levels exceeding 7 percent of GDP. By the end of the projection period, even if revenue-to-GDP recovers to pre-pandemic ratios and the expected expenditure containment materializes, a growing interest bill would put significant pressure on the deficit, causing it to inch up again. The high debt levels implied by the deficit path—in a context of spending rigidities, below-investment grade sovereign

[1] Prepared by Alejandro Simone (AFR). 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.

[2] Also, there was a revision to the national accounts that resulted in an average GDP level increase of about 10 percent. As a result, historical fiscal ratios (debt-to-GDP; fiscal deficit-to-GDP) are lower than previously reported.

ratings, and already onerous borrowing costs for the sovereign—leave no buffers for fiscal policy to respond to any future adverse shocks.

3. Alongside sizable deficits, GFNs are expected to remain high during the projection period. GFNs are projected at 17 percent of GDP, on average in 2021–26, despite the still-favorable maturity and currency structure of the debt (Figure A8.3) and expected to be met by domestic financing sources (primarily non-bank financial institutions) and nonresidents. Domestic financing sources are expected to play a more significant role than in the past, as nonresident local currency bond purchases, which were already declining before the pandemic, fell further following the sovereign downgrade to below investment grade by all three ratings agencies in 2020. Moreover, the authorities have shortened the maturities of long-term debt issuance from the customary 15 to 30-year range, given increasing costs of borrowing at those longer maturities.

Box A8.1. 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 is thus 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 estimated at 4.6 percent in 2021 following the 6.4 percent contraction in 2020, supported by rebounding private consumption and external demand from the global reopening. As real GDP recovers to its pre-pandemic level in 2022 and re-opening effects end, structural constraints are expected to slow growth to about 1.4 percent in the medium term. The GDP deflator is expected to average 4.1 percent in 2021–26.

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 debt. The primary balance is projected to gradually improve but remain in deficit throughout the projection period. Expenditure assumptions are guided by the 2021 MTBPS with the exception of the wage bill, transfers, and capital expenditure. Staff assumes that the wage bill would remain constant in real terms rather than largely frozen. Transfers to SOEs are expected to remain broadly constant as a share of GDP rather than continue to decline, and it is assumed that the COVID-19 grants are extended for one additional year given recent pandemic developments. Lower capital expenditure than projected in the MTBPS is expected to partially offset current spending overruns in line with historical trends.

4. The debt outlook is subject to downside risks:

- ***Growth over-projection***. Given the still-uncertain recovery path, the growth rebound could weaken earlier than expected or be subject to global shocks, thus posing an upside risk to debt-to-GDP forecasts. Growth forecast errors in the past have been on the optimistic side but usually within the interquartile range (Figure A8.2).

- ***Underestimated primary balance***. Pressure on the primary balance could stem from lower-than-anticipated revenue collection and/or higher-than-expected spending arising from lingering pandemic spending needs, new social grants initiatives, further pressures from SOEs, and/or more costly pay agreements. Primary balance projections have not been systematically biased (Figure A8.2).

- ***Higher interest rates***. Borrowing costs may increase due to declines in risk appetite toward EME assets, a tightening of global financing conditions, and/or increased risk perceptions reflecting the credibility of the fiscal path, especially if slippages occur.

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

5. **On the positive side, the favorable composition of the government debt mitigates risks.** The shares of foreign-currency components (10 percent in 2020) and short-term instruments (13 percent in 2020) are low while the average maturity is long (about 12 years).

Scenario Analysis

6. **The analysis illustrates the sensitivity with which an individual shock or a combination of shocks can affect the projected paths of public debt and GFNs** (Figures A8.4, A8.5, and A8.6).

- ***Persistent low growth and temporary growth shock scenarios***. If growth were permanently lower than in the baseline by 1 percentage point on average during 2021–26, the debt-to-GDP ratio would reach 106 percent of GDP in 2026. 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. A 1 standard deviation shock to growth in 2022 and 2023 would drive an increase in the debt-to-GDP ratio to 97 percent by 2026.

- ***Primary balance shock scenario***. If the primary balance improved more gradually than in the baseline due to the materialization of a variety of expenditure pressures, which are only partially offset by reprioritizations, deviating by a cumulative 2.2 percent of GDP during the medium term, the projected debt level would reach 91 percent of GDP in 2026.

- ***Combined macro-fiscal shocks scenario***. A combination of standard shocks to growth (temporary 1 standard deviation shock) 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 to inflation of 0.25) would increase the debt-to-GDP ratio to 104 percent and the gross financing needs by about 4 percentage points of GDP by 2026.

- ***Contingent liability shock scenario***. Should all remaining SOE guarantees be called, debt would rise to 103 percent of GDP by 2026. This scenario underscores the importance of reforming SOEs given the direct risk they pose to the fiscal outlook and the indirect risks posed by the impact on investor confidence and borrowing costs.

- ***Faster implementation of structural reforms***. This scenario assumes that growth becomes permanently higher than in the baseline by 1 percentage point on average during 2021–26 due to accelerated reform implementation. In such a case, the debt-to-GDP ratio would stabilize in 2025 at 74 percent of GDP and start declining thereafter while gross financing needs would be below 15 percent of GDP 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 on spending.

7. **The heat map summarizes the risk assessment of South Africa's debt and GFNs** (Figure A8.1).[3] All shock scenarios for the debt level and gross financing needs flash red given that they both exceed the relevant high-risk thresholds of 70 percent of GDP and 15 percent of GDP, respectively, in the baseline scenario. Mitigating factors are the large domestic institutional investor base and a favorable composition and maturity of the debt. South Africa's bond spreads, at 370 basis points on average in the last three months, have declined significantly with respect to 2020 but are still sizable reflecting elevated external financing requirements, a relatively high share of debt held by nonresidents, and an overall challenging debt outlook in the absence of additional consolidation and growth-enhancing reforms.

8. **The fan charts highlight the importance of adopting decisive policies to reduce downside risks and the probability of debt distress** (Figure A8.1, middle panel). Under a scenario in which downside shocks are predominant, the debt-to-GDP ratio would reach 101 percent by 2026 (using the upper end of the 75th–90th percentile fan chart). Conversely, if shocks were symmetric on the upside and the downside, which could be triggered, for example by somewhat faster progress in consolidating the fiscal accounts and implementing growth-enhancing reforms, the probability of the debt exceeding the same high level would decline and the probability of better-than-baseline outcomes would increase significantly.

[3] 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 EMEs 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.

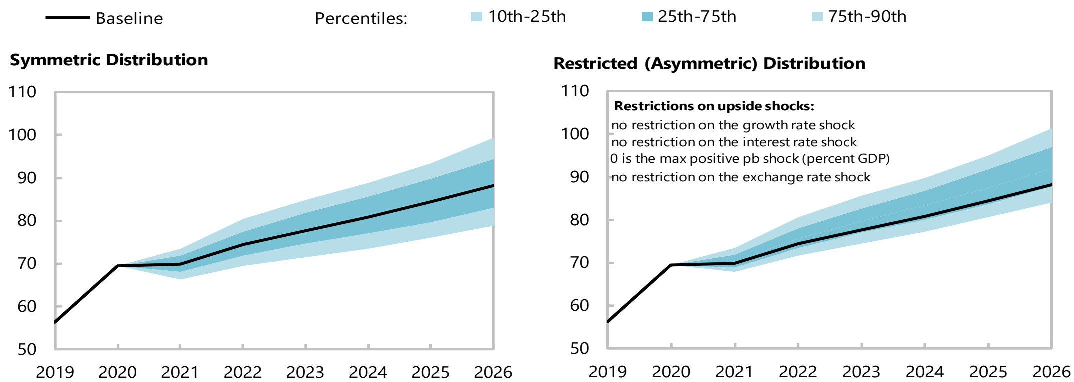
Figure A8.1. South Africa: Public DSA Risk Assessment

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	

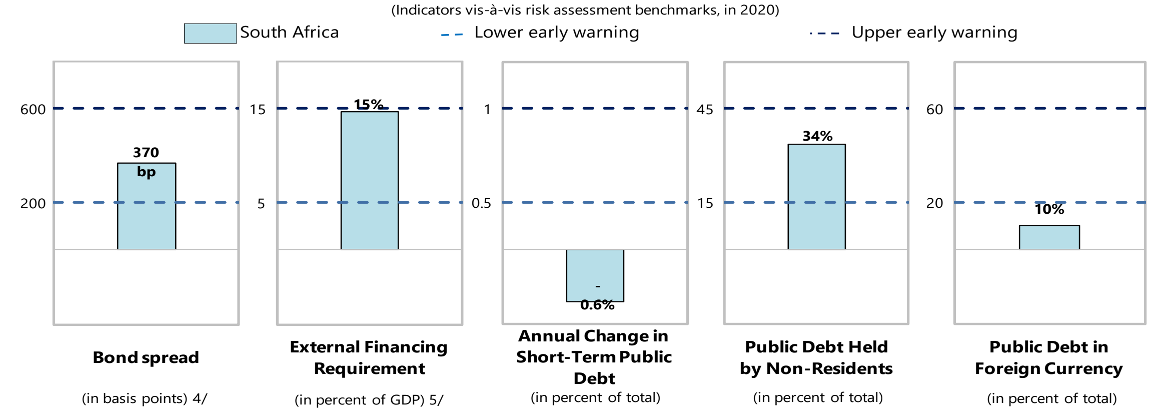
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



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:

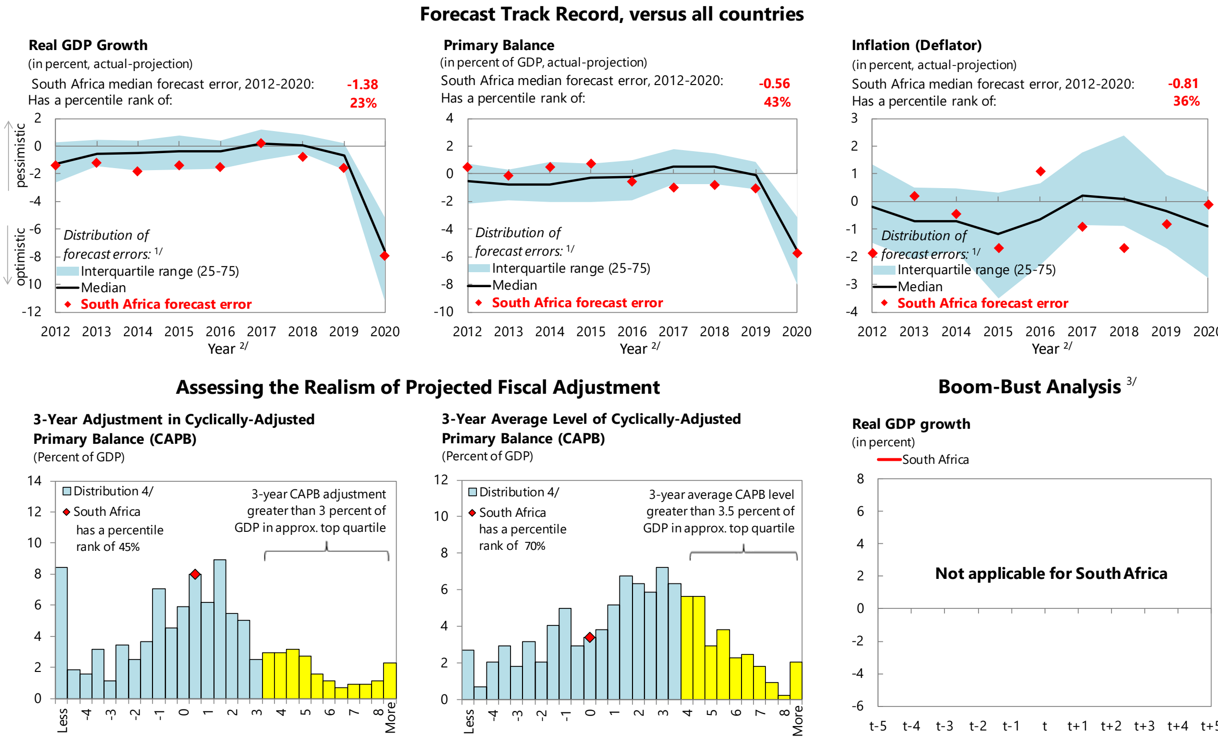
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 10-Sep-21 through 09-Dec-21.

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. 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 A8.2. South Africa: Public DSA – Realism of Baseline Assumptions



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.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure A8.3. South Africa: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

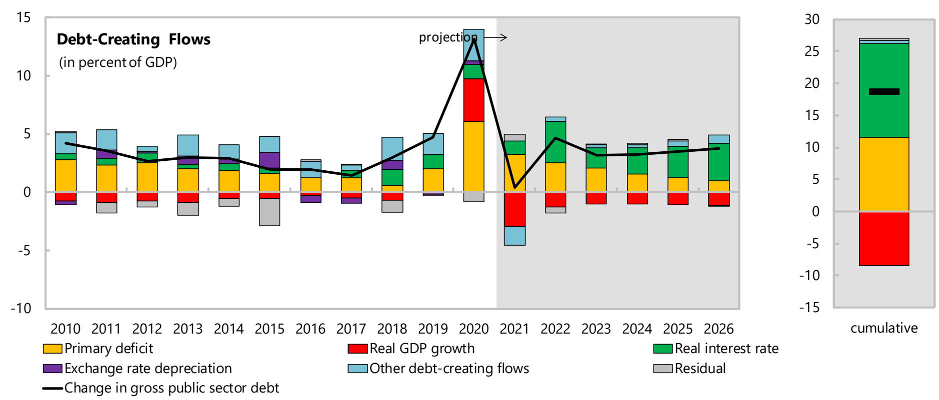
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	42.2	56.3	69.4	69.9	74.5	77.7	80.9	84.3	88.1
Public gross financing needs	10.5	12.9	18.3	15.9	17.1	17.1	16.9	17.5	17.9
Real GDP growth (in percent)	1.9	0.1	-6.4	4.6	1.9	1.4	1.4	1.4	1.4
Inflation (GDP deflator, in percent)	5.5	4.5	5.3	4.7	1.7	4.7	4.5	4.5	4.6
Nominal GDP growth (in percent)	7.5	4.6	-1.5	9.5	3.6	6.2	6.0	6.0	6.1
Effective interest rate (in percent) [4/]	7.3	7.0	7.1	6.7	7.0	7.2	7.6	8.1	8.8

As of December 09, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		368
5Y CDS (bp)		218
Ratings	Foreign	Local
Moody's	Ba2	Ba2
S&Ps	BB-	BB
Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.7	4.7	13.1	0.4	4.7	3.1	3.2	3.5	3.8	18.7	
Identified debt-creating flows	3.4	4.8	14.0	-0.2	5.2	3.1	3.1	3.3	3.8	18.3	
Primary deficit	1.8	2.0	6.1	3.2	2.5	2.1	1.6	1.2	1.0	11.6	2.8
Primary (noninterest) revenue and grants	22.3	23.7	22.1	23.2	24.2	23.7	23.7	23.8	23.9	142.3	
Primary (noninterest) expenditure	24.1	25.7	28.1	26.4	26.7	25.7	25.3	25.0	24.8	154.0	
Automatic debt dynamics [5/]	0.3	1.1	5.2	-1.7	2.3	0.8	1.2	1.7	2.1	6.3	
Interest rate/growth differential [6/]	0.0	1.2	4.9	-1.7	2.3	0.8	1.2	1.7	2.1	6.3	
Of which: real interest rate	0.6	1.2	1.2	1.2	3.5	1.7	2.2	2.7	3.3	14.6	
Of which: real GDP growth	-0.6	-0.1	3.7	-2.9	-1.3	-1.0	-1.0	-1.1	-1.1	-8.4	
Exchange rate depreciation [7/]	0.3	-0.1	0.3	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.4	1.8	2.7	-1.6	0.4	0.2	0.3	0.5	0.7	0.4	
Privatization/Drawdown of Deposits	0.4	1.1	0.8	-1.4	-0.8	-0.4	-0.3	-0.1	0.0	-3.0	
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	1.0	0.7	1.9	-0.2	1.2	0.6	0.6	0.5	0.7	3.4	
Residual, including asset changes [8/]	-0.7	-0.1	-0.8	0.6	-0.5	0.1	0.1	0.1	0.0	0.4	

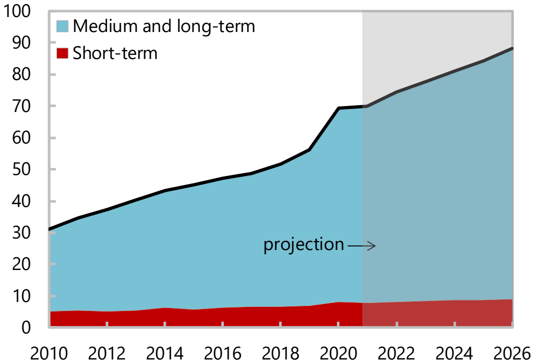


Source: IMF staff.
1/ Public sector is defined as central government.
2/ Based on available data.
3/ Long-term bond spread over U.S. bonds.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times 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.

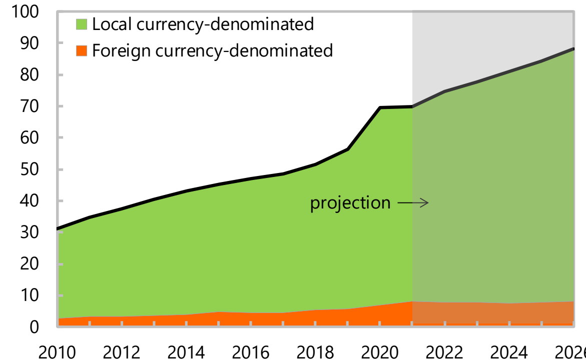
Figure A8.4. South Africa: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



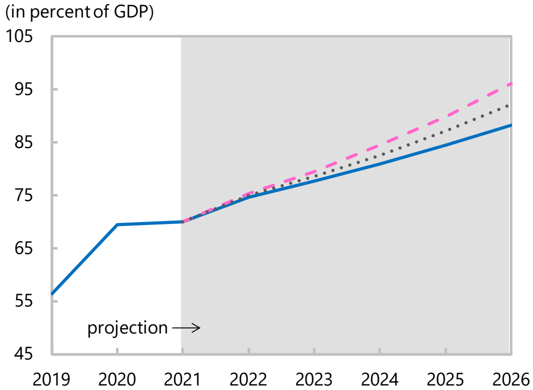
By Currency
(in percent of GDP)



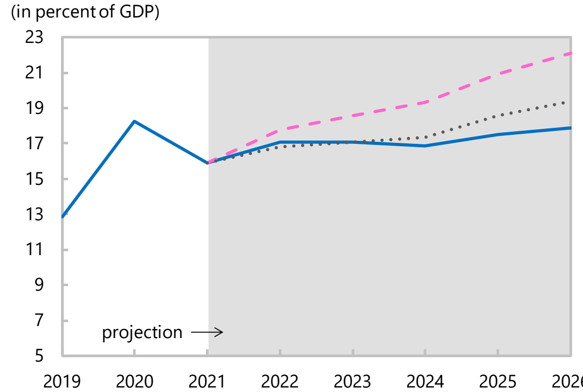
Alternative Scenarios

Baseline
Historical
Constant Primary Balance

Gross Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

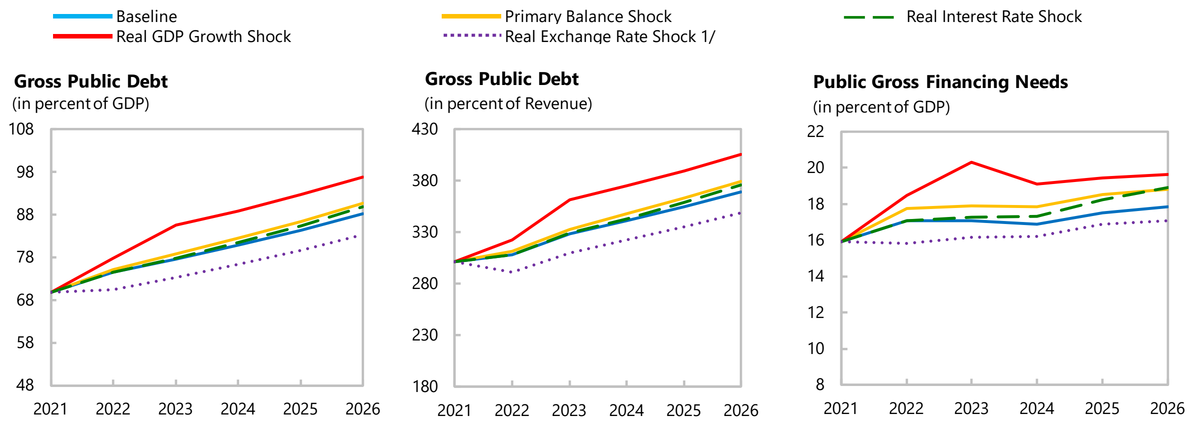
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.6	1.9	1.4	1.4	1.4	1.4
Inflation	4.7	1.7	4.7	4.5	4.5	4.6
Primary Balance	-3.2	-2.5	-2.1	-1.6	-1.2	-1.0
Effective interest rate	6.7	7.0	7.2	7.6	8.1	8.8
Constant Primary Balance Scenario						
Real GDP growth	4.6	1.9	1.4	1.4	1.4	1.4
Inflation	4.7	1.7	4.7	4.5	4.5	4.6
Primary Balance	-3.2	-3.2	-3.2	-3.2	-3.2	-3.2
Effective interest rate	6.7	7.0	7.2	7.6	8.1	8.7

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.6	0.8	0.8	0.8	0.8	0.8
Inflation	4.7	1.7	4.7	4.5	4.5	4.6
Primary Balance	-3.2	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	6.7	7.0	7.1	7.2	7.6	8.1

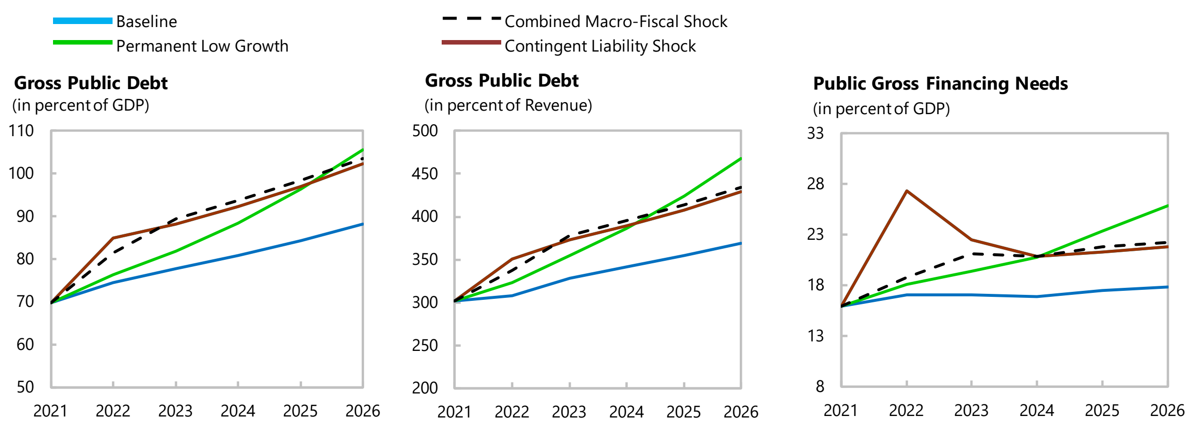
Source: IMF staff.

Figure A8.5. South Africa: Public DSA – Stress Tests-Downside

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

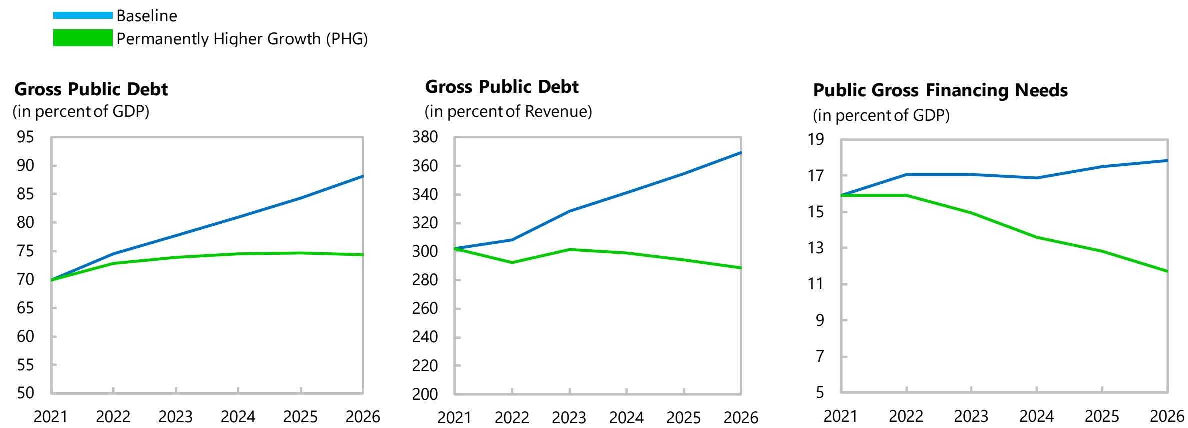
	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	4.6	1.9	1.4	1.4	1.4	1.4
Inflation	4.7	1.7	4.7	4.5	4.5	4.6
Primary balance	-3.2	-3.2	-2.5	-2.1	-1.6	-1.2
Effective interest rate	6.7	7.0	7.3	7.6	8.2	8.8
Real Interest Rate Shock						
Real GDP growth	4.6	1.9	1.4	1.4	1.4	1.4
Inflation	4.7	1.7	4.7	4.5	4.5	4.6
Primary balance	-3.2	-2.5	-2.1	-1.6	-1.2	-1.0
Effective interest rate	6.7	7.0	7.5	8.1	8.7	9.5
Combined Shock						
Real GDP growth	4.6	-0.8	-1.3	1.4	1.4	1.4
Inflation	4.7	1.1	4.0	4.5	4.5	4.6
Primary balance	-3.2	-3.4	-3.9	-2.1	-1.6	-1.2
Effective interest rate	6.7	7.2	7.4	7.9	8.7	9.5

	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	4.6	-0.8	-1.3	1.4	1.4	1.4
Inflation	4.7	1.1	4.0	4.5	4.5	4.6
Primary balance	-3.2	-3.4	-3.9	-1.6	-1.2	-1.0
Effective interest rate	6.7	7.0	7.3	7.7	8.2	8.9
Real Exchange Rate Shock						
Real GDP growth	4.6	1.9	1.4	1.4	1.4	1.4
Inflation	4.7	13.3	4.7	4.5	4.5	4.6
Primary balance	-3.2	-2.5	-2.1	-1.6	-1.2	-1.0
Effective interest rate	6.7	7.2	7.1	7.5	8.0	8.7
Contingent Liability Shock						
Real GDP growth	4.6	1.9	1.4	1.4	1.4	1.4
Inflation	4.7	1.7	4.7	4.5	4.5	4.6
Primary balance	-3.2	-12.8	-2.1	-1.6	-1.2	-1.0
Effective interest rate	6.7	7.0	7.5	8.4	9.2	10.0

Source: IMF staff.

Figure A8.6. South Africa: Public DSA – Stress Tests–Upside

Additional Stress Tests



Underlying Assumptions

(in percent)

Baseline	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	1.9	1.4	1.4	1.4	1.4
Inflation	4.7	1.7	4.7	4.5	4.5	4.6
Primary balance	-3.2	-2.5	-2.1	-1.6	-1.2	-1.0
Effective interest rate	6.7	7.0	7.2	7.6	8.1	8.8

PHG	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	2.9	2.4	2.4	2.4	2.4
Inflation	4.7	1.7	4.7	4.5	4.5	4.6
Primary balance	-3.2	-1.5	-0.7	0.4	1.3	2.1
Effective interest rate	6.7	7.0	7.3	7.7	8.3	9.0

Source: IMF staff.

Annex IX. South Africa's Wage Bill and Cross-Country Experience[1]

South Africa's high and rising government wage bill is primarily driven by high and rising average compensation levels (as opposed to an elevated and increasing number of employees), both compared to other countries and to the private sector. International experience suggests that, under these circumstances, below-inflation cost-of-living adjustments and reforms to the compensation system will be needed to reduce the wage bill relative to GDP and with it the heavy burden on the fiscus.

1. **South Africa's wage bill is high relative to comparators.** In FY20/21, South Africa's consolidated government wage bill stood at 11.4 percent of GDP, while its general government wage bill came to 13.9 percent of GDP.[2] These ratios place South Africa among the highest wage bill spenders in emerging markets by the general government measure and well above the median by the narrower consolidated government measure (Figure A9.1, panel 1). South Africa is also among the highest wage bill spenders in the world (in percent of GDP terms).

2. **The moderate level of government employment as a share of the working-age population suggests that the high wage bill arises from high average compensation levels.**[3] This is corroborated by an analysis of the wage premium, which indicates that, even after controlling for education levels (which tend to be higher in the public sector) and other individual characteristics, South African public-sector employees earn considerably more than employees in the private sector. Moreover, these wage premia have been increasing rapidly in recent years, going from 15 to 44 percent between 2018 and 2020 for general government employees. Employees of South African state-owned enterprises enjoy an even greater premium which went from 28 to 58 percent over the same period (Figure A9.1, panel 2).[4] This rapid growth in the wage premia is explained by the continuous increase in public-sector pay even as private-sector compensation fell slightly in 2020 in the context of the COVID-19 pandemic (Figure A9.1, panel 3).

3. **Staff advised reducing the growth rate of compensation through below-inflation cost of living adjustments (COLAs) and structural reforms to compensation.** COLAs are normally meant to protect purchasing power, but in South Africa they have been used to grant above-inflation pay increases to all government employees regardless of performance. Indeed, the COLAs have been explicitly formulated as "*CPI + x percent*". In addition to this, automatic pay and grade progression contribute an estimated 1.2 percentage points to the nominal wage bill's annual growth. In this context, below-inflation COLAs would help bring government pay back in line with

[1] Prepared by Sébastien Walker (FAD).

[2] The general government includes the consolidated government as well as local governments. These ratios reflect the rebased GDP figures released in 2021. The corresponding ratios with the previous GDP figures were 12.9 and 15.5 respectively.

[3] The conclusion that growth in compensation levels is the main driver of wage bill growth is in line with the authorities' analysis of compensation spending trends in the national and provincial governments, as notably set out in the 2020 MTBPS.

[4] These are estimates of the *average* wage premium across the whole general government and all SOEs, respectively. The wage premium for different positions and institutions may be higher or lower.

the private sector. Moreover, reforms to pay progression and the structure of compensation are needed to reduce the upward pressure on the wage bill, for example by limiting eligibility for such progression, tying it more closely to performance, and phasing out allowances and bonuses that distort the salary scale.

4. **South Africa could usefully adopt a more nuanced and evidence-based approach to pay-setting by relying on pay review bodies, as for instance, in the UK.** The UK's eight independent pay review bodies (PRBs) each provide evidence-based recommendations for different groups of government employees. Each PRB includes members with a broad range of backgrounds in the public or private sector or in academia. The PRBs consider budget constraints, recruitment and retention of qualified personnel, service-delivery targets, and the economic and labor market context; assess evidence from the government, unions, and others; and publish recommendations. While such recommendations are not binding, the government has an incentive to accept them to maintain credibility and protect the integrity of the system. The process does not undermine unions, as it does not prevent industrial action, and rather focuses on balancing the trade-offs inherent in managing the wage bill in an independent, objective, and transparent manner. The PRB system could usefully be adopted in South Africa to increase independence and transparency in pay determination.

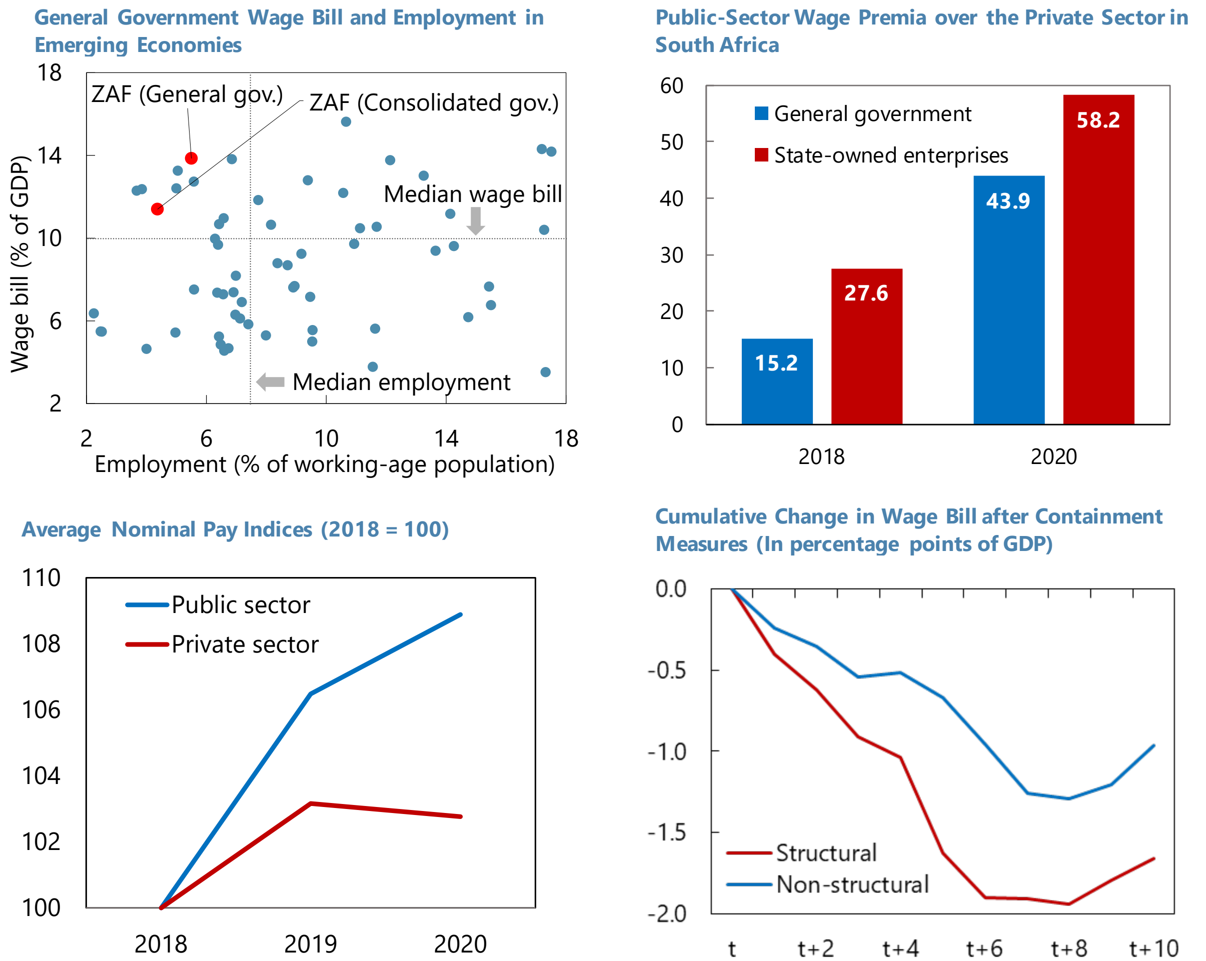
5. **Across-the-board pay freezes or reductions can support fiscal consolidation in the short term but may be difficult to sustain over time.** Such measures can be effective in containing wage pressures when rapid fiscal relief is needed, especially in the presence of a substantial government wage premium. For example, Honduras reduced its wage bill by over two percentage points of GDP between 2013 and 2015 notably thanks to a nominal pay freeze which helped to correct a substantial wage premium (IMF, 2016a).[5] However, crude across-the board measures can, in the longer run, hinder the government's ability to offer competitive compensation where needed to ensure adequate staffing in specific areas; may distort the structure of compensation by leading to growth in allowances and bonuses, as seen in Côte d'Ivoire, Jamaica, Moldova, the Netherlands, and Senegal; and have in some cases been reversed by courts, such as in Portugal and Romania (IMF, 2016b).

6. **Countries have tended to achieve more successful wage bill reductions thanks to structural measures.** Structural wage bill measures involve reforms to the institutional features of wage determination or staffing, as well as public financial management measures that improve the control, oversight, and transparency of the wage bill. This is as opposed to "crude" measures, which are limited to certain parameters (such as the overall rate of pay growth or the total number of new hires). Structural measures, which have tended to improve the efficiency of wage formation and hiring processes, or the range of services provided, or both, have tended to make wage bill reductions fairer, larger, and more durable (IMF, 2014; Forni and Novta, 2014). Ten years after the introduction of wage bill measures, structural measures were found to achieve savings of 1.7 percentage points of GDP on average, compared with 1 percentage point following non-

[5] Thereafter, Honduras's wage bill remained stable relative to GDP until the COVID-19 pandemic intervened.

structural measures (Figure A9.1. Panel 4). Recent examples of countries which have successfully implemented structural measures with respect to compensation are summarized in Table A9.1.

Figure A9.1. Indicators of Public Sector Wage Bill and Employment



Sources: South African authorities, South Africa Quarterly Employment Statistics survey, IMF Government Wage Bill and Employment Dataset, Labor Market Dynamics in South Africa survey 2018, Quarterly Labor Force Survey 2020 Q1–Q3, IMF (2014), and IMF staff calculations.

Note: In panel 1, ZAF general government includes the consolidated government (national government, social security funds, provincial governments, and some public entities) and local governments. Dotted lines are medians calculated also using values for countries not necessarily appearing in the figure. Central government or public-sector data are used where general government data are unavailable. In panel 2, estimates control for education, gender, age, age squared, and province, and are statistically significant at the 1 percent level. The regression's dependent variable is hourly earnings, and the sample is restricted to full-time adult employees. In panel 3, annual figures are averages of quarterly index values. In panel 4, *t* indicates the year of introduction of the wage bill measures. Measures include both compensation- and employment-based measures.

Table A9.1. Examples of Successful Structural Reforms to Compensation

Egypt	Reduced its wage bill by about 3.5 percentage points of GDP between 2014 and 2019, notably thanks to tightened controls of bonuses and allowances, as well as measures to contain employment.
UK	Achieved savings of almost 2 percentage points of GDP between 2010 and 2016 thanks to a combination of short-term pay freezes and structural compensation reforms, including the removal of "automatic time served progression pay" and the introduction of central controls on allowances and bonuses.
Georgia	Reduced its wage bill by over 1 percentage point of GDP between 2016 and 2018 through compensation reforms, which included setting salary ceilings for different grades of the civil service and consolidating bonuses and supplements into the salary structure.

Source: IMF staff.

Notes: The UK also resorted to employment reduction measures, albeit in a context of high government employment. The wage bill remained stable relative to GDP until the COVID-19 pandemic intervened in all three countries.

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Annex X. 2021 FSAP Key Recommendations

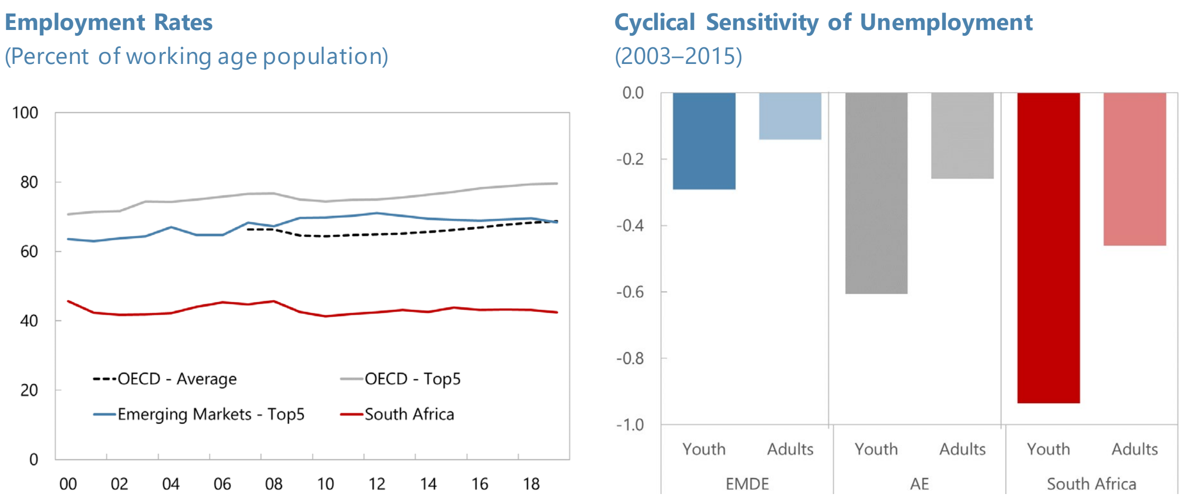
	Adopted by	Timing[1]
Vulnerability analysis		
Further strengthen analytical tools, including for solvency and liquidity stress tests and climate risk analysis, and incorporate results in risk-based supervision	SARB, PA	MT
Financial sector oversight		
Continue to broaden the macroprudential toolkit and close data gaps	SARB	MT
Consider carefully calibrated measures to alleviate the financial sector-sovereign nexus	SARB, NT	MT
Continue safeguarding the supervisory agencies' operational independence, further strengthen resourcing, and enhance coordination	PA, FSCA, NCR NT	MT
Pursue more structured, intrusive, and comprehensive (risk-based) supervision, with greater focus on governance and risk management (credit, liquidity, and other significant sources)	PA, FSCA	ST
Develop a rigorous framework for early intervention in banks	PA	MT
Scrutinize insurers' capital calculations, review products with high lapse and surrender rates, conduct industry-wide stress tests, and analyze the impact of IFRS 17 adoption	PA, FSCA	MT
Enact the COFI bill; develop and implement conduct supervision framework	NT, FSCA	MT
Fast-track adoption of the NPS Act, while buttressing supervision of Fintechs	NT, FSCA,	ST
Implement a consistent, multi-sectoral regulatory framework that articulates supervisory and oversight expectations for cyber resiliency	SARB, PA	MT
Improve climate risk oversight	SARB, PA	MT
Improve the implementation of the risk-based approach to AML/CFT and bring all sectors covered by the FATF standards under the AML/CFT framework	NT, PA	MT
Financial safety nets		
Adopt and operationalize the new resolution and deposit insurance legislation	NT, SARB	ST
Following the adoption of the new legal framework, step up crisis preparedness through resolvability assessments, resolution planning and recurrent simulations.	SARB	ST
Systemic liquidity		
Extend SARB's ELA guidance to temporary liquidity support for solvent banks	SARB	MT
Improve the repo market by establishing collateral interoperability; harmonizing regulatory treatments of different types collateral and repos; and promoting the wide-spread use of repos under the Global Master Repo Agreement (GMRA)	NT, SARB, PA, FSCA	ST
Competition and efficiency, financial inclusion, green and MSME finance		
Enable the provision of payment services by nonbanks	NT, SARB,	MT
Foster retail payment instrument interoperability and open banking standards	SARB	MT
Improve credit information environment	NCR, FSCA	ST
Strengthen secure transaction framework	NT, NCR	MT
Finalize the taxonomy of 'green' economic activities and start monitoring flows	NT, SARB	MT
Finalize guidelines on climate-related financial disclosures	FSCA, NT	MT
1/ ST = short term (0–6 months); MT = medium-term (6 months–2 years)		

Annex XI. Labor Market Reform Options[1]

The employment level in South Africa is significantly lower than in advanced economies and other emerging markets. The COVID-19 pandemic further strained an already fragile labor market, raising the urgency of action. Labor market reform efforts should focus on improving the design of key labor market institutions and active labor market policies to facilitate job creation, which would primarily benefit disadvantaged groups such as the young and inexperienced workers.

1. **South Africa's labor market is characterized by structurally low employment and has long shown limited resilience to shocks.** The aggregate employment rate is extremely low in international comparison (Figure A11.1, left panel), reflecting both low labor force participation and very high unemployment. Further, the gap vis-à-vis comparators has been growing over time. Based on Okun's law estimates, unemployment is more responsive to the business cycle in South Africa than in the average emerging market and developing economy (EMDE). However, it is also more responsive than in the average advanced economy (AE), partly because labor market institutions are not conducive to employment-stabilizing pay and/or working hours adjustments in downturns, as discussed below (Figure A11.1, right panel). Moreover, the cyclicality of disadvantaged groups' (un)employment rates is disproportionately high—for example, youth unemployment is about twice as cyclical as aggregate unemployment, and more cyclical than in AEs and other EMDEs.

Figure A11.1. South Africa: Employment and Unemployment Characteristics



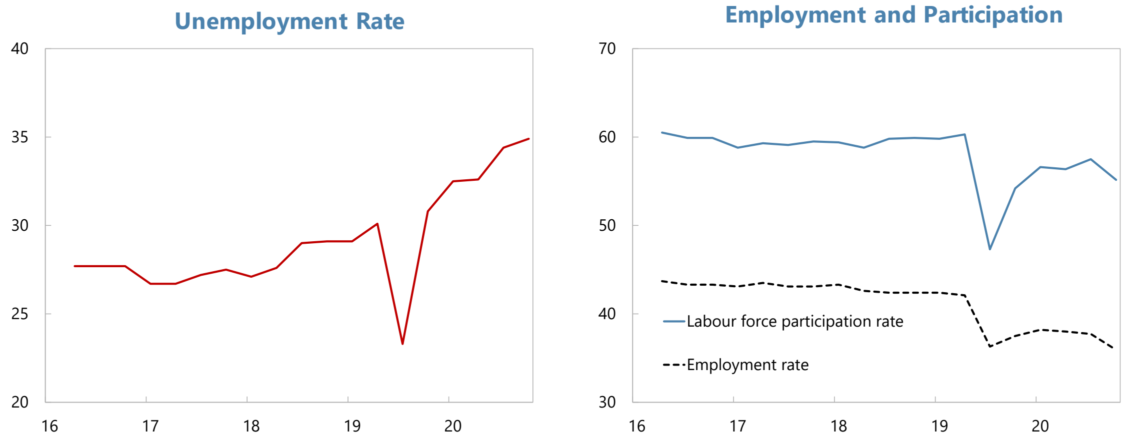
Source: IMF *World Economic Outlook;* South Africa Statistics LFS (2000–2007), QLFS (2008–2019); OECD Labor Market Statistics; ILO STAT; IMF staff calculations.

Note: In the left panel, Top 5 aggregates are the simple average of the five countries with the highest employment rates in the latest year. The right panel shows the estimated response, in percentage points, of the unemployment rate gap to a 1 percentage point rise in the output gap. "Youth" are individuals aged 15–24, while "Adults" denotes the population aged 25–64. All estimates are significant at the 5 percent confidence level. AE = advanced economies; EMDE = emerging market and developing economies.

[1] Prepared by Haonan Qu (AFR) drawing on Duval, Ji, and Shibata. 2021. "Labor Market Reform Options to Boost Employment in South Africa", IMF Working Paper.

2. The COVID-19 pandemic has hit the economy hard, fostering substantial cyclical under-employment. Partly due to the stringency of containment measures, from 2020Q1 to 2020Q2 the employment rate fell by 6 percentage points (to just 36 percent), as people dropped out of the labor force—the labor force participation rate fell by 13 percentage points (to 47 percent) over this same period. Because job seekers also had to temporarily stop looking for jobs, the unemployment rate dropped temporarily (by 7 percentage points, to just over 23 percent). Even though the labor market recovered as people reentered the labor force starting from 2020Q3, the employment rate remained over 6 percentage points below its pre-COVID rate in 2021Q3, and the unemployment rate bounced back to over 34 percent—close to 5 percentage points above its very high pre-COVID rate (Figure A11.2). There was a significant loss of jobs in 2021Q3, partly reflecting the impact of the social unrest in July.

Figure A11.2. South Africa: Labor Market Characteristics
(2017Q1–2021Q3 Percent)



Sources: South Africa Quarterly Labour Force Statistics and IMF staff calculations.

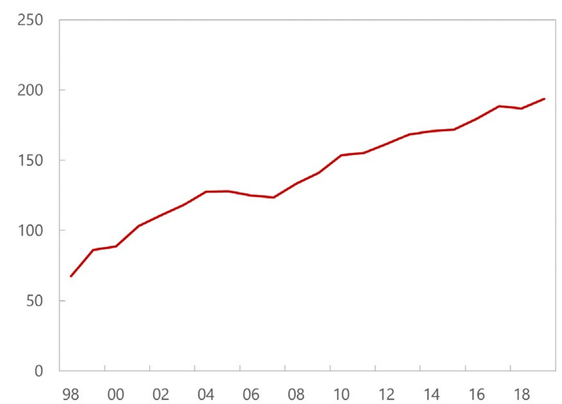
3. The structural employment problem reflects a mismatch between existing labor supply and demand at prevailing market wages. While it has fluctuated over time, South Africa's unemployment rate has never fallen below 20 percent during the last two decades and has slowly risen over time to reach over 30 percent—one of the highest levels globally. Thus, high unemployment in South Africa is a structural problem. On the supply side, low education and entrepreneurship tend to reduce the employability of job seekers, while high commuting costs and, possibly to a lesser extent, social grants paid to some segments of the working-age population, raise reservation wages. On the demand side, labor market institutions—such as wage-bargaining arrangements—further raise wages above levels that would be needed to clear the labor market.

4. Improving the design of labor market institutions and active labor market policies (ALMPs) is necessary to tackle the root causes of extreme structural unemployment. Specifically:

- *Strengthening representation and firm-level flexibility in the collective bargaining system.* South Africa has a relatively centralized bargaining system with low coordination, insufficient representativeness of employers (SMEs particularly), extensive use of administrative extensions, and no firm-level safety valves. These deficiencies prevent the system from delivering high and stable employment. Needed actions include enhancing coordination among social partners, or if too challenging, decentralizing bargaining at the firm level. In any event, collective bargaining should be more representative of all types of firms and workers and allow firms for opting out in collective agreements in case of hardship. Additional criteria for administrative extensions of collective agreements can be designed to incentivize higher SMEs participation in employers' organizations.

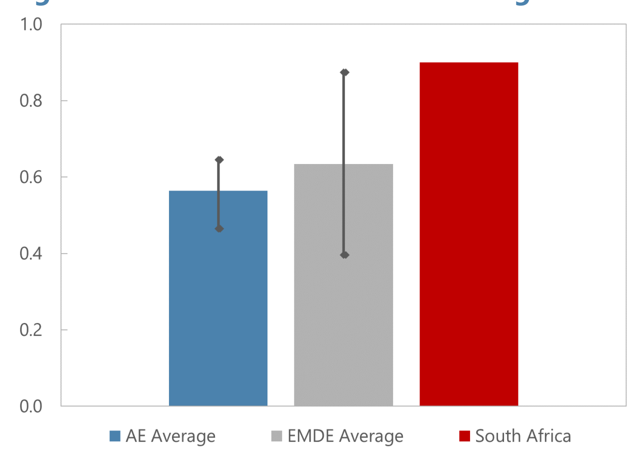
- *Streamlining employment protection legislation* (EPL). While EPL is not particularly tight de jure in South Africa, its enforcement is burdensome and slow, creating undue uncertainty. The number of labor dispute cases has been rising well above the institutional capacity to address them (Figure A11.3). EPL reform should focus on streamlining enforcement by reducing caseloads of labor disputes, shortening dispute resolution procedures, and making settlements more predictable. These efforts should also help reduce labor market dualism as EPL for temporary workers is rather flexible. Considering the risk of further increasing layoffs in the short term amid currently depressed labor market conditions, EPL reform would best be enacted now but with a provision that it will come into force only when economic conditions are stronger. Alternatively, a reform could be grandfathered so that new rules and procedures would apply only to new hires.

Figure A11.3. South Africa: Labor Dispute
(Number of Cases in '000)



Source: 2018/2019 Commission for Conciliation, Mediation and Arbitration (CCMA) Annual Report.

Figure A11.4. Minimum to Median Wage Ratios

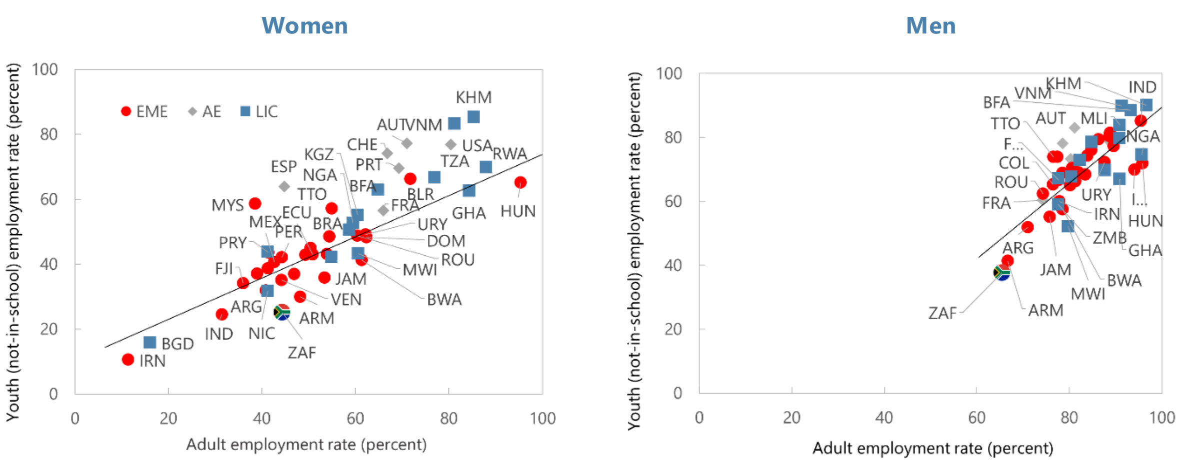


Source: ILO STAT, Statistics South Africa, and IMF staff calculations.
Note: AE and EMDE bars represent average values and vertical lines indicate 90th and 10th percentiles of the distribution. The ratio of South Africa is calculated as nominal minimum wage over median wage of formal sectors, both data coming from South Africa Statistics. AE = advanced economies; EMDE = emerging market and developing economies.

- *Improving minimum wage setting mechanism*. The minimum wage is high in international comparison (Figure A11.4), raising further challenges for SMEs and making it more difficult for disadvantaged workers to find and retain regular jobs. In part, this reflects low absolute median wages, which require that the minimum wage be set at a high relative level to fulfill its antipoverty objective. However, excessively high minimum wages could undermine the job prospects of disadvantaged groups in the labor market, including, among others, the youth. Therefore, minimum wage determination should remain flexible and put due emphasis on the job prospects of disadvantaged groups. In addition, some consideration could be given to introducing sub-minimum wages for certain categories of workers (e.g., the youth), if the minimum wage stays high relative to the median wage in the coming years.

- *Strengthening active labor market policies.* Youth inactivity is stubbornly high in South Africa, with about one-third of the youth neither in employment nor in education or training. As youth employment rates correlate strongly with adult employment rate across countries (Figure A11.5), broad-based labor market reforms will also lift youth job prospects. Well-designed ALMPs could further complement the broad labor market reform effort to raise youth employment rates. While several prominent youth ALMP programs exist in South Africa, there is an emerging consensus that ALMPs need to be very carefully designed to pass a cost-benefit analysis, and that many existing programs are not. International experience suggests that well-designed job search support and geographical mobility subsidies can be effective for South Africa.

Figure A11.5. South Africa: Employment Rates for Youth and Adults
(Adult employment rate percent)



Sources: IPUMS International, and IMF staff calculations.

Note: Youth are 15–29 years old and adults are 30–64 years old. Solid black line is line of best fit. AE = advanced economies; EME = emerging market economies; LIC = low-income countries. ISO 3-letter country codes are indicated for some data points.

Annex XII. Public Spending on Education[1]

South Africa's public spending in education is significantly higher than that of most of its peers, and the education budget allocation has been growing. Nonetheless, the quality of basic education remains subpar, reflecting weak governance and accountability, and insufficient investment in school infrastructure and teacher training. A swelling wage bill and high tertiary education subsidies impair the composition of the education budget. The poor quality of basic education exacerbates the economic impact of skills deficiencies and mismatches—a key labor market constraint contributing to high unemployment rates. There is an urgent need to improve the education system to help better prepare future workers.

1. **South Africa spends more on education than most of its peers.** Public spending on education averaged about 20 percent of total spending over the last decade, above the emerging market economies (EMEs) median of 16 percent (Figure A12.1, left panel). Relative to output, it represented 6.1 percent of GDP compared to an EMEs median of 4.3 percent. High education spending reflects the government's objective of making up for the injustices of the past. The 1994 post-apartheid Reconstruction and Development Program (RDP) set education as a leading pillar to a new and equitable South Africa, where special attention was given to basic education, and "further education and training" (RDP, 1994; National Budget, 1995).[2]

2. **Similar to other EMEs, basic education (primary and secondary) absorbs the largest share of the education budget.** The government spends more on primary education relative to secondary education than other EMEs (and OECD countries). At the same time, the country spends more on further education, adult basic education, and other training (e.g., vocational) than on tertiary education (Figure A12.2, right panel).

3. **Compensation absorbs a large portion of the basic education budget, reflecting relatively high teacher pay mainly in response to teacher unions' demands** (Figure A12.2, left panel). Research shows that compared to other professionals in the public and private sectors, and to most other similar countries, teachers in South Africa are at a pay advantage.[3] Moreover, when compared to countries in the same income group, South African teachers' level of compensation is significantly higher for lower performers (Figure A12.2, right panel). However, the relatively flat salary structure (low remuneration increments for experience and tenure) and the high student-to-teacher ratios have provided little incentive for teachers to perform. Meanwhile, a shrinking capital spending budget exacerbates the ongoing school infrastructure crisis, particularly in rural areas. The country still struggles to provide low-income community schools with proper sanitation facilities,

[1] Prepared by Max Alier (AFR) and Nasha Mavee (local office).

[2] Further education and training include career-oriented education offered in technical colleges, community colleges and private colleges. This qualification is equivalent to grade 10–12 of the basic education system.

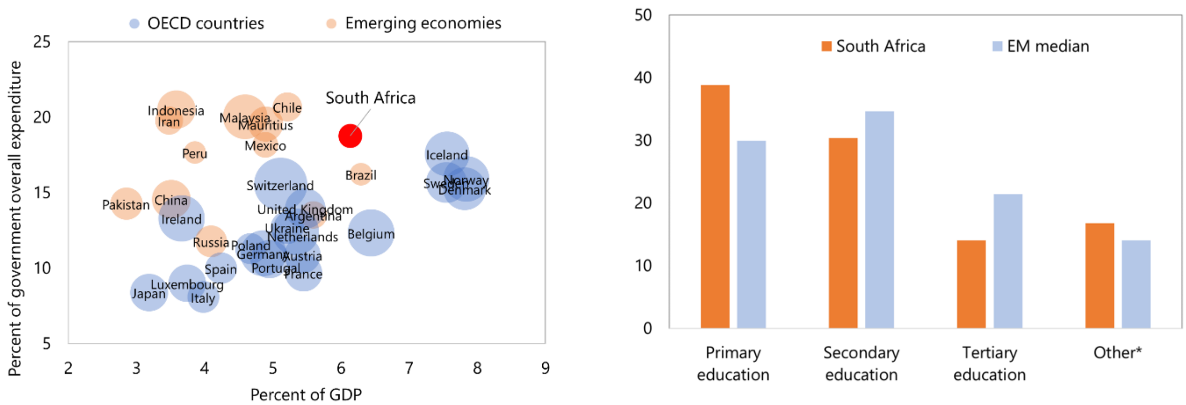
[3] It is only in relation to independent professionals, such as lawyers and doctors, that teachers are at a pay disadvantage (National Development Plan (NDP), Chapter 9, 2012).

electricity, piped water, libraries, and laboratories. Resources allocated to teacher training and support in the basic education are also limited.

Figure A12.1. Government Expenditure on Education, 10-Year Averages

Total

By Level of Education
(Percent of total)



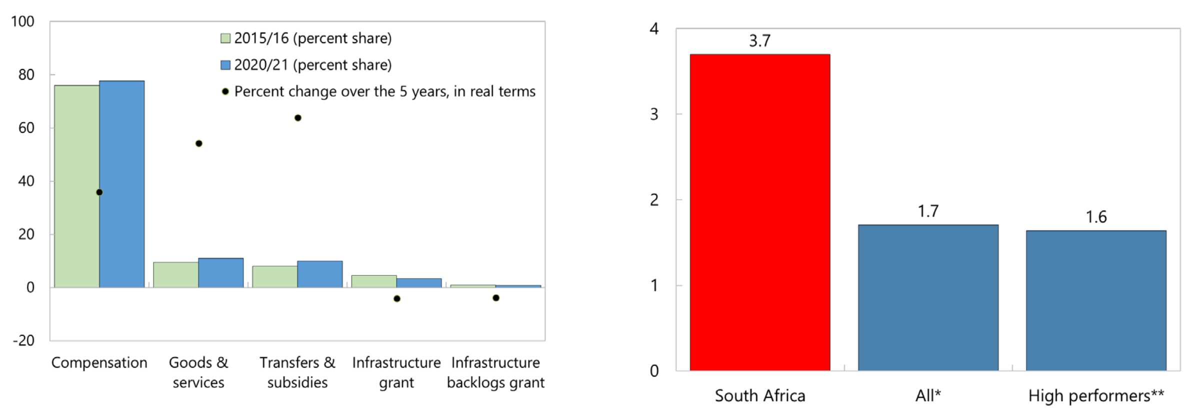
Sources: World Bank World Development Indicators (WDI) 2019, World Economic Forum Global Competitiveness Index, latest 2018.

Note: Left panel: bubble size represents education quality index. Right panel: *Other* refers to "further education and training, adult basic education, and other post school education and training".

Figure A12.2. Government Expenditure on Education

Basic Education Expenditure by Component

Per-teacher Compensation
(Percent of per-capita GDP)



Sources: IMF SDG costing tools, National Treasury South Africa Budget documents,

Note: In the right panel, data are for 2018 or latest. "All" signifies countries with per-capita GDP $6,000–$15,000. High performers are a subset of "All", which excel in scores on Sustainable Development Goal 4: All children have access to a safe, inclusive, and effective learning environment by 2030.

4. **There has been a rapid increase in education spending in recent years, in part reflecting a surge in tertiary education subsidies.** The total education budget rose by over 40 percent in real terms over the past 5 years, during which the tertiary education budget expanded

by almost 80 percent (jumping from 12.6 percent of total education budget in FY15/16 to 19.5 percent in FY20/21), while the basic education budget rose by just over 30 percent (easing from 77.6 percent of total education budget in FY15/16 to 70.3 percent in FY20/21). The rapid surge in funding to the tertiary education system followed the "*fees must fall campaign*" in 2017, which resulted in the increase of the threshold to qualify for free higher education, extending eligibility to students from households with a combined annual income of up to R350,000 (about US$22,000, or four times per-capita GDP).[4]

5. **International evidence shows that contrary to spending in basic education, which is found to be progressive, spending in tertiary education is usually regressive.** Spending in tertiary education tend to benefit the wealthy much more than the poor, as reflected by the lower share of spending devoted to the poorest deciles as compared to spending on the richer deciles. As such, the redistributive effects of tertiary education spending on income inequality are negative (contrary to a positive effect of basic and adult education spending). There is also evidence that tertiary education spending has lower poverty-reduction effects compared to both basic and adult education (Inchauste, G. et al, 2015; World Bank, 2019).

6. **While higher expenditure has been linked to improved school attendance over the years, it has had a limited impact on the quality of education.** According to recent development indicators, including the Global Competitiveness Report (WEF, 2019), South Africa registers marginal improvements but continues to fare poorly in a number of categories, such as the education quality index (Figure A12.1), pupil-to-teacher ratio, adult literacy rate, and ease of finding skilled employees. Empirical studies measuring private and social returns to education through earnings potential (Psacharopoulos and Patrinos, 2018; Salisbury, 2016) have shown that social returns to basic education in South Africa are significantly lower than world averages, in part due to the low quality of the system.

7. **The poor quality of basic education limits the youth's capacity to exploit further opportunities at post-secondary levels.** As a result of the adverse cascading effects of weak basic education, existing skill deficiencies and mismatches are likely to persist in the form of high unemployment, particularly in poor black communities, and a scarcity of skilled workers (World Economic Forum Global Competitiveness Index).

8. **Against this backdrop, the quality of education has ample room for improvement.** There has so far been a disproportionate focus on increasing the reach of education rather than improving its quality, particularly in rural areas. Similarly, focus on curriculum reform has not been accompanied by teacher training to deal with changed curricula. The education system has also

[4] The *"fees must fall campaign"* was a student movement that took place in October 2015, when students protested against large tertiary education fee increases and demanded free tertiary education for all and an increase in university funding. The initial impact of the protests was to prevent any raise in university tuition in 2016. This was followed by a promise by the government to provide free higher education for students as of 2017.

been affected by governance issues and lack of accountability.[5] Lack of clarity in the roles of school governing bodies (including parents, students, teachers, and other staff) and insufficient coordination with schools' management undermine accountability and governance. The evaluation system of teacher performance has proven ineffective in boosting productivity. Apart from being catalysts to poor education outcomes and significant drop-out rates, these inefficiencies have also been identified as factors enticing teachers to migrate out of South Africa (Mlambo and Adetiba, 2020).

9. The COVID-19 pandemic has exposed the education system's fragility and the infrastructure gaps. Lockdown measures significantly disrupted the school curriculum, with most children having lost at least 70 percent of a year of learning since March 2020. The widespread lack of internet access became evident—only 22 percent of households have a computer and 10 percent an internet connection. Pupil dropout rates rose sharply, reaching their highest levels in 20 years with as many as 750,000 children (7–17 years) out of school in 2021 (NIDS-CRAM, 2021) compared with roughly 230,000 before the pandemic (2018). A recovery plan will be necessary in the coming years to reinstitute the original curriculum. Unsurprisingly, students and schools in low-income neighborhoods are less able to catch up. In addition, the loss of teachers' lives due to the pandemic has left a vacuum in the system, while absence rates rose as many others were unable to fulfill their duties due to sickness, self-isolation, and childcare constraints.

10. The education system can improve significantly by reallocating resources and making their use more efficient. With greater resources, the public-school infrastructure in low-income neighborhoods and teacher preparedness would improve. To secure those resources, a pay system that links salary increments to teacher productivity and performance, measured by outcomes, is a key step.[6] Frequent monitoring and evaluation of teachers' performance as well as of education quality outcomes is crucial. The adoption of standardized tests to assess learning; regular participation of students in international assessments; continuous teacher training programs; improved governance and accountability; and better alignment between political incentives and viable economic policies are paramount to achieving the education and skills goals for a new and equal-opportunity society.

[5] Ngoma, W. Govender, L., and Mc Lennan, A. 2017. *Reimagining Basic Education in South Africa: Lessons from the Eastern Cape*. First Edition. MISTRA and the Real African Publishers, Johannesburg.

[6] Globally, the results of pay-for-performance incentives schemes are variable but broadly positive in terms of improvements in the measured performance of students (India, Israel, Kenya, Brazil).

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Annex XIII. Progress in the Fight Against Corruption[1]

South Africa's deeply entrenched corruption documented by the Commissions of Inquiry is a severe impediment to economic growth and development. Aware of this, the government has announced important reforms focusing on strengthening criminal justice institutions and facilitating the investigation of the systemic weaknesses underlying fraud and corruption in both the public and private sectors. While steps have been taken to empower government and civil society to identify and take corrective measures to combat corruption, the depth and breadth of "state capture" calls for sustained actions to establish credible deterrence mechanisms to root out corruption and improve governance.

Commissions of Inquiry

1. **The government instituted several commissions of inquiry in the past three years to investigate the extent of corrupt activities in state institutions** (Table A13.1). Commissions of inquiry into the state-owned energy company (Eskom), the South African Revenue Services (SARS), the National Prosecuting Authority (NPA), and the Public Investment Corporation (PIC) exposed deeply entrenched misuse of funds and power, substantial impropriety, and ineffective governance by public-sector officials and by private companies and individuals. The findings and recommendations of these commissions led to the removal of corrupt personnel, including at higher levels; the appointment of new leaders; and the adoption of turnaround strategies.

2. **The Judicial Commission of Inquiry into "Allegations of State Capture" continues, supported by the government and other institutions.** The Inquiry investigates wide-ranging claims of corruption and fraud in the public sector (including organs of the state). The work of the commission has mostly focused on allegations during former President Zuma's administration and corruption at SOEs and institutions such as Eskom, the rail, port, and pipeline company Transnet, the South African Broadcasting Corporation (SABC), the defense equipment manufacturer Denel, South African Airways (SAA), and the State Security Agency (SSA). Testimony at the commission has shown that the criminal justice system was compromised and weakened. The first of three parts of the final report was published in early-January 2022 and presents evidence of widespread corruption and governance weaknesses at state entities, resulting in misappropriation of public resources and long-lasting institutional damage.

3. **The findings and recommendations of the commissions exposed systemic weaknesses in both the public and private sectors.** Shortcomings include the lack of adequate governance structures entrenched in the legislation; the absence of checks and balances to ensure adherence to sound policies and processes; weaknesses in procurement processes; and appointments of non-qualified officials in key institutions. It is therefore vital that the government sustains the momentum of the rebuilding efforts to address these weaknesses.

[1] Prepared by Max Alier (AFR), Nasha Mavee, and Hermine Ilunga (both local office).

COVID-19 Corruption

4. The Auditor-General identified irregularities in employee/employer payments and the procurement of goods and services. Three special reports on the financial management of the COVID-19 initiatives have been published. In response, the government tightened regulations, established a mechanism (so called *Fusion Centre,* which brings together key law enforcement agencies to share information and resources) to deal with investigations into COVID-19-related fraud and corruption, and gave the *Special Investigating Unit* a wide-ranging mandate to investigate allegations. These inquiries have facilitated the recovery of some misappropriated resources. Further, as part of its governance and transparency commitments, the government also published the details of all COVID-19-related procurement contracts online.[2] However, more needs to be done to address the "significant deficiencies in the procurement and contract management processes" which led to poor internal controls and potential fraud.

Political Party Funding Act

5. *The Political Party Funding Act,* which regulates public and private funding of political parties, entered into effect in April 2021. It establishes the *Represented Political Party Fund (RPPF)* for the funding of political parties represented in national and provincial legislatures. The act sets limits on private donations; requires donors and political parties to disclose all donations to the Independent Electoral Commission (IEC); bans donations for purposes other than political ones; and prohibits donations by organs of state, SOEs, foreign governments, agencies, and individuals except for training, skills development, or policy development. The act is expected to have far-reaching consequences by improving governance and transparency in the political process.

Other Commitments and Actions

6. The government has announced a zero-tolerance policy for corruption in all sectors of society. A *National Anti-Corruption Strategy* was developed to foster the values of integrity, transparency, and accountability, and respect for the rule of law while adhering to the objectives of the National Development Plan 2030 and South Africa's international and regional obligations. Several organizational structures have been and will be established to prosecute high-level corruption and recover stolen public funds. The challenge will be to effectively implement the new policies and procedures and for the prosecution agencies to use their renewed empowerment to successfully investigate and hold accountable those involved in acts of corruption. Passing the new procurement legislation, aimed at consolidating rules and management of the public procurement system within one framework, is also crucial.

[2] The database is incomplete as some government departments failed to report relevant information to the National Treasury (NT). The names of the awarded companies and their directors (rather than beneficial owners per RFI commitment) are listed on the NT's website.

Table A13.1. South Africa: Status of Governance Reforms

Key Findings	Recommendations	Actions Taken	Status of Commission
Parliament Inquiry into Governance, Procurement, and the Financial Sustainability of Eskom /1			
*Systematic flouting of governance rules, which rendered Eskom financially unsustainable. *Eskom allowed irregular procurement practices to serve the interests of private businesses and individuals, including Eskom staff members. *International and domestic audit and consulting firms were co-opted to facilitate corrupt practices.	*Law enforcement agencies to pursue investigations and prosecution of those implicated. *Evidence to be further investigated by the State Capture Inquiry.	*A new board and senior executives were appointed. *Executives are pursuing investigations into fraud, corruption, and other crimes at the power utility. *Global consultancy McKinsey returned 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. *Deloitte agreed to pay back R150 million in fees. *Eskom has demanded that PwC return R95 million in consultancy fees. *The State Investigating Unit (SIU) has frozen assets of former Eskom senior managers implicated in corruption. *Eskom recovered R1.56-billion from Switzerland-based ABB for overpayment of a Kusile contract. *Eskom and SIU issued summonses to recover State capture funds from a Gupta family-owned firm. *Restructuring: ESKOM is set to finalize its restructuring into three separate units by December 2022: legal separation of Transmission expected in December 2021, legal separation of Generation and Distribution expected by December 2022. *State capture also delving into corruption/malfunctions at Eskom.	Concluded
Commission of Inquiry into Tax Administration and Governance by SARS /2			
*Extensive failure of integrity and governance under the leadership of the former commissioner. *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.	*Removal of the former SARS Commissioner. *Criminal prosecution for the awarding of a contract to Bain & Co for the restructuring of SARS. *National Treasury to review the procurement processes of SARS projects to prevent abuse. *Re-establishment of the Large Business Centre, the Compliance Unit, and the establishment of a high-level Integrity Unit. *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.	*Former Commissioner was removed, and several senior staff were forced to resign. *New commissioner appointed through a transparent selection process. *The Large Business Center was re-established and an illicit economy unit—with special focus on tobacco smuggling—has been established. *A separate division at SARS has been established to focus solely on the impact on the fiscus following the outcome of the commissions of inquiry into state capture. *Developing digital capabilities: SARS has promoted the e-filing platform for taxpayers to file returns.	Concluded

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.

Table A13.1. South Africa: Status of Governance Reforms (continued)

Key Findings	Recommendations	Actions Taken	Status of Commission
Commission of Inquiry into the National Prosecuting Authority (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. *Investigating Directorate in the NPA was set up to prosecute high-level corruption. *SIU Special Tribunal was set up to recover stolen public funds.	Concluded
Commission of Inquiry into Allegations of Impropriety Regarding the Public Investment Corporation (PIC)			
*Both impropriety and ineffective governance in a number of investments. *Substantial impropriety and abuse of power by former CEO. *Sound policies, processes, and frameworks were often not adhered to, deliberately bypassed, and/or manipulated. *Substantial loss of funds for the institution to be urgently recovered.	*Internal disciplinary action for former top executives. *Relevant Delegations of Authority be reviewed by no later than June 2020. *Urgent attention and action by different state institutions, including the criminal justice system, National Treasury, and reconstituted PIC Board. *The PIC and GEPF should jointly investigate whether monies were paid and properly accounted for, and whether any of these monies should be recovered – the Commission recommends this be done within 6 months of the report's publication. *A forensic audit on some transactions be undertaken and, if necessary, the matter be referred to regulatory and law enforcement agencies. *Work and appointment of advisors to investees for potential transactions also requires review, including a review of all advisor contracts over the past 5 years. *Skills set of the PIC Board should ensure that Board members and senior management have the requisite knowledge of expertise in relevant fields.	*PIC terminated its investment manager linked to a R4.3 billion deal with Ayo Technology Solutions. *Internal disciplinary action for top executives took place, the PIC Board reconstituted. *The National Treasury was tasked with developing a detailed plan of action for itself and the PIC Board, monitoring the implementation of this plan and reporting to the presidency on progress in implementation steps at regular intervals. *PIC Act was signed into law February 2021, introduced changes to the board which require that it be chaired by a deputy minister appointed by the minister of finance and that it include trade union representation.	Concluded

Table A13.1. South Africa: Status of Governance Reforms (concluded)

Key Findings	Recommendations	Actions Taken	Status of Commission
	*Appointment processes will have to be reviewed to ensure this is the case throughout the organization. *Changes to laws governing the PIC, considering the PIC Amendment Bill of 2017 and their recommendations, as well as operating models.		
Judicial Commission of Inquiry into Allegations of State Capture			
*Most testimonies given to the inquiry have focused on allegations of corruption during the administration of former President Jacob Zuma, maladministration and corruption at state enterprises, and institutions such as Transnet, Eskom, SABC, Denel, SAA, and SSA.	*Pending conclusion of final report.	*Ongoing and hearings concluded in August 2021: President Ramaphosa, among others, participated in hearings. Former President Jacob Zuma was arrested for contempt of court.	The first of three parts of the final report was published in early-January 2022.

Annex XIV. Technical Cooperation

The technical cooperation strategy is aligned with the Fund's surveillance activities. South Africa's technical capacity is high and the authorities appreciated Fund support and anticipate further engagement.

1. **The technical cooperation strategy is aligned with the Fund's surveillance activities**. Priorities include enhancing expenditure rationalization, contingent liability management, and 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 key surveillance issues: reviving growth by implementing structural reforms, consolidating government and SOEs positions, and maintaining credible monetary and financial sector policies.

2. **South Africa's technical capacity is high**. Ensuring support from the authorities requires it to be demand-driven and prioritized. Recent cooperation by the Fund relates to public-sector wage bill management, capital flow management measures, and property price index development. The FSAP also provided an opportunity to discuss reforms in the financial sector area.

Overall Priorities for Further Technical Cooperation:

Priorities	Objectives
Fiscal Risk Management	Support further enhancements to the budgetary framework including in the areas of zero-based budgeting and gender-responsive budgeting. Support the potential introduction of a public debt ceiling as a fiscal anchor to complement the expenditure ceiling.
Tax Administration	Restore a large taxpayers' unit and make it fully operational. Reduce tax base erosion and profit shifting, especially by multinational companies. Update customs legislation.
Public Investment Management	Undertake a public investment management assessment (PIMA).
Financial Stability and Inclusion	Assist the authorities in implementing FSAP recommendations to help enhance the financial stability framework. Explore opportunities for greater financial inclusion. Assist the authorities in developing a capital account liberalization strategy that could facilitate the adherence to the OECD Codes of Liberalization.
Statistics	Continue to improve the seasonal adjustment of quarterly national accounts statistics and assisting in developing a residential property price index (RPPI).

Authorities' Views

3. **The authorities appreciated Fund support and anticipate further engagement**. The FSAP was a key undertaking that helped shape the financial sector reform process. Future cooperation will be guided by the authorities' interest in improving the medium-term fiscal framework; further strengthening tax administration; conducting a public investment management assessment (PIMA); maintaining financial stability while supporting financial inclusion; and upgrading national account statistics.

Appendix I. Status of Key Recommendations from the 2019 Article IV Consultation

	Recommendation	Status
Fiscal Policy	Target medium-term debt stabilization.	Stabilizing debt dynamics has not been possible in the context of the pandemic-induced output contraction and spending pressures, which compounded the budgetary strain from rising interest and wage bills and continuing transfers to SOEs.
	Pursue growth-friendly and largely expenditure-based consolidation measures.	Significant scope remains to rein in the wage bill, harden SOE budget constraints, and streamline poorly targeted tertiary education subsidies.
	Improving expenditure efficiency by institutionalizing periodic spending reviews.	While spending reviews have been carried out, they have not been institutionalized.
	Introduce a debt ceiling in addition to the existing nominal expenditure ceiling.	No debt ceiling was introduced. The authorities prefer to introduce it once there is more certainty about the evolution of public finances to ensure its credibility.
	Improve tax administration and tax efficiency.	Progress has been made in undoing the damage inflicted to the SARS by state capture. Additional budgetary resources were granted to the tax administration to improve compliance and broaden the tax base. However, there remains room to improve tax administration.
State-Owned Enterprises	Improve SOEs' performance through reforms and restructuring, including closure or divestiture.	Some marginal progress. Eskom completed the functional separation of its divisions. The National Transmission Company of South Africa was established as a wholly owned subsidiary of Eskom. However, completion of the planned unbundling requires legislative action and a decision on how to address its unsustainable debt. SAA required further bailouts ahead of the eventual acquisition of a majority stake by a PIC-linked domestic consortium; Transnet National Ports Authority is to be corporatized as an independent subsidiary of Transnet.
	Make further transfers to Eskom conditional on reforms to reduce costs and increase revenues.	Transfers to Eskom remain not conditioned on achieving tangible improvements in reducing costs and increasing revenue.
	Make SOEs more efficient and reduce their operating costs.	Eskom has made some progress in reducing costs However, significant improvements in efficiency and productivity are still needed.
	Collect Eskom's municipal arrears.	Municipal arrears continue to accumulate.

	Recommendation	Status
Monetary and Financial Policy	Monetary policy could remain accommodative but should continue to cautiously monitor both upside and downside risks.	The SARB appropriately loosened monetary policy amid the pandemic. It hiked the policy rate as upside inflation risks emerged.
	Enhance the crisis-management framework.	Plans for a new resolution regime and deposit insurance scheme are progressing. Legislation still needs to be adopted.
	Advance progress on financial inclusion.	Facilitated the creation of more micro insurers and affordable insurance products. Continued to help enhance financial inclusion through digitalization.
	Increase foreign exchange reserves as opportunities arise.	Economic conditions presented limited opportunities to increase reserves. The general SDR allocation was used to increase reserves.
Structural Reforms	Bring to conclusion reforms already in the pipeline in energy, transport, telecommunications, and mining by establishing fair and clear investment rules.	The licensing exemption threshold for embedded electricity generation was raised, and a regulation that allows third-party access to the railway network was finalized. The digital migration and spectrum allocation processes faced further delays. A recent court ruling helped resolve disputes related to the mining charter.
	Move industrial policy from providing subsidies and tax breaks to selected sectors to facilitating favorable business conditions to attract any firms that can compete in global markets.	Industrial policy remains substantially the same, with strong emphasis on localization and protection.
	Intensify efforts to prosecute those engaged in corrupt activities.	The report of the Zondo Commission of Inquiry into State Capture was partially released. Active prosecution to those engaged in corruption activities needs to follow.
	Improve labor market flexibility by decentralizing wage bargaining and relaxing management restrictions. Improve the quality of education to address skills mismatches.	No labor market or education reforms were implemented.
Social	Well-targeted social spending must be safeguarded to protect the poor.	Social assistance was increased during the pandemic.
	Limiting tertiary education subsidies to poor households only.	No education subsidy reform was implemented.
	Improve efficiency of education and health expenditure.	No change was made to expenditure and health expenditure policies to improve efficiency.

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 21, 2022

Prepared By | The African Department in collaboration with other Departments and the World Bank

CONTENTS

RELATIONS WITH THE IMF

As of December 31, 2021

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	5,450.24	178.63
Reserve tranche position	652.45	21.38
Lending to the Fund		
New arrangements to borrow	7.88	

SDR Department:	SDR Million	%Allocation
Net cumulative allocation	4,709.85	100.00
Holdings	4,421.97	93.89

Outstanding Purchases and Loans	SDR Million	%Quota
Emergency Assistance 1/	3,051.20	100.00

1/ Emergency Assistance may include ENDA, EPCA, and RFI

Latest Financial Commitments:

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

Outright Loans:

Type	Date of Commitment	Date Drawn	Amount Approved (SDR million)	Amount Drawn (SDR million)
RFI	Jul 27, 2020	Jul 29, 2020	3,051.20	3,051.20

Projected Payments to the IMF

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

		Forthcoming			
	2022	2023	2024	2025	2026
Principal		381.40	1,525.60	1,144.20	
Charges/interest	33.04	33.11	22.77	6.35	0.30
Total	33.04	414.51	1,548.37	1,150.55	0.30

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. The National Treasury and the SARB will continue to develop the legislative framework for the new capital flow management system.

Article IV Consultation

The 2019 Article IV consultation was concluded by the Executive Board on January 24, 2020. South Africa is on the standard 12-month Article IV consultation cycle.

Safeguards Assessment

A first-time safeguards assessment of the SARB, conducted in connection with the Rapid Financing Instrument (RFI) approved by the Executive Board on July 27, 2020, is substantially complete. The assessment found that the SARB has solid safeguards in place in all assessed areas, including audit mechanisms and financial reporting practices, which adhere to international standards. Governance arrangements are strong, and the SARB Board and its Audit Committee are actively engaged in

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

oversight. That said, the SARB Act's provisions on autonomy could be further strengthened to align with leading practices. The central bank has also a strong control culture, which is supported by a well-developed risk management function. The assessment also found that the business model of the Corporation for Public Deposits (CPD) and the SARB's involvement need to be revisited, and further enhancements to strengthen the analysis of the contingency reserve for risks and the reporting on audit recommendations are needed.

Technical Support

Fiscal Affairs Department (FAD)

Technical 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 workshop with the National Treasury took place in 2013. Missions provided advice on expenditure reviews and options for further strengthening the PBO, and developed a pilot of the Tax Administration Diagnostic Assessment Tool (TADAT) in 2014. Another TADAT assessment was completed in 2021. 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 took place 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 supported the National Treasury in developing a fiscal stress testing framework in June 2018. Subsequent support and training has been provided via AFRITAC South (AFS) in 2018 and 2019.

Both a zero-based budgeting workshop to share OECD experience and a gender-responsible budgeting mission took place in 2021.

Monetary and Capital Markets Department (MCM)

An MCM mission supported the South African Reserve Bank (SARB) on banking sector stress tests in May 2014, and AFS on modernization of monetary frameworks in 2014. Other missions worked with 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 delivered seminars on risk-focused approach to supervision of cross-border transactions in July 2019 and March 2021 (webinar).

In August–October 2020, MCM undertook the first part of the work on Banking Regulation and Supervision–Basel III to collaborate with the South African Prudential Authority (PA) in revising and updating its prudential regulations for traded market risk to align with Basel III. The second part of the work is expected to be held in-country when feasible. In addition, AFS and MCM have collaborated on several webinars in 2020 and 2021 to deliver information to AFS member countries, including South Africa, on regulatory and supervisory responses to the COVID-19 pandemic. AFS also continues to explore ways in which it can collaborate with the SARB Academy, to deliver technical support to the region. The IMF-World Bank join FSAP concluded in the summer of 2021.

MCM has worked with the South African authorities in developing a plan for further capital flow liberalization that is adequately sequenced and considers country-specific macroeconomic, financial, and institutional conditions. A related workshop in November 2019 shared peer countries' experience, thereby facilitating the authorities' design of a plan for liberalizing capital flows, while managing the associated risks. A related mission designed with the authorities a roadmap to judiciously liberalize financial flows considering South Africa's intention to join the OECD Codes of Liberalization.

Legal Department (LEG)

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

Statistics Department (STA)

An STA mission collaborated with Statistics South Africa (STATS SA) in assessing the potential for developing an official residential property price index (RPPI) in 2018. An AFS mission focused on the development of an experimental RPPI series for Pretoria in February 2021. AFS will seek to expand coverage of the RPPI to include other provinces and areas before publication in end-2021.

A series of AFS missions in 2019-21 cooperated with STATS SA's efforts to derive seasonally-adjusted national accounts estimates; and improve the alignment between the quarterly national accounts estimates and short-term indicators, particularly for household final consumption expenditure and monthly retail sales. Other series reviewed included the import and export price series, and the monthly mining series. The mission reviewed in detail with the authorities the approach taken by STATS SA 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. An STA mission supported the SARB's work on compiling a set of integrated national accounts by institutional sector in June 2020.

THE JMAP WORLD BANK IMF MATRIX

The IMF South Africa team led by Ms. Ana Lucía Coronel met with the World Bank South Africa team led by Ms. Marie-Françoise Marie-Nelly in December 2021 to discuss macro-critical structural issues.

The teams agreed that South Africa's challenges include maintaining macroeconomic stability while 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 exchange information on progress in macro-critical structural reforms 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 exchange information on progress in the areas of macroeconomic stability (fiscal, monetary, and financial sector policies) and macro-critical structural reforms. Timing: when milestones are reached (and at least semiannually).

Table 1 lists the teams' separate and joint work programs during May 2021–April 2022.

Table 1. South Africa: Bank and IMF Planned Activities in Macro-Critical Reform Areas, May 2021–April 2022

Title	Products

1. World Bank Work Program[1]	• Development policy operation.
	• PPP framework review
	• Economic updates
	• Analytical work on leveraging trade for recovery
	• Possible public expenditure review
	• Eskom investment support and renewable support projects
	• Government debt and risk management
	• Inclusive economic development at city, regional, and national levels
	• Effective and sustainable fiscal and urban financing
	• Strengthened governance
	• Southern Africa:
	  ◦ Digital engagement and financial inclusion
	  ◦ Skills for gainful employment for the youth

2. IMF Analytical Work Program	The IMF will continue to conduct analytical work on topics related to: • Varying impact of COVID-19 on mobility • Drivers of capital flows • Financial sector-sovereign nexus • Household debt vulnerabilities • Public sector wage bill • SOE's financial situation • Labor market reform options • Climate risks and mitigation
3. Joint Products in the Next 12 Months	• Coordination on structural reform advice • Assist with the implementation of FSAP recommendations

[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 21, 2022)

I. Assessment of Data Adequacy for Surveillance
General: Data provided to the IMF are adequate for surveillance.
National Accounts: Statistics South Africa (STATS SA), which is responsible for compiling GDP data by production, has also taken over the compilation of GDP data by expenditure from the South African Reserve Bank (SARB). GDP data are compiled according to *System of National Accounts 2008*, with a base year of 2010. STATS SA published a revised GDP series in August 2021, raising nominal GDP level by around 10 percent. Reporting of real sector data for *International Financial Statistics (IFS)* is timely. Quarterly labor market statistics are published two months 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. Since 2015, a new Master Sample has been introduced based on the information collected during the 2011 Census. The new Master Sample should improve the level of precision in the estimates produced.
Price Statistics: The consumer price index (CPI) covers all private households in South Africa. The current CPI weights are based on expenditure data collected from the 2014/15 Living Conditions Survey (LCS), supplemented by other data sources to ensure reliable weights. Supported by Africa Regional Technical Assistance Center South (AFS), STATS SA is in the process of developing an official residential property price index (RPPI). An experimental index covering Pretoria has been developed for internal use, and the coverage of the series will be expanded to include other provinces and areas before the data are published externally.
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 the IMF's Statistics Department (STA) for the GFS database need to be fully reconciled. The 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 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 (2000)*. South Africa reports regular and good quality monetary statistics for the central bank, other depository corporations, and other financial corporations in Standardized Report Forms for publication in the *IFS*, although there is room for improving the timeliness of the data on other financial corporations. South Africa reports several data series and indicators of the Financial Access Survey (FAS), including two indicators (commercial bank branches and ATMs, both per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals.

Financial Sector Surveillance: South Africa reports Financial Soundness Indicators (FSIs) to the Fund—published on the IMF's FSI website. All core and eleven "encouraged" FSIs for deposit takers and two "encouraged" indicators for real estate markets are reported monthly. One "encouraged" FSI for deposit takers and two "encouraged" FSIs for households are reported quarterly. The Residential Real Estate Price Index, which had been based on data compiled by a commercial bank, ceased to be reported to STA in 2016.	
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)*. 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 compiled 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	
A subscriber to the IMF's Special Data Dissemination Standard (SDDS) since 1996, South Africa met SDDS specifications on September 18, 2000. South Africa's latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board.	A Report on *Observance of Standards and Codes—Data Module; Response by the Authorities, and Detailed Assessments Using the Data Quality Assessment Framework* was published on October 16, 2001.

Table 2. South Africa: Table of Common Indicators Required for Surveillance

(As of January 21, 2022)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange rates	1/20/2022	1/20/2022	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	12/31/2021	1/7/2022	M	M	M
Reserve/base money	12/31/2021	1/7/2022	M	M	M
Broad money	11/30/2021	1/7/2022	M	M	M
Central bank balance sheet	12/31/2021	1/7/2022	M	M	M
Consolidated balance sheet of the banking system	11/30/2021	1/7/2022	M	M	M
Interest rates[2]	1/20/2022	1/20/2022	D	D	D
Consumer Price Index	12/31/2021	1/19/2022	M	M	M
Revenue, expenditure, balance and composition of financing[3] – general government[4]	Q3 2021	12/31/2021	Q	Q	Q
Revenue, expenditure, balance and composition of financing[3]–central government	11/30/2021	12/31/2021	M	M	M
Stocks of central government debt[5]	11/30/2021	12/31/2021	M	M	M
Stock of central government guaranteed debt	3/31/2020	2/20/2021	A	A	A
External current account balance	Q3 2021	12/9/2021	Q	Q	Q
Exports and imports of goods and services [6]	11/30/2021	12/31/2021	M	M	M
GDP/GNP	Q3 2021	12/07/2021	Q	Q	Q
Gross external debt	Q3 2021	12/31/2021	Q	Q	Q
International investment position	Q3 2021	12/31/2021	Q	Q	Q

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

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

[3] Foreign and 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 Ms. Ita Mannathoko Executive Director for South Africa and Ms. Mmatshepo Maidi, Senior Advisor to the Executive Director for South Africa February 7, 2022

1. Our South African authorities appreciate the constructive discussions with IMF staff during the 2021 Article IV consultation. They broadly share the thrust of the staff assessment, including key policy recommendations to stimulate growth and address socioeconomic challenges.

2. Strong fundamentals helped the South African economy to rebound in 2021, despite the COVID-19 pandemic exacting a heavy toll on economic activity, and contributing to high unemployment, rising public debt, and poverty. The strong recovery reflects the authorities' swift pandemic response with accommodative fiscal, monetary, and financial sector policies to support growth, alongside financial market operations to support market functioning and safeguard financial stability. The Rapid Finance Instrument (RFI) assisted with closing funding gaps and providing budget support to the authorities' health and economic recovery programme.

3. On the health front, the authorities took decisive measures to address the unprecedented threat to lives and livelihoods, including an increase in social grants, employment protection and health spending to support the country's vaccination campaign. As of January 26, 2022, 27.7 percent of the population and 41.4 percent of adult population had been fully vaccinated. The authorities are committed to accelerate vaccinations necessary to mitigate the impact of future waves of the pandemic and support the full reopening of the economy. In this regard, they have announced a planned age-differentiated vaccination rollout expected to improve vaccination in 2022. Furthermore, the newly opened vaccine manufacturing plant represents a significant milestone for the authorities and the continent, given the large dependence on vaccine imports.

4. The authorities are committed to accelerating economic recovery with the implementation of the Economic Reconstruction and Recovery Plan (ERRP) published in October 2020. The ERRP aims to transform the economy through reindustrializing, accelerating economic reforms, improving competitiveness, reducing the high cost of doing business and addressing the weak public sector balance sheet. The plan also seeks to unlock private

sector investment necessary for long term growth and job creation, and foster sustainable, resilient, inclusive, and green growth in line with the vision 2030 National Development Plan which aims to eliminate poverty and reduce inequality by 2030. This is consistent with staff advice to foster private investment to improve productivity and competitiveness, while addressing governance and corruption vulnerabilities, reversing the upward trend in public debt, and mitigating the impact of fiscal consolidation on the most vulnerable groups, supported by increasing the efficiency of government and SOE spending.

Recent Economic Developments and Outlook

5. Economic activity recovered from a sharp contraction in 2020 on the back of strong favourable commodity prices and supportive financial conditions as well as a temporary rebound in investment. Despite the strong recovery in economic activity, labour market and employment prospects have remained weak, as the official unemployment rate rose to 34.9 percent in the third quarter of 2021, while potential output and fixed investment remain low. Going forward, the authorities expect growth to decline to its pre-pandemic level, averaging 1.7 per cent over the medium term, driven by a gradual recovery in confidence and private investment.

6. Inflation remains contained within the target range of 3-6 percent, with headline inflation averaging 4.5 percent in 2021. While demand-side pressures are contained, upward pressure on food and energy prices, wage increases, and exchange rate depreciation present risks to the inflation outlook. Inflation expectations have remained within the mid-point of the inflation target but have ticked up slightly following the most recent South African Reserve Bank (SARB) inflation prints. Going forward, headline inflation is projected to briefly breach the mid-point of the target in 2022 at 4.9 percent before easing back to 4.5 percent at the end of the forecast period.

7. The authorities report that the current account surplus improved from 2 percent of GDP in 2020 to a projected 3.8 percent in 2021 on account of higher commodity export prices. A smaller surplus is expected in 2022 before reversing to small deficits in 2023 and 2024, as imports and export prices normalize, and economic activity picks up. The expectation is that external financing would increasingly come from sources other than historically important non-resident portfolio flows, as these would remain volatile and dampened by weaker investor appetite as global financing conditions tighten. On the reserve position, following the Fund's general allocation of special drawing rights (SDRs), foreign exchange reserves stood at US$57.6 billion in 2021 or 6.2 months of import cover.

Fiscal Policy

8. The authorities recognize that the rising interest rate – growth differential that is likely with interest rate normalization, necessitates reducing deficits to stabilize debt ratios. With that in mind, notwithstanding the elevated spending levels that resulted from the pandemic response package, authorities remain committed to ensuring fiscal and debt sustainability through growth friendly fiscal consolidation to place public debt on a declining path. As such, authorities plan to carefully unwind untargeted policy measures in line with the strength of the recovery. The fiscal deficit is projected to narrow from 6.6 percent of GDP in the FY 2021/22 to 4.9 percent of GDP in FY2024/25, alongside increased revenue collections. Debt is expected to peak at 78.1 percent of GDP in FY2025/26.

9. The authorities broadly agree with staff's assessment of revenue estimates, which were supported by buoyant mining sector performance. They also implemented deliberate revenue boosting measures, which include ongoing measures to capacitate the South African Revenue Service (SARS) and enhance tax compliance and collection, while accelerating SARS modernization initiatives. Announcements regarding the second phase of the carbon tax plans for 2023 and beyond, which aim to reduce allowances on carbon tax, will be made in the 2022 Budget.

10. Our authorities are committed to restraining expenditure as part of fiscal consolidation, including by moderating government wages and strictly controlling headcounts. As an alternative to wage increases in the wake of negotiations with labour unions, authorities provided a once-off gratuity to government employees during the FY2021/22. In addition, they are developing a comprehensive public-sector remuneration strategy to better align competing interests with affordability and are exploring a multifactor index to ensure that wage increases are tied to the performance of the economy, as well as a review of public sector personnel. Spending levels tabled during the November 2022 Medium-Term Budget Policy Statement remain within the expenditure ceiling. Authorities also remain committed to containing fiscal risks from SOEs. Further, to enhance spending efficiency, they are in the process of finalizing the Public Procurement Bill for submission to Parliament in the first quarter of 2022 (subject to Parliamentary processes). Taken together, these efforts will be instrumental in placing debt on a more sustainable path.

11. Regarding the SDR allocation, this has been deposited in the SDR holdings account with the SARB and will be used to meet government's foreign currency commitments in line with liquidity requirements.

Monetary Policy

12. Monetary policy has been accommodative on account of low inflation and well-anchored inflation expectations. Real interest rates turned negative since April 2021, providing much needed support to the economy. However, there are now significant upside risks to inflation. Thus, the Monetary Policy Committee (MPC) increased the repurchase rate in November 2021 and January 2022 by a total of 50 basis points. The SARB's quarterly projection model signals a rise from the current policy rate of 4.0 percent to around 6.5 percent at the end of the forecast period. The MPC has signalled that its decisions will remain data dependent and its preference is for gradual normalisation of policy rates to achieve the right balance between controlling inflation and supporting the economy.

13. In November 2021, the SARB published a consultation paper on its Monetary Policy Implementation Framework. The SARB, which currently follows a classic cash reserve system is considering switching to a tiered floor system. The authorities expect the proposed reform to enhance monetary policy efficiency and confer financial stability benefits, including by providing the SARB with a more superior tool for dealing with excess liquidity, with greater flexibility to pursue balance sheet operations and permitting a larger supply of central bank money while allowing for smoother interaction with regulatory constraints.

Financial Sector Policy

14. The financial sector remains robust thanks to strong regulatory and prudential regulations as confirmed by the findings of the November 2021 Financial Systems Stability Assessment (FSSA). Adequate liquidity and capital buffers in the pre-pandemic period helped banks to weather the COVID-19 pandemic shock. Nevertheless, authorities remain attentive to the possible emergence of financial vulnerabilities; including a possible increase in NPLs that may be exposed once all the regulatory relief provided in response to the COVID-19 pandemic expires, and the bank-sovereign nexus as financial conditions tighten.

15. The Financial Sector Laws Amendment Bill (FSLAB), which aims to introduce a resolution framework for designated financial institutions and reduce fiscal costs in the event of a bank failure has been passed by Parliament and is awaiting Presidential assent. Once enacted, the FSLAB will provide the SARB with the mandate to introduce a deposit insurance scheme and strengthen the resolution framework for financial institutions.

16. The authorities remain committed to safeguarding the integrity of the financial system, in line with international best practice. In this regard, they are taking steps to address deficiencies identified by the October 2021 FATF peer-review. In particular, they are currently strengthening the anti-money laundering and counter-financing of terrorism (AML/CFT) regime, which they plan to complete within the recommended 18-month period. The 2020/21 Financial Sector Assessment Program (FSAP) engagement was also of value. The authorities are committed to addressing vulnerabilities and enhancing financial stability, including through technical assistance on capital account liberalization.

17. Further reforms to the pension sector are being undertaken to ensure a balanced and strong financial system and encourage household savings. In this regard, authorities propose introducing automatic mandatory enrolment and limiting pre-retirement withdrawals, with the introduction of a “two-pot” system consisting of a pot to be preserved till retirement and an accessible pre-retirement pot, that would curb the tendency in some severely impacted groups to resign from jobs to access retirement funds. Authorities will concurrently improve associated governance in retirement funds.

18. The SARB and the BIS are conducting a feasibility study on the role of Central Bank Digital Currency (CBDCs) in promoting financial inclusion. They recognize the need to address challenges to inclusion, low levels of literacy, and the reliance on cash. They have established an Intergovernmental Fintech Working Group (IFWG) to develop fintech and innovation-oriented policies and regulations, including an effective and proportional regulatory framework to address risks associated with crypto assets.

Structural and Governance Reforms

19. The authorities remain committed to fast-tracking structural reforms to foster job-led growth, with great importance placed on addressing long-term structural constraints and reducing scarring from the effects of the pandemic. This is enabled by implementing reforms outlined in Operation Vulindlela, a joint operation between the National Treasury and the Presidency. Reforms on track include a roll-out of e-visa by March 2022 as well as a review of the legal regime governing skilled migration to address the skills mismatch,

with positive implications for employment. Among other things, authorities have also advanced the transition to digital communication with a spectrum auction expected by March 2022. There is also progress on addressing port inefficiencies by increasing private sector investment in port infrastructure and involvement in port operations. Similarly, water use reforms are advancing, with the establishment of a National Water Resource Infrastructure Agency to manage bulk water resources, remaining on track.

20. In the energy sector, the Department of Mineral Resources and Energy has made progress in the review of the Electricity Regulation Act and the Electricity Pricing Policy which are critical in clarifying Government's intention regarding the future end state of the electricity sector. The authorities have also announced additional measures to increase private sector investment in electricity generation, including additional windows of the Renewable Energy Independent Power Producers Purchase (REIPPP) program. Eskom procures renewable energy from Independent Power Producers (IPPs) under the Department of Mineral Resources and Energy's REIPPP Program, which envisages 8 500MW of renewable energy to come online before 2025. IPPs continue to support Eskom's generation capacity and increase the country's energy mix. A total of 90 IPP projects with a capacity of 6 899 MW have been connected to the grid since inception of the REIPPP Program. On 28 October 2021, the Minister of Mineral Resources and Energy announced 25 preferred bidders for Bid window 5 for the procurement under the REIPPP Program with total contracted capacity of 2 583 MW. The total capacity that will be procured by the first quarter of 2022/23 under REIPPP program plus Risk Mitigation Independent Power Producers Purchase Program is 10 901MW and the total investment will exceed R323 billion.

21. In the meantime, given the importance of energy security, work is underway to restructure Eskom with the establishment of the Transmission Company as a subsidiary which was registered by the Companies and Intellectual Property Commission as of 31 December 2021. The authorities will now be engaging the Eskom lenders to seek their consent in order to transfer the Transmission assets to the Transmission company to operate. Eskom has also applied to the National Energy Regulator of South Africa for the transmission license for the Transmission Company. The legal separation of the Generation and Distribution subsidiaries is envisaged to be concluded by 31 December 2022.

22. The climate change agenda remains a priority for our authorities and they are committed to ambitious targets for net zero greenhouse gas emissions by 2050. Adaptation is also a priority, as part of achieving a just transition and promoting climate resilience. In this regard, the National Climate Change Bill, which provides for a coordinated and integrated response for a just transition to a climate resilient and lower carbon economy, was approved by Cabinet on September 14, 2021 and has been submitted to Parliament. Work is also underway to review Eskom's Just Energy Transition plan to decarbonize the energy sector and facilitate migration to renewable energy. A Presidential Climate Commission has been set up to develop pathways by March 2022, to a low-carbon, climate resilient society. The authorities estimate that about US$30 billion in international support would be required over the 5-year period to achieve the Nationally Determined Contributions. In this regard, they appreciate commitments from development partners in the mobilization of US$8.5 billion at the 26th United Nations Climate Change Conference

of Parties (COP 26), in support of South Africa's transition to a low-carbon, climate-resilient future.

23. The first part of South Africa's State Capture Commission report was submitted to the President on January 4, 2022. It addresses governance and corruption challenges and aims to restore integrity and ensure the credibility of state institutions. The remaining parts of the report should be completed by February 28, 2022 and are expected to be submitted to Parliament with an implementation plan by end-June 2022. The National Prosecuting Authority has already set up a dedicated taskforce to respond to the State Capture report.

RFI and post-financing assessment

24. The IMF RFI purchase supported the authorities' efforts in addressing the challenging health situation and severe economic impact of the COVID-19 shock. The authorities express once again their appreciation for the timely RFI disbursement and reiterate that they have used the resources transparently. Some progress has been made in meeting the governance and transparency commitments accompanying the RFI request, though there are delays. In addition, a first-time safeguards assessment of the SARB is substantially complete. It found that overall, the SARB has a strong safeguards framework. South Africa's capacity to repay the Fund under the RFI is adequate under both the staff baseline and adverse scenarios.

25. The authorities remain committed to ensuring full transparency and accountability in the use of the Fund's RFI disbursement. This includes publishing credible spending reports to fulfil their governance and transparency commitments under the letter of intent and ensuring credible reporting in the public financial management system as of February 2022. The National Treasury has published a dashboard with information on procurement contracts and allocation, although the authorities are still working to publish a comprehensive report. At the same time, the Auditor-General has published three special audit reports on the COVID-19 relief package. Corrective actions were put in place to address irregularities found, and some fraudulent transactions were reversed. In addition, a report on investigation into COVID-19 related procurement by state institutions was submitted to the President on January 25, 2022.

Conclusion

26. The authorities recognize the need to address deep-rooted socioeconomic challenges, including unemployment and poverty while stabilizing government debt. To this end, they remain committed to a growth-friendly fiscal consolidation, while prioritizing structural reforms critical to foster strong, sustainable, inclusive, and green growth that will improve the lives of South Africans. Monetary policy decisions remain data dependent and the authorities stand ready to take necessary steps to safeguard price and financial stability. The authorities value the Fund's support and look forward to further engagement, including through technical support.