

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

Staff Report for the 2003 Article IV Consultation

Prepared by the Staff Representatives for the
2003 Consultation with South Africa

Approved by Anupam Basu and Leslie Lipschitz

July 29, 2003

- The 2003 Article IV consultation discussions were held in Pretoria and Cape Town during May 8-21, 2003. The staff team met with the Minister of Finance; the Governor of the South African Reserve Bank (SARB); senior officials in the Ministries of Agriculture, Trade and Industry, Public Services, Education, Health, and Labour; parliamentary committee members; and representatives of the business, trade union, and the academic communities.
- The staff team comprised M. Nowak (head), V. Arora, L. Ricci, M. Vocke (all AFR), K. Hviding (PDR), and M. Horton (FAD). Mr. E. Ibrahim, the Fund's Resident Representative in Pretoria, also participated in the discussions. Prior to the discussions, the team met with market analysts in London.
- At the conclusion of the previous Article IV consultation on July 1, 2002, Directors commended the authorities for maintaining strict fiscal discipline, skillfully handling currency developments, and reducing the central bank's net open forward position. They emphasized, however, that the central policy challenge remained the achievement of higher, broad-based, job-creating economic growth, and encouraged the authorities to persevere with structural reform efforts that were essential for higher sustained growth and employment.
- South Africa accepted the obligations of Article VIII in 1973 and maintains an exchange system free of restrictions on payments and transfers for current international transactions.
- South Africa's relations with the IMF, including recent technical assistance, are summarized in Appendix I, and its relations with the World Bank Group in Appendix II. Statistical issues are discussed in Appendix III. The quality and timeliness of South Africa's reporting of economic and financial data are generally satisfactory for surveillance purposes, but weaknesses remain in the reporting of key labor market statistics. The medium-term outlook, including alternative scenarios, is discussed in Appendix IV. An update of the HIV/AIDS situation is provided in Appendix V.

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Executive Summary

- **South Africa's economy has performed well over the past year, notwithstanding difficult global economic conditions.** Supported by sound macroeconomic management and a highly competitive exchange rate, real GDP growth rose slightly to 3 percent in 2002. However, growth slowed in the first quarter of 2003, largely in response to tight financial conditions and a strong currency appreciation. It is expected to fall to about 2¼ percent in 2003, but rebound modestly to 3 percent in 2004.
- **The SARB has appropriately moved cautiously to ease monetary conditions in response to a major improvement in the inflation outlook.** It lowered interest rates by 150 basis points in June 2003. CPIX inflation declined to 9 percent in January-May (average annual rate) and should fall within the 3–6 percent official target range by the end of 2003.
- **South Africa's external position has strengthened considerably.** The currency has appreciated over the past 18 months as a result of several factors, including an unwinding of the overshooting that took place in 2001; a widening of interest rate differentials in favor of South Africa; an improvement in the external current account balance; firmer commodity export prices; and an overall strengthening in investor confidence. The net open forward position of the SARB, which represented a major source of external vulnerability in the past, has been brought down to below zero.
- **Fiscal policy continues to be sound.** The budget overperformed again in 2002/03 (April-March), registering a deficit of 1.2 percent of GDP, compared with an original target of 2.1 percent. The 2003/04 budget projects an increase in the deficit to 2.4 percent of GDP, mainly reflecting higher spending on economic infrastructure and social services. The moderate expansion in the fiscal stance envisaged for 2003/04 is appropriate in light of South Africa's social and developmental needs and the countercyclical support that it provides to economic activity. The medium-term deficit profile is consistent with a decline in the ratio of public debt to GDP. There are some risks in executing the budget in 2003/04, though these are likely to be limited in scope.
- **Key prudential indicators suggest that the banking and corporate sectors are generally sound.** The banking system has recovered from the difficulties experienced by some of the smaller banks in 2002, while the corporate sector appears well protected against exchange and interest rate shocks.
- **A number of structural challenges need to be overcome if growth is to be raised and unemployment reduced from its current very high level.** Given the low domestic saving rate, attracting foreign investment will be particularly important. The successful privatization of Telkom in March 2003 marked an important step in this direction. However, foreign investors have been deterred by the economic costs of HIV/AIDS, insufficient labor market flexibility, and potential strains on social stability arising from

high rates of unemployment and crime, combined with wide disparities in incomes and land ownership.

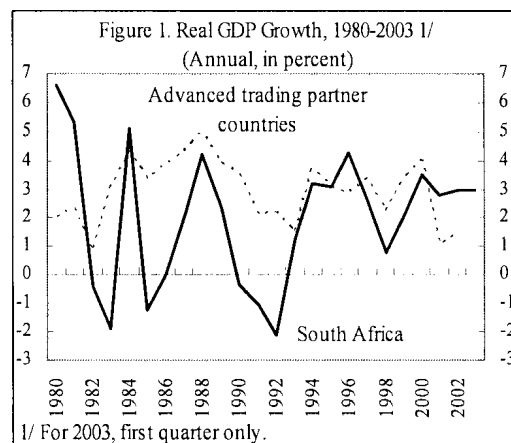
- **Skill shortages and labor market rigidities continue to impede job creation, despite efforts to address the unemployment problem.** The effectiveness of the government's skills development strategy could be further enhanced by focusing more on training the unemployed and relying less on payroll taxes as a source of funding. Moreover, greater decentralization of the collective bargaining system would allow small businesses greater flexibility in setting wages and would thereby encourage job creation.
- **Black economic empowerment initiatives can help strengthen social stability.** However, uncertainties remain about the financing of asset transfers in sectors such as mining, while land reform has been moving ahead rather slowly.

I. RECENT ECONOMIC DEVELOPMENTS

- *The economic recovery continued in 2002, supported by sound macroeconomic management and a highly competitive exchange rate. More recently, however, the recovery appears to have lost some momentum as a result of a strengthening of the rand and weak global economic conditions.*
- *Formal sector employment rose in 2002 for the first time in many years, but labor productivity growth slowed markedly.*
- *Monetary policy was tightened in 2002, and inflation has since fallen sharply.*
- *The budget overperformed in 2002/03, but it is now set on a mildly expansionary track.*
- *External sector performance has generally been good, and substantive progress has been made in strengthening the central bank's international reserve position.*

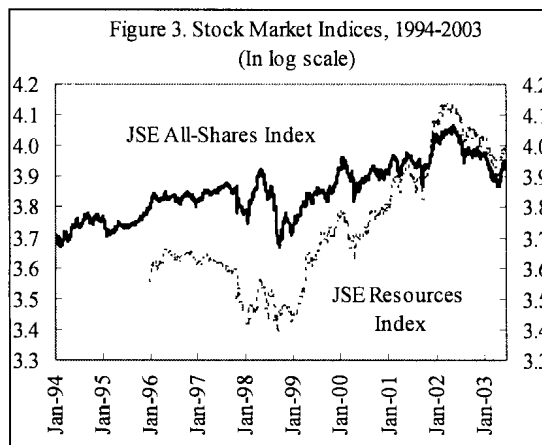
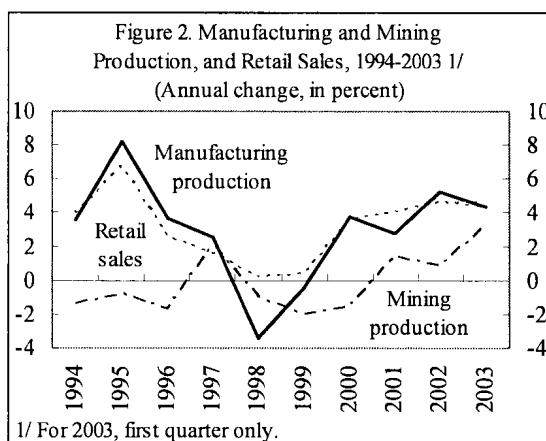
1. **The South African economy has continued to perform well, despite adverse global economic conditions.** Supported by sound macroeconomic management and a highly competitive exchange rate, the recovery that began towards the end of 1998 picked up steam in 2002 (Table 1). Real GDP grew by 3.0 percent, which was slightly up from the previous year. For the first time in many years, gains were made in formal sector employment. These developments have been accompanied by an overall strengthening of confidence in the economy, as evidenced by recent upgrades from credit rating agencies.¹

2. **More recently, however, there are signs that the pace of the recovery has been losing momentum** (Figure 1). Growth slowed to 1.5 percent in the first quarter of 2003, largely in response to a downturn in export demand that was reflected in a contraction in manufacturing output (Figure 2). Domestic demand, nevertheless, remained relatively buoyant and, unlike previous business cycles, South Africa's growth performance has been stronger than that of its industrial partner countries and many

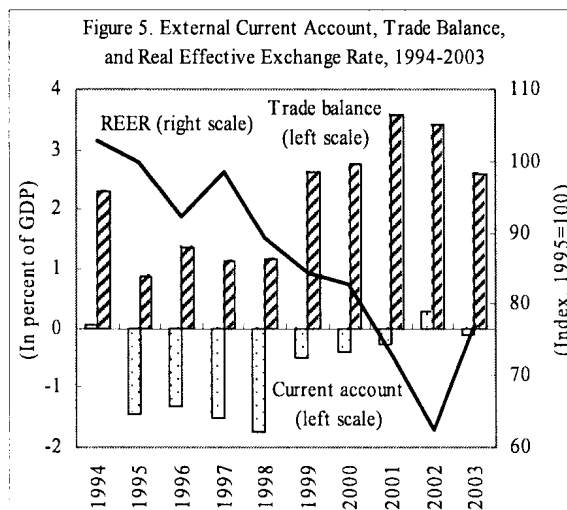
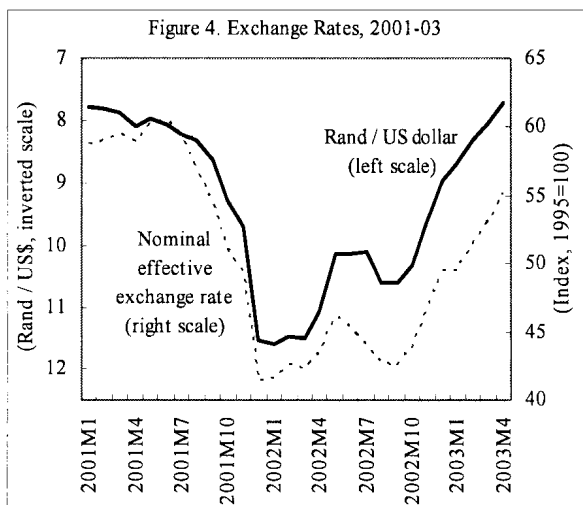


¹ Fitch IBCA and Standard and Poor's upgraded South Africa's long-term foreign currency debt (to BBB) in May 2003.

emerging market economies. The slowdown, which has been evident in weakening stock market prices (Figure 3), reflects a combination of factors, notably a strengthening of the rand, rising labor costs, and relatively tight financial policies.



3. **To a significant extent, growth performance has mirrored movements in the exchange rate.** The sharp currency depreciation in the second half of 2001 (Figure 4) provided a major boost to economic activity during much of 2002. The rand has subsequently recovered in value, appreciating by about 40 percent on a trade-weighted basis since the end of 2001; in real effective terms, the exchange rate is presently around the level prevailing in the second half of 2000 (Figure 5). The currency has also undergone large swings in value, moving from R 13.8 per U.S. dollar in December 2001 to R 7.1 per U.S. dollar in April 2003, a range of about 50 percent in local currency terms. Much of this appreciation reflects a

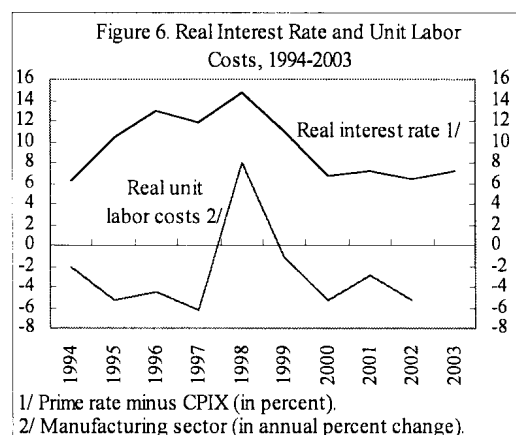


reversion to long-run equilibrium following the overshooting that took place in 2001, but macroeconomic fundamentals have also contributed to a strengthening of the currency. These include the following:

- firmer prices for South Africa's commodity exports;²
- tighter domestic credit conditions, accompanied by widening interest-rate differentials vis-à-vis overseas capital markets;
- a greater appetite by global investors for emerging market bonds since mid-2002; and
- an improvement in the external current account balance of 0.6 percent of GDP in 2002, resulting in a surplus (albeit small) for the first time since 1994 (Table 2).

In response to the currency appreciation, however, the current account subsequently swung back into deficit in the first quarter of 2003.

4. **Labor markets conditions have also contributed to the weakening in growth.** After a period of sustained decline, real unit labor costs flattened out in the second half of 2002, reflecting stronger wage growth and slowing productivity gains (Figure 6); the rise in productivity in the fourth quarter of 2002 was less than 2 percent, which is the lowest recorded in the past ten years. Although employment in the formal sector increased slightly in 2002, the unemployment rate in September 2002 rose to 30.5 percent, compared with 29.5 percent a year previously.³



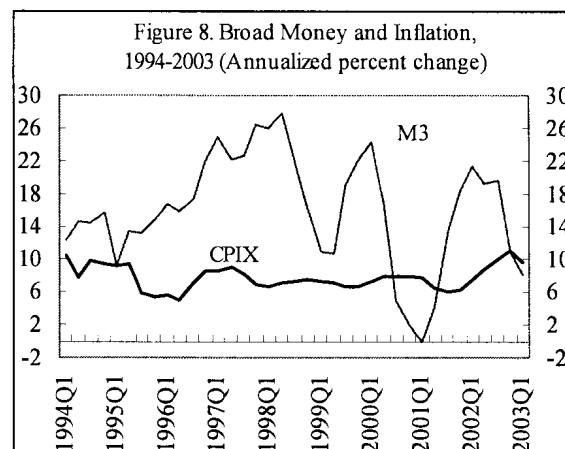
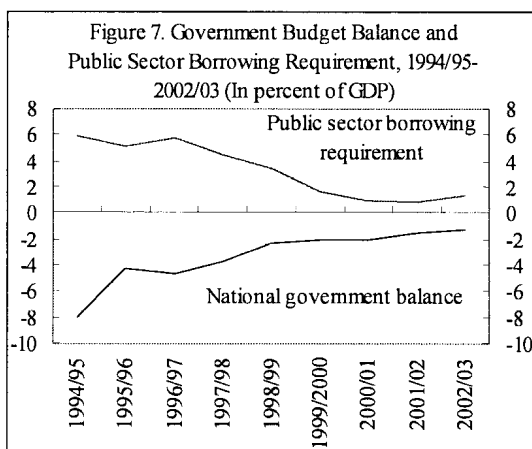
5. **Fiscal policy was relatively tight in 2002/03.** The national government budget deficit narrowed slightly to 1.2 percent of GDP, compared with an original target of 2.1 percent (Table 3 and Figure 7). This outturn reflected both strong revenue performance,

² The prices of gold and platinum, which together account for one-fifth of South Africa's merchandise exports, have risen by about 25 and 45 percent, respectively, since end-2001.

³ These data are taken from semiannual surveys and are subject to considerable measurement error. They exclude "discouraged" workers; when such workers are included, the "expanded" unemployment rate rose marginally from 41.5 percent to 41.8 percent in the year through September 2002.

particularly in the area of company taxation, and higher-than-expected inflation, which led to some compression of expenditures in real terms. Fiscal “overperformance” over the past three years totaled 2.4 percent of GDP.⁴

6. **In response to a buildup in inflationary pressures, monetary conditions were tightened during 2002.** The South African Reserve Bank (SARB) raised short-term interest rates by 400 basis points in 2002, and monetary growth was sharply curtailed (Figure 8 and Table 5). Rates were subsequently lowered by 150 basis points in mid-June 2003 following an improvement in the inflation outlook (see below). Quasi-fiscal profits made by the SARB on forward market operations contributed to a further dampening of aggregate demand.



7. **Robust private investment has been a particularly positive feature of recent growth performance.** Private fixed capital formation grew by 7 percent in 2002, and a further 5½ percent (annualized rate) in the first quarter of 2003. It has been supported by low long-term interest rates, which have fallen by nearly 450 basis points since the end of 2001 as a result of lower inflation expectations, fiscal restraint, and narrower sovereign risk spreads (Figure 9). In the process, the yield curve has become steeply inverted.⁵

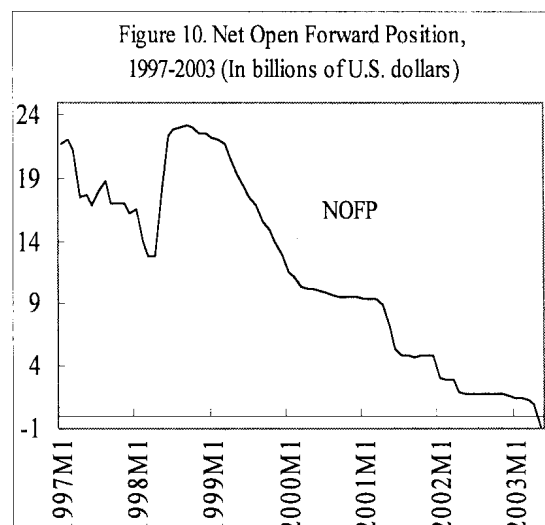
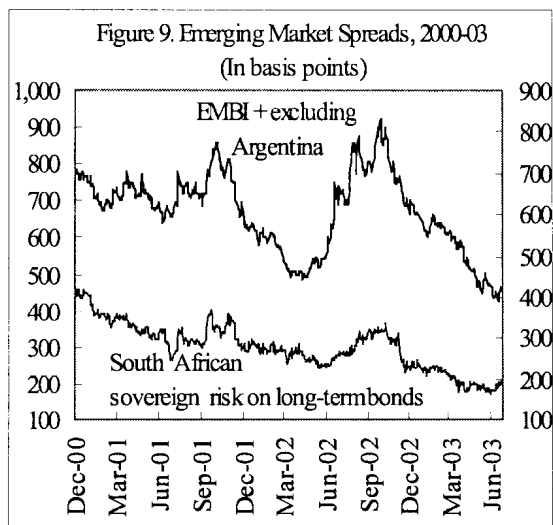
8. **Inflation surged during 2002, but has declined sharply so far this year.** Average inflation rose from 6.6 percent in 2001 to 9.3 percent in 2002, which was well above the

⁴ This overperformance has largely reflected one-time effects (such as windfall tax revenue from platinum producers in 2001/02), cautious baseline projections for revenue, and gains from improved tax administration.

⁵ In early June 2003 the repo rate was some 450 basis points higher than the yield on government bonds maturing in 2010.

SARB's target range of 3-6 percent under its inflation-targeting strategy.⁶ The increase in inflation reflected a significant pickup in broad money growth in 2001, the pass-through impact of the currency depreciation, and increases in food costs as a result of serious drought conditions elsewhere in the region. Inflationary pressures subsequently eased appreciably. After peaking at just over 11 percent on a twelve-month basis in November 2002, inflation fell below 8 percent in May 2003. During January-May 2003, inflation was only 3 percent on an annualized basis. In May 2003, Statistics South Africa announced a correction to the consumer price indices for January 2002-March 2003 to reflect more accurate information on housing prices (see Appendix III). The correction implied a lower level of inflation during the period than previously indicated (for example, by 1.6 percentage points in 2002), and confirmed the overall trend of a steady decline in inflation.

9. **Continued progress has been made in reducing South Africa's vulnerability to external shocks.** The NOFP, which for many years constituted a major source of vulnerability, was lowered into negative territory in end-May 2003 from US\$1.6 billion at the end of 2002 (Figure 10).⁷ The reduction was achieved through the retention of proceeds from official external borrowing and privatization and through modest intervention in the foreign exchange market. The improved NOFP, together with credit rating upgrades, have contributed to a reduction in sovereign risk spreads of about 100 basis points since the end of



⁶ These are CPIX inflation rates. CPIX is the consumer price index (CPI) less interest payments on mortgage bonds and is the measure targeted by the SARB.

⁷ NOFP (net open forward position) is the SARB's open position in the forward market less its net international reserves. It reached a peak of over US\$23 billion in October 1998.

2001.⁸ The Treasury and SARB have both recently issued debt overseas; the issues were heavily over-subscribed at spreads significantly lower than for previous issues.⁹

10. **South Africa is systemically important in the region by virtue of its relative economic size and position in various monetary and trade groupings.**¹⁰ The pursuit of sound macroeconomic policies has, therefore, generally had a stabilizing influence on the region, although other members of the Common Monetary Area have shared South Africa's large currency swings and higher inflation rate over the past two years. South Africa has also been an important force in helping harmonize macroeconomic policies and in liberalizing trade within the region. In recent years, it has been a significant source of fixed investment in Africa.

II. ECONOMIC AND SOCIAL POLICY FRAMEWORK

11. **South Africa has accomplished a great deal in recent years in establishing a sound and stable financial environment and in strengthening the economy's resilience to external shocks and contagion.** The removal of international sanctions in the early 1990s and the adoption of structural reforms have opened up the economy to competition, enabling South Africa to gain greater penetration into overseas markets and to realize significant productivity gains. As a result, since 1994 South Africa has enjoyed an average annual growth rate of 2.8 percent, compared with 1.2 percent during 1980-94 (Box 1 and table below).

South Africa: Sources of Growth, 1980-2002
(annual averages, in percentage points)

	1980-1994	1995-2000	1980-2002
Annual real GDP growth (percent)	1.2	2.8	1.7
Labor (including informal sector)	0.7	0.7	0.7
Capital	0.9	0.6	0.8
Total factor productivity	-0.5	1.5	0.2

Source: Staff calculations, based on data from *Statistics South Africa*.

⁸ The reduction in spreads for South Africa is about 30 basis points larger than that for similarly rated emerging market countries during the period.

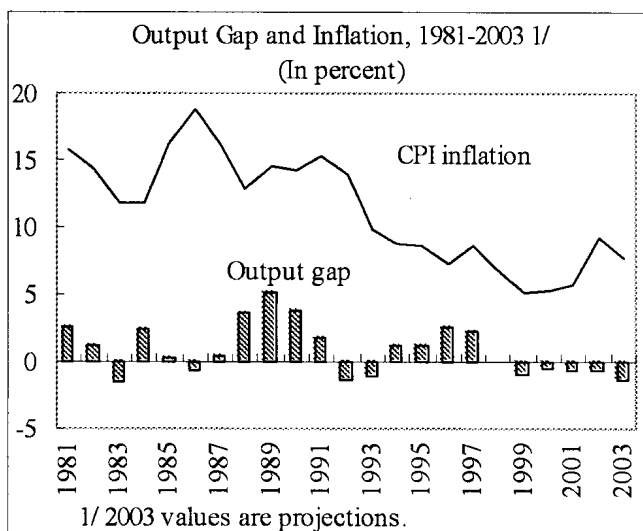
⁹ In May 2003, the Treasury raised €1.25 billion in a ten-year euro-denominated bond issue. The issue took place in New York and included collective action clauses; there appears to have been no additional cost associated with the inclusion of these clauses. In June, the SARB finalized the terms of a US\$1 billion syndicated loan that will mature in 2006.

¹⁰ South Africa belongs to the Common Monetary Area and the Southern African Customs Union (both with Lesotho, Namibia, and Swaziland, and the latter also with Botswana). It is also a member of the Southern African Development Community (SADC, with 13 other countries from Southern and Eastern Africa).

Box 1. Potential Output and Long-Run Growth

Staff analysis suggests that, during 1995–2002, the average rate of potential output growth rose to around 3 percent, from 1¼ percent during 1980–94. The estimates are based on a production function approach, and are robust to alternative methodologies.¹ They imply a small negative output gap in recent years, that will widen in 2003 as growth slows down (see figure). A more negative output gap is associated with a reduction in inflationary pressures.

The substantial increase in real GDP growth after 1994 reflects a turnaround in total factor productivity (TFP) growth, which more than offset the impact of a decline in the growth contribution of capital. The growth rate of employment remained broadly unchanged at 1¼ percent annually, while that of the capital stock declined to 1¼ percent during 1995–2002 from 2 percent during 1980–94. The strong TFP performance in part reflects policy and institutional changes, particularly greater trade



openness and private sector participation in the economy. It is significant because growth can generally be sustained over longer periods of time when it is based on improvements in technology and efficiency—which are embodied in TFP—rather than on factor accumulation, which is subject to inherent limits based on demographics and diminishing returns.

In the long run, growth prospects depend importantly on policies and institutions that will help to maintain strong TFP growth, reduce unemployment (by increasing labor market flexibility and lowering the cost of labor relative to capital), and improve the investment environment. If recent TFP growth rates (1½ percent) are maintained and the unemployment rate is steadily reduced by 10 percentage points through the end of the decade, annual real GDP growth could reach 5½ percent. This assumes a reduction in labor costs relative to capital costs that encourages investment that absorbs rather than displaces labor.² However, there are several risks to the long-term outlook. A key risk is that labor force growth may turn out to be slower than currently projected due to HIV/AIDS. If it is only half as rapid as projected, GDP growth could only be in the 3–3½ percent range. Growth could also be much lower than this if policy reversals were to weaken the institutional framework that has supported the strong rates of TFP growth in recent years.

¹ The approach is discussed in V. Arora, A. Bhundia, and G. Bagattini, “Potential Output and the Sources of Growth,” *South Africa: Selected Issues*, IMF Staff Country Report No. 03/18, (Washington: IMF, 2003). In contrast to that paper, the present analysis is based on total employment rather than formal employment.

² The calculation implies a decline in the capital-labor ratio. Investment that simply increases the capital-labor ratio from already high levels would result in temporarily higher GDP growth, but this would be unsustainable in the long run and would not be enough to significantly reduce unemployment.

12. **While the improved growth performance is welcome, growth rates of about 3 percent will not be sufficient to make an appreciable dent in South Africa's acute unemployment problem.** To raise growth, private investment must increase well above its present level of about 13 percent of GDP. The scope for funding a significant increase in investment from domestic sources is limited, and South Africa will have to rely substantially on investment from overseas. However, foreign direct investment inflows have been small so far, averaging only 1½ percent of GDP annually during the past five years. While much has been accomplished in establishing a sound and stable macroeconomic environment, foreign investors have been deterred by high rates of crime, inflexible labor market practices, the economic cost of HIV/AIDS, and potential social and political strains associated with wide income, wealth, and land ownership disparities.

13. **Higher investment alone, however, will not be enough to raise growth and reduce unemployment.** The South African economy has experienced a secular increase in capital intensity that needs to be reversed by raising worker productivity and lowering labor costs. Attracting skilled immigrant labor would temporarily help ease South Africa's chronic skills deficiency, but the long-term solution lies in the education and training of the young and the unemployed. In the meantime, more could be done to address institutional and legal impediments to labor market flexibility. Growth performance would also benefit from further trade liberalization and continued efforts to restructure the parastatal sector.

South Africa: Policy Contributions to Economic Growth

Investment	Employment Expansion	Total Factor Productivity Growth
Inflation-targeting to achieve low and predictable inflation	Labor market reforms	Trade liberalization
Reserve accumulation to reduce currency volatility	Skills development	Parastatal restructuring/privatization
Fiscal restraint to maintain international competitiveness and low real interest rates	Judicious application of minimum wages	Technology transfer through foreign direct investment
Social policies to address HIV/AIDS, and wealth disparities	Immigration of skilled labor	

14. **The government has further increased budgetary allocations for the social sectors and is taking steps to improve the delivery of social services.** Past efforts in this direction have been reflected in improvements in social indicators relating to education and

access to basic amenities. The government is focusing particular attention on the HIV/AIDS pandemic, which represents a major social and economic challenge (Appendix V).

15. **The Fund's advice to South Africa in recent years has focused on the central policy challenge of achieving high growth and reducing unemployment.** The authorities have been very responsive on macroeconomic issues, and their performance in stabilizing the economy has been commendable. With regard to the labor market and other structural areas critical to more rapid growth of output and employment, the pace of reform has been constrained by the authorities' commitment to building the broad-based political and social consensus essential to success of the reform effort.

III. POLICY DISCUSSIONS

16. **The staff and the authorities broadly agreed on the short-term outlook, with inflation continuing to fall and the growth slowdown being relatively limited.** Inflation was expected to decline within the 3–6 percent target range by the end of 2003 and to remain at that level in 2004. The recent declines in interest rates were seen as supporting private investment and the budget for 2003/04 as providing a mildly expansionary impulse to activity. The staff envisaged that real GDP growth would slow to 2¼ percent in 2003 and rebound modestly to 3 percent in 2004. The SARB's projections were similar, but the Treasury envisaged somewhat higher growth. The risks to the outlook were seen as being largely on the downside, in view of the weak economic state of South Africa's main European trading partners, the lagged impact of the recovery of the rand, and an anticipated rise in real wages in 2003. However, it was recognized that the economy's resilience to external shocks had improved and that the debt dynamics were sustainable under a range of scenarios.¹¹

A. Macroeconomic Stabilization

Inflation targeting and interest rate policy

17. **The discussions took place against the background of a marked improvement in South Africa's inflation outlook.** Broad money growth had declined significantly since October 2002, the currency appreciation had contributed to a decline in producer prices, and oil prices were lower in the aftermath of the conflict in Iraq. Food prices were dropping with the end of drought conditions in the region. The slowdown in economic activity also suggested some further dissipation of inflationary pressures. Although the decline in inflation and downward revision in the CPI data would help ease wage pressures, the mission and the SARB agreed that an anticipated rise in real wages during 2003, reflecting the backward-looking nature of pay settlements, represented a risk to the inflation outlook.

¹¹ Appendix IV provides a detailed analysis of alternative medium-term scenarios.

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¹¹ Appendix IV provides a detailed analysis of alternative medium-term scenarios.

18. **On balance, it was clear to both the authorities and the mission that there was a strong basis for a reduction in short-term interest rates.** In June 2003, the SARB's Monetary Policy Committee (MPC) lowered its key intervention instrument, the repo rate, by 150 basis points to 12.0 percent. Other short-term rates moved in tandem, and the inversion in the yield curve became less pronounced. Since the rate cut was widely anticipated in the market, it did not have any appreciable impact on the exchange rate of the rand.

19. **The frequency of MPC meetings, which has important implications for implementation of the inflation-targeting strategy, was increased in June 2003 from four to six meetings per year.** The MPC had met once a quarter to coincide with the availability of key economic data. But this timing did not allow the SARB to respond sufficiently quickly to changing conditions unless unscheduled meetings were convened, which risked being construed as emergency events. The greater frequency of meetings also makes it easier for the SARB to maintain a smooth and continuous flow of information to the market, thereby reducing the risk of creating surprises and adding to asset price volatility.

20. **The inflation-targeting framework includes explicit escape clauses to be invoked in the event that the targets are missed.** These clauses cover higher inflation arising from spurts in oil and food prices and from the impact of currency changes "unrelated to domestic economic fundamentals and domestic monetary policy." The clauses were not invoked when the inflation target for 2002 was exceeded. However, the staff considered that the presence of escape clauses risked weakening public confidence in the resolve of the SARB to meet its targets, and that this had important macroeconomic implications (Box 2). The mission suggested, therefore, that the clauses be dropped. If the inflation targets were missed, the SARB should, of course, provide a full explanation as to the reasons for the slippage and also indicate when it expected inflation to be brought back on track. This approach would be more in line with the practice of most other inflation-targeting central banks.

External vulnerability and exchange-rate policy

21. **The mission commended the authorities on having brought down the NOFP to below zero.** This was a major accomplishment. The mission, nevertheless, suggested that there were benefits in further strengthening the SARB's net international reserve position:

- a stronger reserve position, in conjunction with the implementation of stable financial policies, would help reduce currency volatility (Box 3);
- South Africa's gross reserves were still equivalent to only about one-half of total short-term debt, a very low ratio by emerging market standards;
- the SARB retained an open position in the forward market of about US\$5 billion; losses and profits on this exposure could have potentially destabilizing macroeconomic consequences; and

Box 2. Indicators of the SARB's Credibility on Inflation Targeting

In 2002, average CPIX inflation was 9.3 percent, compared with an official target of 3-6 percent. Despite declining year-on-year inflation rates over the past six months (Figure 1), CPIX inflation at 7.7 percent in May 2003 remained somewhat above the target range. The inflation outlook is encouraging, however, as the repo rate at end-June 2002 was still 250 basis points above its level at the peak of the depreciation in December 2001 and the rand has strengthened beyond the precrisis levels of August 2001.

Figure 1. Exchange Rate, CPIX Inflation, and Repo Rate
 (In percent, unless otherwise indicated)

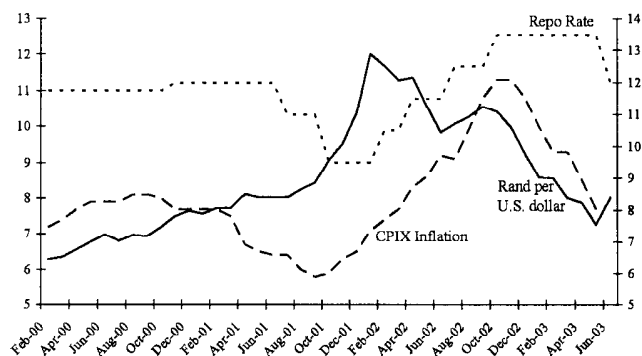
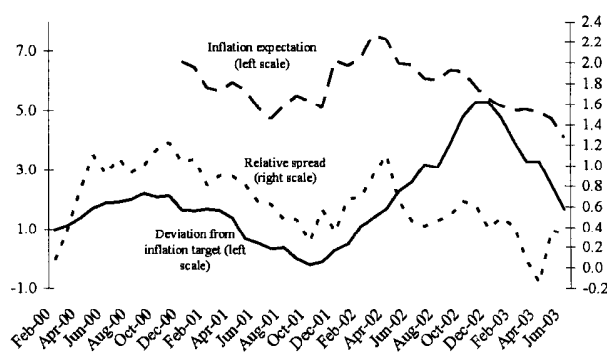


Figure 2. Inflation Performance and the Difference in Sovereign Risk Spreads (In percent)



A decline in long-term yields and inflation expectations since April 2002 may indicate the growing credibility of the SARB's inflation targeting. A monetary tightening of 400 basis points between January and September 2002 occurred at a time of declining short-term interest rates in South Africa's most important trading partners and coincided with additional support for the rand from rising gold and platinum prices. Long-term bond yields fell from above 13 percent at end-March 2002 to below 9 percent at end-May 2003, as inflation expectations declined. Between March 2002 and May 2003, inflation expectations—calculated as the yield difference between regular and inflation-indexed bonds with similar maturities—fell by 3 percent to below 4¾ percent (Figure 2).

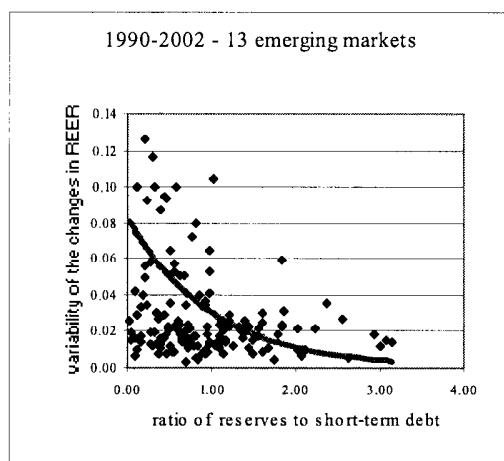
Prospects for a sustained decline in inflation are also reflected in falling sovereign yield spreads. Rising inflation increases the likelihood of a nominal depreciation, which—if inflation does not reflect higher real demand for goods and services—leads to a higher default premium on foreign currency debt in response to a depreciation-related rise of the foreign currency-denominated debt stock in domestic currency terms. Figure 2 suggests strong comovements of U.S. dollar-denominated South African yield spreads¹ and inflation expectations, which are reflected in a positive correlation of 0.6. In consequence, falling inflation expectations result in declining risk premiums, for which sovereign risk spreads are an indicator. Hence, the credibility of the inflation-targeting regime could be an important determinant of the relative strength of the rand against other currencies.

¹ Spreads are shown for South Africa vis-à-vis a benchmark that is composed of a group of countries with credit ratings similar to that of South Africa. The benchmark was calculated as an unweighted average of sovereign yield spreads for Chile, Malaysia, Mexico, and Korea.

Box 3. The Benefits of Holding International Reserves

The net open forward position (NOFP) was eliminated in May 2003. However, there may be a number of benefits to a further buildup in net international reserves, even under a freely floating exchange rate regime (some of these benefits are discussed in the main text):

- **International evidence on early warning indicators suggests that the risk for a currency crisis falls with the ratio of reserves to short-term debt.** Larger foreign exchange reserves could reduce the risk for a self-fulfilling collapse in cross-border liquidity in the event that foreign investors refused to roll over short-term foreign exchange obligations.¹
- **External and domestic borrowing costs tend to fall with larger reserve holdings.** Empirical evidence suggests that there is a positive relationship between the level of reserves and credit ratings and a negative relationship between reserves and sovereign risk.² Lower sovereign risk spreads will translate into lower long-term domestic interest rates.
- **Larger reserves can contribute to lower exchange rate volatility.** Evidence over the past decade suggests that, in emerging market economies with freely or managed floating exchange rates, a higher level of reserves relative to short-term debt is associated with lower volatility of the real effective exchange rate (REER), as indicated in the figure below. While a large set of the observations is clustered at relatively low levels of volatility and reserves, extremely high levels of volatility seem to be much more closely associated with low levels of reserves.



This observation is supported by more rigorous econometric analysis undertaken by the mission. Covering the period 1994-2002, a panel regression with 13 emerging markets³ indicates a significant nonlinear relationship between the ratio of reserves to short-term debt and the volatility of the REER, even after controlling for other determinants of volatility (see below), as well as country-specific effects. Such a nonlinear relation is shown in the accompanying figure.

The nonlinearity of this relationship is particularly important for South Africa in view of its present low reserve level, as it suggests that small increases in reserves can have a relatively large impact in reducing currency volatility. More precisely, the results for South Africa suggest that an increase of only US\$6 billion could

reduce the volatility of the exchange rate by about 40 percent. Such a reduction would imply that the probability that the REER would move by less than 4 percent within a month would increase from the level of 75 percent prevailing in 2002 to about 95 percent.

In terms of the influence of other determinants of the volatility of the REER, the volatility of broad money, trade openness, and the volatility of terms of trade were also found to have a significant effect, while the fiscal deficit, inflation, and growth proved less important.

¹ "Debt- and Reserve-Related Indicators of External Vulnerability," IMF Board document at <http://www.imf.org/external/np/pdr/debtres/index.htm>

² C. Christofides, C.B. Mulder, A.J. Tiffin, "The Link Between Adherence to International Standards of Good Practices, Foreign Exchange Spreads, and Ratings," April 1, 2003, IMF Working Paper [WP/03/74](#) (Washington, IMF, 2001). For evidence on South Africa, see G. Jonsson. "The Risk Premium in South Africa: Long-Term Interest Rates", in SM/01/79.

³ The set of countries includes emerging market economies that were considered to have a floating or managed floating exchange rate as of December 2001. The volatility of the real effective exchange rate is measured by the standard deviation of its monthly changes. The figure above excludes outlier cases (defined for each variable as exceeding four times the mean value).

- higher reserves would contribute to a further reduction in long-term interest rates by strengthening credit ratings and reducing sovereign risk spreads.

While acknowledging the advantages of a stronger reserve position, the authorities expressed concern over the potential fiscal costs involved in sterilizing the domestic liquidity impact of a reserve buildup.

22. **The SARB has continued to allow the exchange rate to float in response to market conditions.** To acquire international reserves, however, it has been purchasing relatively small amounts of foreign exchange in the market during periods of comparative rand strength. The mission expressed support for the strategy, which had been explained well to the market. It believed that this intervention had not had any significant negative impact on the exchange rate or inflation since the liquidity impact had been sterilized.¹²

23. **The mission reiterated its support for the authorities' gradual approach to the relaxation of capital controls.** Further steps in the liberalization process were announced in February 2003 (Box 4), although significant restrictions remain on residents, particularly with regard to corporate transfers and certain institutional investors, notably unit trusts (mutual funds). In view of the possible impact that liberalization could have on exchange rate volatility, the mission suggested that completion of the process should wait until international reserves had been built up to more comfortable levels.

24. **The authorities have pursued a cautious strategy with regard to external debt management.** The success of the recent international bond issue demonstrates a high degree of investor confidence in the strategy and in economic management more generally. The mission noted that the authorities had resisted the temptation of incurring significant long-term foreign currency debt in order to reduce the NOFP. As a consequence, medium- and long-term official external debt had been kept at manageable and sustainable levels of less than 10 percent of GDP.

Fiscal policy

25. **The staff commended the government for its impressive track record in budgetary management.** Fiscal policy had played a key role in stabilizing the economy,

¹² A staff study suggests that intervention that lowers the NOFP by US\$1 billion (or approximately 1 percent of GDP) will lead to a real depreciation of the rand of less than 1 percent in the short run. In contrast, in the long run such intervention will result in a real appreciation of nearly 1 percent because a lower NOFP would allow a larger sustainable current account deficit. See L. Ricci and R. MacDonald, 2003, "Estimation of the Equilibrium Real Exchange Rate in South Africa," IMF Working Paper WP/03/44 (Washington: IMF).

Box 4. Capital Control Liberalization

Since 1994, the South African authorities have pursued a gradual approach to liberalizing capital flows, and they plan eventually to replace capital controls with prudential regulations. The current regulations put strict limits on residents' ability to invest abroad or borrow in foreign currency. External portfolio and direct investment remains subject to specific ceilings, while domestic borrowing and lending in foreign exchange are strictly limited to residents with documented, trade-related exposure in foreign exchange. No significant restrictions exist for nonresidents.

Consistent with the gradual approach, the National Treasury and the SARB announced in February 2003 changes in controls for institutional investors, corporations, and emigrants effective May 1, 2003, along with a temporary capital control and income tax amnesty:

Institutional investors

- The limit on annual outflows of 10 percent of the previous year's inflow was removed, although ceilings on the stock of foreign investment remain at 15 percent for insurers, pension funds, and fund managers, and 20 percent for unit trust companies.

Corporate investors

- The limit applied to foreign direct investment (FDI) by South African companies to destinations outside Africa was doubled to R 1 billion. Limits for outward FDI to Africa were raised to R 2 billion in October 2002. Repatriated dividends from foreign subsidiaries of South African companies are eligible for an exchange control credit that would allow companies to reexport the capital, upon application, for approved FDI.

Emigrants

- A common foreign allowance for both residents and emigrants of R 750,000 per individual (or R 1.5 million per family) was introduced; transfers in excess of this allowance might also be approved, subject to a 10 percent exit charge. Emigrants 'blocked assets' (assets that were not allowed to leave South Africa because their size exceeded allowed amounts) are to be unwound.

Capital control and income tax amnesty

- Individuals with excess funds abroad on or before February 28, 2003 are allowed to file for an exchange control and income tax amnesty from June 1 to November 30, 2003.
- Individuals filing for the exchange control amnesty will be released from all civil penalties and criminal liabilities. In return, there will be a 5 percent exchange control charge on funds above the exchange control limits that are repatriated and a 10 percent charge on declared funds remaining offshore.
- Individuals filing for income tax amnesty will be released from all income taxes, interest, and civil and criminal penalties stemming from the failure to disclose gross income or capital gains from foreign sources.

reviving confidence in economic management, and laying a solid basis for high growth and poverty reduction.

26. **The budget for 2003/04, which was presented in February, seeks to stimulate aggregate demand by providing tax relief and increasing investment, while helping address the country's pressing social needs in an affordable and durable manner.** It targets an increase in the central government budget deficit to 2.4 percent of GDP from 1.2 percent in 2002/03. The mission considered this mildly expansionary stance appropriate in light of macroeconomic conditions and the fiscal overperformance of recent years.

27. **The major elements of the 2003/04 budget are:**

- personal income tax relief and a cut in tax rates on retirement funds, equivalent in total to over 1 percent of GDP;
- an increase in outlays on economic infrastructure (transport, electricity, water) that will raise public sector investment to 6 percent of GDP, from 5.2 percent in 2002/03;
- increases in social service outlays of 0.5 percent of GDP, bringing the overall increase to over 1 percent of GDP since 2001/02 (see table below). The additional funds are targeted at HIV/AIDS awareness and treatment and at child support, disability, and old age grants (Box 5); and
- primary surpluses equivalent to 1-2 percent of GDP through the medium term that will help lower the ratio of public debt to GDP from its present level of about 40 percent. The reduced interest bill will release additional resources for economic and socially productive purposes.

28. **The mission felt that the Treasury faced certain risks in implementing the budget for 2003/04.** Corporate profitability and, therefore, company tax receipts were likely to be squeezed as a result of the strength of the rand and ongoing increases in wage costs. Moreover, there appeared to be nearly $\frac{1}{2}$ of 1 percent of GDP in additional revenue effort that was only partially supported by administrative measures. On the other hand, interest payments could fall below the budget allocation as a result of lower borrowing costs, while import expenditures (mainly on arms procurement) would be cushioned by the more appreciated exchange rate. On balance, the mission agreed with the authorities that any widening of the budget deficit over target, should it occur, would likely be limited in magnitude and would in any event provide a countercyclical impulse to economic activity.

Box 5. Expenditure Policy, Social Indicators, and Absorptive Capacity

The reduction of the budget deficit over the past decade has been accompanied by a reorientation of spending toward poverty reduction and other social priorities, thereby helping lay the basis for stronger economic growth. Spending on welfare, crime prevention, health, and education has increased, while defense expenditures have declined in percent of GDP. Medium-term spending plans announced in the 2003/04 budget (April-March) continue this focus, with eligibility for child grants to be extended from 7 to 14 years—providing targeted support to an additional 4.2 million recipients—and public investment to increase from 2.2 percent of GDP in 2002/03 to 2.6 percent during 2003/04-2005/06. Declining debt service and wage moderation will help limit the impact of higher social expenditures on the deficit. Health and education spending will focus on increases in nonpersonnel, noncapital items to improve service quality.

	1992/93	2002/03 ^{1/}	2005/06 Budget Projections
	In percent of GDP		
Social security and welfare	2.3	3.7	4.3
Crime prevention (police, prisons, courts)	2.3	2.9	2.9
Health	2.9	3.1	3.1
Education ^{2/}	5.5	5.6	5.4
Housing and community development	1.0	1.2	1.4
Defense and intelligence	2.4	1.9	1.7

Sources: National Treasury and staff estimates.

1/ Preliminary outturn (April-March).

2/ Wage moderation contributes to a decline in education spending in the medium term. Targeted wage increases will be provided to key professionals (health) and sectors (policing).

The reorientation of spending has contributed to improved social development indicators in a range of areas. The proportion of South Africans with access to improved sanitation facilities and water resources increased from 46 percent and 70 percent, respectively, in 1994 to 86 percent for both categories in 2000, exceeding average ratios for middle-income countries. During 1994-2002, 1.5 million low-income housing units were constructed, and 3.5 million houses were electrified. The share of schools with utility services increased sharply, while enrollment and literacy rates also rose.¹ However, HIV/AIDS has severely strained the health system and contributed to a decline in life expectancy from 64 years in 1994 to 52.1 in 2000.

While enormous social needs remain to be addressed, the authorities have been cautious in limiting increases in spending until sound institutional arrangements are in place to ensure effective expenditure management and value for money. Progress has been made in building capacity at the national and provincial levels, and efforts will increasingly focus on local governments. Improvements in absorptive capacity at all levels are needed both to improve the quality of social spending and to support further potential expenditure increases in such areas as health (HIV/AIDS), education, and land reform. The Public Finance Management Act (1999) has helped focus efforts and strengthen national and provincial institutional capacity through provisions on multiyear budgeting and strategic planning. A major initiative introduced in 2003 was the linking of expenditure plans to measurable program objectives. Capacity gains through improved planning, contracting arrangements, and reporting requirements have helped provinces (responsible for schools, health, welfare, housing, and agriculture) reduce underspending and increase investment (from 0.7 percent of GDP to 1.2 percent during 1999-2002). Key outstanding issues that need to be addressed include the simultaneous shortage of skilled staff (health and criminal justice) and the excess of low-skilled employees (agriculture and public works), and the considerable variation in resources among provinces.

Municipalities (responsible for household utilities) have initiated reforms only recently, following a sharp consolidation in the number of cities and towns, from 843 in 1993 to 284 in 2001. Staffing was unified at the highest prevailing wage levels, with few retrenchments, thereby resulting in high personnel costs. Municipal financial and performance information is poor, while single-year budgeting and ineffective planning and management have contributed to underspending, implementation delays, and service losses. As with the provinces, there are skills shortages, overstaffing and a need to extend and improve service quality. Passage of the Municipal Finance Management Bill, expected in mid-2003, will help promote institutional improvements, while the national government will provide targeted capacity-building grants totaling R 2.8 billion during 2003/04-2005/06 (0.1 percent of GDP per year). Efforts will focus first on the 40 largest cities, which comprise 80 percent of local government spending (6½ percent of GDP).²

¹ In 2000, 17 percent of schools lacked toilets, compared with 55 percent in 1996. Thirty-six percent of schools lacked telephones in 2000, compared with 60 percent in 1996, while 28 percent lacked water (35 percent in 1996) and 43 percent electricity (58 percent in 1996).

² One complication may be the restructuring of the electricity sector over the next three years, which will involve formation of six regional companies from municipal electric utilities and the national utility, Eskom. In addition to absorbing management resources, one-third of local revenues come from electricity sales, which provide a subsidy for other services that will need to be replaced.

South Africa: National Government Main Budget, 2000/01-2005/06 ^{1/}
 (In percent of GDP)

	2000/01	2001/02		2002/03		2003/04	2004/05	2005/06
		Budget	Actual	Budget	Prelim.	Treasury Projections		
Total revenue and grants	23.6	23.6	24.6	24.5	24.7	24.7	24.6	24.6
Total expenditure	25.6	26.2	26.1	26.6	25.8	27.1	27.0	27.0
Of which: Social services ^{2/}	12.8	12.8	12.9	13.3	13.6	14.1	14.2	14.1
Education	5.6	5.9	5.5	5.5	5.6	5.6	5.5	5.4
Health	3.1	3.0	3.1	3.1	3.1	3.2	3.2	3.1
Social security and welfare	3.2	3.2	3.2	3.8	3.7	3.9	4.1	4.3
Other ^{3/}	0.8	0.7	1.0	0.9	1.2	1.4	1.4	1.4
Balance	-2.0	-2.5	-1.5	-2.1	-1.2	-2.4	-2.4	-2.3
Primary balance	3.1	2.4	3.3	2.3	3.0	1.7	1.5	1.4

Sources: South African authorities; and staff estimates.

^{1/} Fiscal year begins April 1.

^{2/} Consolidated national and provincial government.

^{3/} Includes housing and community development.

29. **During the discussions, the Treasury outlined its fiscal strategy.** The strategy consists of three major strands. First, personal and corporate income tax burdens have been lowered in order to generate a supply-side response and provide a durable boost to aggregate demand. These tax cuts have been funded by a broadening of the tax base, such as with the introduction in the past two years of a residence-based income tax system and a capital gains tax, and from a strengthening of tax administration, so as to leave the overall tax effort at about 25 percent of GDP. Second, savings on the wage and interest bills have been directed at spending on social and economic infrastructure, as well as on crime prevention and security. And third, important steps have been taken in the area of expenditure management and data reporting. Most notably, implementation of the Public Finance Management Act has significantly improved expenditure monitoring and control, and work is under way on improving fiscal performance in the municipalities.¹³

¹³ The 2003/04 budget incorporated a number of recommendations from last year's fiscal Report of the Observance of Standards of Codes (ROSC), including enhanced presentation of contingent liabilities and tax expenditures and a mapping of differences between the presentation of fiscal statistics by the National Treasury and by the SARB (Government Finance Statistics). Improvements have also been made in reporting by local governments and public enterprises, and in strengthening internal audits.

B. Structural Reforms

Financial and corporate sectors

30. **All key macro-prudential indicators for South Africa's financial system are at healthy levels and the foreign exchange exposure of banks is relatively small.**¹⁴

Difficulties experienced by certain of the smaller banks in early 2002 now appear to have been fully resolved.

31. **A number of changes to the banking system have recently been made or are presently under consideration:**

- South Africa passed anti-money-laundering legislation in 2002, and in June 2003 it was accepted as a member of the Financial Action Task Force;
- legislation for the introduction of a compulsory deposit insurance scheme is being finalized;
- the SARB is considering the introduction of a second tier of banks aimed at expanding the delivery of services in rural and disadvantaged areas; the banks would accept new deposits but would be required to invest in money market instruments; and
- the Minister of Finance has announced plans to merge the supervisory functions of the SARB and the Financial Services Board, which regulates financial markets and the nonbank financial institutions.

On the matter of the merger of the supervisory agencies, the mission noted that the uncertainties persisting over the timing of the merger could make present supervisory activities more difficult to undertake. The mission acknowledged the good progress that had been made in following up on the recommendations of a Financial Sector Assessment Program (FSAP) report.¹⁵ In keeping with the FSAP recommendation, it also suggested that issues relating to the availability of skilled personnel be addressed prior to unification of the supervisory agencies.

¹⁴ At end-April 2003, the capital adequacy ratio of the banks was just over 12 percent, while nonperforming loans were equivalent to less than 3 percent of total loans and advances. Foreign currency loans constituted less than 10 percent of total loans and advances.

¹⁵ The main report was discussed by the Executive Board of the Fund in February 2000 and the follow-up report in March 2001. One recommendation that has yet to be adopted relates to delegating the SARB authority to appoint a curator for troubled banks.

32. **The corporate sector is also in generally good health.**¹⁶ The level of indebtedness is relatively low, although it has increased recently, while cash flow and liquidity indicators are favorable (Box 6). Profitability is on par with other emerging markets, and the vulnerability of the corporate sector to exchange and interest rate shocks appears low.

Labor market

33. **Unemployment is arguably the single most important impediment to poverty reduction in South Africa.** Even with higher investment, South Africa's growth potential will remain limited until substantive progress is made in reducing unemployment. The high rate of unemployment broadly reflects two factors: the legacy of apartheid practices, which have contributed to chronic skills imbalances; and various obstacles to labor market flexibility that have kept labor costs relatively high. In response to the unemployment problem, the government has engaged in intensive consultations with key stakeholders (Box 7) and embarked on a number of initiatives.

34. **A job skills development program has been launched that correctly identifies skill deficiencies as a fundamental cause of structural unemployment.** The program is funded by a 1 percent payroll tax. The pace of implementation has, however, been rather slow, particularly among small enterprises, many of which have found the bureaucratic requirements to be cumbersome and costly. The mission was, nevertheless, assured that most of the performance targets established under the program for 2005 would be met. In order to sharpen its effectiveness, the mission suggested that the program focus more on enhancing the skills of those presently unemployed rather than workers who already had jobs.¹⁷ Furthermore, the mission argued that funding the program through a payroll tax was counterproductive to the goal of job creation, and that alternative sources of funding might be considered.¹⁸

35. **Changes were introduced to South Africa's labor legislation in August 2002.**¹⁹ A number of the amendments will help increase flexibility in labor market practices and reduce procedural costs, while others provide greater protection for workers' rights. On balance, the

¹⁶ This conclusion is based on the findings of an ICM mission to South Africa in April-May 2003.

¹⁷ Statistically, workers who have been previously employed are far more likely to find jobs than those with no employment experience.

¹⁸ While up to 60 percent of the tax is refundable upon proof that training was provided, in practice the proportion refunded has been far less.

¹⁹ These were summarized in Box 8 of IMF Country Report No. 03/17, (Washington: IMF, 2003).

Box 6. Financial Health of the Corporate Sector

The nonfinancial corporate sector in South Africa is in healthy condition, according to traditional indicators of financial risk.

- **Corporate debt is on par with other emerging market countries.** In 2002, the debt-equity ratio was 52 percent, compared with 42 percent in Asia and 57 percent in Latin America. Short-term debt—which rose in 2001—occurred mainly in the form of bank loans or overdraft credit lines. However, interest rates paid by large South African corporations are usually considerably below prime rate, and large corporations therefore face relatively low average costs for nonequity financing. Foreign currency debt is limited, owing to the imposition of capital controls (one-third of total exports).
- **Liquidity is relatively high.** Liquidity in the corporate sector increased strongly in 2002 as a result of higher gold and platinum prices, strong external competitiveness, and the long planning horizon of investment projects, in particular in the mining sector.
- **Corporate profitability is at levels comparable to those in other emerging market countries, despite a prolonged period of declining profit margins.** A sectoral breakdown shows that profitability patterns are largely unrelated to a sector's exposure to international competition, as profitability is high, for example, in both chemicals (traded) and retail trade (nontraded).

Nevertheless, some potential vulnerabilities remain and will require careful monitoring.

- **Corporate debt, although quite low, has been increasing.** It may grow further as asset transfers under the black economic empowerment initiative need to be financed.
- **The large share of short-term debt may become a concern if corporate solvency deteriorates due to increased debt financing.** Though highly unlikely, the absence of a liquid corporate bond market in South Africa may make it difficult for large corporations to quickly shift to longer-term bond financing in the event of higher short-term interest costs or to avoid potential problems with short-term debt rollover.

Financial Ratios for the Nonfinancial Corporate Sector, 1998-2002

	1998	2001	2002
Leverage and debt structure			
Debt-to-equity	0.37	0.54	0.52
Short-term debt to total debt	0.31	0.42	0.34
Liquidity			
Current ratio 1/	2.30	2.42	3.96
Profitability			
Gross margins 2/	0.12	0.11	0.12
Return on equity 3/	0.25	0.29	0.29

Sources: Worldscope; and IMF staff estimates.

1/ Current assets to current liabilities.

2/ Earnings before interest and taxes (EBIT) as a share of sales.

3/ EBIT as a share of shareholders' equity.

Box 7. Growth and Development Summit, June 2003

A Growth and Development Summit attended by business, labor, government, and civil society representatives. The summit focused on efforts to halve unemployment by 2014, including through skills development and labor-intensive investment. Key actions that were envisaged included the following:

- learnership programs for at least 72,000 young unemployed people by May 2004, up from 23,000 at present;
- an expanded public works program aimed at providing income to poor communities by granting short-term jobs delivering social services to unemployed;
- a commitment to ensure that a minimum of 70 percent of the labor force possesses at least basic literary skills by 2005;
- additional support for the development of labor-intensive sectors, including clothing, agriculture, tourism, and call centers;
- a conference of pension and provident fund trustees in 2004 to discuss investments in labor-intensive projects; and
- a review of import parity pricing and administered prices as possible impediments to employment creation.

amendments are a step in the right direction, but by themselves are unlikely to lead to significant job creation.

36. **The area that holds the greatest near-term potential for employment generation relates to bargaining procedures.** South Africa's collective bargaining system is highly centralized. In most sectors, agreements on pay and conditions reached by trade unions and the largest employers are legally binding on small and medium-sized businesses. Since these businesses are labor-intensive, granting them more autonomy in setting wages could significantly expand job opportunities and encourage the formation of new businesses.

37. **The Ministry of Labour is introducing statutory minimum wages to those sectors not presently covered by collective bargaining agreements.** Minimum wages have already been applied to agricultural, retail, and domestic workers. The application of minimum wage rates needs to strike an appropriate balance between, on the one hand, protecting the livelihoods of those with jobs and, on the other hand, encouraging employment generation. In setting minimum wages, the mission considered that the goal of poverty alleviation would be better served by emphasizing employment generation. The mission, therefore, expressed

concern over recent layoffs in the agricultural sector that appeared to be the result of minimum wage provisions.

38. **Attracting labor from overseas would help ease shortages of skilled labor.** To facilitate this, new immigration legislation came into effect in April 2003 that should make it easier for foreign workers to obtain work permits. The new system has, however, encountered serious capacity problems, and efforts are under way to correct these problems and substantially reduce the time taken to process work permit applications.

Trade policy

39. **South Africa has undertaken extensive trade reform since the early 1990s.** The average (unweighted) tariff rate has been lowered from 22 percent in 1988 to its present level of 11 percent, and nontariff barriers have been removed.²⁰ Trade liberalization has been a major source of total factor productivity growth.

40. **South Africa has adopted a two-pronged approach to trade liberalization.** First, free-trade agreements have been concluded with the EU and with other SADC members, and agreements with Mercosur and a number of individual countries, such as the United States, are being negotiated.²¹ Second, a review is being undertaken of South Africa's trade regime that should provide the basis for a further simplification of the tariff structure and for duty reductions, particularly those that provide relatively heavy protection for sectors such as textiles. A new regional tariff board is expected to be established shortly that will provide other SACU members besides South Africa with a greater say in trade policy; this is clearly a welcome initiative, but the mission expressed hope that the more consensual approach to policy formulation would not act as a brake on the liberalization process.

Parastatal reform and privatization

41. **The parastatal reform strategy set out in August 2000 aims to accelerate the pace of privatization and enterprise restructuring in order to improve service quality, promote competitiveness, mobilize private and foreign investment, and foster growth.** The program gained momentum in March 2003 with the sale of a 28 percent stake in Telkom

²⁰ South Africa has a rating of 5 in the Fund's trade restrictiveness index; this compares reasonably well with other emerging markets economies. South Africa's nontrade barriers are relatively minor and relate primarily to restrictions on textiles from certain countries in the region. While South Africa resorted relatively frequently to antidumping measures in 1995-99, their usage has fallen rapidly in recent years, and only one case was reported in 2002. There have been no major changes in the trade regime since the last Article IV consultation.

²¹ South Africa is already benefiting significantly from increased access to the U.S. market under the U.S. African Growth and Opportunity Act (AGOA). Exports to the United States, which represent about 10 percent of South Africa's total exports, rose by 45 percent in 2002.

(the state telecommunications company), which brought the company under majority private ownership. Proceeds from the sale, however, amounted to only 0.4 percent of GDP, which was far less than originally envisaged (1 percent), owing largely to the weak state of the global telecommunications market. Privatization proceeds in 2002/03 totaled 0.7 percent of GDP. A number of complex restructuring initiatives are planned for 2003-04 to help improve critical utility and transportation infrastructure.²²

42. **Trade unions have led local opposition to privatization, voicing concerns over job losses.** However, as the major enterprises have already cut staffing as part of their restructuring plans, any further adverse employment impact from restructuring should be limited. The authorities are, nevertheless, sensitive about the social impact of job losses, and have been preparing job retraining and staff redeployment programs.

C. Empowerment Policies

43. **There is a general appreciation within South Africa that initiatives to reduce wealth disparities are necessary and desirable for maintaining long-term social stability.** The authorities have developed empowerment and land reform strategies that aim at addressing these disparities.

44. **The black economic empowerment (BEE) strategy seeks to encourage the transfer of productive assets and to promote black participation in management and operations, without recourse to legislated targets** (Box 8). Within this framework, a charter has been agreed with the mining companies. It is very ambitious and targets an increase in ownership by historically disadvantaged groups from present levels of about 2 percent to 26 percent over a period of ten years. The mining companies have offered to "facilitate" funding of about US\$10 billion, and small amounts will be provided from the budget. More financing, however, will probably be needed, and the mission noted that uncertainties surrounding the source of this financing could deter foreign investment. Moreover, the foreign exchange demands associated with the purchase of equity from nonresidents could be substantial. The mission also observed that the empowerment initiative

²² A second, fixed-line national phone operator will be licensed through the sale of a 51 percent stake in a new venture to a strategic partner, chosen from a tender initiated in April. To boost competition in the electricity sector, 30 percent of the generation assets of Eskom (the electricity company) will be sold, while its distribution network will be restructured. The port operations of Transnet (the transportation company) and the Durban container terminal will be concessioned, and a restructuring of the railways is underway. Sales of stakes in South African Airways and the airport authority are under consideration. Following termination of negotiations in early 2003 on the sale of a 30 percent stake in Dencel (the defense and aerospace parastatal) to British Aerospace, the authorities will focus on the cost cutting and divestiture of noncore activities while continuing efforts to find an investor.

Box 8. The Black Economic Empowerment Initiative

In March 2003, the South African government published for comment a draft strategy for promoting broad-based “black economic empowerment” (BEE).¹ BEE is part of the government’s ongoing effort since 1994 to reverse the legacy of apartheid and transform the economy by 2014 into one that is characterized by growth, employment, and racial equity. The proposed strategy tries to clarify the government’s approach to BEE, which hitherto comprised several disparate initiatives, and emphasizes a cooperative approach. The strategy will be state driven, but it includes nonstatutory guidelines rather than legislated targets and it envisages that BEE will be financed largely by the private sector rather than the government.

1. The main objectives of the strategy are the following:

- higher economic growth and greater income equality;
- a substantial increase in the number of black people who own and control enterprises, particularly in priority sectors,² and who are in executive and senior management positions;
- a significant increase in the number of new black-, black-empowered, and black-engendered enterprises;
- a rising proportion of black ownership and management of “community and broad-based enterprises” (such as trade unions and employee trusts) and cooperatives; and
- greater black ownership of land and other productive assets, improved access by blacks to infrastructure and skill acquisition, and increased black participation in productive economic activities in under-developed areas.

2. The key policy instruments include legislation that establishes a framework for promoting BEE and allows the government to issue a code of good practice on BEE, and:

- a “balance scorecard” to measure progress toward achieving BEE by enterprises and sectors that will measure three core elements of BEE: direct empowerment through ownership and control; human resource development and employment equity; and indirect empowerment, including through preferential procurement;
- discounted shares in implementing the privatization program to promote black ownership;
- higher levels of preference to black-empowered enterprises in preferential procurement;
- institutional support, including through a BEE Advisory Council, to advise on implementation of the strategy; and
- partnerships and charters with the private sector.

3. Financing. The strategy does not envision BEE as being largely state-financed; in contrast, it rules out assumption by the state of large-scale commercial risk and notes the need to avoid jeopardizing macroeconomic stability through excessive debt or deficit financing. The main elements are:

- the state will facilitate access to capital and collateral (structural problems for the black community), and the 2003/04 budget envisages that over the next five years R 10 billion (0.2 percent of annual GDP) will be set aside to support BEE;
- the government envisages the use of alternative financing mechanisms to support BEE, including grants and incentives, guarantees, loans, and equity financing; and
- BEE will be implemented for individual sectors on the basis of specific transition plans and goals. In order to ensure that progress is being made with BEE, the government will take the scorecard into account in dealings with the private sector, such as when granting licenses and concessions, selling state assets, and granting public-private partnerships.

¹ Department of Trade and Industry, 2003, “South Africa’s Economic Transformation: A Strategy for Broad-Based Black Economic Empowerment,” Pretoria, March 24.

² Agriculture and agro-processing, aerospace, automobiles and parts, clothing and textiles, mining, minerals, information technology, chemicals, cultural industries, and high-value-added services.

did not include safeguards against the concentration of assets in a few hands, and that such a concentration could itself be a source of social tension in the future.

45. **The implementation of land reform is important not only for reasons of equity and social cohesion, but also because it provides a potentially viable means for alleviating the problem of rural unemployment.** While good progress has recently been made in restituting land to owners dispossessed under apartheid practices, the pace of land redistribution, more generally, has been disappointingly slow. After several years of implementation, only 2-3 percent of agricultural land has been transferred to black farmers, compared with an official target of 30 percent by 2015. Various recent initiatives should help speed up the process, but several constraints remain to be addressed. These include limited administrative capacity in the Departments of Agriculture and Land Affairs, restrictions on the subdivision of land, relatively small numbers of willing sellers, and regressive land taxes that encourage oversized farms. An intraministerial study on the financial and economic implications of land reform is examining whether funding may also be a constraint.

IV. STAFF APPRAISAL

46. **South Africa has now enjoyed 24 consecutive quarters of positive economic growth.** Sound macroeconomic management, a highly competitive exchange rate, and the adoption of structural policies that have exposed the economy to greater competition have rendered it more resilient, robust, and efficient. Growth rose to 3 percent in 2002, although the recovery appears recently to be losing some steam, largely in response to the strength of the rand and weak demand conditions overseas.

47. **The slowdown in the pace of economic activity should be relatively limited in both magnitude and duration.** The staff expects real GDP to grow by about 2¼ percent in 2003 and to rebound modestly to 3 percent in 2004, supported by recent declines in interest rates and a mildly expansionary budget for 2003/04. However, there are downside risks. In particular, the recent currency appreciation has weakened South Africa's competitiveness at a time of continuing uncertainty over global economic conditions, while an anticipated rise in real wages during 2003 could dampen activity and reverse recent employment gains.

48. **The stabilization effort is now largely complete.** The dissipation of inflationary pressures has allowed the SARB to move cautiously in lowering interest rates, and the inflation target of 3–6 percent for 2004 should be met. Strong fiscal performance has helped keep long-term real interest rates low, maintain a competitive exchange rate, and revive confidence in the economy. At the same time, additional budgetary resources have been freed up to address South Africa's acute social needs.

49. **The rand has fluctuated dramatically in value over the last 18 months.** The rapid depreciation in 2001 represented a clear case of overshooting, and the exchange rate has since recovered in value. Its present strength is consistent with macroeconomic fundamentals, such as increases in commodity prices, the tight stance of financial policies, and the improvement in the current account in 2002.

50. **The government is to be commended once again for maintaining fiscal discipline in the face of budgetary pressures.** The mildly expansionary budget envisaged during 2003/04–2005/06 is appropriate, as it will allow for additional spending on critical social needs and infrastructure while maintaining competitive tax rates and allowing a decline in debt relative to GDP. The revenue projections for 2003/04, however, appear somewhat ambitious, and efforts to strengthen tax administration will need to continue.

51. **A major milestone was reached in May 2003 when the NOFP, long a source of external vulnerability, was brought to below zero.** The staff would, nonetheless, encourage the SARB to seek a further strengthening of its reserve position. This would not only help reduce currency volatility, which has made long-term business planning difficult, but would also eliminate the SARB's remaining exposure in the forward market and thereby remove a potential source of macroeconomic instability. The staff commends the authorities' cautious debt-management strategy and supports their gradual approach to the removal of capital controls.

52. **South Africa's financial and corporate sector indicators remain sound.** In particular, the sectors appear sufficiently strong to sustain major exchange and interest rate shocks.

53. **The primary policy challenge facing South Africa is to achieve higher rates of sustainable economic growth and make substantive progress in the fight against poverty.** A durable solution to reducing unemployment and raising living standards across the board must consist of actions to enhance job skills and remove legal and institutional barriers to job creation. Further action to boost economic efficiency through trade reform and privatization would also be helpful in boosting growth.

54. **The government recognizes the causes of unemployment and is making a strong effort to address the problem.** A skills development strategy, which includes a program to raise education standards, is being implemented, although the staff believes that it should focus more on training the unemployed rather than those already with jobs. Less reliance on funding from payroll taxes would also help raise labor demand. Amendments were made in 2002 to the legal framework governing the labor market that should significantly reduce the statutory cost of doing business, while providing added protection for workers' rights. The amendments are a step in the right direction, and the staff would reiterate that the government should undertake further reviews as experience unfolds. An effort should also be made to decentralize the system of collective bargaining by allowing small and medium-sized enterprises more latitude in setting wages at the plant level. This would have a considerable impact on job growth and on the competitiveness of the South African economy. The staff would also urge that statutory minimum wages be applied judiciously in order to avoid causing job losses.

55. **The present tariff review will provide an opportunity to accelerate trade liberalization.** In particular, there is scope to further simplify the tariff regime and reduce

tariff rates, particularly in relatively heavily protected sectors. To maximize the potential employment benefits, trade liberalization should be accompanied by labor market reforms.

56. **Privatization and parastatal restructuring provide an opportunity to realize efficiency gains and benefits from the transfer of technology.** Moving ahead forcefully with privatization will also help strengthen investor confidence in the government's ability and determination to sustain the process of economic reform. The government is keenly aware of job losses that may potentially arise as a result of restructuring, and safety nets are being erected to address this issue.

57. **South Africa faces a number of difficult social problems, many of which relate to the HIV/AIDS epidemic.** The disease is causing untold human suffering, lowering life expectancy, and undermining growth performance. The government is appropriately treating the disease as a fiscal, as well as a social, priority while ensuring that budgetary resources are well spent through planning, capacity building, and phased implementation of new initiatives.

58. **Wealth disparities pose a potential threat to social harmony.** The black empowerment and land reform strategies are welcome initiatives to ensure a more equitable and sustainable distribution of productive assets. The voluntary approach to these initiatives should help coalesce stakeholder support and avoid undue regulation in the marketplace. The staff would urge, however, that uncertainties over the funding of the black economic empowerment strategy be resolved quickly and that the benefits are distributed as widely as possible. Implementation of the land redistribution program has been very slow, and consideration should be given to removing some of the more prominent impediments to progress in this area.

59. **South Africa's economic data are of high quality.** They are provided to the Fund, and generally to the public, with a detail, frequency, and timeliness that are fully adequate for surveillance. South Africa subscribes to the Special Data Dissemination Standard (SDDS) and is publishing all data on the reserve template. The authorities are resolving recent problems with the CPI data by obtaining more reliable data on residential rents from external sources, and their intention to improve data quality by relying on alternative surveys is welcome. The staff encourages the authorities to implement the recommendations of the IMF Statistics Department in the context of the data ROSC (Data Module), most notably those relating to government finance and monetary statistics. The authorities should address the weaknesses that remain in the quality and frequency of labor market data, and their recent efforts, including the introduction of revised household labor force and employment surveys, are commendable.

60. It is expected that the next Article IV consultation will be held on the standard 12-month cycle.

Table 1. South Africa: Selected Economic and Financial Indicators, 1999-2004

	1999	2000	2001	2002	2003	2004
	Proj.					
	(Annual percent change, unless otherwise indicated)					
National income and prices						
Real GDP	2.0	3.5	2.8	3.0	2.2	3.0
Real GDP per capita	-0.2	2.0	0.8	1.0	0.3	1.0
Nominal GDP (billions of rand)	801	888	983	1,099	1,212	1,303
Nominal GDP per capita (U.S. dollars, at purchasing power parity)	7,629	7,909	8,132	8,268	...	...
GDP deflator	6.2	7.2	7.6	8.5	7.8	4.5
CPI (annual average)	5.2	5.4	5.7	9.1	7.7	4.9
CPI (end of period)	2.7	7.2	3.7	12.3	4.5	4.8
CPDX (period average) 1/	6.9	7.7	6.6	9.3	7.2	5.1
Labor market						
Unemployment rate (official definition; in percent) 2/	23.3	25.8	29.5	30.5	31.0	30.7
Average remuneration (formal nonagricultural private sector)	9.4	9.2	8.8	9.5	10.0	9.0
Labor productivity (formal nonagricultural)	4.2	6.3	4.8	1.5	3.7	4.5
Nominal unit labor costs (formal nonagricultural)	2.9	2.7	4.1	8.0	6.3	4.5
External sector						
Merchandise exports, f.o.b. 3/	-1.8	10.9	-3.1	4.3	8.5	3.6
Merchandise imports, f.o.b. 3/	-9.9	11.5	-5.5	6.5	11.8	4.5
Export (goods and services) volume	1.4	8.4	2.5	-1.4	1.4	3.4
Import (goods and services) volume	-7.4	7.1	0.3	3.1	4.6	3.9
Terms of trade	-2.9	-1.8	0.1	2.6	0.5	-1.7
Nominal effective exchange rate 4/	-8.5	-5.1	-14.6	-20.9	...	...
Real effective exchange rate 4/	-5.2	-3.0	-13.5	-17.2	...	...
Money and credit						
Net domestic assets 5/	2.9	8.7	18.6	-0.2	...	...
Credit to the government 5/	-0.5	0.2	-1.6	4.1	...	...
Credit to the rest of the economy 5/	3.4	8.6	20.2	-4.3	...	...
Broad money (including foreign exchange deposits)	10.1	7.5	16.7	12.8	7.4	8.2
Velocity (GDP/average broad money)	1.8	1.8	1.8	1.7	1.7	1.7
	(In percent of GDP, unless otherwise indicated)					
Investment and saving						
Investment (including inventories)	15.9	15.6	15.1	15.8	16.0	16.0
Of which: public fixed investment	2.5	2.3	2.2	2.2	2.5	2.6
private fixed investment	12.9	12.6	12.5	13.0	13.1	13.3
Gross national saving	15.4	15.2	14.8	16.1	15.4	15.2
Public	0.3	0.2	1.9	1.9	0.5	0.3
Private	15.1	15.0	12.9	14.2	14.9	14.9
National government budget 6/						
Revenue, including grants	24.3	23.7	24.4	24.7	24.7	24.6
Expenditure and net lending	26.3	25.7	25.9	25.9	26.7	27.0
Overall balance	-2.0	-2.0	-1.6	-1.2	-2.1	-2.4
Primary balance	3.4	3.2	3.2	3.1	2.1	1.6
National government debt	47.0	44.4	43.1	39.9	38.6	38.3
General government balance 7/	-1.6	-1.6	-1.2	-1.2	-2.0	-2.3
Public sector borrowing requirement of the nonfinancial public sector	2.0	1.1	0.8	1.2	2.7	2.9
External sector						
Current account balance (in billions of U.S. dollars)	-0.6	-0.5	-0.3	0.3	-0.9	-1.2
Current account balance	-0.5	-0.4	-0.3	0.3	-0.5	-0.7
Overall balance of payments	3.2	0.6	0.8	3.3	0.3	0.3
Foreign currency-denominated debt (in billions of U.S. dollars)	23.9	24.9	24.0	25.0	26.1	24.8
Of which: short term (in billions of U.S. dollars)	13.5	12.9	11.2	11.4	11.4	10.6
Total external debt / exports of goods and services (in percent)	115.4	100.7	87.4	89.4	84.6	77.9
Total external debt service (in billions of U.S. dollars) 8/	6.0	5.1	5.6	5.1	6.0	6.4
Total external debt service / exports (in percent) 8/	17.9	14.0	15.8	14.0	15.2	15.6
Gross official reserves (in billions of U.S. dollars)	7.4	7.5	7.5	7.6	...	...
(in months of total imports)	2.9	2.7	2.9	2.8	...	...
Net open forward position of SARB (in billions of U.S. dollars) 9/	13.0	9.5	4.8	1.6	...	...
U.S. dollar exchange rate (end of period)	6.15	7.57	12.09	8.66	...	...

Sources: South African Reserve Bank (SARB); IMF, *International Financial Statistics*; and Fund staff projections.

1/ CPDX is the consumer price index (CPI) less the interest on mortgage bonds.

2/ Excludes individuals who have not taken active steps to look for work or start self-employment in the four weeks prior to the interview. September.

3/ In U.S. dollars; annual percent change.

4/ Annual average, Information Notice System (INS) definition.

5/ Contribution (in percentage points) to the growth of broad money.

6/ Calendar-year figures, based on National Treasury data and staff's GDP projections.

7/ Excluding sales of state assets and profit/losses from forward market operations of the SARB.

8/ Excluding rand-denominated debt held by nonresidents; end of period.

9/ Defined as net forward liabilities less net international reserves.

Table 2. South Africa: Balance of Payments, 1998-2004

	1998	1999	2000	2001	2002	Proj.	
						2003	2004
(In billions of U.S. dollars)							
Balance on current account	-2.3	-0.6	-0.5	-0.3	0.3	-0.9	-1.2
Balance on goods and services	1.5	3.4	3.5	4.2	3.6	3.0	2.8
Exports of goods and services	34.4	33.7	36.6	35.3	36.7	39.5	40.8
Exports of goods	29.1	28.6	31.7	30.7	32.0	34.8	36.0
Nongold	24.4	24.6	27.9	27.3	27.9	30.7	31.8
Gold	4.7	4.0	3.9	3.4	4.2	4.1	4.2
Exports of services	5.3	5.1	4.9	4.5	4.6	4.7	4.8
Imports of goods and services	-32.8	-30.2	-33.1	-31.1	-33.0	-36.5	-38.0
Imports of goods	-27.2	-24.5	-27.4	-25.9	-27.6	-30.8	-32.2
Imports of services	-5.6	-5.7	-5.7	-5.2	-5.5	-5.6	-5.8
Balance on income	-3.1	-3.2	-3.1	-3.7	-2.7	-3.3	-3.4
Income receipts	1.3	1.6	2.3	2.3	1.9	1.9	2.0
Income payments	-4.4	-4.7	-5.4	-6.0	-4.6	-5.2	-5.3
Balance on transfers	-0.7	-0.9	-0.9	-0.7	-0.6	-0.6	-0.6
Capital flows (including unrecorded transactions)	1.6	4.9	1.3	1.3	3.1	1.4	1.7
Balance on capital and financial account	3.1	5.3	0.3	-0.4	1.6	1.4	1.7
Balance on capital account	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Balance on financial account	3.1	5.3	0.3	-0.4	1.6	1.4	1.7
Direct investment	-1.2	-0.1	0.6	10.8	1.1	0.5	0.5
Liabilities	0.6	1.5	0.9	7.3	0.7	1.3	1.4
Assets	-1.8	-1.6	-0.3	3.5	0.4	-0.8	-0.8
Portfolio investment	3.7	8.6	-2.0	-8.3	-0.4	-0.5	0.0
Liabilities	9.1	13.7	1.7	-3.0	0.5	0.5	0.5
Assets	-5.4	-5.2	-3.7	-5.3	-0.9	-1.0	-0.5
Other investment	0.7	-3.2	1.7	-2.9	1.0	1.4	1.2
Liabilities	1.2	-1.5	1.6	-1.3	-0.4	-0.4	-0.5
Assets	-0.5	-1.6	0.1	-1.6	1.4	1.8	1.6
Unrecorded transactions	-1.5	-0.4	1.0	1.7	1.5	0.0	0.0
Overall balance of payments	-0.7	4.2	0.7	1.0	3.4	0.5	0.5
Gross reserves (central government and SARB)	5.4	7.4	7.5	7.5	7.6	...	...
Gross reserves (including the banking sector)	7.2	11.2	11.1	12.6	15.3	...	...
Net open forward position of the SARB 1/	22.5	13.0	9.5	4.8	1.6	...	...
(In percent of GDP)							
Balance on current account	-1.7	-0.5	-0.4	-0.3	0.3	-0.5	-0.7
Balance on goods and services	1.2	2.6	2.8	3.7	3.5	1.9	1.7
Exports of goods and services	25.7	25.7	28.6	30.9	35.1	25.0	24.9
Imports of goods and services	-24.6	-23.1	-25.8	-27.2	-31.6	-23.1	-23.2
Balance on income	-2.3	-2.4	-2.4	-3.3	-2.6	-2.1	-2.0
Balance on transfers	-0.6	-0.7	-0.7	-0.6	-0.5	-0.4	-0.4
Capital flows (including unrecorded transactions)	1.2	3.7	1.0	1.1	3.0	0.9	1.0
Balance on capital and financial account	2.3	4.0	0.2	-0.4	1.5	0.9	1.0
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	2.3	4.1	0.2	-0.4	1.6	0.9	1.0
Direct investment	-0.9	-0.1	0.5	9.4	1.0	0.3	0.3
Portfolio investment	2.8	6.5	-1.6	-7.3	-0.4	-0.3	0.0
Other investment	0.5	-2.4	1.3	-2.5	0.9	0.9	0.7
Unrecorded transactions	-1.1	-0.3	0.8	1.5	1.4	0.0	0.0
Overall balance of payments	-0.5	3.2	0.6	0.8	3.3	0.3	0.3
Gross reserves (central government and SARB)	4.3	5.7	5.9	6.6	7.3	...	...
Gross reserves (including the banking sector)	5.7	8.6	8.7	11.1	14.7	...	...
Net open forward position of SARB	16.8	10.0	7.4	4.2	1.5	...	...

Sources: South African Reserve Bank (SARB); and Fund staff estimates and projections.

1/ Defined as net forward liabilities less net international reserves.

Table 3. South Africa: National Government Main Budget, 1999/2000-2004/05 1/

	1999/00	2000/01	2001/02		2002/03			2003/04	2004/05
			Original Budget	Outturn	Original Budget	Auth. Proj. Feb. 2003	Prelim. Outturn	Projection 2/	
(Billions of rand)									
Total revenue and grants	198.6	215.6	233.4	248.3	265.2	275.7	278.2	304.7	327.1
Tax revenue	193.8	211.9	228.6	244.1	260.2	271.8	273.7	300.5	322.7
Income tax	116.5	126.1	131.6	147.3	155.7	162.5	165.4	178.0	193.8
<i>Of which</i> : personal income tax (PIT)	85.9	86.5	90.1	90.4	90.0	93.2	95.1	96.8	108.6
corporate taxes (CIT+STC)	24.1	33.5	34.2	49.5	57.4	61.2	63.3	73.9	77.2
Indirect taxes	72.2	79.1	86.7	86.9	92.8	97.6	96.9	109.7	116.3
<i>Of which</i> : value-added tax (VAT)	48.3	54.5	60.4	61.1	66.2	70.6	69.8	81.1	87.3
Trade and other (less SACU payments) 3/	5.0	6.6	10.3	9.9	11.7	11.8	11.5	12.8	12.6
Trade taxes	6.8	8.2	9.4	8.7	10.6	9.8	9.7	11.3	12.0
Other tax revenue	5.4	6.8	9.1	9.4	9.3	10.2	10.0	11.2	12.1
Less: SACU payments 3/	7.2	8.4	8.2	8.2	8.3	8.3	8.3	9.7	11.5
Nontax revenue	4.8	3.7	4.8	4.2	5.0	3.8	4.5	4.2	4.4
Grants	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Total expenditure	214.8	233.9	258.3	262.9	287.9	291.8	291.2	334.2	359.2
Interest	44.3	46.3	48.1	47.6	47.5	47.3	46.8	51.0	52.5
Transfer to subnational governments	103.5	114.5	123.9	127.6	141.0	145.7	145.7	171.1	186.5
<i>Of which</i> : provinces	99.0	108.9	117.4	121.1	132.4	136.9	136.9	159.1	173.4
Other	67.0	73.1	86.3	87.7	99.4	98.9	98.7	112.1	120.1
Budgetary balance	-16.2	-18.4	-24.9	-14.6	-22.7	-16.1	-13.0	-29.5	-32.0
Extraordinary payments 4/	...	...	...	...	...	-7.0	-7.0	-7.0	-7.0
Augmented balance	-16.2	-18.4	-24.9	-14.6	-22.7	-23.1	-20.0	-36.5	-39.0
Financing	16.2	18.4	24.9	14.6	22.7	23.1	20.0	36.5	39.0
Domestic loans (net)	4.9	11.4	-3.9	-17.8	-7.0	0.9	1.2	15.3	20.2
Foreign loans (net)	8.5	1.9	11.3	33.1	16.3	14.5	14.3	11.8	12.6
Privatization, cash, and other	2.7	5.1	17.4	-0.7	13.4	7.7	4.5	9.4	6.3
(Percent of GDP, unless otherwise specified)									
Total revenue and grants	24.2	23.6	23.6	24.6	24.5	24.6	24.7	24.7	24.6
Tax revenue	23.6	23.2	23.2	24.2	24.0	24.3	24.3	24.3	24.3
Income tax	14.2	13.8	13.3	14.6	14.4	14.5	14.7	14.4	14.6
<i>Of which</i> : personal income tax (PIT)	10.5	9.5	9.1	9.0	8.3	8.3	8.4	7.8	8.2
corporate taxes (CIT+STC)	2.9	3.7	3.5	4.9	5.3	5.5	5.6	6.0	5.8
Indirect taxes	8.8	8.7	8.8	8.6	8.6	8.7	8.6	8.9	8.8
Trade and other (less SACU payments) 3/	0.6	0.7	1.0	1.0	1.1	1.1	1.0	1.0	1.0
Nontax revenue	0.6	0.4	0.5	0.4	0.5	0.3	0.4	0.3	0.3
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	26.2	25.6	26.2	26.1	26.6	26.1	25.8	27.1	27.0
Interest	5.4	5.1	4.9	4.7	4.4	4.2	4.1	4.1	3.9
Transfer to subnational governments	12.6	12.5	12.5	12.7	13.0	13.0	12.9	13.9	14.0
Other	8.2	8.0	8.7	8.7	9.2	8.8	8.7	9.1	9.0
Budgetary balance	-2.0	-2.0	-2.5	-1.5	-2.1	-1.4	-1.2	-2.4	-2.4
Extraordinary payments 4/	...	...	...	...	...	-0.6	-0.6	-0.6	-0.5
Augmented balance	-2.0	-2.0	-2.5	-1.5	-2.1	-2.1	-1.8	-3.0	-2.9
Financing	2.0	2.0	2.5	1.5	2.1	2.1	1.8	3.0	2.9
Domestic loans (net)	0.6	1.2	-0.4	-1.8	-0.6	0.1	0.1	1.2	1.5
Foreign loans (net)	1.0	0.2	1.1	3.3	1.5	1.3	1.3	1.0	0.9
Privatization, cash, and other	0.3	0.6	1.8	-0.1	1.2	0.7	0.4	0.8	0.5
Memorandum items:									
Fiscal period GDP (billions of rand)	820	914	987	1,009	1,083	1,120	1,128	1,236	1,329
Primary balance	3.4	3.1	2.4	3.3	2.3	2.8	3.0	1.7	1.5
Debt	46.5	43.7	41.6	42.9	40.5	39.4	38.9	38.4	38.2
Domestic	43.4	40.2	37.0	34.7	32.3	31.4	31.0	30.3	29.7
Foreign	3.1	3.5	4.6	8.1	8.2	7.9	7.8	8.1	8.5

Sources: South African authorities; and Fund staff estimates and projections.

1/ Fiscal year begins April 1.

2/ Projection based on authorities' medium-term framework.

3/ Southern African Customs Union (SACU) payments are based on a revenue-sharing formula.

4/ Provision of bonds to the South African Reserve Bank in settlement of the Gold and Foreign Exchange Contingency Account.

Table 4. South Africa: Nonfinancial Public Sector Operations, 1999/2000-2004/05 1/

	1999/00	2000/01	2001/02		2002/03		2003/04	2004/05	
			Original	Outturn	Original	Auth. Proj. (Feb. 2003)			Prelim. Outturn	Projection 2/
(Billions of rand)									
General govt. (excl. local govts.)									
Total revenue and grants	211.2	228.2	246.6	261.8	279.3	292.0	294.8	323.3	346.2
National government	198.6	215.6	233.4	248.3	265.2	275.7	278.2	304.7	327.1
Provinces (own revenue)	4.0	4.5	4.0	4.3	4.1	5.4	5.8	5.7	5.9
Social security funds (own revenue)	7.8	7.1	8.4	7.8	9.2	9.2	9.2	11.5	11.7
Extrabudgetary and other	0.9	1.0	0.8	1.4	0.8	1.7	1.7	1.5	1.5
Total expenditure	223.6	243.5	270.4	272.4	303.2	310.2	309.6	351.6	376.4
Current	211.3	230.6	248.4	250.9	280.3	285.2	284.6	318.9	341.9
Wages and salaries	86.5	91.8	98.9	100.9	106.8	111.4	111.3	122.6	130.0
National government	27.3	28.0	...	33.2	...	36.6	36.5	41.4	44.2
Provincial governments	59.1	63.8	...	67.6	...	74.8	74.8	81.2	85.8
Other goods and services	28.2	32.5	39.2	34.3	43.8	42.0	41.9	47.4	52.8
Interest	44.3	46.3	48.1	47.6	47.5	47.3	46.8	51.0	52.5
Transfers	52.3	60.0	65.2	68.1	82.3	84.6	84.5	97.8	106.7
Capital expenditure	12.3	13.0	19.0	21.4	22.8	25.0	25.0	32.7	34.5
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-12.4	-15.4	-23.8	-10.6	-23.8	-18.2	-14.7	-28.3	-30.2
Public sector borrowing requirement (PSBR)	12.8	8.5	12.4	7.9	14.9	15.9	15.4	38.1	38.0
National government	16.2	18.4	24.9	14.6	22.7	16.1	13.0	29.5	32.0
Provinces	-3.0	-3.2	-0.6	-3.8	1.7	3.3	3.0	0.2	-0.8
Local govts. and local enterprises	1.0	-2.3	2.0	4.4	1.0	5.5	5.5	4.7	4.9
Nonfinancial public enterprises	2.4	-5.6	3.0	-3.5	-0.5	-2.9	-2.9	7.8	5.3
Other 3/	-3.7	1.2	-16.8	-4.0	-10.0	-6.1	-3.2	-4.2	-3.5
(Percent of GDP)									
General govt. (excl. local govts.)									
Total revenue and grants	25.8	25.0	25.0	25.9	25.8	25.9	26.1	26.2	26.1
National government	24.2	23.6	23.6	24.6	24.5	24.4	24.7	24.7	24.6
Provinces (own revenue)	0.5	0.5	0.4	0.4	0.4	0.5	0.5	0.5	0.4
Social security funds (own revenue)	0.9	0.8	0.9	0.8	0.9	0.8	0.8	0.9	0.9
Extrabudgetary and other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total expenditure	27.3	26.6	27.4	27.0	28.0	27.5	27.4	28.5	28.3
Current	25.8	25.2	25.2	24.9	25.9	25.3	25.2	25.8	25.7
Wages and salaries	10.5	10.0	10.0	10.0	9.9	9.9	9.9	9.9	9.8
National government	3.3	3.1	...	3.3	...	3.2	3.2	3.4	3.3
Provincial governments	7.2	7.0	...	6.7	...	6.6	6.6	6.6	6.5
Other goods and services	3.4	3.6	4.0	3.4	4.0	3.7	3.7	3.8	4.0
Interest	5.4	5.1	4.9	4.7	4.4	4.2	4.1	4.1	3.9
Transfers	6.4	6.6	6.6	6.8	7.6	7.5	7.5	7.9	8.0
Capital expenditure	1.5	1.4	1.9	2.1	2.1	2.2	2.2	2.6	2.6
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.5	-1.7	-2.4	-1.1	-2.2	-1.6	-1.3	-2.3	-2.3
Public sector borrowing requirement (PSBR)	1.6	0.9	1.3	0.8	1.4	1.4	1.4	3.1	2.9
National government	2.0	2.0	2.5	1.5	2.1	1.4	1.2	2.4	2.4
Provinces	-0.4	-0.4	-0.1	-0.4	0.2	0.3	0.3	0.0	-0.1
Local govts. and local enterprises	0.1	-0.3	0.2	0.4	0.1	0.5	0.5	0.4	0.4
Nonfinancial public enterprises	0.3	-0.6	0.3	-0.3	0.0	-0.3	-0.3	0.6	0.4
Other 3/	-0.4	0.1	-1.7	-0.4	-0.9	-0.5	-0.3	-0.3	-0.3

Sources: South African authorities; and Fund staff estimates and projections.

1/ Fiscal year begins April 1.

2/ Projection based on authorities' medium-term framework.

3/ "Other" includes social security funds, other extrabudgetary funds, and privatization receipts.

Table 5. South Africa: Monetary Survey, 1997-2002

7/29/2003 9:39	1997	1998	1999	2000	2001	2002
	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.
	(In billions of rand)					
Net foreign assets	-19.9	-28.9	5.7	14.7	35.9	87.3
Gross reserves	37.8	50.7	79.9	102.3	183.6	167.0
SARB	28.5	31.6	45.4	57.0	90.6	66.0
Other monetary institutions	9.3	19.1	34.5	45.3	93.0	101.0
Liabilities	57.6	79.6	74.1	87.6	147.7	79.7
SARB	9.8	18.1	18.8	19.7	48.3	21.5
Other monetary institutions	47.8	61.5	55.3	67.9	99.4	58.2
Net domestic assets	394.1	457.6	466.4	492.9	556.5	580.9
Credit to government, net	20.0	31.3	29.2	30.0	21.9	46.2
Claims on government	48.2	59.1	61.3	64.2	67.5	84.9
Government deposits	28.2	27.8	32.2	34.2	45.6	38.7
Credit to private sector	420.1	490.1	532.7	590.1	673.6	703.5
Other items, net	-46.0	-63.8	-95.5	-127.2	-139.0	-168.9
Broad money (M3)	374.2	428.7	472.2	507.6	592.5	668.2
Of which: M1	173.1	213.9	258.3	266.9	313.2	350.6
	(Annual percentage change)					
Net foreign assets	23.9	-45.4	119.9	156.3	144.5	143.0
Net domestic assets	14.1	16.1	1.9	5.7	12.9	4.4
Credit to government, net	96.2	56.4	-6.6	2.8	-27.1	111.2
Credit to private sector	14.4	16.7	8.7	10.8	14.2	4.4
Other items, net	-44.2	-38.7	-49.6	-33.2	-9.2	-21.5
Broad money (M3)	17.2	14.6	10.1	7.5	16.7	12.8
	(Contribution to growth in M3, unless otherwise specified)					
Net foreign assets	1.9	-2.4	8.1	1.9	4.2	8.7
Net domestic assets	15.2	17.0	2.1	5.6	12.5	4.1
Credit to government, net	3.1	3.0	-0.5	0.2	-1.6	4.1
Credit to private sector	16.6	18.7	9.9	12.1	16.5	5.1
Other items, net	-4.4	-4.8	-7.4	-6.7	-2.3	-5.0
Memorandum item:						
Income velocity of M3	1.92	1.77	1.75	1.84	1.76	1.73
	(In percent, unless otherwise specified)					
Official risk indicators 1/						
Share of nonperforming loans in total lending	3.3	4.1	4.9	4.5	3.2	3.0
Risk-based capital adequacy ratio	9.9	10.6	11.8	12.3	11.4	11.9
Financial sector risk factors						
Share of foreign currency loans in total lending 2/	3.8	4.1	5.9	8.4	13.6	13.2
Share of foreign currency deposits in total deposits	2.3	3.5	3.5	4.2	6.2	4.6
Share of foreign liabilities in total liabilities 2/ 3/	7.3	7.1	6.1	7.3	9.7	5.4
Share of short-term deposits in total deposits 4/	41.6	45.6	49.9	47.9	48.6	48.1
Share of mortgage advances in private credit	42.3	39.9	38.2	38.3	38.5	40.7
Market assessment						
Financial index of Johannesburg Stock Exchange (index, 2000=100) 5/	91.1	82.4	101.5	100.0	94.2	82.2

Sources: South African Reserve Bank (SARB); and Fund staff estimates.

1/ Banks are audited using generally accepted international standards; capital adequacy requirements are also imposed on securities trading. The figure for 2000 refers to September.

2/ Including foreign financing in banks' own name on-lent to clients.

3/ Including foreign currency deposits and other foreign loans and advances.

4/ Short-term deposits include check and demand deposits.

5/ Includes banks and financial services; insurance services; and investment trusts and private equity funds.

Table 6. South Africa: Indicators of External Vulnerability, 1998-2003
 (In percent of GDP, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	date
Financial indicators							
Public sector debt 1/	48.2	47.0	44.4	43.1	39.9	38.6	April
Broad money (percent change; 12-month basis)	14.6	10.1	7.5	16.7	12.8	8.1	May
Private sector credit (percent change; 12-month basis)	16.7	8.7	10.8	14.2	4.4	21.9	April
Repurchase rate (in percent) 2/	19.3	12.0	12.0	9.5	13.5	12.0	June
Repurchase rate (in percent; real) 2/ 3/	11.3	5.5	3.9	3.5	2.4	4.5	June
External indicators							
Exports (percent change; U.S. dollar value)	-5.9	-2.0	8.7	-3.7	4.0	...	
Imports (percent change; U.S. dollar value)	-5.9	-7.9	9.4	-6.1	6.4	...	
Terms of trade (percent change)	-1.0	-2.9	-1.8	0.1	2.6	...	
Current account balance	-1.7	-0.5	-0.4	-0.3	0.3	...	
Capital and financial account balance	2.3	4.0	0.2	-0.4	1.5	...	
Gross official reserves (in billions of U.S. dollars) 2/	5.4	7.4	7.5	7.5	7.6	7.8	May
Short-term official foreign liabilities (in billions of U.S. dollars) 2/	3.1	3.0	2.6	4.0	2.4	2.4	May
Net official reserves (in billions of U.S. dollars)	2.3	4.3	4.9	3.5	5.2	5.4	May
Open forward position of SARB (in billions of U.S. dollars) 2/	24.8	17.4	14.4	8.3	6.8	4.4	May
Net open forward position of SARB (in billions of U.S. dollars) 2/ 4/	22.5	13.0	9.5	4.8	1.6	-0.8	May
Short-term external debt by remaining maturity (in billions of U.S. dollars)	14.5	13.5	12.9	11.2	11.4	11.4	May
Short-term external debt plus open forward position (in billions of U.S. dollars)	39.3	30.9	27.3	19.5	18.3	15.8	May
Gross official reserves as a percent of the above	13.7	23.9	27.6	38.4	41.8	49.3	May
Foreign currency-denominated external debt (in billions of U.S. dollars)	25.0	23.9	24.9	24.0	25.0	...	
As a percent of total exports	72.6	71.0	67.9	68.2	68.3	...	
External interest payments (as a percent of total exports)	8.7	8.9	6.6	6.4	6.2	...	
Exchange rate (per U.S. dollar; period average)	5.53	6.11	6.94	8.60	10.52	8.07	May
Real effective exchange rate appreciation (period average; in percent) 5/	-8.9	-5.2	-3.0	-13.5	-17.2	...	
Financial market indicators 2/							
Stock market index (1994=100)	91.3	143.6	140.0	175.5	155.9	144.0	May
Percent change in U.S. dollar terms	-27.3	49.8	-20.7	-21.5	24.0	-7.9	May
Foreign currency debt rating—Standard & Poor's	BB+	BB+	BBB-	BBB-	BBB-	BBB	May
Foreign currency debt rating—Moody's 6/	BBB-	Baa3	Baa3	Baa2	Baa2	Baa2	May
Spread of benchmark bonds (basis points) 7/	572	308	411	281	240	172	May

Sources: South African Reserve Bank (SARB); and Fund staff estimates.

1/ National government debt; end of period.

2/ End of period.

3/ Deflated by the percent change in end-period CPI (consumer price index less interest on mortgage bonds).

4/ Defined as net forward liabilities less net international reserves.

5/ Based on IMF's Information Notice System.

6/ In November 2001, Moody's upgraded South African sovereign foreign currency debt to Baa2.

7/ Spread on 15-20-year dollar-denominated bond relative to comparable U.S. treasury bond.

Table 7. South Africa: Social and Demographic Indicators
 (2001, unless otherwise specified)

Area		Population	
1.22 million square kilometers		Total	44.6 million
		Annual rate of growth	2.0 percent
Population characteristics		Health (2000)	
Population density	36.6 per sq. km.	Life expectancy at birth Total (years)	48
Urban population (percentage of total)	55		
Proportion in capital city (1995) (as a percentage of urban population)	13	Infant mortality (per thousand live births)	63
Population age structure (percent)		Labor force	
0-14 years	34		
15-64	62	Female (percentage of labor force)	38
65 and above	4		
GDP per capita at current prices		Percentage of employment	
In U.S. dollars	2,912	Agriculture	12
		Mining	4
		Industry	20
		Government	17
		Trade	25
		Other	22
Nutrition (1999)		Education (2000)	
Per capita calorie intake per day		Adult literacy (15+, percentage)	
Mean	2,424	Male	86
Median	2,358	Female	84
		Total	85

Sources: World Bank, *World Development Indicators*; UNDP, *Human Development Report*; Statistics South Africa; and staff estimates.

South Africa: Relations with the Fund
 (As of May 31, 2003)

I. Membership Status: Joined: 12/27/1945; Article VIII

II.	<u>General Resources Account:</u>	<u>SDR Million</u>	<u>Percent Quota</u>
	Quota	1,868.50	100.00
	Fund holdings of currency	1,868.07	99.98
	Reserve position in Fund	0.43	0.02

III.	<u>SDR Department:</u>	<u>SDR Million</u>	<u>Percent Allocation</u>
	Net cumulative allocation	220.36	100.00
	Holdings	222.78	101.10

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
Stand-By Arrangement	11/03/1982	12/31/1983	364.00	159.00
CCFF	12/22/1993	--	614.43	614.43

VI. Projected Obligations to Fund: None.

VII. Exchange Rate Arrangement:

The South African rand floats against other currencies. South Africa formally accepted the obligations of Article VIII, Section 2, 3, and 4 of the Fund's Articles of Agreement, as from September 15, 1973. On June 30, 2003 the exchange rate of the rand was US\$0.1332=R 1.

South Africa has followed a strategy of progressively easing exchange controls on capital transactions since 1994, reflecting the government's commitment to the eventual abolition of these controls, and has made considerable progress in this regard in recent years. With the abolition of the financial rand in 1995, all exchange controls on nonresidents were eliminated. They are free to purchase shares, bonds, and other assets without restriction and to repatriate dividends, interest receipts, and current and capital profits, as well as the original investment capital. Nonresidents are also free to hold rand accounts in the banking system, but they are constrained as to the amount they may borrow domestically. This constraint has also been relaxed, and only organizations with more than 75 percent nonresident ownership are subject to limits on their domestic borrowing.

Since 1995, exchange controls on capital transaction by residents have also been relaxed considerably. Rather than allowing complete liberalization of a particular type of current or capital transaction, the authorities have pursued a strategy of allowing an increasing array of transactions, with each subject to a quantitative cap that has been progressively raised over time. The limit on foreign exchange holdings by authorized dealers has been eliminated, although they continue to be subject to prudential regulations. There are no controls on the transfer of funds arising from the import or export of goods and services, although the foreign currency proceeds from exports must be repatriated to South Africa within 180 days. South African corporates are allowed to invest up to R 1 billion abroad, except for investments in other African countries where the cap is R 2 billion. In 2001, the mechanism for asset swaps by institutional investors (insurance companies, unit trusts, and pension funds) was terminated. In 2003, the investment limit of 10 percent of net inflows of funds during the previous year for institutional investors was abolished, although the overall foreign investment limit of 15 (20) percent of total assets for insurance companies and pension funds (unit trusts) remains in place. Private individuals (both residents and emigrants) are allowed to invest up to R 750,000 offshore (R 1.5 million per family). Transfers in excess of this allowance might also be approved, subject to a 10 percent exit charge. Corporations may, upon application, be permitted to establish primary listings offshore under certain conditions.

VIII. Article IV Consultations

The 2002 Article IV consultation was concluded by the Executive Board on July 1, 2002 (SM/02/176). South Africa is on the standard 12-month Article IV consultation cycle.

IX. Technical Assistance

An FAD staff visit on natural resource taxation took place in June 2003. An FAD mission on capital gains taxation took place during November/December 2000.

South Africa: Relations with the World Bank Group (As of May 31, 2003)

Between 1951 and 1966, the Bank made 11 loans to South Africa, totaling US\$241.8 million, largely for expanding the country's rail and harbor systems, and for generating and transmitting electricity. The Bank ceased lending operations to South Africa in 1966, and the loans from that earlier period have been fully repaid.

Between 1990 and 1994, the Bank resumed activities in South Africa through a comprehensive program of economic policy advice and capacity building. There was open participation between the Bank and relevant sectors of the South African society, such as the government, the South African Reserve Bank, (then) opposition parties, universities, labor unions, industrialists, and nongovernmental organizations. Several discussion papers and reports were produced on all the key sectors: the macroeconomy, education, health, agriculture, fiscal decentralization, labor markets, trade policy, and microfinance.

Since 1994, the emphasis has shifted slightly toward the provision of policy advice to government, particularly in the areas of municipal services and welfare financing, the macroeconomic strategy, poverty, the medium-term expenditure framework, the economic impact of HIV/AIDS, and the business environment. The Bank's nonlending involvement has ranged from traditional economic and sector work, focusing on sectoral analysis and policy recommendations, to more formal research outputs, including numerous policy support exercises that provided the government with advice on strategic policy options.

In addition, the Bank Group has provided financial and technical support through a number of different channels. The Bank began limited project lending leading to the Industrial Competitiveness and Job Creation Project (for US\$46 million in 1997, of which US\$21.5 million was subsequently cancelled at the government's request and US\$7.4 million has so far been disbursed), and the Cape Peninsula Biodiversity Conservation Project (Global Environmental Facility grant of US\$12.3 million in 1998) that was prepared under the auspices of the Global Environment Facility. A World Bank team visited Pretoria during December 2001 to appraise the Municipal Financial Management Support Project (MFMSPP), and negotiations took place at the end of January 2002. A request for the Bank's assistance on hospital rehabilitation (the project was appraised in 2001) is also being reviewed by the authorities.

The International Finance Corporation (IFC) has been operating in South Africa for only the last four years. Total disbursement of loans amounts to US\$62.3 million, and an additional US\$21.2 million in loans has been committed. The IFC's strategy focuses on efforts to benefit previously disadvantaged groups directly with SME project funding and indirectly through job creation, infrastructure financing, and business ownership diversification. The Multilateral Investment Guarantee Agency (MIGA) has issued three guarantees for US\$13 million in the banking and manufacturing sectors.

South Africa: Statistical Issues

Real sector

In June 1999, Statistics South Africa released a major revision of the national income accounts based on the United Nations' *System of National Accounts* (1993). The revision raised nominal GDP by some 13 percent for the 1993-98 period and raised the average annual rate of growth of real GDP from 2.2 percent to 2.7 percent for the period 1994-98.

Reporting of real sector data for *International Financial Statistics (IFS)* is timely. Data reported for *Direction of Trade Statistics (DOTS)*, however, show substantial inconsistencies with external trade data reported for *IFS*, particularly exports.

Labor market statistics are published with lags of about six months, and unemployment data are available only at an annual frequency. Given the seriousness of the unemployment problem, labor market analysis and policy design need to be based on better, more frequent, and timely labor market data.

Beginning with the April 2003 index, Statistics South Africa issued revisions to the Consumer Price Index for the period January 2002 to March 2003, reflecting the incorporation of more reliable data on residential rents.

Government finance

South Africa currently reports data for the consolidated central government and for regional and local governments for publication in the *Government Finance Statistics Yearbook*. It also reports monthly data covering the operations of the budgetary central government for publication in *IFS*.

Monetary statistics

South Africa regularly reports monetary statistics for publication in the *IFS*, although there is room for improving the timeliness of the data on nonbank financial institutions.

Balance of payments

South Africa is a regular reporter of balance of payments data. It has recently revised its balance of payments data to be consistent with the fifth edition of the *Balance of Payments Manual*. However, there are deficiencies in the coverage of trade with Southern African Customs Union (SACU) countries, and in the coverage of some service transactions, mainly travel and construction service components. Only partial data are compiled on communications services, and the coverage of reinvested earnings on direct investment is limited to foreign branches of domestic banks.

Although South Africa disseminates its international reserve position in line with the requirements of the IMF's template on international reserves and foreign currency liquidity, the reporting of its international reserve position could be brought closer to best practices in a number of ways, including the application of a consistent formula for the valuation of gold, and the exclusion of regional currency holdings from reserves.

Technical assistance missions in statistics (1994-present)

Subject	Staff Member	Date
Data standards	Peter L. Joyce Ruth Lituma	November 1995
Report on Observance Of Standard of Codes (ROSC)	Charles Enoch (head) Wipada Soonthornsima Teresa Villacres Nataliya Ivanyk Ana Ansmitt	June 2001

South Africa: Reporting of Main Statistical Indicators (As of June 17, 2003)							
	Exports/Imports	Current Account Balance	Overall Government Balance	GDP/GNP	Debt Service	Debt	
Date of latest observation	4/03	Q4 2002	Q4 2002	Q4 2002	Q4 2002	Q4 2002	Q4 2002
Date received	5/30/03	3/26/03	3/26/03	3/26/03	3/26/03	3/26/03	3/26/03
Frequency of data 1/	M	Q	Q	Q	S	S	S
Frequency of reporting 1/	M	Q	Q	Q	Q	Q	Q
Source of data 2/	P, C	P, C	P, C	P, C	P, C	P, C	P, C
Mode of reporting 3/	E	R	R	R	R	R	R
Confidentiality 4/	C	C	C	C	C	C	C
Frequency of publication 1/	M	Q	Q	Q	Q	Q	Q

1/ M - monthly; Q - quarterly; S - semiannual.

2/ P - commercial publication; C - commercial electronic data provider; A - direct reporting by authorities.

3/ E - electronic data transfer; C - cable or facsimile; R - Reserve Bank Quarterly Bulletin.

4/ C - unrestricted use.

South Africa: Reporting of Main Statistical Indicators (concluded) (As of June 17, 2003)									
	Exchange Rates	International Reserves	Reserve/Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index		
Date of latest observation	6/17/03	5/03	4/03	5/03	4/03	6/17/03	5/03		
Date received	6/17/03	6/6/03	5/30/03	6/6/03	5/30/03	6/17/03	6/17/03		
Frequency of data 1/	D	M	M	M	M	D	M		
Frequency of reporting 1/	D	M	M	M	M	D	M		
Source of data 2/	P, C	P, C	P, C	P, C	P, C	P, C	P, C		
Mode of reporting 3/	E, C	E, C	E, C	E, C	E, C	E, C	E, C		
Confidentiality 4/	C	C	C	C	C	C	C		
Frequency of publication 1/	D	M	M	M	M	D	M		

1/ D - daily; M - monthly; Q - quarterly; S - semi annual
 2/ P - commercial publication; C - commercial electronic data provider.
 3/ E - electronic data transfer; C - cable or facsimile; R - Reserve Bank Quarterly Bulletin
 4/ C - unrestricted use.

Medium-Term Outlook

Baseline scenario

1. The staff's baseline medium-term scenario is based on a projection for annual real GDP growth of about 3 percent during 2004–08.¹ The scenario assumes the continuation of current policies, including sound fiscal policy, the achievement of the CPIX² inflation target, and steady, but very modest, progress with structural reforms. It also incorporates a recovery in the world economic environment in line with the WEO (Table 1).
2. More specifically, the baseline scenario assumes the following:
 - annual world real GDP growth of 4–4½ percent through the medium term, consistent with the assumptions in the May 2003 *World Economic Outlook*;
 - implementation and extension of the authorities' medium-term budget framework (MTBF), in which the national budget deficit averages about 2–2½ percent of GDP;
 - achievement of the CPIX inflation target starting in 2004;
 - a strengthening of the net reserve position;
 - continued trade liberalization under the commitments to the World Trade Organization (WTO) and in the free trade agreements with the European Union and the Southern African Development Community, including further simplification and reduction of tariff rates;
 - continued restructuring and privatization of public enterprises to realize efficiency gains and benefits from the transfer of technology; and
 - gradual progress in removing rigidities in the labor market along with training efforts to improve job skills, in particular among the previously unemployed.
3. Under these assumptions, achieving a trend decline in unemployment remains uncertain as firms may continue to rely on labor-saving technologies as long as skill levels

¹ The impact of HIV/AIDS on medium-term economic growth is highly uncertain. Estimates of the decline in annual output growth range from ½ to 2½ percentage points, with per capita income higher (or lower) by up to 1 percentage point per year. In the baseline scenario, the HIV/AIDS pandemic is one among several factors that limit potential output growth to 3 percent over the medium term. See Appendix V “HIV/AIDS in South Africa—An Update” for details.

² CPIX is consumer price inflation excluding interest on mortgage bonds.

remain low and rigidities persist in the labor market. The national government's medium-term fiscal program is consistent with a steadily declining ratio of debt to GDP, reflecting a primary surplus of about 1½ percent of GDP annually and the sale of state assets under the privatization program. It assumes that increased spending on HIV/AIDS, black economic empowerment, and land reform—amounting up to 0.7 percent of GDP—are carried out within this framework, including by redirecting spending. Provincial finances should remain strong, and the resulting decline in the public sector borrowing requirement would help sustain lower real interest rates.

4. Fiscal restraint should also help support external competitiveness over the medium term. Consequently, the share of South African exports in other countries' markets is expected to rise, reversing the declining trend in recent years. However, the pickup in private investment and the recovery in GDP growth are expected to contribute to growth in import demand and turn the external current account from a surplus in 2002 into a small deficit by 2006. The import cover of gross reserves is projected to remain at a little under three months over the medium term.

5. The risks to the medium term outlook are broadly balanced. They mainly originate from a more rapid implementation of economic reform policies on the upside and a discontinuation or slowdown in implementing economic reform policies on the downside. In the context of a downside scenario, it seems more appropriate to examine the discontinuation of economic policy reforms than an external shock because the South African economy has proved relatively resilient to external shocks such as slower global economic activity and higher oil prices.³ The sustainability analyses for public and external debt provide further support for South Africa's resilience to external shocks.

Rapid implementation of economic reform policies (alternative scenario 1)

6. Growth effects resulting from the timely implementation of comprehensive reform efforts in the areas of labor markets and trade liberalization under continued sound fiscal and monetary policies could increase annual real GDP growth to about 5 percent over the medium term (Table 2). Structural reforms can raise real output growth through contributions from increases in labor, capital inputs, and total factor productivity (TFP). The scenario assumes higher growth contributions from employment creation and investment relative to both the baseline scenario and the actual experience during 1994–2001, which was mainly

³ This resilience has been the result of sound macroeconomic policies, a flexible exchange rate, and a relatively low dependence on oil imports combined with higher world market prices for gold and platinum, which account for about 30 percent of South Africa's goods exports.

based on strong growth in TFP as a result of trade liberalization and greater private sector participation in the economy.⁴

7. Since the increase in real growth would be largely labor-driven, it should result in lower unemployment. Investment as a share of GDP would rise earlier and more strongly than under the baseline medium-term scenario and would reach 17 percent by 2007. Gross national savings as a share of GDP would fall initially, reflecting strong import growth, before recovering to 16¼ percent by 2007. Higher export-oriented investment through a pick-up in FDI inflows would increase real growth rates of both imports and exports. Investment growth, partly stemming from capital inflows, would result in a current account deficit of 0.6 percent of GDP by 2007. The path of inflation is projected to remain unchanged under the first alternative medium-term scenario, consistent with the successful implementation of inflation targeting. Higher fiscal revenue would allow for increased social spending.

Discontinuation of economic reform policies (alternative scenario 2)

8. A complete halt to all structural economic reform efforts could eliminate further TFP growth, the main source of growth in South Africa during 1994-2002. Without further trade liberalization and related structural reforms (such as price liberalization and reforms to labor market and competition policies), TFP in the traded goods sector would not improve further. This would reduce the real GDP growth rate to about 2 percent over the medium term. The growth slowdown would be accompanied by a larger current account deficit and a weaker real exchange rate relative to the baseline. Inward foreign direct investment would decline from already low levels, as higher consumption expenditure would crowd out investment over the medium term. Lower inward FDI would imply less transfer of technology and skills—an important source of TFP growth in the past.

9. A weaker TFP performance would translate into lower investment and private sector wage growth. Unemployment would rise and export volume growth would decline as FDI inflows cease. The impact of lower export growth on the current account would be reduced through a decline in real effective exchange rates, which would also limit the impact on the current account deficit (1.2 percent of GDP by 2007). With investment-to-GDP ratios stagnant, the macroeconomic counterpart of a wider current account deficit would be a fall in gross national savings to 15 percent of GDP in 2007, mainly reflecting a rise in consumption. The path of inflation is projected to remain unchanged under the second alternative medium-term scenario. Also, the overall impact on South Africa's fiscal position is expected to be minor, as lower revenue is largely offset by lower capital spending. However, declining fiscal revenue would also create pressure to cut back on social spending.

⁴ See Section IV of IMF Staff Country Report No. 03/18 (*South Africa: Selected Issues*) for a discussion of the sources of growth during 1980–2001 and of the medium-term outlook.

Sensitivity tests on public and external debt

10. Tables 3-6 present the results from a stylized set of sensitivity tests on the baseline's projection of public sector and external debt levels. For both public sector and external debt, the alternative scenarios included the use of historical averages for real GDP growth, real interest rates and primary fiscal deficits or—in the case of external debt—the current account balance excluding interest payments. A set of standard shocks, lasting for two years, were applied to these variables (both individually and jointly), and a 30 percent decline in the nominal exchange rate was also simulated.

11. Public debt dynamics are sustainable under all tested stress scenarios (Tables 3-4). If the primary fiscal balance is assumed to deteriorate to its historical average minus two standard deviations, the resulting deficit of 6 percent of GDP (compared with present projections of primary surpluses of 1¾-2 percent of GDP) would imply an increase in public debt ratios from 40 percent of GDP in 2002 to nearly 55 percent of GDP in 2007. External debt dynamics are also sustainable, as external debt ratios remain at or revert to moderate levels under all scenarios over the medium term (Tables 5-6).

Table 1. South Africa: Selected Economic and Financial Indicators, 2001-07 (Baseline Scenario)

	2001	2002	2003	2004	2005	2006	2007
		Est.			Proj.		
(Percentage change, unless otherwise indicated)							
National income and prices							
Real GDP	2.8	3.0	2.2	3.0	3.3	3.0	3.0
Real GDP per capita	0.8	1.0	0.3	1.0	1.3	1.1	1.1
Nominal GDP (in billions of rand)	982.9	1,098.7	1,211.5	1,303.4	1,404.8	1,500.8	1,605.6
Nominal GDP per capita (in U.S. dollars, at PPP)	8,132	...	...	...	...	...	...
CPI (annual average)	5.7	9.2	7.7	4.9	4.6	3.8	3.9
CPI (end of period)	3.8	12.1	4.5	4.8	4.2	3.9	3.7
CPIX (period average) 1/	6.6	9.3	7.2	5.1	4.8	4.0	4.0
Labor market							
Labor force	1.4	2.3	2.0	1.9	1.9	1.9	1.9
Unemployment rate (official definition; in percent) 2/	29.5	30.5	31.0	30.7	30.7	30.7	30.7
Labor productivity (formal nonagricultural)	4.8	1.5	3.7	4.5	4.8	4.5	4.5
Nominal unit labor costs (formal nonagricultural)	4.1	8.0	6.3	4.5	1.7	1.6	0.8
External sector							
Exports (goods and services), f.o.b. 3/	-3.7	4.0	7.6	3.4	4.0	3.3	4.1
Imports (goods and services), f.o.b. 3/	-6.1	6.4	10.4	4.3	4.0	4.6	4.8
Exports (goods and services) volume	2.5	-1.4	1.4	3.4	3.7	3.0	3.5
Imports (goods and services) volume	0.3	3.1	4.6	3.9	3.4	4.1	4.0
Terms of trade	0.1	2.6	0.5	-1.7	-1.1	-0.6	-0.1
(In percent of GDP, unless otherwise indicated)							
Investment and saving							
Investment (including inventories)	15.1	15.8	16.0	16.0	15.9	16.0	16.1
Public fixed investment	2.2	2.2	2.5	2.6	2.6	2.6	2.6
Private fixed investment	12.5	13.0	13.1	13.3	13.3	13.5	13.6
Gross national saving	14.8	16.1	15.4	15.2	15.2	15.1	15.1
Public	1.9	1.9	0.5	0.3	0.3	0.5	0.6
Private	12.9	14.2	14.9	14.9	14.9	14.6	14.6
National government budget 4/							
Revenue, including grants	24.4	24.7	24.7	24.6	24.6	24.6	24.6
Expenditure and net lending	25.9	25.9	26.7	27.0	27.0	26.9	26.9
Overall balance	-1.6	-1.2	-2.1	-2.4	-2.4	-2.3	-2.2
Primary balance	3.2	3.1	2.1	1.6	1.4	1.4	1.4
National government debt	43.1	39.9	38.6	38.3	38.2	38.0	37.7
General government balance 5/	-1.2	-1.2	-2.0	-2.3	-2.3	-2.1	-2.0
Public sector borrowing requirement of the nonfinancial public sector 5/	0.8	1.2	2.7	2.9	2.8	2.8	2.9
External sector							
Current external balance (in billions of US\$)	-0.3	0.3	-0.9	-1.2	-1.2	-1.7	-1.9
Current external balance	-0.3	0.3	-0.5	-0.7	-0.7	-0.9	-1.0
Overall balance of payments	0.8	3.3	0.3	0.3	0.3	0.2	0.1
Foreign currency-denominated debt (in billions of US\$)	24.0	25.0	26.1	24.8	24.5	25.6	25.4
Total external debt / exports of goods and services (in percent)	87.4	89.4	84.6	77.9	74.1	75.0	71.5
Total external debt service (in billions of US\$) 6/	5.6	5.1	6.0	6.4	4.3	4.7	4.6
Total external debt service / exports (in percent) 6/	15.8	14.0	15.2	15.6	10.1	10.6	10.2
Gross official reserves (in months of total imports)	2.9	2.8	2.7	2.7	2.8	2.7	2.6

Sources: South African Reserve Bank (SARB); IMF, *International Financial Statistics*; and Fund staff projections.

1/ CPIX is the CPI less the interest on mortgage bonds.

2/ Excludes individuals who have not taken active steps to look for work or start self-employment in the four weeks prior to the interview.

3/ In U.S. dollars, annual percent change.

4/ Calendar year figures, based on National Treasury data and staff's GDP projections.

5/ Excluding sales of state assets and profit/losses from forward market operations of the Reserve Bank.

6/ Excluding rand-denominated debt held by nonresidents; end of period.

Table 2. South Africa: Selected Economic and Financial Indicators, 2001-07 (Alternative Scenarios)
 (Annual percentage change, unless otherwise specified)

	2001	2002	2003	2004	2005	2006	2007
		Est.			Staff projections		
Alternative Scenario 1 (Accelerated Reform Policies)							
National income and prices							
Real GDP	2.8	3.0	2.3	3.5	4.9	5.0	5.0
Real GDP per capita	0.8	1.0	0.3	1.6	3.0	3.0	3.0
CPI (annual average)	5.7	9.2	7.7	4.9	4.6	3.8	3.9
CPIX (annual average)	6.6	9.3	7.2	5.1	4.8	4.0	4.0
Labor market							
Unemployment rate (official definition; in percent)	29.5	30.5	30.2	29.1	28.0	27.0	26.0
Nominal unit labor costs (formal nonagricultural)	4.1	8.0	6.2	4.0	0.0	-0.2	-0.5
External sector							
Exports (goods and services) volume	2.5	-1.4	1.4	3.4	5.5	6.2	6.7
Imports (goods and services) volume	0.3	3.1	5.6	5.7	5.3	6.2	6.5
Current external balance (in percent of GDP)	-0.3	0.3	-0.3	-0.8	-0.7	-0.7	-0.6
Investment and saving							
Investment (including inventories; in percent of GDP)	15.1	15.8	16.2	16.4	16.4	16.6	16.8
Gross national saving (in percent of GDP)	14.8	16.1	15.9	15.6	15.7	15.9	16.3
Alternative Scenario 2 (No Reform Policies)							
National income and prices							
Real GDP	2.8	3.0	2.2	2.2	2.0	2.0	2.0
Real GDP per capita	0.8	1.0	0.3	0.3	0.1	0.1	0.1
CPI (annual average)	5.7	9.2	7.7	4.9	4.6	3.8	3.9
CPIX (annual average)	6.6	9.3	7.2	5.1	4.8	4.0	4.0
Labor market							
Unemployment rate (official definition; in percent)	29.5	30.5	31.0	31.1	31.5	31.8	32.2
Nominal unit labor costs (formal nonagricultural)	4.1	8.0	6.3	5.3	2.9	2.6	1.8
External sector							
Exports (goods and services) volume	2.5	-1.4	1.4	1.7	2.1	1.2	1.7
Imports (goods and services) volume	0.3	3.1	3.8	2.2	2.0	2.8	2.8
Current external balance (in percent of GDP)	-0.3	0.3	-0.4	-0.6	-0.7	-1.1	-1.2
Investment and saving							
Investment (including inventories; in percent of GDP)	15.1	15.8	16.0	16.0	15.9	16.0	16.1
Gross national saving (in percent of GDP)	14.8	16.1	15.6	15.3	15.2	15.0	14.9

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

(UNIT PERCENT UNLESS OTHERWISE INDICATED)

	Actual				Projections						
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
I. Baseline Medium-Term Projections											
Public sector debt 1/ of which foreign-currency denominated	47.0	48.2	47.0	44.4	43.1	39.9	38.6	38.3	38.2	38.0	37.7
Change in public sector debt identified debt-creating flows (4+7+12)	1.7	2.1	2.1	2.7	3.3	6.5	7.7	8.0	8.4	8.4	8.2
Primary deficit	3.2	1.2	-1.2	-2.6	-1.3	-3.2	-1.3	-0.3	-0.1	-0.2	-0.3
Revenue and grants	-0.3	-0.8	-2.7	-2.8	-1.5	-5.8	-3.1	-0.6	-0.7	-0.3	-0.5
Primary (noninterest) expenditure	-1.1	-3.1	-3.8	-3.5	-3.6	-3.0	-2.1	-1.7	-1.5	-1.6	-1.6
Automatic debt dynamics 2/ Contribution from interest rate/growth differential 3/ Of which contribution from real interest rate	24.8	23.7	25.8	25.2	25.7	26.1	26.2	26.0	26.0	26.0	26.0
Contribution from exchange rate depreciation 4/ Other identified debt-creating flows	23.7	22.6	22.0	21.6	22.1	23.0	24.1	24.4	24.5	24.4	24.4
Privatization receipts (negative)	1.2	2.7	1.9	1.2	2.5	-2.1	-0.4	1.6	1.2	1.4	1.2
Recognition of implicit or contingent liabilities	1.1	2.3	1.8	0.5	0.5	-0.2	0.4	1.3	1.0	1.3	1.2
Other (specify, e.g. bank recapitalization)	2.2	2.6	2.7	2.0	1.7	0.9	1.2	2.3	2.2	2.4	2.2
Residual, including asset changes (2-3)	-1.0	-0.3	-0.9	-1.5	-1.1	-1.1	-0.8	-1.1	-1.2	-1.1	-1.1
Public sector debt-to-revenue ratio 1/	0.1	0.4	0.1	0.7	2.0	-1.9	-0.9	0.4	0.2	0.1	0.1
Gross financing need 5/ in billions of U.S. dollars	-0.4	-0.4	-0.8	-0.5	-0.4	-0.7	-0.6	-0.5	-0.4	-0.2	-0.1
Key Macroeconomic and Fiscal Assumptions	-0.4	-0.4	-0.8	-0.5	-0.4	-0.7	-0.6	-0.5	-0.4	-0.2	-0.1
Real GDP growth (in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Average nominal interest rate on public debt (in percent) 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.5	2.0	1.5	0.2	0.1	2.7	1.8	0.3	0.6	0.1	0.2
Inflation rate (GDP deflator, in percent)	189.3	187.7	182.0	176.5	167.6	152.9	147.4	146.8	146.7	146.0	144.8
Growth of real primary spending (deflated by GDP deflator, in percent)	8.8	7.0	5.8	6.1	3.7	7.2	4.9	5.6	5.1	4.0	3.4
	13.1	9.3	7.6	7.9	4.3	7.6	7.7	9.2	8.8	7.2	6.5
II. Stress Tests for Public Debt Ratio											
Real GDP growth (in percent)	2.6	0.8	2.0	3.5	2.8	3.0	2.2	3.0	3.3	3.0	3.0
Average nominal interest rate on public debt (in percent) 6/	13.8	12.9	12.3	12.2	12.0	11.1	11.4	11.1	10.7	10.4	10.2
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.7	6.0	6.1	5.0	4.3	2.6	3.6	6.6	6.3	6.7	6.4
Inflation rate (GDP deflator, in percent)	8.1	7.0	6.2	7.2	7.6	8.5	7.8	4.5	4.4	3.7	3.9
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.9	-3.8	-0.8	2.0	5.0	7.3	6.8	4.2	3.8	2.7	2.8
Historical Statistics for Key Variables (past 10 years)											
Primary deficit	Historical Average		Standard Deviation		Average 2002-07						
Real GDP growth (in percent)	-0.4		3.2		-1.9						
Nominal interest rate (in percent) 6/	13.3		0.9		10.8						
Real interest rate (in percent)	4.1		2.2		5.4						
Inflation rate (GDP deflator, in percent)	9.2		2.8		5.5						
Revenue to GDP ratio	25.2		0.5		26.1						

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
 2/ Derived as $(r - \pi(1+g) - g + \alpha\varepsilon(1+r))/(1+g+\pi+gr)$ times previous period debt ratio, with r = interest rate, π = growth rate of GDP deflator, g = real GDP growth rate, α = share of foreign-currency denominated debt, and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
 3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.
 4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
 5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
 6/ Derived as nominal interest expenditure (nominal interest rate times debt) minus domestic inflation (based on GDP deflator).

Table 4. Country: Public Sector Debt Sustainability Framework—Gross Public Sector Financing Need, 1997-2007
 (In percent of GDP, unless otherwise indicated)

	Actual				Projections						
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Gross financing need 1/ in billions of U.S. dollars	8.8	7.0	5.8	6.1	3.7	7.2	4.9	5.6	5.1	4.0	3.4
	13.1	9.3	7.6	7.9	4.3	7.6	7.7	9.2	8.8	7.2	6.5
Gross financing need 2/											
I. Baseline Projections											
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2003-2007						7.2	6.9	6.5	6.0	4.8	4.4
2. Real interest rate is at historical average plus two standard deviations in 2003 and 2004						7.2	6.8	6.7	5.5	4.4	3.7
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004						7.2	5.1	6.1	5.5	4.3	3.6
4. Primary balance is at historical average minus two standard deviations in 2003 and 2004						7.2	13.5	15.6	8.0	6.5	5.7
5. Combination of 2-4 using one standard deviation shocks						7.2	11.3	11.9	6.0	4.5	3.6
6. One time 30 percent real depreciation in 2003 3/						7.2	5.2	6.7	6.1	4.9	4.2
7. 10 percent of GDP increase in other debt-creating flows in 2003						7.2	5.5	7.5	6.9	5.6	4.9
8. Revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04						7.2	7.0	8.1	5.8	4.6	4.0
Gross financing need in billions of U.S. dollars 2/											
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2003-2007						9.2	10.9	10.4	10.1	8.4	8.1
2. Real interest rate is at historical average plus two standard deviations in 2003 and 2004						9.2	10.7	10.9	9.5	7.9	7.2
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004						9.2	7.7	9.1	8.7	7.1	6.4
4. Primary balance is at historical average minus two standard deviations in 2003 and 2004						9.2	21.3	25.4	13.7	11.6	10.9
5. Combination of 2-4 using one standard deviation shocks						9.2	17.5	18.5	9.9	7.7	6.6
6. One time 30 percent real depreciation in 2003 3/						9.2	4.6	6.0	5.8	4.8	4.5
7. 10 percent of GDP increase in other debt-creating flows in 2003						9.2	8.7	12.2	11.9	10.0	9.3
8. Revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04						9.2	11.1	13.1	10.0	8.3	7.6

1/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
 2/ Gross financing under the stress test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long-term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.
 3/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 5. South Africa: External Debt Sustainability Framework, 1997-2008
 (In percent of GDP, unless otherwise indicated)

	Actual				Projections							
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	
I. External debt	33.0	33.5	34.6	34.6	34.6	33.1	38.5	26.0	23.8	22.3	22.2	20.9
2 Change in external debt	2.2	0.6	1.1	-0.1	-1.5	5.3	-12.5	-2.2	-1.5	-0.1	-1.2	-1.2
3 Identified external debt-creating flows (4+8+11)	-7.9	-4.8	-9.2	-2.6	-4.6	-1.8	-8.2	-1.8	-2.3	-1.9	-1.9	-1.9
4 Current account deficit, excluding interest payments	-0.6	-0.6	-2.1	-1.8	-2.1	-3.0	-1.1	-0.8	-0.7	-0.3	-0.2	-0.2
5 Deficit in balance of goods and services	-1.4	-1.4	-3.1	-3.3	-4.5	-4.3	-0.2	-1.1	-0.9	-0.7	-0.7	-0.3
6 Exports	30.7	30.8	30.0	34.4	37.9	43.1	30.7	30.5	30.1	28.6	28.1	27.8
7 Imports	29.3	29.4	27.0	31.1	33.4	38.8	28.3	28.5	28.1	27.9	27.8	27.8
8 Net non-debt creating capital inflows (negative)	-7.8	-8.2	-9.0	-1.8	-5.5	-0.8	-1.2	-1.3	-1.6	-1.7	-1.7	-1.8
9 Net foreign direct investment, equity	3.2	0.4	1.0	0.8	7.6	0.5	1.0	1.0	1.4	1.5	1.5	1.6
10 Net portfolio investment, equity	4.6	7.7	8.0	1.0	-2.0	0.3	0.2	0.2	0.2	0.2	0.2	0.2
11 Automatic debt dynamics 1/	0.5	4.0	1.9	0.9	3.0	2.0	-5.8	0.3	0.0	0.1	0.1	0.1
12 Contribution from nominal interest rate	2.6	2.8	2.2	2.2	2.4	2.7	1.8	1.7	1.5	1.4	1.4	1.4
13 Contribution from real GDP growth	-0.8	-0.3	-0.7	-1.2	-1.1	-1.1	-0.6	-0.7	-0.7	-0.6	-0.6	-0.6
14 Contribution from price and exchange rate changes 2/	-1.3	1.4	-0.2	0.0	1.7	0.4	-7.0	-0.7	-0.8	-0.7	-0.7	-0.7
14 Residual, incl. change in gross foreign assets (2-3)	10.1	5.4	10.3	2.6	3.2	7.2	-4.3	-0.4	0.8	1.8	1.8	0.7
External debt-to-exports ratio (in percent)	107.3	109.0	115.4	100.7	87.4	89.4	84.6	77.9	74.1	77.5	74.4	74.4
Gross external financing need (in billions of US dollars) 3/	17.0	16.3	14.9	13.8	13.8	10.5	13.1	13.0	9.9	12.4	12.4	12.4
in percent of GDP	14.3	14.6	13.3	12.9	14.8	12.3	10.2	9.7	7.1	8.4	7.9	7.9
Key Macroeconomic and External Assumptions												
Real GDP growth (in percent)	2.6	0.8	2.0	3.5	2.8	3.0	2.2	3.0	3.3	3.0	3.0	3.0
Nominal external interest rate (in percent)	8.7	7.6	8.0	6.2	6.1	7.4	7.1	7.0	6.9	6.8	6.7	6.7
Growth of exports (US dollar terms, in percent)	3.5	-5.9	-2.0	8.7	-3.7	4.0	7.6	3.4	4.0	0.0	0.0	3.3
Growth of imports (US dollar terms, in percent)	4.6	-5.9	-7.9	9.4	-6.1	6.4	10.4	4.3	4.0	4.6	4.8	4.8
II. Stress Tests for External Debt Ratio												
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2003-2007						38.5	39.7	35.8	33.0	30.9	27.6	27.6
2. Nominal interest rate is at historical average plus two standard deviations in 2003 and 2004						38.5	26.6	25.1	23.6	23.5	22.2	22.2
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004						38.5	27.2	26.3	24.8	24.7	23.5	23.5
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2003 and 2004						38.5	52.1	62.3	60.8	60.8	59.7	59.7
5. Non-interest current account is at historical average minus two standard deviations in 2003 and 2004						38.5	27.7	27.1	25.6	24.2	24.2	24.2
6. Combination of 2-5 using one standard deviation shocks						38.5	49.3	56.0	54.5	54.6	53.4	53.4
7. One time 30 percent nominal depreciation in 2003						38.5	38.1	36.0	34.5	34.4	33.2	33.2
Historical Statistics for Key Variables (past 10 years)												
Current account deficit, excluding interest payments									Average			
Net non-debt creating capital inflows									2002-07			
Nominal external interest rate (in percent)									-1.2			
Real GDP growth (in percent)									0.8			
GDP deflator in US dollars (change in percent)									2.9			
									1.1			
									7.5			
									1.1			
									2.7			
									-4.8			
									7.3			

1/ Derived as $[-g - \rho(1+g) + \epsilon\alpha(1+\rho)] / (1+g+\rho)$ times previous period debt stock, with $r =$ nominal effective interest rate on external debt; $\rho =$ change in domestic GDP deflator in US dollar terms, $g =$ real GDP growth rate, $\epsilon =$ nominal appreciation (increase in dollar value of domestic currency), and $\alpha =$ share of domestic-currency denominated debt in total external debt.
 2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \epsilon\alpha(1+\rho)] / (1+g+\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\epsilon > 0$) and rises in inflation (based on GDP deflator).
 3/ In percent of GDP.

Table 6. South Africa: External Sustainability Framework—Gross External Financing Need, 1997-2008

	Actual			Projections								
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Gross external financing need in billions of U.S. dollars 1/ in percent of GDP	17.0 14.3	16.3 14.6	14.9 13.3	13.8 12.9	13.8 14.8	10.5 12.3	13.1 10.2	13.0 9.7	9.9 7.1	12.4 8.4	12.4 7.9	12.0 7.4
Gross external financing need in billions of U.S. dollars 2/												
I. Baseline Projections												
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2003-2007						10.5	13.7	12.9	9.1	9.8	8.4	7.0
2. Nominal interest rate is at historical average plus two standard deviations in 2003 and 2004						10.5	13.9	14.3	10.5	13.2	13.1	12.8
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004						10.5	13.2	13.2	10.2	12.8	12.7	12.5
4. Non-interest current account is at historical average minus two standard deviations in 2003 and 2004						10.5	15.6	16.2	11.5	14.3	14.3	14.0
5. Combination of 2-5 using one standard deviation shocks						10.5	15.0	16.5	12.9	16.1	16.1	16.1
6. One time 30 percent nominal depreciation in 2003						10.5	12.9	10.1	8.0	10.0	9.9	9.8
II. Stress Tests												
Gross external financing need in percent of GDP 2/												
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2003-2007						12.3	16.4	15.8	11.4	12.6	11.0	9.4
2. Nominal interest rate is at historical average plus two standard deviations in 2003 and 2004						12.3	10.8	10.7	7.5	8.9	8.4	7.8
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004						12.3	10.6	10.7	7.9	9.4	8.9	8.3
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2003 and 2004						12.3	19.8	25.6	19.7	23.4	22.2	21.3
5. Non-interest current account is at historical average minus two standard deviations in 2003 and 2004						12.3	12.1	12.1	8.1	9.7	9.2	8.5
6. Combination of 2-5 using one standard deviation shocks						12.3	19.6	23.8	17.7	21.0	19.9	19.0
7. One time 30 percent nominal depreciation in 2003						12.3	19.6	14.8	11.1	13.2	12.5	11.8

1/ Defined as non-interest current account deficit, plus interest and amortization on medium- and long-term debt, plus short-term debt at end of previous period.
 2/ Gross external financing under the stress-test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.

HIV/AIDS in South Africa—An Update

Background

An estimated 5 million South Africans, or 11½ percent of the population, live with HIV/AIDS, compared with 200,000 in 1990. Prevalence rates are higher among 15–49-year old adults (20 percent) and are highest among the unemployed, unskilled workers, and pregnant women.¹ Infection rates continue to rise for most groups, and the incidence among adults may reach 25 percent by 2005.² AIDS-related illnesses claim an estimated 775 to 1,300 lives each day, one-fourth of all deaths, and 40 percent of deaths of adults aged 15–49-years. Without significant changes in intervention policies, total deaths related to the pandemic could reach 5-7 million by 2010, or 10-15 percent of the population. Population and labor force growth could slow to zero, compared with a non-HIV/AIDS projection of 1.5 percent annual growth. Life expectancy, which has already declined from 64 years in 1994, could drop further from 48 to 38 years by 2010 for men and from 52 to 37 years for women.

Economic impact

HIV/AIDS is expected to have a significant economic impact on South Africa. A number of studies have pointed to negative effects on output growth and per capita income through declines in the labor force and in savings and investment, and increased spending on medical care.³ The pandemic might lower output growth by 0.5 to 2.5 percentage points per year. Studies have shown mixed results on the impact on per capita income growth, with estimates

¹ Estimates of prevalence vary according to different methodologies. Official estimates of 5 million and 20 percent of adults aged 15-49 years are based on an annual survey of women attending pre-natal clinics. A 2000 study by the Actuarial Society of South Africa placed prevalence at 6.5 million, while more recent studies have used household surveys to estimate incidence of approximately 5 million, but with different prevalence rates among subgroups. See “South African National HIV Prevalence, Behavioral Risks and Mass Media: Household Survey 2002,” (South Africa: Nelson Mandela Foundation/Human Sciences Research Council, 2002), which estimated prevalence among adults of 16 percent.

² Prevalence among 15–19 year-old women has declined slightly in recent years, possibly reflecting efforts to raise HIV/AIDS awareness.

³ See, for example: Bureau of Economic Research “The Macro-Economic Impact of HIV/AIDS in South Africa” (Cape Town: BER, 2001); M. Haacker “The Economic Consequences of HIV/AIDS in Southern Africa” IMF Working Paper/02/38 (Washington: IMF, 2002); and C. Arndt and J. Lewis “The HIV/AIDS Pandemic in South Africa: Sectoral Impacts and Unemployment,” *Journal of International Development*, Vol. 13, 2001.

ranging from higher growth of up to 1 percentage point per year to lower growth of the same magnitude, reflecting assumptions about labor productivity, the disproportionate effects of AIDS on unskilled workers, and impacts of reduced population pressures on land and capital. A recent IMF working paper argues that estimates of the impact of HIV/AIDS on per capita income capture only a small portion of welfare losses arising from increased mortality and lower life expectancy. The study finds that cumulative aggregate welfare losses in South Africa may be equivalent to 60 percent of GDP in 2003 and to 75-80 percent of GDP by 2010.⁴

A forthcoming World Bank study assesses the longer-term effects of HIV/AIDS by considering impacts on the formation and transmission of human capital in an overlapping generations model, particularly transmission from young adults hit hardest by the disease to the huge population of eventual orphans born after 2010. With no changes in intervention policies, the study predicts dire consequences for human capital formation and productivity over the span of four generations.⁵

All of the studies point to the need for increased expenditures on health care and welfare grants to the sick and their dependents and to decreased revenues from the impact of slower growth. The fiscal impact may exceed 3 percent of GDP per year within ten years. A stepped-up response, including enhanced spending on preventive measures, the treatment of opportunistic infections, and the widespread provision of antiretroviral drug treatments (ARVs) through the public health system, may avoid the most severe consequences for long-run productivity and output.⁶

Policy response

The authorities' response to the HIV/AIDS pandemic is guided by a Strategic Plan for 2000-2005, issued in May 2000 and updated by cabinet statements made in April and October 2002 and March 2003. The strategy involves four priority areas:

- public awareness and prevention;

⁴ N. Crafts, and M. Haacker (2003) "Welfare Implications of HIV/AIDS," IMF Working Paper/03/118, (Washington: IMF, 2003).

⁵ C. Bell, S. Devarajan and H. Gersbach "The Long-run Economic Costs of AIDS: Theory and an Application to South Africa," (Washington: The World Bank, 2003).

⁶ Antiretroviral treatments act to suppress viral loads and restore or preserve immune functions, thereby preventing opportunistic infections, extending lives and reducing dependency, and possibly reducing HIV transmission.

- treatment and support;
- research and monitoring; and
- legal and human rights.

Direct government spending on HIV/AIDS increased from R 30 million in 1994/95 to R 343 million in 2001/02. The official response was stepped up further in 2002/03, with a threefold expansion of direct spending to over R 1 billion (0.1 percent of GDP). Additional spending has targeted prevention and awareness and the initial provision of drug therapies to specific population groups. Direct expenditures are set to increase further to R 3.6 billion by 2005/06 (0.2 percent of GDP). Total HIV/AIDS-related spending—direct and indirect—is estimated by the authorities to have accounted for one-fifth of public health spending in 2002/03, or 0.6 percent of GDP. The authorities consider nutrition programs (0.1 percent of GDP in 2002/03) and targeted income support (0.5 percent) as key elements of their response to the disease.⁷

The authorities' efforts to improve HIV/AIDS awareness and to provide a supportive legal and human rights environment are well recognized. After initial controversy, drug therapies are now being provided to HIV-positive pregnant women to prevent transmission at birth and to victims of sexual assault. A pilot program for pregnant women was initiated at 18 sites in 2001; in July 2002 a court ruling expanded the coverage by ordering immediate, nationwide access. As of May 2003, the program had been expanded to 650 facilities, with full coverage in three provinces. The authorities are targeting full national coverage by the end of 2003/04. While drug-makers are providing treatment for pregnant women free of charge for five years, the rollout has required additional expenditures on staff training, counseling and testing facilities, and postnatal monitoring.⁸

The authorities have considered providing ARVs to the wider population, but have expressed concerns about the costs of universal access, implications for the capacity of the strained public health system, the potential toxicity and complexity of the drug treatments, and the

⁷ Targeted child support grants (CSGs) were provided to 2.5 million recipients in 2002/03 at a cost of 0.4 percent of GDP, while another 200,000 care grants were provided for foster children, orphans and other dependents (0.1 percent of GDP). Eligibility for the CSGs will be progressively extended over the next three years from 7- to 14-year olds, adding 4.2 million recipients at a cost of 0.4 percent of GDP in 2005/06.

⁸ Grants to provinces to support the mother-to-child transmission program increased four-fold in 2002/03 to R 210 million (one-fifth of direct spending) and will increase again by two-and-a-half times by 2005/06.

need for adequate nutritional support.⁹ No formal decision has yet been taken, which has led to public protests; however, discussions are ongoing with labor, business, and civil society, and efforts are continuing to better assess costs and other implications. A study of options has been prepared for cabinet consideration in the coming months, and one possibility may involve the phased introduction of treatment over five years to 500,000 people, half of those with late-stage AIDS. Preliminary estimates place additional expenditures at R 4 billion in 2008 (0.2 percent of GDP), assuming further substantial declines in ARV costs.¹⁰ Legislative provisions enacted in May 2003 will allow for a greater import and production of generic ARVs, which should help reduce costs.

The provision of ARVs to 500,000 people would be unprecedented in scope and complexity worldwide. The largest program at present involves 130,000 people receiving treatment in Brazil.¹¹ Implementation will require substantial improvements and additional expenditures on staffing and training, particularly in rural areas, on health facilities to permit enhanced counseling and testing, on information systems to permit better monitoring and follow-up, and on pharmaceutical distribution networks and laboratory infrastructures.

Response of the business community

As mounting HIV/AIDS prevalence rates impose increasing direct and indirect costs, private insurance providers and South African companies have also stepped up their responses to HIV/AIDS, often by moving ahead of the government in providing ARVs to infected employees.¹² Corporations have found that indirect costs (lower productivity, absenteeism,

⁹ The retail price of ARV treatments in South Africa in early 2003 was R 900-1,600 per month per person. Initial and follow-up testing is needed to monitor toxicity and adjust treatments; tests cost R 500-1,500 per round (Health Systems Trust, *South African Health Review 2002*, (Durban: Health Systems Trust, 2003)). By comparison, average monthly wages in the formal, non-agricultural business sector in South Africa were R 6,294 in February 2003.

¹⁰ The estimate is consistent with findings of other studies, including a 2003 report that assumed a six-year phase-in and placed annual costs at R 10,400 per person. See N. Geffen, N. Natrass, and C. Raubenheimer, "The Cost of HIV Prevention and Treatment Interventions in South Africa" University of Cape Town, Centre for Social Science Research Working Paper No. 28 (University of Cape Town, 2003).

¹¹ ARV treatments in South Africa covered 20,000 people in 2002 (through private insurers and involving victims of sexual assault).

¹² Private medical insurance covers approximately 7 million South Africans, approximately 16 percent of the population. Annual private medical insurance contributions were 1.2 times larger than general government health expenditures in 2002/03.

staff turnover, and recruitment and training costs) are generally higher than direct costs (health care expenses and other benefits), and thus ARVs offer prospects for savings. The active response has come mainly from larger companies with sufficient human and financial resources to manage complex awareness, testing, and treatment programs.¹³ Large companies may also be concerned with reputational issues.

The mining sector has particularly high prevalence rates, up to 40 percent at operations using less skilled migrant labor, and has been a leader in the recent corporate response to HIV/AIDS.¹⁴ Mining activities are physically demanding and involve work by teams that can ill afford lower productivity or absenteeism, thus giving impetus to enhanced treatment.¹⁵ Issues that have emerged from private sector ARV programs are the provision of the drugs to dependents, responsibility for continuing provision to workers who become physically incapacitated and no longer employed, and the extension of treatment programs to local mining communities.

¹³ Compulsory testing of employees or job applicants is illegal in South Africa.

¹⁴ By comparison, prevalence estimates for the banking sector are in the range of 5-8 percent.

¹⁵ One large, multinational mining company with more than 120,000 employees in southern Africa has pioneered provision of ARVs to employees. The company's ARV program is open to all employees, and 253 workers were enrolled in May 2003. The number of participants increased rapidly, and the company recently estimated annual treatment and testing costs per employee of around \$1,000. This is equivalent to about 8 percent of the average wage costs for the firm's global operations, which were approximately \$13,700 per worker in 2002.



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IMF Concludes 2003 Article IV Consultation with South Africa

On [August, 20, 2003], the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with South Africa.¹

Background

In 2002, the South African economy performed well, notwithstanding difficult global economic conditions. Supported by sound macroeconomic management and a highly competitive exchange rate, real GDP growth rose from 2.8 percent in 2001 to 3.0 percent in 2002. However, growth slowed to 1.5 percent (on an annualized basis) in the first quarter of 2003, largely in response to a strong currency rebound and tight financial conditions. While the rand appreciation resulted in lower export growth and a deterioration of the trade balance, a recent pickup in private consumption and continuing strong investment growth suggest that the slowdown should be of limited duration and magnitude.

Growth performance has mirrored, to a significant extent, movements in the exchange rate. The sharp currency depreciation that occurred in the second half of 2001 provided a major boost to activity during much of 2002. The rand has subsequently recovered in value, appreciating by about 40 percent on a trade-weighted basis since the end of 2001; in real terms, the exchange rate is presently around the level prevailing in the second half of 2000. Much of the appreciation reflects a reversion to long-term equilibrium following the overshooting that took place in 2001,

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. 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. This PIN summarizes the views of the Executive Board as expressed during the [August, 20, 2003] Executive Board discussion based on the staff report.

but fundamentals have also contributed to a strengthening of the exchange rate. These include firmer export commodity prices; a widening of interest rate differentials with overseas capital markets when domestic credit conditions were tight; increasing appetite by global investors for emerging market assets; and a strong external current account position. At the same time, the net open forward position (NOFP) of the South African Reserve Bank (SARB), which represented a major source of external vulnerability in the past, has been reduced to below zero; this is a major achievement.

Following a buildup in inflationary pressures, monetary conditions were tightened during 2002. Average CPI-X inflation (consumer price inflation less interest on mortgage bonds) jumped from 6.6 percent in 2001 to 9.3 percent in 2002, which was well above the SARB's target range of 3-6 percent under the inflation-targeting strategy. In response, the SARB raised short-term interest rates by 400 basis points in 2002. Subsequently, as inflation declined steadily and the inflation outlook brightened, the SARB opted for a cautious easing of monetary policy by lowering interest rates by 150 basis points in June 2003.

Economic performance continues to be underpinned by sound fiscal policy. The budget overperformed again in 2002/03 (April-March), registering a deficit of 1.2 percent of GDP, compared with an original target of 2.1 percent. The 2003/04 budget targets an increase in the deficit to 2.4 percent of GDP, mainly reflecting higher spending on economic infrastructure and social services. The moderate expansion in the fiscal stance envisaged for 2003/04 seems appropriate in light of South Africa's social and developmental needs, and the countercyclical support that it provides to economic activity. The government has further increased budgetary allocations to social sectors.

Important structural challenges remain, despite progress with reforms in many areas. Labor market conditions—including skills shortages, rigidities, centralized collective bargaining, and the stalling decline in real unit labor costs—continue to impede job creation, despite efforts to address the unemployment problem. Notwithstanding the first increase in formal employment in many years in 2002, the unemployment rate has risen to over 30 percent. The successful sale of a majority stake in Telkom in March 2003 has revived the privatization process, but foreign investors still appear deterred by the prevalence of HIV/AIDS, labor market rigidities, and high rates of unemployment and crime. While the black economic empowerment strategy can make an important contribution to social stability, uncertainties remain about the financing of asset transfers and safeguards in place against the concentration of assets in just a few hands.

Executive Board Assessment

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Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

South Africa: Selected Economic Indicators

	1999	2000	2001	2002
	(In percent)			
Domestic Economy				
Change in real GDP	2.0	3.5	2.8	3.0
Unemployment rate 1/	23.3	25.8	29.5	30.5
Change in consumer prices (end of period)	2.3	7.6	3.8	12.1
	(In billions of U.S. dollars, unless otherwise noted)			
External Economy				
Exports, f.o.b.	28.6	31.7	30.7	32.0
Imports, f.o.b.	24.5	27.4	25.9	27.6
Current account balance (deficit -)	-0.6	-0.5	-0.3	0.3
Direct investment	-0.1	0.6	10.8	1.1
Portfolio investment	8.6	-2.0	-8.3	-0.4
Financial account balance (deficit -)	5.3	0.3	-0.4	1.6
Gross official reserves	7.4	7.5	7.5	7.6
Current account balance (in percent of GDP, deficit -)	-0.5	-0.4	-0.3	0.3
Change in real effective exchange rate (in percent) 2/	-5.2	-3.0	-13.5	-17.2
Net open forward position of the Reserve Bank 3/	13.0	9.5	4.8	1.6
External debt (in percent of GDP) 4/	29.7	28.8	27.0	31.4
Exchange rate, rand per U.S. dollar (end of period)	6.15	7.57	12.09	8.66
	(In percent, unless otherwise noted)			
Financial Variables				
National government balance (in percent of GDP, deficit -) 5/	-1.6	-1.6	-1.2	-1.2
Change in broad money	10.1	7.5	16.7	12.8
Interest rate 6/	12.0	12.0	9.5	13.5

Sources: South African Reserve Bank; and staff estimates.

1/ Official definition.

2/ (+)=appreciation (period average).

3/ Defined as net forward foreign exchange liabilities less net spot reserves.

4/ Includes rand-denominated external debt.

5/ Fiscal year starting on April 1.

6/ Bank/repo rate (end of period).