INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/189

SOUTH AFRICA

July 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SOUTH AFRICA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with South Africa, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 26, 2017 consideration of the staff report that concluded the Article IV consultation with South Africa.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 26, 2017, following discussions that ended on May 16, 2017, with the officials of South Africa on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 9, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for South Africa.

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 17/263
FOR IMMEDIATE RELEASE
July 6, 2017

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

IMF Executive Board Concludes 2017 Article IV Consultation with South Africa

On June 26, 2017, the Executive Board of the International Monetary Fund concluded the Article IV consultation[1] with South Africa.

Living conditions have ameliorated substantially for the bulk of South Africa's population during the past two decades, but the pace of improvement has gradually slowed. Following last year's near-standstill in economic activity, growth is projected to increase to 1.0 percent in 2017 and 1.2 percent in 2018, still insufficient to keep pace with the rising population. The current account deficit is projected to decline to 3 percent of GDP in 2017, boosted by mining and agricultural exports, and to widen to just below 4 percent of GDP in the medium term. Consumer price inflation recently returned below 6 percent, owing in part to the easing of the drought, and is projected to remain marginally below the upper threshold of the 3-6 percent target band for the remainder of 2017 and in 2018.

South Africa's vulnerabilities have become more pronounced and are set to increase further unless economic growth revives. Low growth has taken a toll on the state of the public finances, increasing government debt. The public sector's balance sheet is also exposed to sizable contingent liabilities from state-owned enterprises (SOEs). Perceptions of weakening governance and uncertainties regarding the direction of future economic policies, partly related to the electoral calendar, have also adversely affected consumer and investor confidence. In the external sector, large gross external financing needs, financed mainly by portfolio flows, expose South Africa to significant financing risks. Vulnerabilities from exchange rate fluctuations are attenuated by South Africa's track record of a freely floating exchange rate, corporate resilience to sizable exchange rate depreciation during the past few years, and high share of domestic-currency-denominated government debt. Even so, external and domestic contexts could result in significant shocks, whose implications could in turn be amplified by linkages among the real, financial, and fiscal sectors, especially if accompanied by further downgrades of local currency sovereign credit ratings to below investment grade.

[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.

Monetary and fiscal policies have been focused on keeping inflation in check and maintaining medium-term debt sustainability. The South African Reserve Bank (SARB) tightened the repo rate in stages by 75 bps in early-2016 to 7.0 percent and has kept it at that level since then. The headline fiscal deficit was reduced to 3.9 percent of GDP in FY2016/17 from 4.5 percent the previous fiscal year, and the budget for FY2017/18 envisages a further moderate tightening. The pace of reform in the labor market and in product/service markets has been insufficient to make a noticeable contribution to reviving economic growth.

Executive Board Assessment[2]

Executive Directors considered that the scope for monetary or fiscal policy to provide stimulus is limited. They noted that, with headline inflation projected marginally below the upper threshold of the target band, keeping policy rates on hold is appropriate. Directors highlighted the need for prudent fiscal policy aimed at maintaining debt sustainability while prioritizing pro-growth and pro-poor spending. They encouraged the authorities to strengthen budget execution and the implementation of revenue and fiscal reform measures to ensure that government debt stabilizes significantly below 60 percent of GDP. In particular, they emphasized the need to monitor and manage fiscal risks from explicit or implicit government guarantees, and the importance of reform of state-owned enterprises.

Directors urged the authorities to accelerate the pace of reforms in product, service, and labor markets to spur economic growth and job creation, especially for young people. Reforms should focus on sectors providing crucial inputs for firms in the economy, such as power generation, telecommunications, transportation, and financial services for SMEs. In the labor market, improving educational attainment and skills will be crucial. Directors considered that wage determination should become more responsive to firm-specific circumstances, including productivity. They noted that the recently-agreed national minimum wage has the potential to make a material difference for large segments of the population, although its impact on employment should be carefully monitored. They urged the authorities to stand ready to introduce complementary measures to support young workers and SMEs. They also encouraged them to promote parallel initiatives to improve labor relations, including implementation of a code of good practice in collective bargaining. Strengthening governance and fighting corruption will also be critical.

Directors considered that bringing to fruition ongoing reforms in the financial sector to adapt prudential regulation fully to international best practice and enhance the resolution framework would further buttress resilience. These reforms should be complemented with greater competition in the banking system. Robust implementation of the Financial Intelligence Center Amendment Act will be important to strengthen the integrity of the financial system. Directors

---

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

considered that greater access to finance, combined with proper supervision, would help reduce inequality.

Directors commended South Africa’s resilience, which owes to its flexible exchange rate, low reliance on foreign currency debt, large domestic investor base, and broadly balanced international investment position. They noted that attracting more durable foreign investment and increasing international reserves would further enhance resilience.

Table 1. South Africa: Selected Economic and Social Indicators, 2012–17

Social Indicators

GDP		**Poverty (percent of population)**	
Nominal GDP (2016, billions of US dollars)	295	Headcount ratio at $1.90 a day (2011 PPP) (percent of population)	16.6
GDP per capita (2016, in US dollars)	5272	Undernourishment (2015)	5.0
Population characteristics		**Inequality (income shares unless otherwise specified)**	
Total (2016, million)	55.9	Highest 10 percent of population	51.3
Urban population (percent of total), 2014	64	Lowest 20 percent of population	2.5
Life expectancy at birth (years), 2016	62	Gini coefficient (2010)	63.4

Economic Indicators

	2013	2014	2015	2016 Est.	2017 Proj.	2018 Proj.
National income and prices (annual percentage change unless otherwise indicated)						
Real GDP	2.5	1.7	1.3	0.3	1.0	1.2
Real GDP per capita	0.9	0.1	-0.3	-1.3	-0.6	-0.5
Real domestic demand	3.2	0.4	1.7	-0.7	0.7	1.2
GDP deflator	6.1	5.8	5.0	6.8	5.8	5.7
CPI (annual average)	5.8	6.1	4.6	6.3	5.7	5.6
CPI (end of period)	5.4	5.3	5.3	6.7	5.6	5.5
Labor market (annual percentage change unless otherwise indicated)						
Unemployment rate (percent of labor force, annual average)	24.7	25.1	25.4	26.7	27.4	28.0
Average remuneration (formal nonagricultural, nominal)	7.2	6.5	7.0	8.1	7.5	7.4
Labor productivity (formal nonagricultural)	1.9	1.3	1.9	1.9	1.9	1.9
Unit labor costs (formal nonagricultural)	5.1	5.1	5.1	6.2	5.5	5.4
Savings and Investment (percent of GDP unless otherwise indicated)						
Gross national saving	15.4	15.5	16.3	16.2	16.1	15.7
Public (incl. public enterprises)	-0.9	1.1	1.1	1.0	0.9	1.0
Private	16.2	14.4	15.2	15.1	15.2	14.7
Investment (including inventories)	21.3	20.8	20.7	19.4	19.1	19.1
Public (incl. public enterprises)	7.1	7.3	7.6	7.6	7.6	7.6
Private	13.3	13.3	12.8	12.0	11.7	11.7
Fiscal position (percent of GDP unless otherwise indicated) 1/						
Revenue, including grants 2/	27.3	27.6	28.3	28.9	29.1	29.4
Expenditure and net lending	31.6	31.8	32.9	32.9	33.2	33.4
Overall balance	-4.3	-4.2	-4.6	-4.0	-4.1	-4.0
Primary balance	-1.3	-1.1	-1.3	-0.5	-0.4	-0.2
Structural balance (percent of potential GDP)	-4.2	-4.0	-3.9	-3.5	-3.5	-3.3
Gross government debt 3/	44.1	47.0	49.3	51.7	52.6	54.7
Government bond yield (10-year, percent) 4/	8.2	8.0	9.7	8.9	8.7	...
Money and credit (annual percentage change unless otherwise indicated)						
Broad money	5.9	7.3	10.3	6.1	6.8	6.9
Credit to the private sector	6.6	7.2	8.3	5.6	4.8	5.1
Repo rate (percent, end-period) 4/	5.0	5.8	6.3	7.0	7.0	...
3-month Treasury bill interest rate (percent) 4/	5.1	5.8	6.1	7.2	7.4	...
Balance of payments (percent of GDP unless otherwise indicated)						
Current account balance (billions of U.S. dollars)	-21.6	-18.7	-14.0	-9.6	-9.6	-11.1
percent of GDP	-5.9	-5.3	-4.4	-3.3	-3.0	-3.4
Exports growth (volume)	3.6	3.2	3.9	-0.1	1.9	2.4
Imports growth (volume)	5.0	-0.5	5.4	-3.7	0.9	2.5
Terms of trade (percentage change)	-1.4	-1.6	3.4	0.3	0.3	-1.4
Overall balance	0.1	0.4	-0.2	0.9	0.0	0.0
Gross reserves (billions of U.S. dollars)	49.6	49.1	45.8	47.4	47.4	47.4
Total external debt	37.2	41.3	39.1	48.5	45.2	46.2
Nominal effective exchange rate (percentage change, period average) 5/	-14.4	-10.3	-5.6	-11.0	12.7	…
Real effective exchange rate (percentage change, period average) 6/	-10.1	-3.3	1.1	-3.7	12.9	…
Exchange rate (Rand/U.S. dollar, end-period) 7/	10.5	11.6	15.6	13.7	13.1	…

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

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

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

3/ Central government.

4/ Average of January-May 2017 data

5/ Percentage change January-May 2017 average with respect to 2016 average.

6/ Percentage change January-March 2017 average with respect to 2016 average.

7/ End May 2017

SOUTH AFRICA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

June 9, 2017

KEY ISSUES

Context. Living conditions have ameliorated substantially for the bulk of South Africa's population since the advent of democracy, but the pace of improvement has gradually slowed. Economic growth is currently insufficient to make a dent in widespread unemployment and longstanding inequalities. Public debate is increasingly questioning whether the prevailing economic policy paradigm can deliver results for all citizens.

Outlook and risks. Following last year's near-standstill in economic activity, growth is projected to pick up to 1.0 percent in 2017 and 1.2 percent in 2018, largely owing to a recovery in agricultural and mining output in 2017 and a gradual improvement in consumption and investment thereafter. Consumer and investor confidence remain low. South Africa's vulnerabilities have risen, owing to rising government debt and contingent liabilities, especially in state-owned enterprises, and perceptions of weakening governance. On the external front, the main risks stem from a possible decline in commodity prices, faster-than-expected rise in global interest rates, or a retreat from cross-border integration.

Fiscal and monetary policies. With government debt projected to reach 56 percent of GDP in 2020 and inflation projected marginally below the upper end of the 3–6 percent target band for the remainder of 2017 and in 2018, room for macroeconomic stimulus is limited. Implementation of this year's approved budget and of the envisaged moderate improvement in the structural fiscal balance in the next few years will be key to strengthening confidence. With respect to monetary policy, rates can remain on hold; an increase would be appropriate if inflation expectations were to rise.

Structural reforms. Reforms are urgently needed to reignite growth and render it more inclusive. In product and service markets, such as power generation, telecommunications, and transportation, fostering entry by new firms would reduce costs for a wide range of businesses, supporting an increase in output as well as job creation. In the labor market, there is a need for wage setting to become more reflective of firm-specific circumstances. Introduction of the national minimum wage, expected in mid-2018, could help millions of employees; its impact on jobs should be monitored, standing ready to take complementary measures to support small firms or youth. In the financial sector, ongoing reforms to the prudential and resolution framework should be brought to fruition. Greater financial inclusion is needed to provide affordable credit to small firms and low-income households.

Approved By
Anne-Marie Gulde-Wolf (AFR) and Peter Allum (SPR).

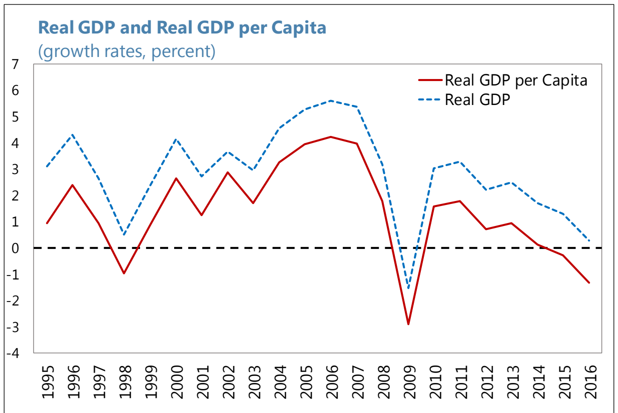
Discussions took place in Pretoria, Johannesburg, and Durban during May 3–16, 2017. The staff team comprised P. Mauro (head, AFR), L. Christiansen (SPR), K. Miyajima, A. Simone, J. Zhang (all AFR), assisted by M. Mlachila (Senior Resident Representative). Mr. H. Miao (MCM) contributed from HQ. Ms. Tshazibana and Mr. Sishi (OED) also participated in the discussions.

CONTENTS

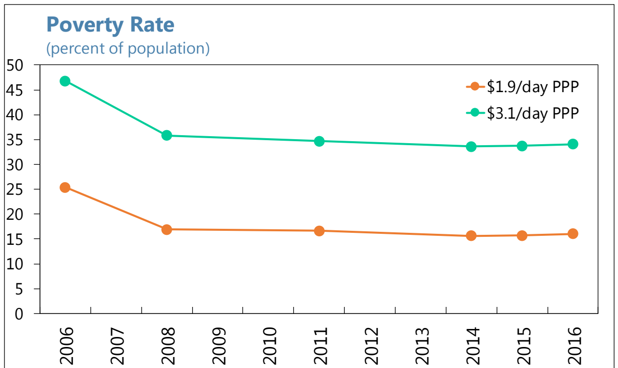
ANNEXES

BACKGROUND: SLOWDOWN IN ECONOMIC GROWTH

1. **Living conditions have ameliorated substantially for the bulk of South Africa's population during the past two decades, but the pace of improvement has gradually slowed.** Robust economic growth and sound macroeconomic policies were mutually reinforcing in the decade that followed the advent of democracy, fostering economic transformation and reducing poverty. However, potential growth has abated in more recent years and poverty reduction has stalled. Following the global economic and financial crisis that erupted in 2008 and the decline in commodity prices that began in 2011–12, economic activity dwindled to a near-standstill in 2016.

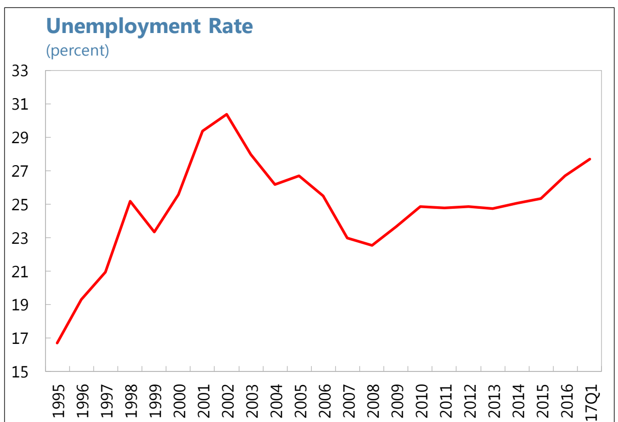


Source: World Economic Outlook



Source: World Bank, World Development Indicators
Note: Percent of population with per capita income below $1.9 and $3.1 a day in purchasing power parity terms.

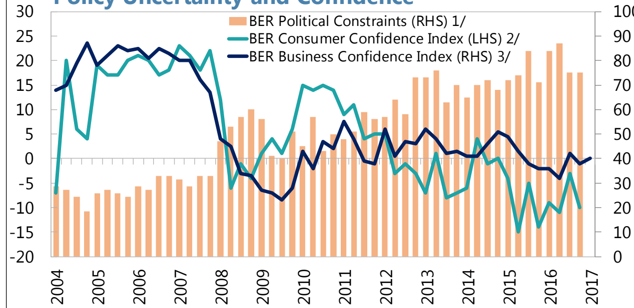
2. **Weak economic growth impedes the economy's ability to curb unemployment and inequality, and creates new vulnerabilities.** South Africa remains one of the world's most unequal societies (Figure 1), largely owing to the legacies of apartheid. A 2016 survey by the national statistical office found that average incomes for blacks are still one-fifth of those for whites. The rate of unemployment, at 27.7 percent (54.4 percent for ages 15–24) in the first quarter of 2017, is high by international standards and has risen by five percentage points since 2008 (Figure 2). Projected output growth, at 1 percent in 2017, is insufficient to keep pace with the increase in population. In view of lackluster job creation and the rapid rise in the working-age population, the unemployment rate is set to rise further and inequality is unlikely to decline. Slow growth and persistent inequalities have contributed to increased questioning in the public discourse of whether the prevailing economic policy paradigm can deliver results for all citizens.



Source: Quarterly Labor Force Survey, StatsSA

3. The electoral calendar has heightened perceived uncertainty regarding future economic policies. Public discourse in the run-up to the 2019 presidential elections is increasingly focusing on "radical economic transformation," including more rapid transfer of economic resources to the black majority and other disadvantaged groups. A government reshuffle in late March 2017 led the rand to depreciate by 8 percent within a few days although the currency has largely recovered since then. The remainder of this year may bring increased competition among candidates for election in December to the presidency of the African National Congress—the party with an absolute parliamentary majority since 1994. Low investment and consumer confidence have been associated with rising uncertainty regarding the direction of policies as well as perceptions of weakening governance (including control of corruption), as illustrated for example by a gradual worsening during the past few years of the Doing Business index (text table) and the Control of Corruption index assembled by the World Bank.

Policy Uncertainty and Confidence



1/ BER Political Constraints shows the percentage of manufacturers who consider the political climate as a business constraint.
2/ BER Consumer Confidence Index is expressed as a net balance. The net balance is derived as the percentage of respondents expecting an improvement less the percentage expecting a deterioration.
3/ BER Business Confidence Index shows the percentage of business respondents who consider current business conditions as "satisfactory" as opposed to "unsatisfactory".

South Africa's Doing Business Rankings (DBR) and World Governance Indicators (WGI)

	2010	2013	2016
Doing Business Rankings (rank of total number of countries ranked)			
Overall	34 of 183	41 of 189	74 of 190
Start a business	75	64	131
Dealing with construction permits	52	26	99
Getting electricity		150	111
Registering property	91	99	105
Getting credit	2	28	62
Protecting minority investors	10	10	22
Paying taxes	24	24	51
Trading across borders	149	106	139
Enforcing contracts	85	80	113
Resolving insolvency	74	82	50
World Governance Indicators (percentiles)			
	2005	2010	2015
WGI government effectiveness	72	66	65
WGI control of corruption	70	61	58

Source: World Bank Doing Business, World Governance Indicators.

Note: DBR measures regulations affecting business, based on quantitative indicators such as the number of days it takes to start a business. WGI is a systematic aggregation of perception-based indices from a large number of sources. Although both DBR and WGI aim to ensure methodological consistency, caution is in order when interpreting comparisons across countries or over time. For DBR, the country with the best business conditions is scored as number one. For WGI, the data are reported as percentiles in the global distribution, with the 100th percentile indicating the country with the highest institutional quality. Data downloaded from the World Bank's Governance website on 5/26/2017.

4. Growth weakened further to 0.3 percent in 2016 from 1.3 percent in 2015 (Figure 3). Domestic demand ground to a halt, as private investment declined consistent with weakening business confidence, and private consumption was constrained by tighter credit conditions and higher unemployment. The ensuing decline in imports more than offset the weakening in export demand, resulting in a positive contribution of net exports to growth. On the supply side, these developments were mirrored by a decline in agricultural and mining production, owing to drought conditions and low commodity prices, combined with weak growth in financial services and other business-cycle sensitive sectors. Employment growth fell to 0.3 percent in 2016 from 3.9 percent in 2015 as employment shrank in agriculture, mining, and manufacturing, and hiring slowed in the construction, financial, real estate, and business services sectors, as well as in the general government.

5. Headline inflation (y-o-y) fell to 5.3 percent in April 2017—the first observation within the 3–6 percent target range in about three quarters. Above-target inflation in 2016 and early 2017 stemmed primarily from the drought, a slight rebound in oil prices, increases in fuel excises, and the lagged impact of nominal depreciation of the effective exchange rate (by 16 percent during calendar year 2015). To reduce the likelihood of second-round effects, the South African Reserve Bank (SARB) tightened the repo rate in stages by 75 bps in early 2016 and has kept it at that level since then. The recent drop in inflation was largely due to improved rainfall. Core inflation remained comfortably below 6 percent throughout 2016 and into 2017 (Figure 4).

6. The fiscal policy stance was moderately tightened in FY2016/17 (Table 2). The headline deficit was reduced to 3.9 percent of GDP from 4.5 percent the previous fiscal year. Expenditures declined as a share of GDP (and remained broadly stable excluding a one-off recapitalization of Eskom that took place during the previous fiscal year). Gross tax revenues as a share of GDP remained stable in FY2016/17 for the first time since FY2012/13, despite considerable tax measures, as both economic growth and revenue buoyancy fell short of expectations.[1]

7. The current account deficit narrowed markedly to 3.3 percent of GDP in 2016, and was financed by portfolio flows (Figure 5). The trade balance turned to a surplus in 2016: beyond the positive net export contribution to growth, the terms of trade improved modestly. Unit labor cost growth has been broadly stable since 2011 and has been marginally above consumer price inflation. Overall, the current account deficit narrowed by more than 1 percentage point of GDP compared with 2015, despite a deteriorating income balance. Financing of the current account deficit relied fully on portfolio investment flows, in part as a review of equity portfolio investment flows led to a reallocation from unrecorded transactions toward portfolio flows.[2] Net direct investment outflows fell to 0.4 percent of GDP in 2016 from net outflows of 1.3 percent of GDP the previous year. Overall, the 2016 external position is assessed as moderately weaker than implied by fundamentals and medium-term desirable policy settings (Annex I. External Sector Assessment).

8. Rising integration between South Africa and its partners has been mutually beneficial but has also increased their interdependence. In 2016, South Africa's imports and exports of goods and services were each equivalent to about 30 percent of GDP (11 and 9 percentage points of GDP higher than in 1994, respectively), with sub-Saharan Africa its largest regional recipient (28 percent of total goods exports) (Figure 6). During the same period, FDI integration almost quadrupled as a share of GDP.[3] Greater linkages have contributed to more significant inward and outward transmission of shocks. The decline in commodity prices has had not only a direct impact on South Africa, but also indirect effects through a slowdown in other commodity-exporting trading partners in sub-Saharan Africa. Similarly, a growth slowdown in South Africa would have adverse repercussions for its regional partners.

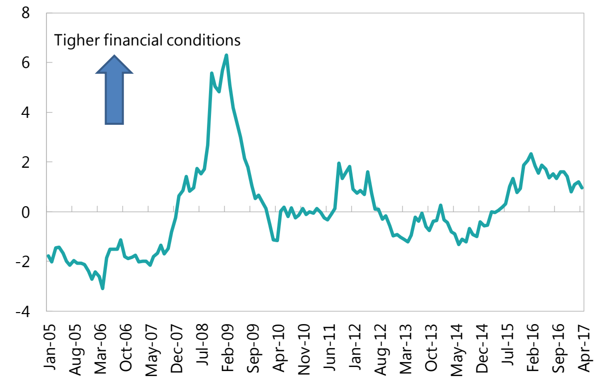
[1] Tax measures in the 2016/17 budget amounted to 0.4 percentage point of GDP, from increases in the fuel levy and specific excise duties, as well as limiting relief for the effects of inflation ("bracket creep") on the personal income tax.

[2] In recent years, unrecorded transactions had been significantly positive (i.e., net inflows). A comprehensive review of the balance of payments statistics by the SARB revealed that a large portion of such transactions consist of portfolio inflows, which are now appropriately recorded.

[3] Roughly half of the increase in FDI assets since 2010 has reflected valuation effects on a single private investment in an internet startup in China, which has grown into one of the world's largest companies in the sector.

9. Financial conditions remain tight. An index summarizing conditions in the banking sector and capital markets is somewhat above its 10-year average, reflecting relatively high interest rates and credit spreads, as well as uncertainties measured by the implied 1-year volatility of the rand.[4] Credit growth moderated, especially for households. Whereas large corporations have adequate liquidity, small- and medium-sized enterprises (SMEs) encounter greater challenges to access financing.

Financial Conditions Index



Sources: Bloomberg, L.P. and IMF staff calculations.

10. Sovereign ratings have weakened. The most recent downgrades occurred in April 2017, after the government reshuffle in late March. Market response was muted and temporary, benefiting from abundant global liquidity conditions. Foreign currency (FX) debt is now below investment grade for two rating agencies; local currency (LC) debt is below investment grade for one agency and, therefore, South Africa's LC debt has been excluded from the JPMorgan GBI-EM GD IG index. Credit ratings have also weakened for corporates, including banks and SOEs. An additional downgrade of LC debt to below investment grade rating would lead to exclusion from further indices, forcing divestment by several institutional investors, adversely affecting external funding and capital flows to South Africa.[5] The rating actions reflected weak growth resulting in a worsening fiscal outlook, sizable contingent liabilities in state-owned enterprises (SOEs), and perceptions of uncertainty regarding the direction of economic policies.

South Africa's Long-term Sovereign Ratings, May 31, 2017

	Foreign Currency Debt			Local Currency Debt		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Rating	Baa2	BB+	BB+	Baa2	BBB-	BB+
Outlook	Negative	Negative	Stable	Negative	Negative	Stable
Date of last outlook change	Dec-15	Dec-15	Apr-17	Dec-15	Dec-15	Apr-17
Date of last rating change	Nov-14	Apr-17	Apr-17	Nov-14	Apr-17	Apr-17

Sources: S&P, Moody's and Fitch.

[4] The IMF staff's index of financial conditions is the first principal component of the Z-scores of seven financial market variables: SARB policy rate, 10-year government bond yield, sovereign CDS spread, property price index, JSE top-40 stock index, 1-year implied volatility of rand/US$, spread of 1-year interbank rate over repo.

[5] Staff had estimated that downgrades of foreign and local currency sovereign debt to sub-investment grade could trigger forced sales by non-resident investors of US$2 billion and US$6 billion, respectively (IMF country report 16/218, "Macrofinancial linkages: Capital flows, Sovereign Ratings, and the Financial Sector Nexus."). More recent analyst reports suggest that forced sales could be even larger.

11. Non-financial corporates are more profitable and less indebted, on average, than in other emerging markets. Profitability is generally healthy and has improved in the mining sector with the recovery of metal prices in 2016. While non-financial corporate (NFC) debt has increased during the past decade, it does not stand out relative to other emerging markets, and corporates tend to be hedged against currency risk (Figure 7).

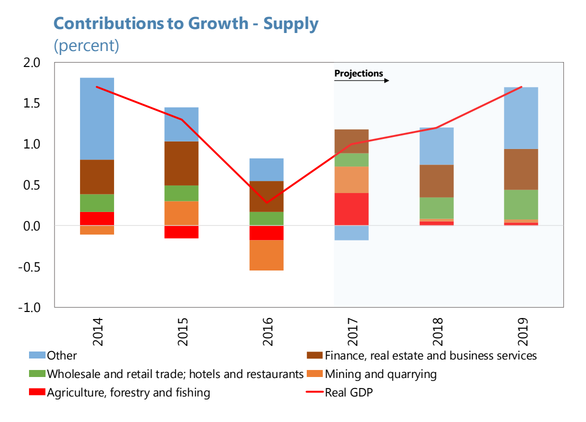
12. The financial sector has been resilient to slowing economic activity, but many less affluent individuals and SMEs have limited access to credit (Figures 8 and 9, Table 5). The banking sector has traditionally been well capitalized and highly profitable, partly owing to high concentration and pricing power, including sizable fees for financial services. Major performance indicators broadly improved in 2017, largely because of higher interest income. Capital ratios (both risk weighted and unweighted) increased, with the Tier 1 capital ratio at 14.6 percent in April 2017, well above regulatory requirements. The non-performing loan ratio (NPL) declined to 2.4 percent in April 2017 from 3.1 percent in 2015 and 2.9 percent in 2016. Banks' profitability improved as the rise in interest rates was transmitted more rapidly to their lending rates (often linked to the SARB's repo rate) than to their deposit rates. Return on assets (1.7 percent) and return on equity (22 percent) are one of the highest since the global financial crisis and compare favorably with international peers. Wholesale funding has been an important but generally stable source of funding for banks (customer deposits accounted for 49 percent of total non-interbank loans in April 2017). The Johannesburg Stock Exchange bank index rose by 27 percent in 2016. The banking sector's resilience to the sluggish macro-economy stems from the sector's conservative management, which focuses lending on less risky/higher net worth firms and individuals. However, compared to other emerging markets, less affluent individuals and smaller or riskier firms have more limited access to formal credit channels, with adverse implications for entrepreneurship and economic growth. For example, only 9 percent of SMEs have credit facilities with banks and only 4 percent of the poorest 40 percent of households have borrowed from a bank in the past year (Annex II. Financial Inclusion).

OUTLOOK: MODEST RECOVERY IN CHALLENGING EXTERNAL AND DOMESTIC CONTEXTS

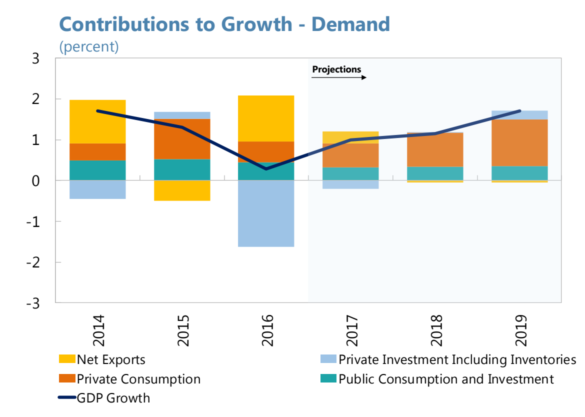
13. A modest improvement in real growth is expected in 2017 and the following few years. Growth is projected to rise to 1.0 percent in 2017 with better rainfall, an increase in mining output prompted by a moderate rebound in commodity prices, and prospects for a continued low number of days lost to strikes.[6] Private consumption growth is projected to be broadly unchanged, at about 1 percent, with relatively weak credit growth to households. Private investment is expected to decline—consistent with high uncertainty and low business confidence—but at a slower pace than last year. Net exports are expected to remain supportive of growth, as the rebound in commodity prices fosters export growth sufficiently to offset the rise in imports from the slight pickup in domestic demand. Economic growth is projected to recover gradually in subsequent years,

[6] Key contracts in the mining sector for 2017 have already been signed. Workdays lost to strikes were relatively low in both 2015 and 2016, a major improvement over 2013 and, especially, 2014, the most recent peak.

as consumption and investment recover and the output gap closes, to 2.2 percent, slightly above population growth.



Sources: Stats South Africa and IMF staff calculations.

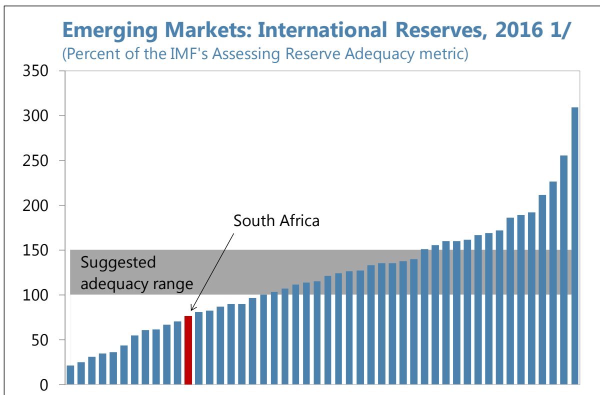


Sources: Stats South Africa and IMF staff calculations.

14. Headline inflation (y-o-y) is projected marginally below 6 percent for the remainder of 2017 and in 2018. Inflation expectations are well anchored at about 6 percent for the next two years (Figure 4). Slowing wage growth, a widening output gap, and the easing of the drought are expected to prevail over the rebound in oil prices and the increases in excises. Imported inflation is projected to be limited (Annex III. Exchange Rate Pass-Through to Core Inflation).

15. The current account deficit is expected to narrow further in 2017 before gradually widening over the medium term. The current account deficit is projected to decline to 3 percent of GDP this year as the surplus on the goods balance is boosted by mining and agricultural exports. Meanwhile, the deficit on the transfer balance is expected to widen moderately to its 2010–16 average. Over the medium term, the current account is projected to return to just below 4 percent of GDP as the surplus on the trade balance dissipates. External debt is seen rising to almost 50 percent of GDP over the medium term (Figure 11 and Annex IV. External Debt Sustainability Analysis).

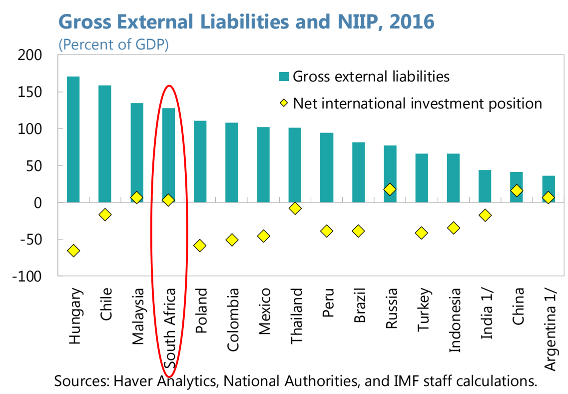
16. South Africa's vulnerabilities have risen and are set to increase further unless economic growth revives. Low growth has taken a toll on the state of the public finances, with government debt projected at 52.6 percent of GDP by the end of fiscal year 2017 and the public sector's balance sheet exposed to significant contingent liabilities from SOEs (10 percent of GDP). Weak growth and rising interest rates would pose risks also for some corporates: interest coverage ratios (cash flow profits divided by interest payments) were relatively low in personal services, energy, and business services (Figure 10). In the



Sources: Haver Analytics, National authorities, and IMF staff calculations.
1/ Sample of 48 emerging markets.

external sector, gross external debt equivalent to 48½ percent of GDP at end-2016, as well as significant gross external financing needs (projected at above 17 percent of GDP in 2017) expose South Africa to significant financing risks. Gross external liabilities are large at 128 percent of GDP at end-2016, though the net international investment position is marginally positive (3½ percent of GDP on the back of valuation effects). Vulnerabilities from exchange rate fluctuations are attenuated by South Africa's track record of a freely floating exchange rate, corporate resilience to sizable exchange rate depreciation during the past few years, and high share of domestic-currency-denominated government debt. Gross international reserves as of end-2016 covered 104 percent of short-term debt (residual maturity). However, at 77 percent of the IMF's Assessing Reserve Adequacy metric (without considering capital flow management measures; 84 percent after considering them), they were below the recommended range of 100 to 150 percent.

Sources: World Economic Outlook Database and IMF staff calculations.



Sources: Haver Analytics, National Authorities, and IMF staff calculations.
1/ 2015.

17. Risks to the outlook are tilted to the downside given challenging external and domestic contexts (Annex V. Risk Assessment Matrix).

- *External Risks.* South Africa's highly liquid financial markets are vulnerable to tightening global financial conditions as investors may reassess policy fundamentals, in the event of international policy uncertainty and/or a faster-than-expected normalization of U.S. interest rates. Risks from unstable wholesale funding from European banks and exposure to sub-Saharan African borrowers would increase in such scenarios, especially if accompanied by additional local currency sovereign credit rating downgrades to below-investment level. A fall in the prices of South Africa's main commodity exports would reduce investment and worsen the current account. A slowdown in partner growth (e.g., China, destination for about 10 percent of South Africa's exports, or other large emerging markets) or structurally weak growth in key advanced and emerging economies would have both direct and indirect spillovers to South Africa through financial markets and trade channels.[7]

[7] For a detailed discussion of these channels, see IMF Country Report 16/217, 2016 Article IV consultation.

- *Domestic Risks*. These include protracted domestic policy uncertainty and continued deterioration in perceptions of the quality of governance; renewed spending pressures (such as resurfacing demands for free university tuition, a new costly public wage settlement in 2018, or the materialization of contingent liabilities from SOEs); reversal of the recent improvement in labor relations; or a deterioration in banks' balance sheets stemming from protracted low growth.

18. Feedback loops between the real, financial, and fiscal sectors could amplify the impact of these shocks. A continued low growth outlook with rising unemployment would worsen the financial situation of households and firms, resulting in higher NPLs in banks' loan portfolios as well as portfolio rebalancing by foreign investors and domestic non-bank institutions, which would reduce liquidity and increase funding costs for banks. Under these circumstances, banks would likely curtail credit, further exacerbating the growth downturn. Staff estimates suggest that, for instance, following a one percentage point decline in GDP growth, the NPL ratio would increase by 0.5 percentage point. This would in turn dampen credit growth by 2 percentage points (Annex VI. Macro-financial Linkages in South Africa). Lower growth and weaker bank profitability would also have sizeable implications for tax revenues. To maintain debt sustainability, further fiscal adjustment would be required, thus imparting an additional negative impulse to growth.

Authorities' Views

19. The authorities broadly concurred with staff regarding the main factors shaping the outlook and the assessment of external risks. In support of near-term growth, they highlighted the improvements in agricultural output and the pickup in mining production. However, while the medium-term outlook will only be reviewed in October 2017, they expected that a more gradual increase in domestic demand in the medium term would be reflected in weaker import growth than in staff's forecast and a higher contribution of net exports to growth. With respect to external risks, the authorities emphasized risks from higher global uncertainty, including a possible decline in commodity prices, potentially related to a growth slowdown in China, as well as a tightening of U.S. monetary policy. On domestic risks, the authorities emphasized their commitment to policy continuity and the resolution of issues in the mining sector. They argued that markets have sometimes reacted excessively to near-term political developments, rather than focusing on economic fundamentals and the actual conduct of policies. The authorities concurred that prolonged low growth would result in greater vulnerabilities, though they emphasized that they saw the risk of a sudden stop as relatively low. They agreed with the relevance of feedback loops but highlighted the resilience of the well-capitalized banking system and the high domestic currency share in total liabilities.

POLICIES TO LIFT GROWTH, PERMIT MORE GRADUAL FISCAL ADJUSTMENT, AND INCREASE RESILIENCE

With fiscal and monetary policy space constrained by rising government debt and the need to maintain inflation within the target band, the priority to stimulate economic growth and job creation rests with structural reforms, especially in labor and product/service markets. To the extent the authorities succeed in doing so, there will be an opportunity to reduce the pace of fiscal adjustment. An early start in undertaking such reforms would also reduce the likelihood of extreme downside risks materializing.

A. Fiscal Policy[8]

20. The 2017 budget strikes an appropriate balance between maintaining debt sustainability and safeguarding a fragile recovery. The authorities' proposed deficit reduction path aims to stabilize the gross government debt to GDP ratio at 53 percent of GDP in 2018/19, thus allowing the phasing of necessary fiscal measures over the next few fiscal years. Under staff's more conservative assumptions regarding nominal GDP growth, the debt ratio would increase during the budget projection period reaching 56 percent in 2019/20. The cumulative measures proposed for 2017/18–2019/20 amount to 1.9 percent of GDP, evenly split between expenditures and revenues (with specific measures for 2018/19–2019/20 to be determined). This moderate degree of fiscal adjustment during the next few years is broadly appropriate. Indeed, staff's assessment is that fiscal space is limited, consistent with the rising debt, sizable contingent liabilities, the relatively high cost of government borrowing, and significant uncertainties regarding the future path of economic growth and interest rates (see below). Abiding by the approved budget ceilings is necessary to preserve investor confidence.

21. Fiscal risks from lower economic growth and SOEs are sizable, and the room for policy response to further adverse shocks is limited. The debt sustainability analysis highlights that the debt would increase significantly faster in the event of weaker economic growth (Annex VII. Public Debt Sustainability Analysis). If growth turned out 1 percentage point lower than in the baseline, on average, during 2018–22, the debt ratio would reach a level 14 percentage points of GDP higher than in the baseline by the end of the projection period. Accommodating a shock of such magnitude would likely lead to significantly higher financing costs, perhaps accompanied by a local currency debt downgrade to below-investment grade. A sizable rise in the debt ratio could also stem from the realization of contingent liabilities (estimated at 18 percent of GDP at end-March 2017, more than half of which are related to SOEs), or recapitalizations of SOEs that might be needed to address cumulated losses (which averaged 0.4 percent of GDP in the last eight fiscal

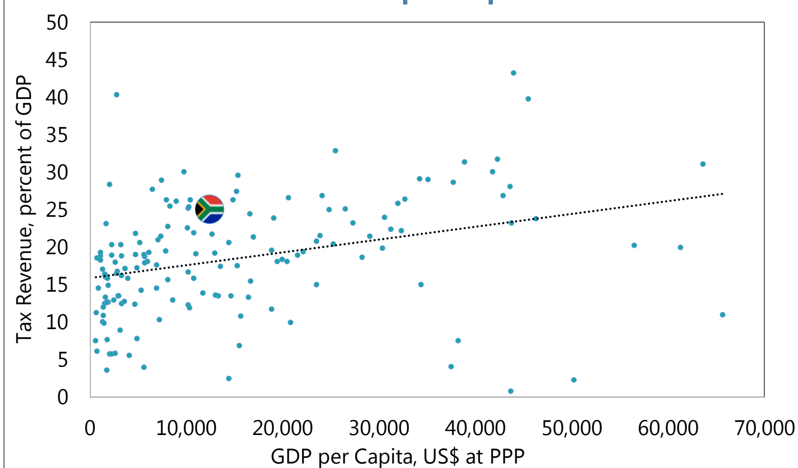
[8] Revenues reported under "transactions in assets and liabilities" in the budget are here considered as domestic financing (excluded from revenues), because they consist of proceeds from the sales of assets, realized exchange rate valuation gains from holding of foreign currency deposits, and other conceptually similar items.

years). The publication of a fiscal risks statement as part of the MTBPS documentation beginning in October 2016 is a welcome step toward enhanced monitoring and disclosure of such risks.

22. The outlook for the public finances underscores the urgent need for reforms to increase the potential rate of economic growth. Although the modest measures embedded in the 2017/18 budget will likely persuade investors to finance this year's deficit at reasonable cost, the rising debt ratio could soon cause market participants—in the absence of pro-growth reforms—to require higher interest rates.

23. During the past few years, the share of both revenues and expenditures continued its rising trend. The size of general government in South Africa is one of the highest among international peers at a similar level of development (text chart). Primary expenditures rose by 1.5 percentage points of GDP between 2012/13 and 2015/16, owing primarily to public enterprise-related transfers (0.8 percent of GDP, including a 0.6 percent of GDP equity injection for Eskom in 2015/2016) as well as relatively generous wage agreements combined with an increase in consolidated government employment (0.3 percent of GDP) (Figure 12).[9] In recent years, including the 2017 budget, higher personal income taxation has been the main tax policy instrument to collect revenue combined with higher excise rates.

Tax Revenue and GDP per Capita



Sources: WEO and IMF staff calculations.
Note: Sample of 161 countries. Outliers Qatar, Luxembourg, Kuwait, Brunei and Singapore have been removed from the sample. The data refer to 2016.

24. In selecting fiscal adjustment measures, priority needs to be given to supporting economic growth and job creation, as well as reducing inequality. The progressivity of the personal income tax helps to reduce inequality, although obtaining additional revenues from this instrument may become increasingly difficult, particularly in an economy that is generally open to international financial investment. Further revenue measures could be informed by the Davis Tax Committee proposals and could include moderate increases in the standard VAT rate (while using social grants to compensate the poor),[10] higher taxation of property, and measures to reduce base erosion and profit shifting. Expenditure reduction measures could include lower transfers to public

[9] More than half of the average overall employment growth recorded in the Labor Force Survey since 2010 occurred in the general government services category.

[10] Social grants are preferable to VAT exemptions for specific products consumed by the poor as these benefit better-off households more than proportionately, owing to their higher consumption levels.

enterprises—these averaged 0.8 percent of GDP annually in the last 8 years—supported by reforms to improve their finances (see below), as well as lower increases in public sector wages,[11] while protecting well-targeted social programs and productive investment. Within infrastructure projects, a priority is to improve opportunities for labor force participants to commute to work and, to the extent that subsidized housing is planned, choosing its location near new business developments where jobs are being created. Further strengthening of spending efficiency through the imposition of penalties for failures to adhere to procurement guidelines and other irregular expenditures is also warranted, given the Auditor General's finding of a notable acceleration of irregular expenditures in government departments.

25. SOE reforms are needed to reduce their cost to the budget, manage fiscal risks from contingent liabilities, and increase efficiency in the economy. Public enterprises play a major role, often with limited competition, in providing key products/services, such as power, telecommunications, and transportation (e.g., ports, airways). Their performance thus affects not only the public finances and the borrowing costs of the whole economy, but also economic growth and job creation through the cost of important inputs for a wide range of businesses and households. Potential directions for reform include: (i) comprehensive stocktaking and review of the SOEs and their subsidiaries, with information on their commercial viability and the relevance of their objectives from a public policy perspective; (ii) stricter vetting process for establishing new SOEs and, especially, their subsidiaries, in view of their large existing stock; (iii) inclusion of costs incurred by the SOEs for public service delivery in the government budget; and (iv) stricter enforcement, with sanctions, for breaches of the Public Financial Management Act (Annex VIII. SOE Reforms–International Experience).

Authorities' Views

26. The authorities reiterated their commitment to meeting the fiscal targets embedded in the 2017/18 budget through strengthening budget execution and revenue mobilization, while monitoring and mitigating fiscal risks as required. Over the medium term, fiscal policy focuses on containing the budget deficit and slowing the pace of debt accumulation to maintain spending programs and promote confidence in the economy. A key feature is a reduction of the expenditure ceiling through reducing operating budgets, lowering transfers to public entities and stringent wage bill controls achieved in part through the withdrawal of all funding for non-critical vacant posts. The authorities are also implementing measures to make public spending and budget execution more efficient, including through a new financing facility for large multi-year infrastructure projects. Since April 1, 2016 all public procurement has been managed through a web-based e-portal system which publicly provides information on all public-sector procurement and contracting. This reform, alongside broader procurement reforms, will promote increased transparency, reduce the scope for

[11] Specific measures to keep the public sector wage bill in check include: aligning the wage negotiation cycle with the budget cycle, to ensure that wage bill decisions compete on an equal footing with other primary spending items; reforming the wage negotiation framework to cover all aspects of compensation, while limiting sources of automatic wage increases not based on performance, such as automatic pay scale progression or promotions; and implementing pay reform by benchmarking public sector salaries to those of the private sector.

fraud, and contribute toward making public procurement a more effective tool for economic transformation. The authorities are also implementing additional revenue measures concentrated at the upper end of the income spectrum and fuel levies, while continuing to work with the Davies Tax Committee on options for future revenue adjustments.

27. The authorities highlighted their determination to improve the operating efficiency, governance, and financial performance of state owned enterprises, alongside strengthened oversight for all national public entities. The average return on equity for state owned enterprises has been weakening since 2012 and is now well below borrowing costs. To address these issues, in November 2016, cabinet adopted a new governance framework for these entities, including guidelines for remuneration and incentives for directors, standards for the appointment of boards and executive officers, and a framework to guide collaboration between stated owned companies and the private sector on infrastructure projects. Implementation is expected during this fiscal year.

B. Monetary and Financial Sector Policies

28. Monetary policy can remain on hold unless inflation expectations rise or external financing becomes challenging. Keeping the repo rate unchanged at current levels is appropriate, given that inflation is projected marginally below the upper threshold of the 3–6 percent band for the remainder of 2017 and in 2018, and that inflation expectations currently remain well anchored at about 6 percent. This also avoids injecting an additional contractionary impulse in a weak economy experiencing moderate fiscal adjustment. Even so, further tightening would be warranted if inflation expectations were to rise, owing for example to larger-than-expected second-round effects of fuel and food price inflation, an unexpected fiscal loosening, or rapid exchange rate depreciation from increased political and policy uncertainty. Opportunities to increase international reserves to the recommended range, such as large FDI inflow transactions, should be seized, consistent with meeting the inflation objective.

29. Bringing to fruition ongoing reforms of prudential regulation and the resolution framework is expected further to buttress financial sector resilience. The authorities have made progress in implementing the 2014 IMF FSAP recommendations (Annex IX), particularly on modernizing the macro-prudential framework, including the introduction of "Twin Peaks" and resolution regimes.[12] These reforms will likely increase financial stability by removing regulatory gaps and reducing implicit contingent liabilities from the banking sector. The Financial Sector Regulation bill to execute the Twin Peaks reform is likely to be approved and implemented in 2017, and the Designated Institutions Resolution bill to introduce the new resolution regime is expected to be submitted to parliament in late 2017. In this context, National Treasury and the SARB published for public comment a policy document on an explicit, privately-funded deposit insurance

[12] A "Twin Peaks" model refers to setting up a prudential authority to regulate the safety of financial institutions through group-wide supervision and a market conduct authority whose role includes protecting customers with respect to financial products and services. The draft Designated Institutions Resolution Bill contains a framework for the resolution of banks and systemically important financial institutions (which includes restructuring and bail-in powers), and establishes a deposit insurance scheme.

scheme. The SARB is also working toward an enhanced macro-prudential framework, including the addition of new tools such as countercyclical capital buffers, sectoral capital requirements, dynamic provisioning, as well as leverage and liquidity ratios. Moreover, the tightening of credit standards that began in 2015 has helped to correct past frothiness in the market for credit to households; slow consumption growth reflects not only these measures, but also an appropriate, continued reduction in the indebtedness of many overstretched households. A third draft on the OTC derivative regulatory framework will be reviewed by National Treasury and the SARB in 2017. However, limited progress has been made on the reform of collective investment schemes, promotion of fair competition and financial inclusion, and better consumer protection.

30. Access to financial services for low-income households and SMEs needs to be enhanced. Greater access of firms and households to banking services or the lifting of their financial constraints may be expected to foster economic growth and to reduce income inequality. At the same time, access to credit should be expanded with proper supervision to prevent an increase in financial stability risks, as illustrated by the recent bankruptcy of African Bank arising from its unsecured lending to low income customers. The authorities are taking steps to increase financial inclusion. For the first time in 11 years, the SARB granted three provisional banking licenses in 2016 (to Post Bank, Discovery Bank, and TYME (Take Your Money Elsewhere), a local mobile payments start-up acquired by Commonwealth Bank of Australia). The market conduct authority under twin peaks is also expected to introduce more transparency to financial products sold to consumers and SMEs. Even so, more could be done to expand financial inclusion while keeping financial risks in check. International experience suggests several options, such as encouraging community-based credit unions, institutions relying on emerging technologies ("FinTech"), and microcredit insurance; promoting financial literacy; better protection of low-income borrowers from predatory lending and abusive loan-recovery; streamlined disclosure standards for small-scale lending; expansion of eligible collateral and improved and centralized credit registry systems. Hurdles faced by potential entrants, such as non-transparent rules for access to clearing and payment systems operated by incumbents, should also be reduced.

31. Full and swift implementation of the Financial Intelligence Center Amendment (FICA) Act is needed to bring South Africa closer to international standards against money laundering, financing of terrorism, and other illegal financial transactions. The FICA Bill was signed by President Zuma in April 2017 and the next step is to issue and enact regulations to fully implement the FICA Act. Lack of comprehensive implementation might lead to a statement by the Financial Action Task Force about the risk of doing business with South Africa and could increase international transaction costs for South African businesses.

Authorities' views

32. The authorities broadly shared the mission's views on monetary policy and regulatory reforms. They considered that the monetary policy tightening cycle may have reached its end, but that the inflation outlook would need to improve in a durable manner before rates could be reduced. This assessment may change if the inflation outlook and the risks to the outlook deteriorate. The authorities highlighted their continued progress on reforms of prudential regulations. The implementing regulations for the FICA (Financial Intelligence Centre Act) law are being prepared for full implementation by late 2017.

33. On the banking system, the authorities highlighted its resilience and their plans to enhance competition in the sector. Capital adequacy ratios and profitability remain high across the banking system, with low NPLs and limited foreign currency exposure. Despite headwinds from low economic growth, banks are well positioned to cope with lower profits and higher impairment. The high degree of concentration in the banking sector provides stability but also has downsides, such as a tendency for "too-big-to-fail" situations and greater risk of contagion. This tradeoff can be managed through a combination of effective prudential regulations and the oversight of competition authorities. In addition, the authorities were analyzing possible ways of moving toward a tiered banking system allowing for mid-sized banks with proportionally less stringent regulatory requirements. Further analysis of the sources of high fees in the retail banking industry and action to reduce them would also be beneficial. In the past few years, regulations have been issued to limit interest rates and fees on loans as well as the cost of credit life insurance for various credit facilities.

34. The authorities believe that more needs to be done to improve financial inclusion, supported by strong market conduct and consumer protection regulation. The authorities agreed that greater financial inclusion could favorably impact economic growth and reduce inequality, but views differed regarding the extent of impact. The authorities highlighted that increased access to credit had unintended consequences, including over-indebtedness. A more sustainable approach to financial inclusion would be to encourage savings to support asset and wealth creation. The authorities are exploring ways to improve availability of credit information, establish viable risk-sharing schemes, extend the asset classes that can practically be used as collateral, and promote FinTech. Subject to the passage of the Financial Sector Regulation Bill, the Financial Sector Conduct Authority and Ombud Council will be established in 2017 to ensure a fairer and more effective financial sector. A FinTech regulatory framework (part of the Conduct of Financial Institutions Bill) could include a "regulatory sandbox" to encourage innovation within a controlled environment while managing any potential risks.

35. On contingency planning, the authorities highlighted the use of existing frameworks and their plans for further enhancement. The Financial Sector Contingency Forum (FSCF) had recently conducted a simulation exercise to assess operational risk. The SARB established a Financial Crisis Planning Working Group (FCPWG) in early-2017, including external stakeholders such as the National Treasury and the Financial Services Board, with a view to enhancing the existing crisis management framework and aligning it with the new regulatory framework.

C. Reforms of Labor and Product/Service Markets

36. The authorities have made progress in increasing electricity capacity and improving labor relations, but reforms in other areas have lagged.

Labor market. Recent efforts to reform the labor market have focused on the introduction of a national minimum wage (NMW), combined with measures to improve labor relations. A recent agreement among social partners (government, trade unions, and entrepreneurs' associations) under the aegis of the National Economic Development and Labor Council envisages the new NMW at R20 per hour (R18 for agriculture and R15 for domestic workers), as well as the establishment of a draft Code of Good Practice for Collective Bargaining, Industrial Action, and Picketing, which contains steps in the right direction, such as strengthening the expectation of a secret ballot ahead of a strike and initiatives to reduce the likelihood of violence or intimidation by any parties involved. If the agreement on the NMW is swiftly transferred into draft legislation and approved, implementation could begin as early as May 1, 2018. The proposed NMW level—on the high side in international comparisons (Annex X. Introduction of a National Minimum Wage)—seeks to ensure a reasonable living standard for millions of workers who are currently near or below the poverty line. To reduce the risk of adverse employment effects, the initial NMW phase-in period should be closely monitored, while standing ready to introduce complementary measures to support vulnerable sectors (e.g., SMEs or youth).

Product/service markets. Efforts to facilitate entry by new firms in key markets such as energy, transportation, and telecommunications need to be strengthened.[13] With new coal-fired plants brought online by national utility Eskom, as well as rising participation of independent power producers (IPPs), especially renewables, and with no significant load-shedding since August 2015, availability of power is no longer a constraint on economic activity. However, further expansion of IPP activity has been delayed by Eskom's reluctance to sign new power purchase agreements. Similarly, there is a need to reduce port tariffs, which remain above international norms for some sectors; and in telecommunications, allocation of broadband spectrum has suffered from delays. More generally, there is a need to allow private firms to compete on a more equal footing with large SOEs. Higher competition will also lead to reduced markups and a lower response of inflation to cost pressures. For several product/service markets where a few private firms or groups of firms are dominant, the Competition Commission's proactive inquiries have helped to curtail anti-competitive behavior.

Land/Mining. New legislation proposals or issues related to the interpretation of existing legislation may have increased perceived uncertainty with respect to land and mining, with associated adverse effects on investment. Examples include the Land Expropriation bill, which aims to allow the state to redress racial imbalances in land ownership through a process whereby a Land Commission would audit the present ownership of agricultural land, and assist in determining just and legitimate compensation in land transfers; the proposed new Mining Charter, which calls for companies to keep black ownership at a minimum of 26 percent—including in the event that black shareholders sell their stakes; and, separately, a new Mineral and Petroleum Resources Development bill, which

[13] Cross-country evidence shows that reforms of product/service markets (including network industries) are followed by significant increases in output and employment (IMF working papers 16/114 and 16/116).

proposes to give the state a 20 percent free stake in new energy projects and the ability to buy further shares.

37. Undertaking a set of initial, focused reforms in labor and product/service markets would strengthen confidence, foster investment, and promote inclusive growth. Priorities include the following.

- Barriers to entry, including those resulting from multiple and occasionally conflicting regulations, should be reduced. Priorities to foster competition, with benefits for a broad range of businesses and consumers, include: swiftly allocating broadband spectrum through auctions or other transparent processes that will promote competition in the market; allowing private sector producers to compete with the state-owned utility on an equal footing in power generation as demand grows; and reducing port tariffs to levels that are more reflective of costs and international norms, especially for those sectors which they currently place at a disadvantage. These reforms would also help further to diversify production and exports, and to increase their value-added content. Maintaining and enhancing trade integration, including regional integration, also helps to instill competition, reduce input costs and facilitate reaping economies of scale.
- Further labor market reforms to ensure that wage levels are determined by market conditions that are relevant to firm-specific conditions—for example, by exempting SMEs from collective bargaining outcomes. It would also be desirable to introduce a single employment contract with gradual, continuous increases of rights and benefits that would accrue with tenure—to make it easier for young people to obtain their first job. Subsidies for transportation to young unemployed taking up new jobs would be worth considering. Greater use of profit-sharing and allocation of shares to workers could also be considered as an additional avenue to reduce inequality while improving labor relations.
- Reforming the public schools to improve educational outcomes, where South Africa scores worse than international peers.[14] Possible measures include: (i) enhancing opportunities for upgrading the skills of teachers and to make them more accountable; (ii) improving equity and efficiency in the allocation of resources among school districts, especially between rural and urban areas; and (iii) enhancing the cooperation between educational institutions and employers with respect to internships and other avenues for school-to-work transition, especially for disadvantaged youth (Annex XI. Educational Outcomes: Causes and Consequences).

Authorities' Views

38. The authorities remain committed to the objectives outlined in the 2017/18 budget to transform the structure of the economy to be more inclusive and for growth to be more sustainable. They see an urgent need to accelerate the pace of economic transformation while pursuing the same measures that would support investor confidence. In such pursuit, South Africa

[14] Murtin F., 2013, "Improving Education Quality in South Africa", OECD Economics Department Working Papers, No. 1056, OECD Publishing, Paris. http://dx.doi.org/10.1787/5k452klfn9ls-en

would continue to rely on a mixed economic system, with government policy playing the central role in transformation by promoting redistribution and promoting a healthy investment climate by directing scarce resources towards catalytic investments in human and physical capital alongside a vibrant private sector to modernize and diversify the economy.

39. The authorities plan to reform product and service markets and to reduce legislative uncertainty in land and mining to increase confidence, job creation, and potential growth. Working with business, labor, and civil society, the authorities intend during this fiscal year to finalize ongoing mining and land legislation to reduce policy uncertainty in these areas, allocate spectrum to broadband services to expand business opportunities and reduce costs, and expand the independent producer program in renewables and gas to boost power supply and enhance competition in the energy sector.

40. In the labor market, the authorities emphasized the improved relations among social partners. The agreement on a national minimum wage and a draft Code of Good Practice for Collective Bargaining were positive developments, and had been attained following an extensive consultation process among a wide range of stakeholders. Improved relations had also been reflected in fewer days lost to strikes.

STAFF APPRAISAL

41. Against the background of declining confidence and rising impatience with longstanding inequalities, the authorities face the dual challenge of reigniting growth and rendering it more inclusive. Addressing that challenge will require early policy action as well as clear and consistent communication of the strategy to be pursued. International historical experience shows that successful reductions in inequality that eschewed societal or economic upheaval, thus preserving healthy, broad-based economic growth occurred gradually, over several years. Fiscal discipline and good governance will be key; reforms promoting inclusive growth will need to start promptly and to be implemented assiduously.

42. A near-term priority is to foster domestic demand by reassuring businesspeople and consumers regarding the future direction of policies. Policymakers should seize available opportunities to reassert their commitment to pursuing inclusive growth within available financial means and in a way that supports investment and job creation by the private sector. In this regard, the authorities' recent reaffirmation of their budget objectives approved by parliament is helpful. Implementation of the budget and an initial set of reforms will be necessary to improve confidence.

43. If reforms are undertaken to reignite activity, revenues will rise and the need for fiscal adjustment will become commensurately lower in the years ahead, further supporting growth. Conversely, with insufficient reforms, the country would likely become stuck in a prolonged, vicious cycle of anemic growth and rising public debt. South Africa would then become more exposed to shocks, such as worsening sentiment of foreign and domestic investors alike; in an extreme scenario, capital inflows, imports, and domestic activity could contract abruptly.

44. The scope for monetary or fiscal policies to provide stimulus to the economy is limited. With headline inflation projected marginally below 6 percent in the remainder of 2017 and in 2018, keeping policy rates on hold is appropriate. The central bank should stand ready to increase rates if inflation expectations were to rise—for example, because of sizable exchange rate depreciation from heightened uncertainty. To ensure that government debt peaks significantly below 60 percent of GDP, a modest improvement in the structural primary fiscal balance—as envisaged by the medium-term path in the 2017 budget documents—will be needed in the next few years. It will also be necessary to monitor, disclose, and manage fiscal risks from explicit or implicit government guarantees and other firm or contingent, future obligations. Reforms of public enterprises—to strengthen governance, increase transparency in public procurement, apply penalties for failures to adhere to procurement guidelines, and quantify public service obligations—would reassure investors and the public at large, with associated benefits for borrowing costs and economic efficiency.

45. With limited room for stimulus through macroeconomic policies, the priority to stimulate economic growth and job creation rests with structural reforms, notably in product and service markets and in the labor market. The focus should be on sectors providing crucial inputs for most firms in the economy, such as power generation, telecommunications, transportation, and financial services for small- and medium-sized enterprises. Beyond the direct contribution of output and jobs by new firms, declining costs of inputs would have beneficial, indirect effects through production and employment increases by a wide range of other businesses. The Competition Commission should be strongly supported in its proactive market inquiries and vigorous anti-cartel actions. It is also important to reduce uncertainty regarding new proposed legislation or the interpretation of existing legislation in areas such as land ownership and mining.

46. Labor market reforms should aim at generating jobs, especially for youth. Wage-setting processes should become more reflective of firm-specific circumstances, including productivity. Improving educational attainment for students in all age groups is also crucial to ensure that the large and growing number of young people will have the right skills to find jobs when they enter the labor market. Introducing the agreed national minimum wage has the potential to make a material difference for millions of people; at the same time, its impact on employment will need to be carefully monitored in the early stages of implementation, standing ready to introduce complementary measures for vulnerable sectors such as small- and medium-sized enterprises or youth. A parallel agreement on a Code of Good Practice for Collective Bargaining also contains steps in the right direction; introduction of such Code into legislation would increase its effectiveness.

47. In the financial sector, bringing to fruition ongoing reforms to modernize prudential regulation and to enhance the resolution framework is expected further to buttress resilience. This includes implementation of the Financial Sector Regulation Act beginning later this year, soon to be followed by a financial sector resolution bill, including a deposit insurance scheme. In addition, full and swift implementation of the FICA Act is needed to bring South Africa closer to international standards against money laundering, financing of terrorism, and other illegal financial transactions.

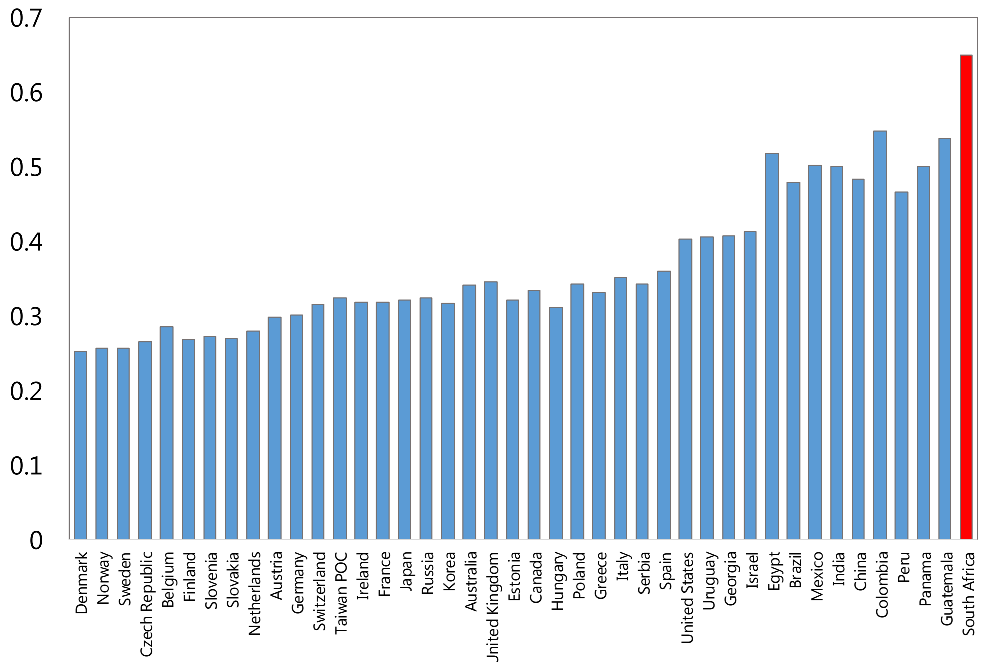
48. Meanwhile, there is a need to foster competition in the banking system, especially by promoting entry of new players to enhance financial inclusion. This would allow small- and medium-sized enterprises as well as low-income households greater access to finance, thereby helping to reduce inequality. In that regard, the expected provision of new banking licenses is a step toward greater competition. At the same time, access to credit should be expanded with proper supervision to prevent an increase in financial stability risks.

49. Resilience would be enhanced by attracting more durable foreign investment and increasing international reserves. South Africa's strengths include a freely floating exchange rate, low reliance on foreign currency debt, a large domestic investor base, and a broadly balanced international investment position. In staff's view, the external position in 2016 was moderately weaker than implied by fundamentals and desirable policy settings. Improving perceived governance and investor confidence would help to attract foreign direct investment—a relatively stable source of financing—and to reduce the gap between the actual current account deficit and the estimated norm. The SARB should seize opportunities to increase reserves to the desirable level, consistent with meeting the inflation objective.

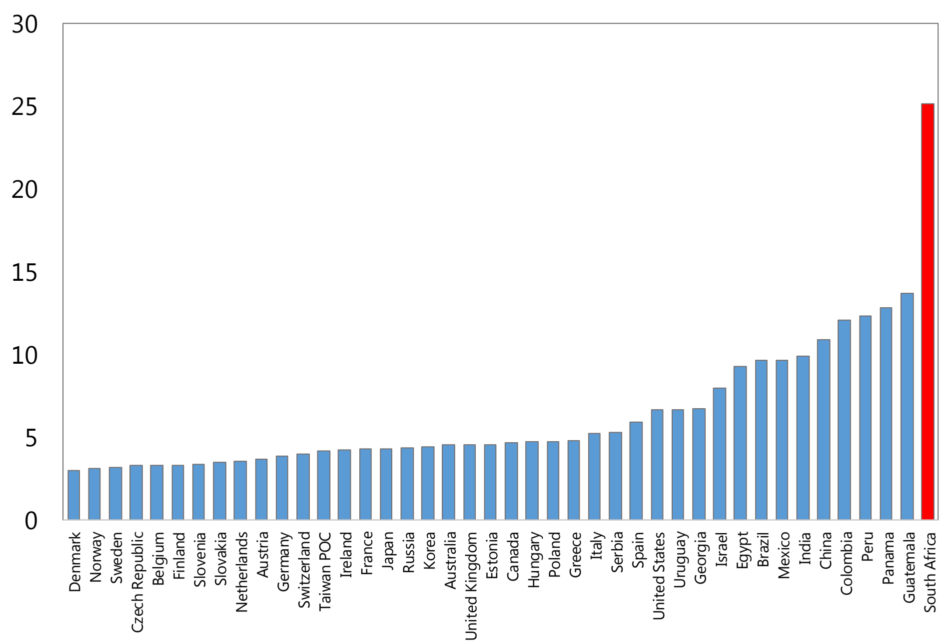
50. It is proposed that South Africa remain on the standard 12-month Article IV cycle.

Figure 1. South Africa Remains One of the World's Most Unequal Societies

Gini Index



90:10 Ratio



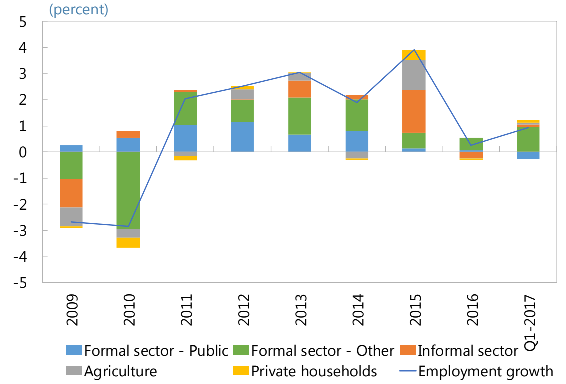
Sources: Luxembourg Income Study and World Bank.

Notes: The Gini index ranges from 0 for perfect equality to 1 for the limiting case in which all income accrues to one individual. The 90:10 ratio refers to the ratio of the income of an individual at the 90th percentile in a given country's distribution to the income of an individual at the 10th percentile. The data are from the most recent household survey available. Further details from Hellebrandt and Mauro, 2016, *World on the Move: Consumption Patterns in a More Equal Global Economy*, Peterson Institute for International Economics.

Figure 2. South Africa: Employment Creation has been Insufficient to Curb Unemployment

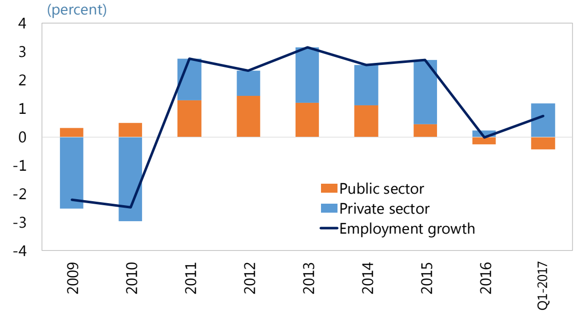
Job growth has been weak in all sectors...

Employment Growth: Contribution by Sector
(percent)



...more reliant on public sector employment creation until recent efforts to contain the wage bill were implemented.

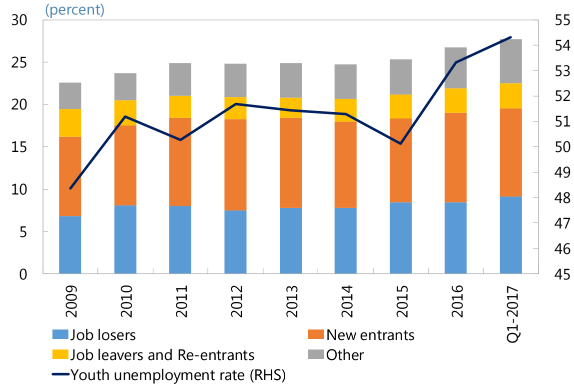
Formal Employment Growth: Contributions of Public and Private Sector 1/
(percent)



1/ Using non-agriculture formal sector employment from Quarterly Labor Force Survey.

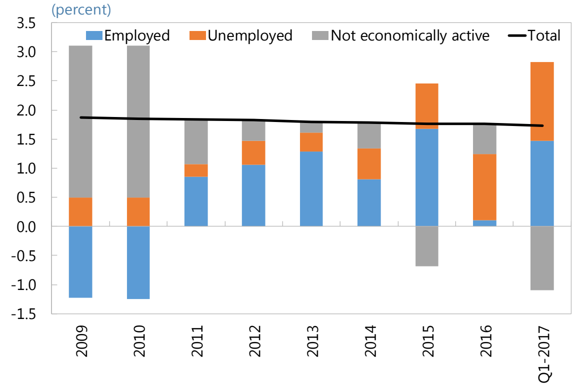
...and not sufficient to keep pace with new entrants in the labor market...

Unemployment Rate
(percent)



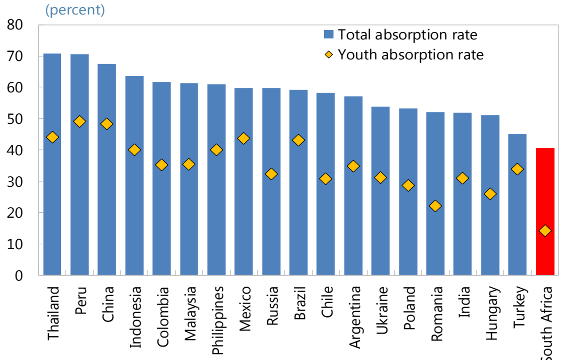
...especially in 2016 with almost no employment growth.

Working-age Population Growth
(percent)



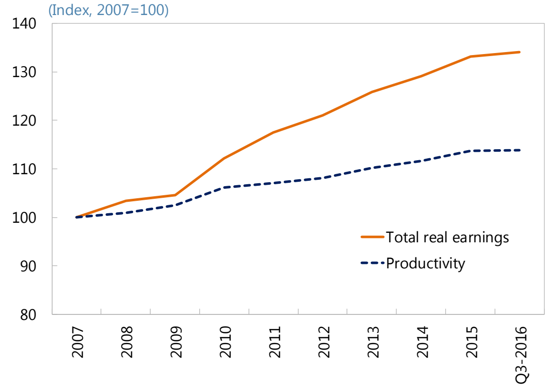
The proportion of working age population employed is one of the lowest among EMs, especially for youth.

Absorption Rate, 2016
(percent)



Earnings have outpaced productivity despite a recent slowdown.

Total Earnings and Productivity
(Index, 2007=100)



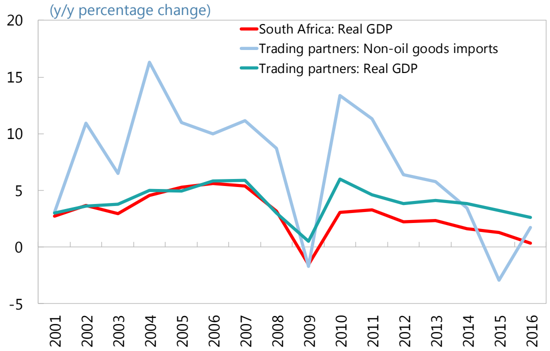
Sources: Haver Analytics, ILO, SARB, StatsSA, and IMF staff estimates.

Figure 3. South Africa: Growth Slowed Down Further in 2016

Trading partner growth continued to slow in 2016.

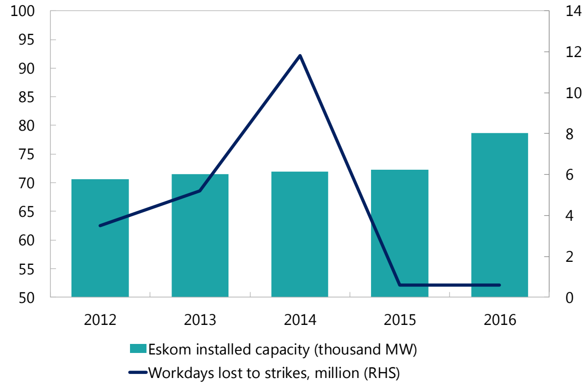
South Africa GDP Growth,Trading Partners' GDP and Import Growth

(y/y percentage change)



Labor relations remained stable and electricity capacity increased.

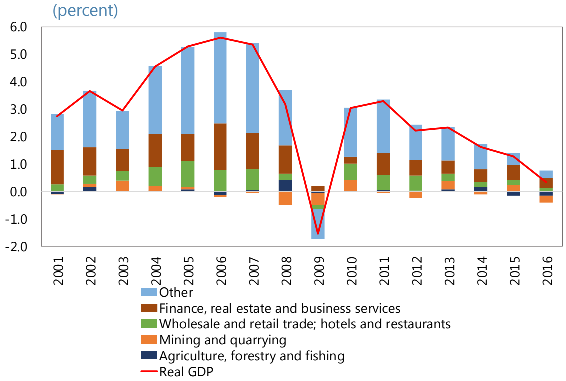
Workdays Lost and Electricity Capacity



Agricultural and mining production declined owing to drought conditions and low commodity prices.

Contributions to Growth- Supply

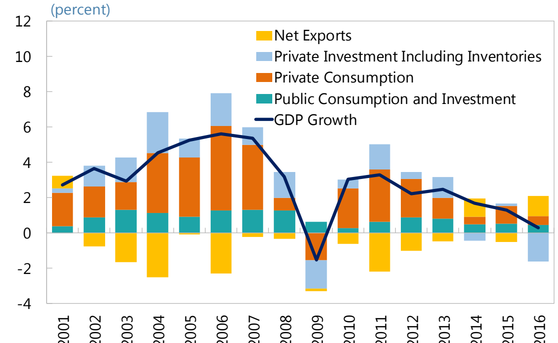
(percent)



Domestic demand ground to a halt due to slowing consumption and declining private investment...

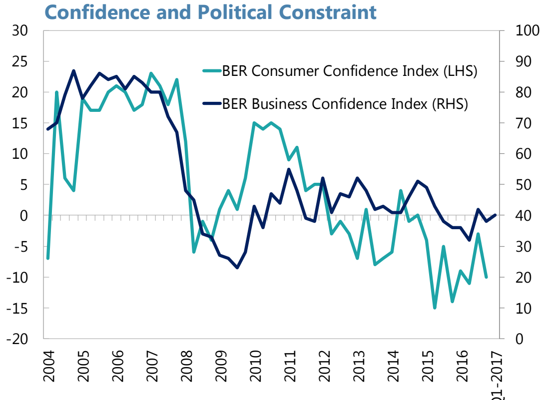
Contributions to Growth

(percent)



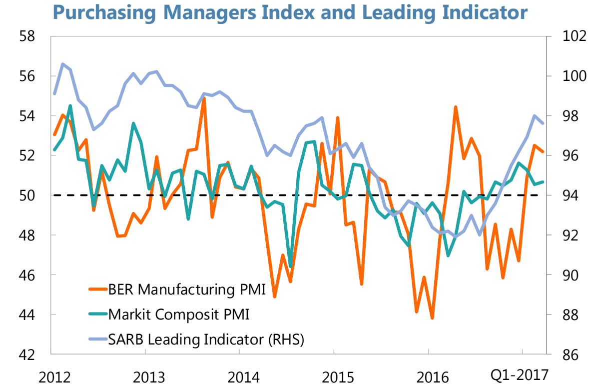
...reflecting weak business confidence and record low consumer confidence.

Confidence and Political Constraint



Forward looking indicators are consistently pointing to a modest recovery in 2017.

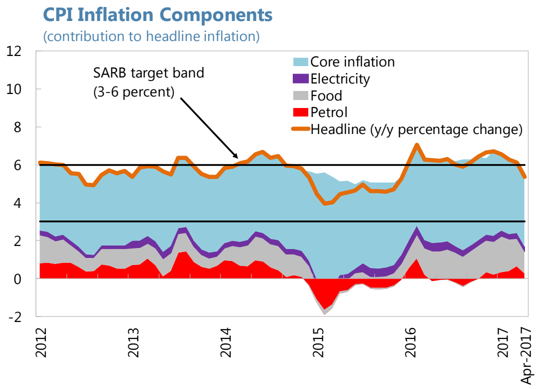
Purchasing Managers Index and Leading Indicator



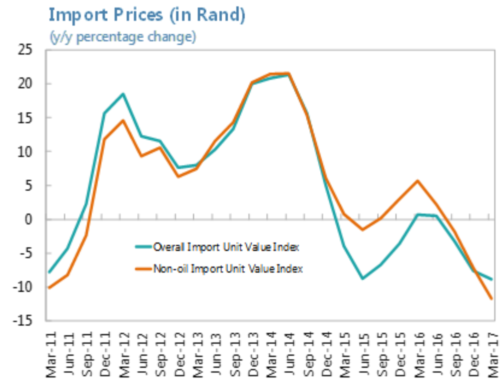
Sources: Andrew Levy Employment Publications, Haver Analytics, Eskom, SARB, and IMF staff estimates.

Figure 4. South Africa: Monetary Policy Focused on Bringing Inflation Back into the Target Band

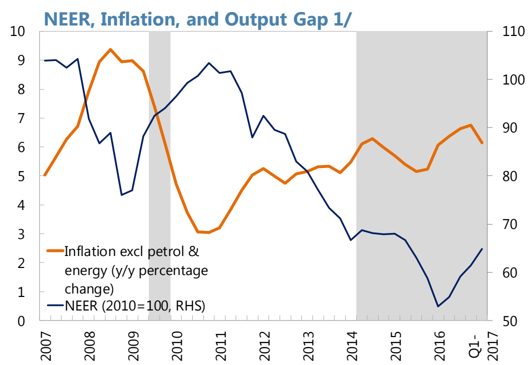
Headline Inflation rose above the 6 percent top band in 2016 driven by higher food and fuel prices. Core inflation also increased but remained below 6 percent.



Import prices continued their decline despite a temporary recovery.

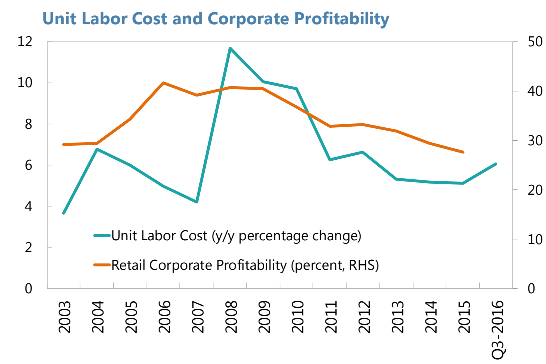


A growing output gap kept exchange rate pass through subdued despite significant depreciation since 2011 Q1.



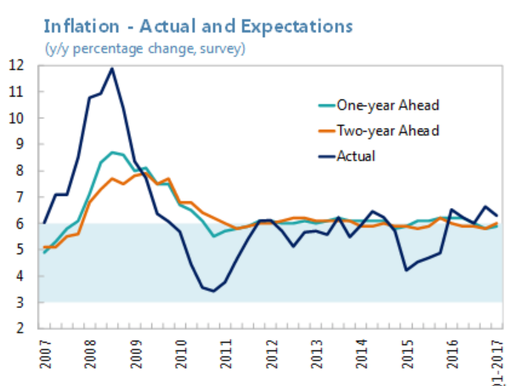
1/ Light grey areas represent a negative and rising output gap.

Retailers have earned sizable profits while unit labor costs have been contained.

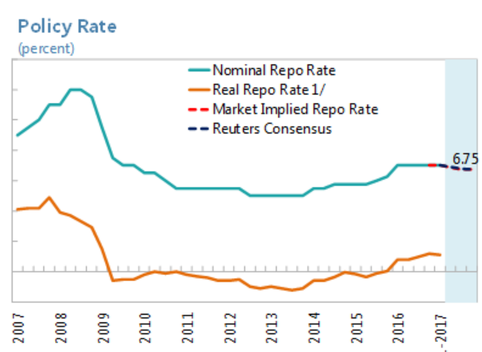


1/ Return on equity, weighted by market capitalization. 2015 is estimated.

Inflation expectations have been well anchored near the ceiling of the target band.



After a tightening of 200 bps since December 2013, markets expect the SARB to keep the policy rate stable.

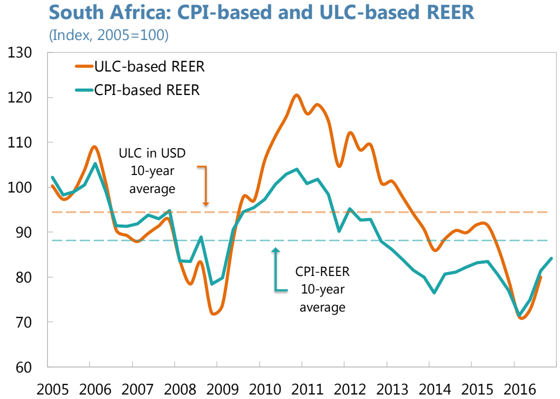


1/ Nominal rate deflated with one-year ahead inflation expectations.
The light blue area represents the forecast period.

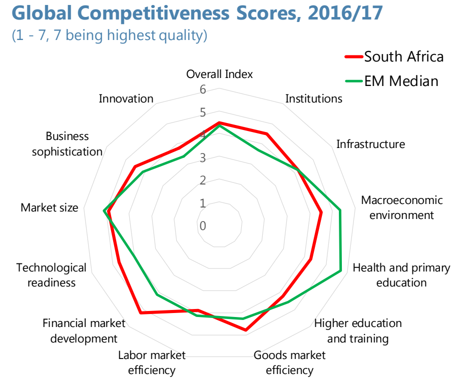
Sources: Bloomberg L.P. Haver Analytics, Reuters, SARB, WEO, and IMF staff estimates.

Figure 5. South Africa: The Current Account Deficit Remained Large Despite an Improving Trade Balance

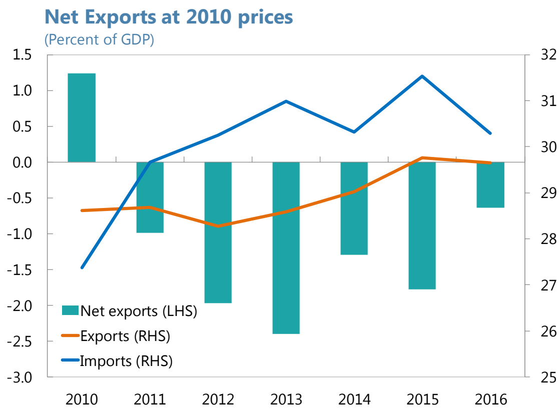
REER depreciation has recently turned around…



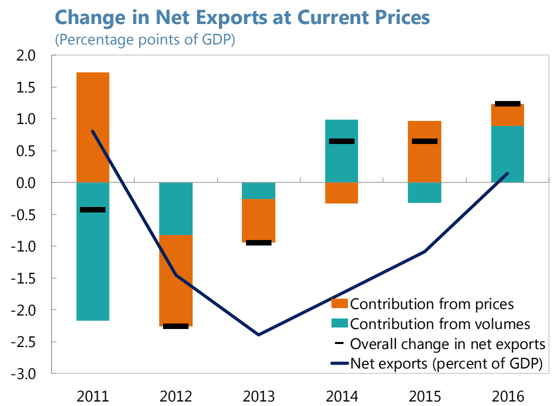
…and competitiveness remains a challenge.



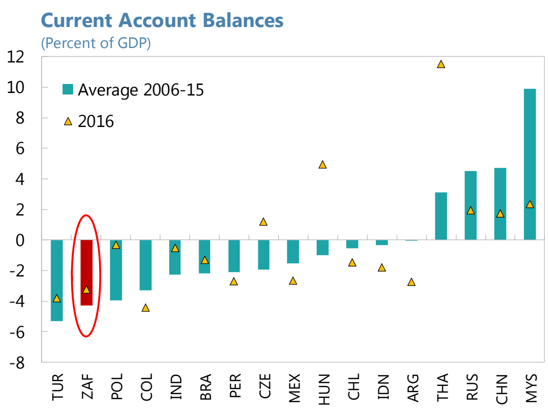
Net export volumes improved in 2016…



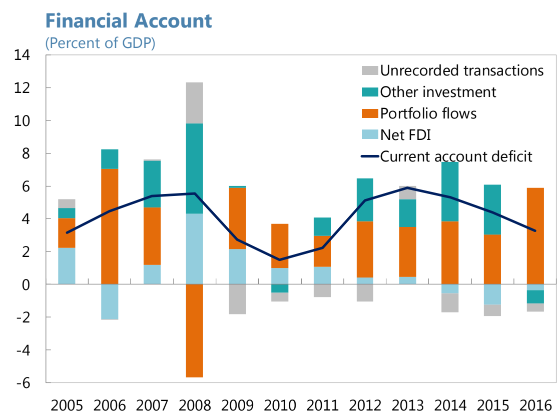
…supporting the overall balance.



The current account deficit remains large…



…financed by non-FDI flows.

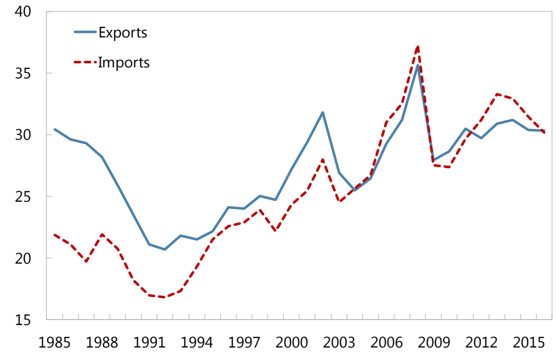


Sources: Haver Analytics, SARB, WEB, and IMF staff calculations.

Figure 6. South Africa: Rising Trade and Foreign Direct Investment Integration

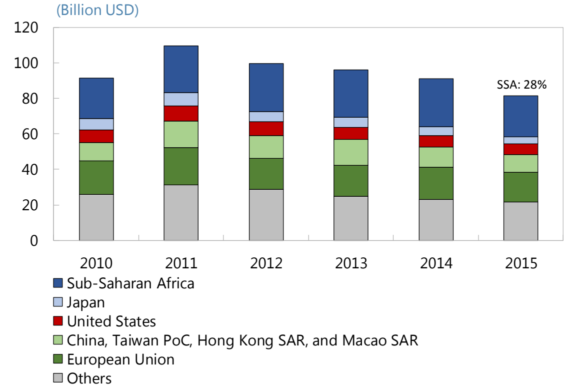
South Africa's trade linkages have steadily increased…

Exports and Imports of Goods and Services
(Percent of GDP)



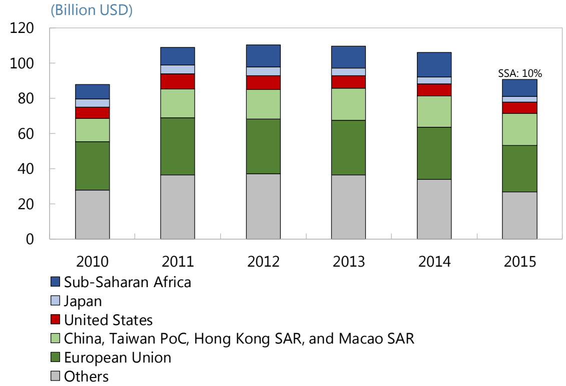
…and are significant with sub-Saharan Africa.

Exports by Country or Region of Destination
(Billion USD)



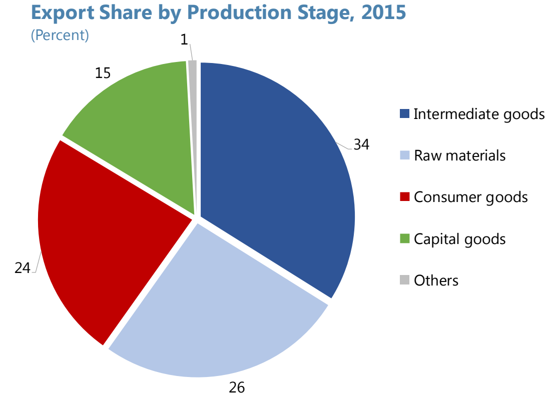
Imports are largely from Europe and Asia.

Imports by Country or Region of Origin
(Billion USD)



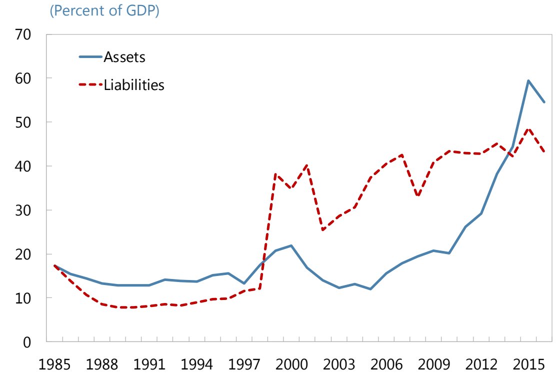
South Africa is integrated in the value-added chain.

Export Share by Production Stage, 2015
(Percent)



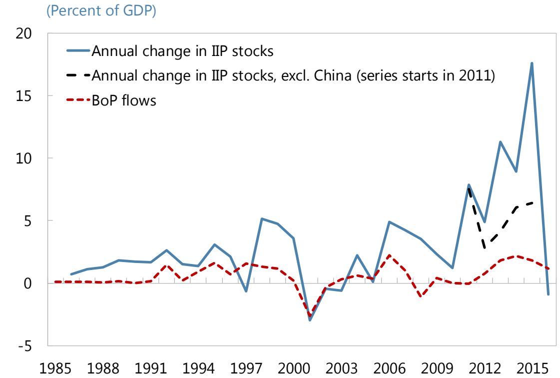
South Africa has become increasingly integrated in FDI…

Foreign Direct Investment
(Percent of GDP)



…partly reflecting valuation gains on investment in China.

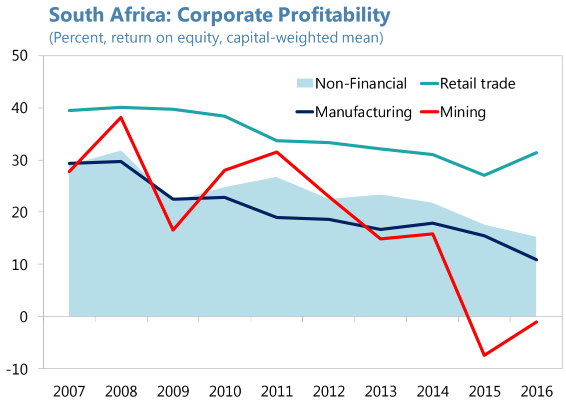
Assets: Foreign Direct Investment Flows
(Percent of GDP)



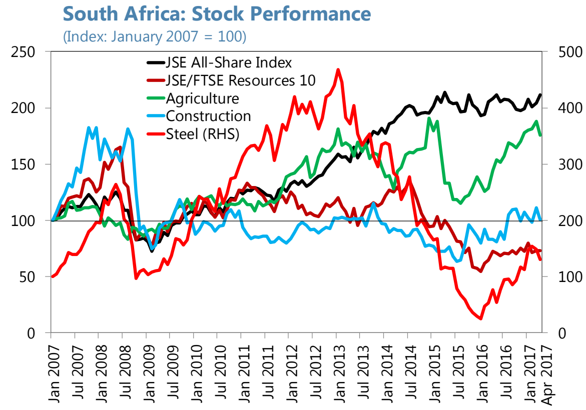
Sources: Direction of Trade Statistics, Haver Analytics, IMF Coordinated Direct Investment Survey (CDIS), SARB, World Integrated Trade Solution (WITS), and IMF staff calculations.

Figure 7. South Africa: The Corporate Sector has Earned Healthy Profits Despite the Economic Weakening

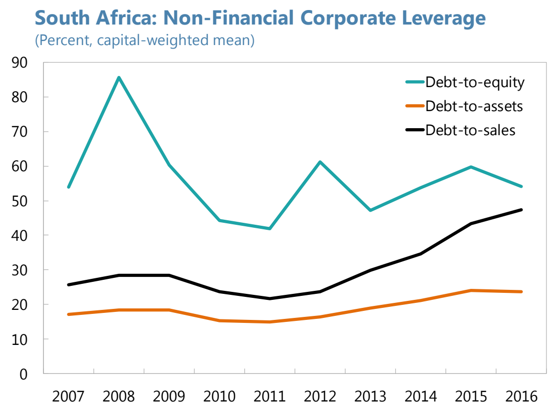
Profitability has weakened in manufacturing and mining...



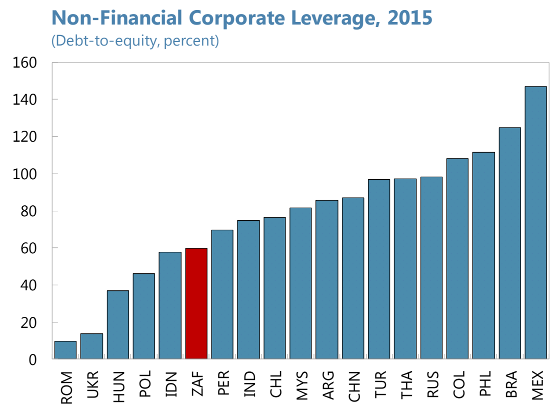
...but steel and agriculture have started to strengthen.



Corporate leverage has risen...

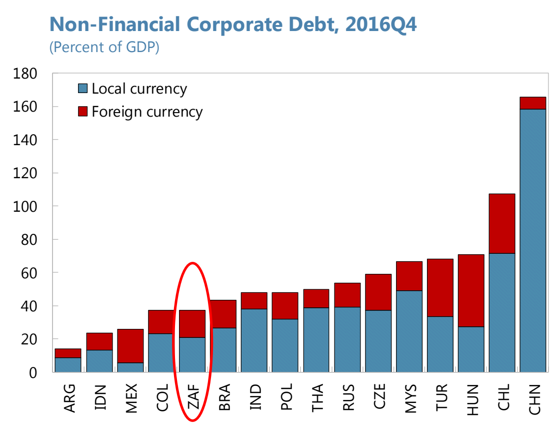


...though it remains below that in peers.



Corporate debt has increased...

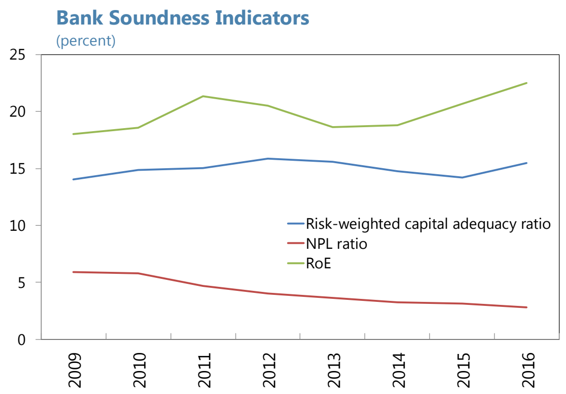
...but does not stand out relative to other emerging market economies.



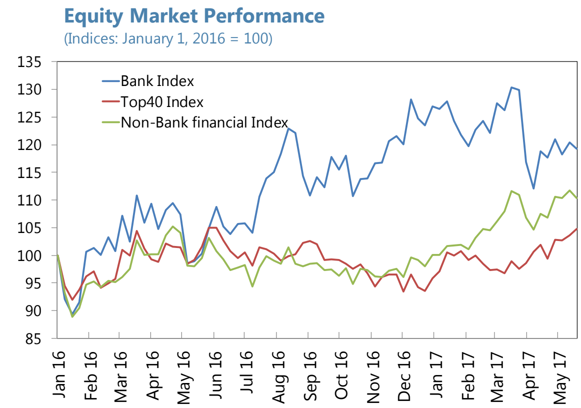
Sources: Bloomberg, L.P., Corporate Vulnerability Utility, Haver Analytics, Institute of International Finance, Orbis, SARB, World Economic Outlook, and IMF staff calculations.

Figure 8. South Africa: The Financial Sector Remains Resilient

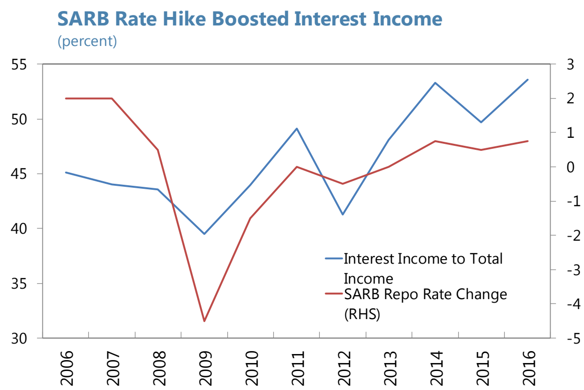
Banking sector fundamentals improved.



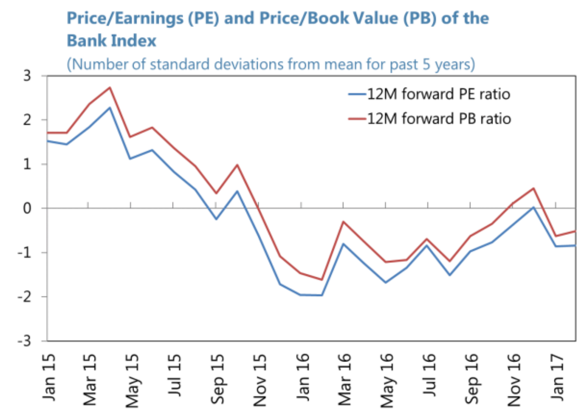
Bank stocks outperformed the JSE index.



SARB rate hike boosted interest rate margin.



Bank stocks are still reasonably valued.

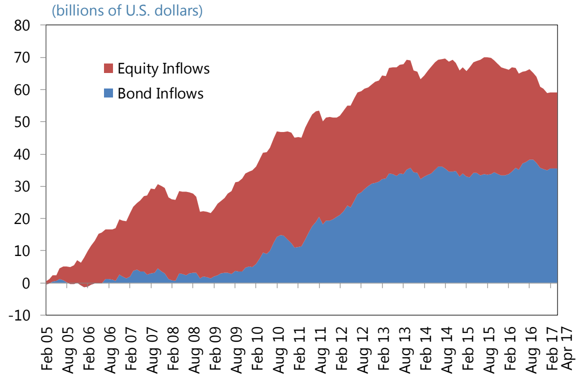


Sources: Bloomberg, L.P., S&P, EPFR, Haver Analytics, and IMF staff calculations.

Figure 9. South Africa: Financial Markets Have Recovered but Market Uncertainty Remains High

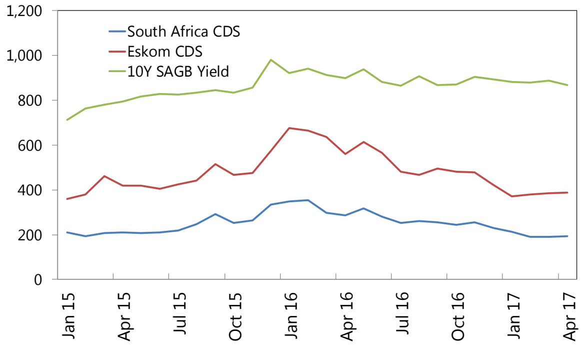
Large cumulative equity and bond inflows are starting to reverse, particularly for equities.

Cumulative Portfolio Flows
(billions of U.S. dollars)



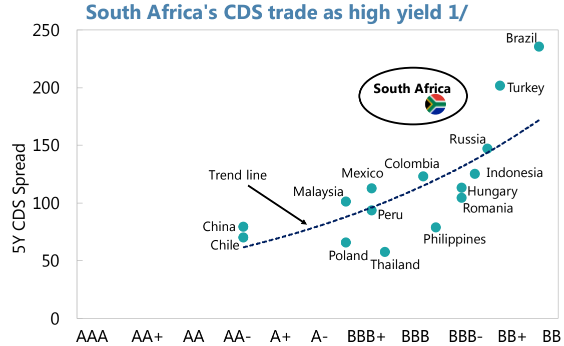
Bond yields are elevated, in part reflecting sizable credit spreads.

CDS Spread and Bond Yield
(bps)



CDS spreads have for some time been on the high side, even by sub-investment grade standards.

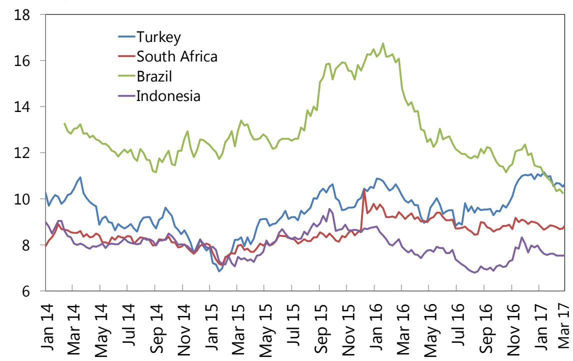
South Africa's CDS trade as high yield 1/



1/ Credit Rating represents average of ratings from S&P, Fitch and Moody's for each country. Data as on May 24, 2017.
Source: Bloomberg, L.P.

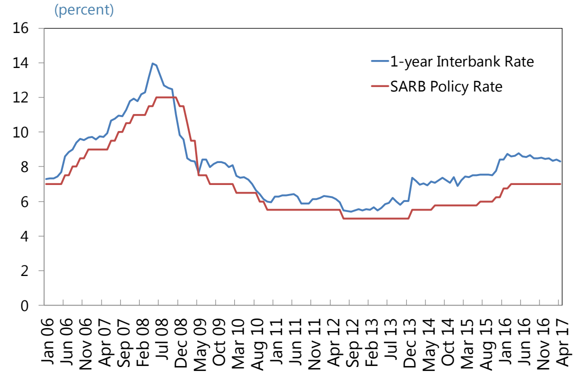
Government bond yields have been less volatile than in other key emerging markets.

10-Year Government Bond Yield
(percent)



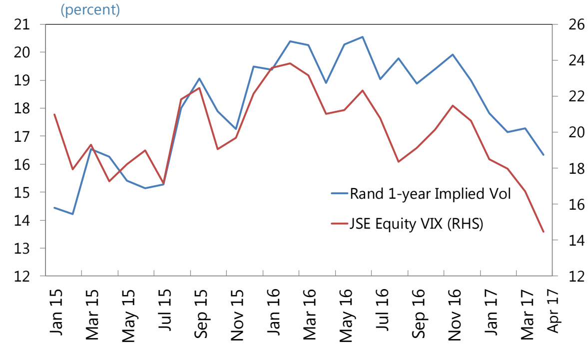
The 1-year JIBAR is well above the repo rate.

JIBAR and SARB Policy Rate
(percent)



Stock market uncertainty has declined from relatively high levels.

JSE Equity Index and Foreign Exchange Volatility
(percent)

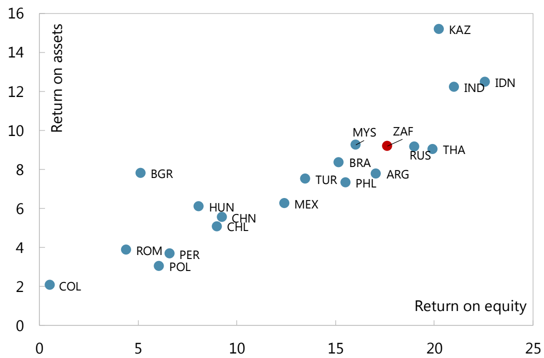


Sources: Bloomberg, L.P., S&P, IIF, and IMF staff calculations.

Figure 10. South Africa: Corporate Sector Balance Sheets are Sound with some Pockets of Vulnerability

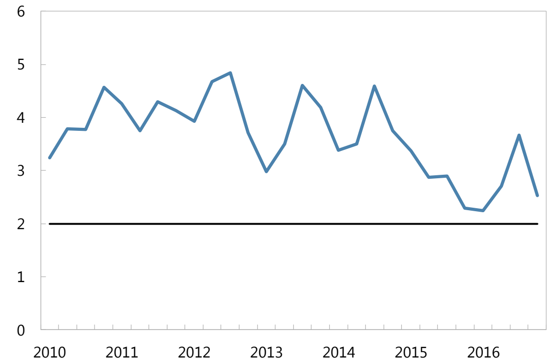
South African corporations are highly profitable…

Emerging Markets: Profitability, 2015
(Percent)



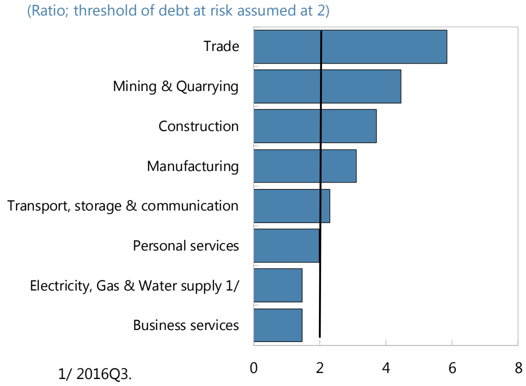
…though corporate financial health has weakened.

South Africa: Interest Coverage Ratio
(All industries; ratio; threshold assumed at 2)



Some sectors could face difficulties in meeting payments…

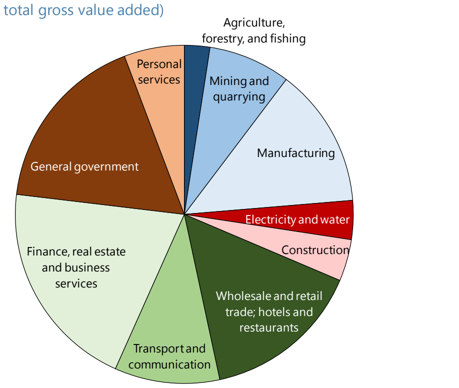
South Africa: Interest Coverage Ratio, 2016Q4
(Ratio; threshold of debt at risk assumed at 2)



1/ 2016Q3.

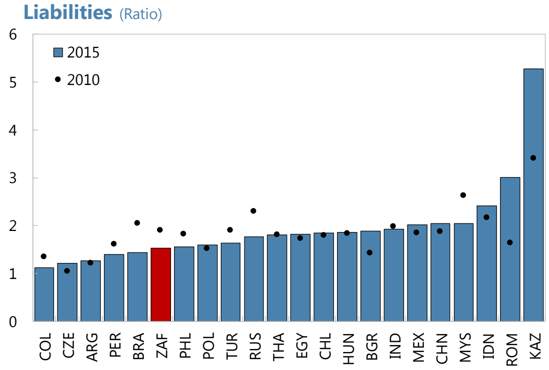
…which could hamper growth.

South Africa: Sectoral Shares in Gross Value Added, 2016
(Percent of total gross value added)



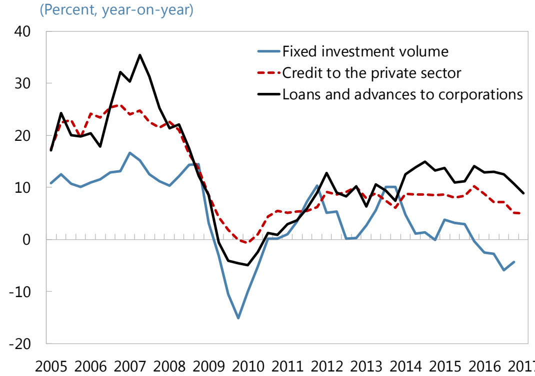
In addition, liquidity has worsened somewhat…

Non-Financial Sector: Current Assets Relative to Current Liabilities (Ratio)



…and weakening credit growth weighs on the outlook.

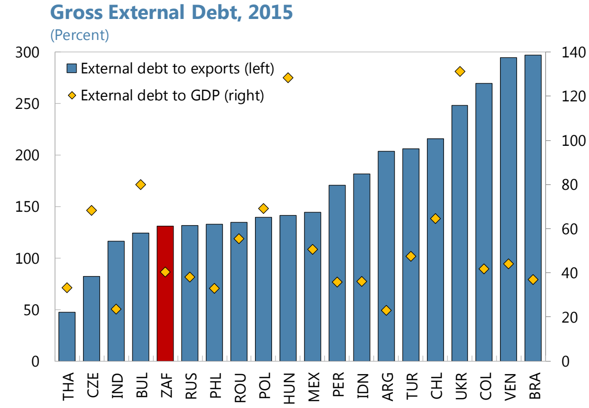
South Africa: Investment and Credit Growth
(Percent, year-on-year)



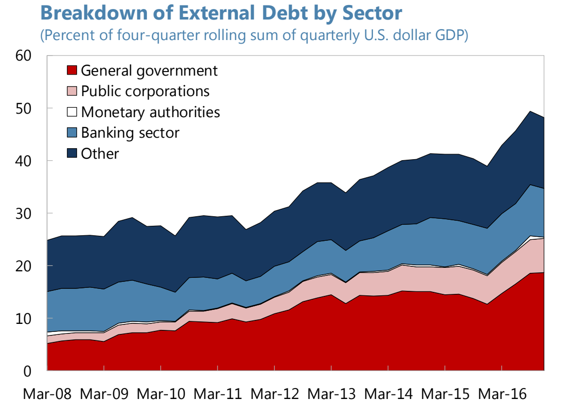
Sources: Corporate Vulnerability Utility, Haver Analytics, SARB, and IMF staff calculations.

Figure 11. South Africa: Gross External Debt Has Risen but Does Not Stand Out Relative to Peers

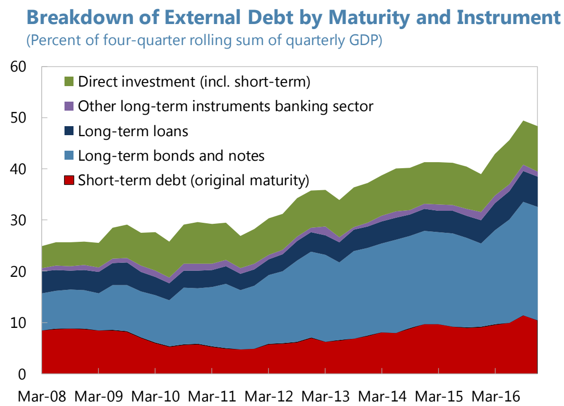
Gross external debt does not stand out relative to other EMs.



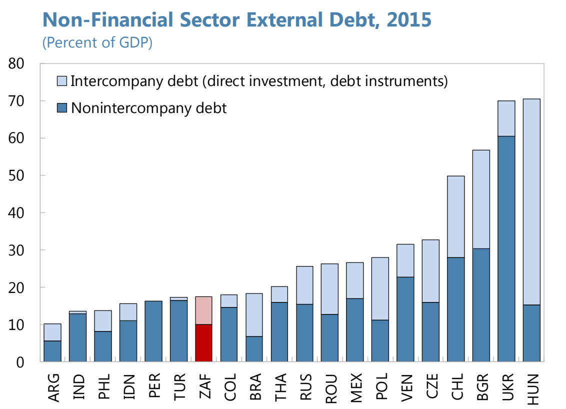
While public sector external debt has risen…



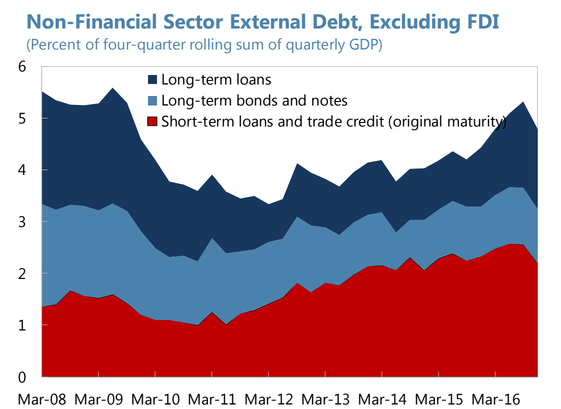
…the debt increase has largely been of long-term maturity.



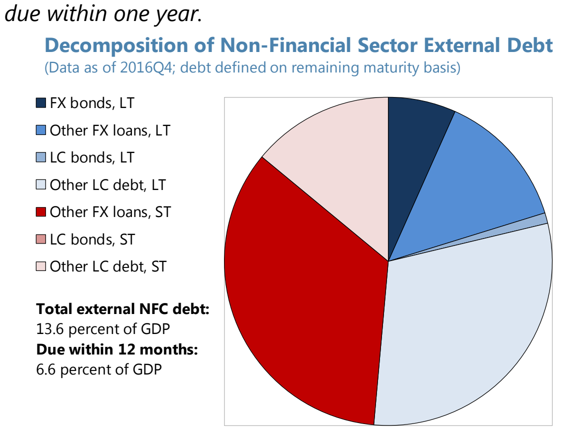
Non-financial sector external debt also compares well…



…but has increasingly been of short-term nature…



…and a large share of external non-financial sector debt is due within one year.

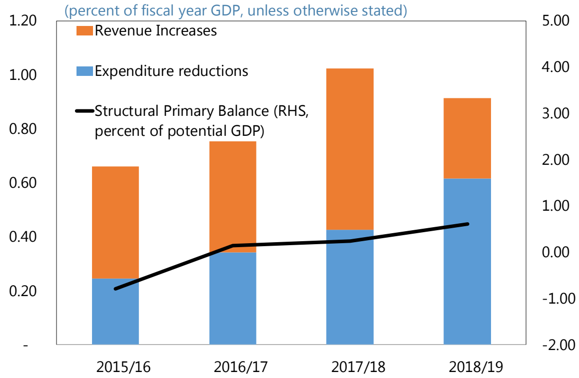


Sources: Haver Analytics, International Financial Statistics, SARB, World Economic Outlook database, and IMF staff calculations.

Figure 12. South Africa: Consolidation Against Low Growth Headwinds and Increasing Fiscal Risks

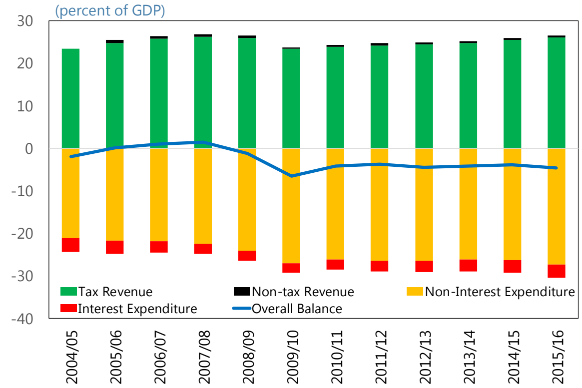
Stepped up consolidation efforts in recent years…

Planned Fiscal Consolidation
(percent of fiscal year GDP, unless otherwise stated)



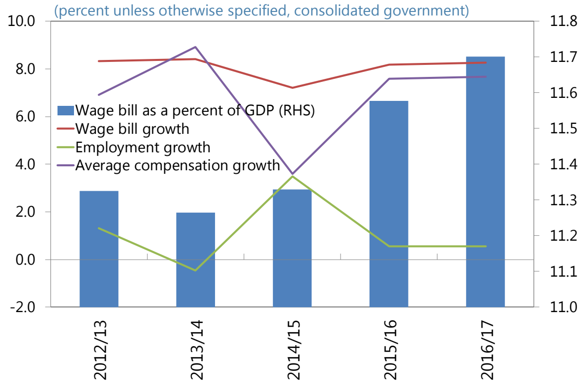
…kept the fiscal deficit broadly stable as revenue buoyancy largely offset the increasing expenditure ratio…

Fiscal Deficit
(percent of GDP)



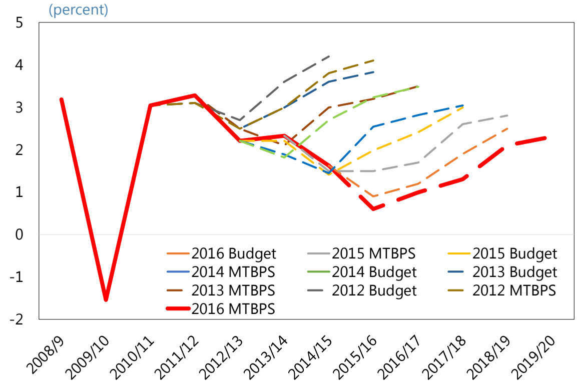
…driven in part by an increasing wage bill as public wage agreements have yet to adjust to weaker growth…

Wage Bill Growth
(percent unless otherwise specified, consolidated government)



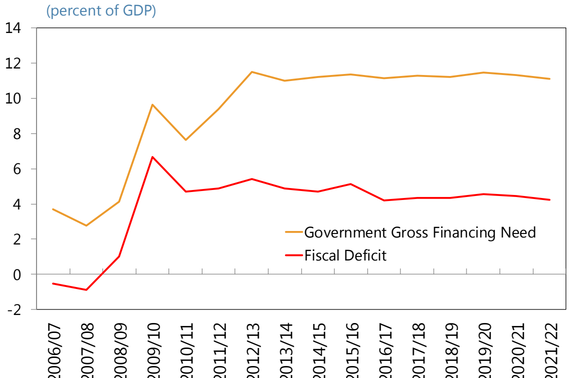
…which has been consistently been revised down….

GDP Growth Revisions in the Budget
(percent)



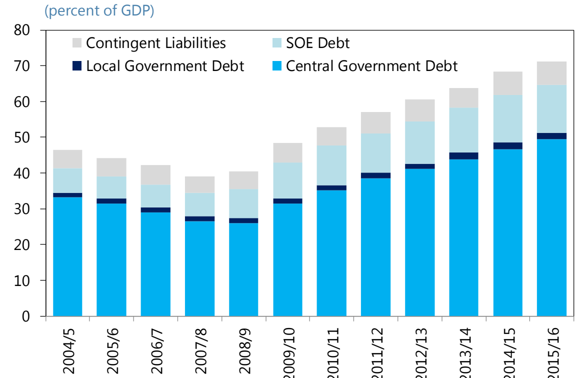
…making debt stabilization challenging…

Deficit and Gross Financing Need
(percent of GDP)



…especially in a context of sizable and growing fiscal risks.

Public Sector Debt
(percent of GDP)



Sources: National Treausury, and IMF staff calculations.

Table 1. South Africa: Selected Economic Indicators, 2013–18

Social Indicators

GDP		Poverty (percent of population)	
Nominal GDP (2016, billions of US dollars)	295	Headcount ratio at $1.90 a day (2011 PPP) (percent	16.6
GDP per capita (2016, in US dollars)	5272	Undernourishment (2015)	5.0
Population characteristics		**Inequality (income shares unless otherwise specified)**	
Total (2016, million)	55.9	Highest 10 percent of population	51.3
Urban population (percent of total), 2014	64	Lowest 20 percent of population	2.5
Life expectancy at birth (years), 2016	62	Gini coefficient (2010)	63.4

Economic Indicators

	2013	2014	2015	2016	2017	2018
				Est.	Proj.	Proj.
National income and prices (annual percentage change unless otherwise indicated)						
Real GDP	2.5	1.7	1.3	0.3	1.0	1.2
Real GDP per capita	0.9	0.1	-0.3	-1.3	-0.6	-0.5
Real domestic demand	3.2	0.4	1.7	-0.7	0.7	1.2
GDP deflator	6.1	5.8	5.0	6.8	5.8	5.7
CPI (annual average)	5.8	6.1	4.6	6.3	5.7	5.6
CPI (end of period)	5.4	5.3	5.3	6.7	5.6	5.5
Labor market (annual percentage change unless otherwise indicated)						
Unemployment rate (percent of labor force, annual average)	24.7	25.1	25.4	26.7	27.4	28.0
Average remuneration (formal nonagricultural, nominal)	7.2	6.5	7.0	8.1	7.5	7.4
Labor productivity (formal nonagricultural)	1.9	1.3	1.9	1.9	1.9	1.9
Unit labor costs (formal nonagricultural)	5.1	5.1	5.1	6.2	5.5	5.4
Savings and Investment (percent of GDP unless otherwise indicated)						
Gross national saving	15.4	15.5	16.3	16.2	16.1	15.7
Public (incl. public enterprises)	-0.9	1.1	1.1	1.0	0.9	1.0
Private	16.2	14.4	15.2	15.1	15.2	14.7
Investment (including inventories)	21.3	20.8	20.7	19.4	19.1	19.1
Public (incl. public enterprises)	7.1	7.3	7.6	7.6	7.6	7.6
Private	13.3	13.3	12.8	12.0	11.7	11.7
Fiscal position (percent of GDP unless otherwise indicated) 1/						
Revenue, including grants 2/	27.3	27.6	28.3	28.9	29.1	29.4
Expenditure and net lending	31.6	31.8	32.9	32.9	33.2	33.4
Overall balance	-4.3	-4.2	-4.6	-4.0	-4.1	-4.0
Primary balance	-1.3	-1.1	-1.3	-0.5	-0.4	-0.2
Structural balance (percent of potential GDP)	-4.2	-4.0	-3.9	-3.5	-3.5	-3.3
Gross government debt 3/	44.1	47.0	49.3	51.7	52.6	54.7
Government bond yield (10-year, percent) 4/	8.2	8.0	9.7	8.9	8.7	...
Money and credit (annual percentage change unless otherwise indicated)						
Broad money	5.9	7.3	10.3	6.1	6.8	6.9
Credit to the private sector	6.6	7.2	8.3	5.6	4.8	5.1
Repo rate (percent, end-period) 4/	5.0	5.8	6.3	7.0	7.0	...
3-month Treasury bill interest rate (percent) 4/	5.1	5.8	6.1	7.2	7.4	...
Balance of payments (percent of GDP unless otherwise indicated)						
Current account balance (billions of U.S. dollars)	-21.6	-18.7	-14.0	-9.6	-9.6	-11.1
percent of GDP	-5.9	-5.3	-4.4	-3.3	-3.0	-3.4
Exports growth (volume)	3.6	3.2	3.9	-0.1	1.9	2.4
Imports growth (volume)	5.0	-0.5	5.4	-3.7	0.9	2.5
Terms of trade (percentage change)	-1.4	-1.6	3.4	0.3	0.3	-1.4
Overall balance	0.1	0.4	-0.2	0.9	0.0	0.0
Gross reserves (billions of U.S. dollars)	49.6	49.1	45.8	47.4	47.4	47.4
Total external debt	37.2	41.3	39.1	48.5	45.2	46.2
Nominal effective exchange rate (percentage change, period average) 5/	-14.4	-10.3	-5.6	-11.0	12.7	...
Real effective exchange rate (percentage change, period average) 6/	-10.1	-3.3	1.1	-3.7	12.9	...
Exchange rate (Rand/U.S. dollar, end-period) 7/	10.5	11.6	15.6	13.7	13.1	...

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

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

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

3/ Central government.

4/ Average of January-May 2017 data

5/ Percentage change January-May 2017 average with respect to 2016 average.

6/ Percentage change January-March 2017 average with respect to 2016 average.

7/ End May 2017

Table 2. South Africa: Consolidated Government Operations, 2012/13–2019/20 1/

	2012/13	2013/14	2014/15	2015/16	2016/17		2017/18		2018/19		2019/20	
					Auth.	Staff	Auth.	Staff	Auth.	Staff	Auth.	Staff
	(in billions of Rand)											
Total revenue and grants	893.6	992.1	1,083.5	1,178.6	1,280.5	1,274.5	1,396.8	1,376.1	1,522.0	1,486.2	1,651.2	1,610.7
Tax revenue 2/	771.7	856.6	934.6	1,019.0	1,104.9	1,104.6	1,209.5	1,193.9	1,322.0	1,292.1	1,443.0	1,402.7
Non-tax revenue 3/	14.5	14.8	15.6	13.9	15.2	13.9	15.6	15.6	15.8	15.8	11.2	11.2
Provinces, social security, and other entities	107.4	120.7	133.4	145.7	160.4	156.0	171.7	166.6	184.2	178.3	197.0	196.8
Total expenditure	1,043.4	1,143.4	1,233.5	1,364.2	1,445.2	1,447.2	1,563.1	1,567.1	1,677.1	1,681.1	1,814.3	1,822.7
Current expenditure	919.6	1,005.4	1,082.5	1,175.7	1,276.5	1,278.5	1,378.1	1,382.1	1,480.9	1,484.9	1,599.4	1,607.8
Wages and salaries	376.3	408.0	437.4	473.1	512.2	512.2	550.4	550.4	588.7	588.7	631.1	631.1
Other goods and services	162.9	174.2	185.5	195.6	208.3	208.3	221.7	221.7	237.5	237.5	253.6	253.6
Interest	93.3	109.6	121.4	136.3	153.4	155.4	169.3	173.3	187.6	191.6	206.4	214.8
Transfers	287.1	313.7	338.3	370.6	402.7	402.7	436.7	436.7	467.1	467.1	508.4	508.4
Capital expenditure	118.7	133.8	145.3	158.3	162.3	162.3	173.5	173.5	181.2	181.2	189.7	189.7
Payment for financial assets	5.1	4.2	5.6	30.3	6.4	6.4	5.6	5.6	5.0	5.0	5.2	5.2
Contingency	0.0	0.0	0.0	0.0	0.0	0.0	6.0	6.0	10.0	10.0	20.0	20.0
Primary balance	-56.6	-41.8	-28.6	-49.3	-11.4	-17.4	3.0	-17.7	32.5	-3.3	43.3	2.8
Overall balance	-149.8	-151.3	-149.9	-185.6	-164.7	-172.7	-166.3	-191.0	-155.1	-194.9	-163.1	-212.0
Structural primary balance	-48.6	-39.6	-24.5	-32.7	n.a.	6.4	n.a.	11.2	n.a.	30.9	n.a.	33.0
Gross government debt	1,366	1,585	1,799	2,019	2,238	2,238	2,478	2,502	2,713	2,778	2,905	3,038
	(in percent of GDP)											
Total revenue and grants	26.9	27.5	28.0	28.6	29.0	28.9	29.5	29.2	29.7	29.5	29.8	29.7
Tax revenue	23.2	23.7	24.2	24.7	25.1	25.1	25.5	25.3	25.8	25.6	26.0	25.9
Non-tax revenue	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Provinces, social security, and other entities	3.2	3.3	3.5	3.5	3.6	3.5	3.6	3.5	3.6	3.5	3.6	3.6
Total expenditure	31.4	31.7	31.9	33.1	32.8	32.8	33.0	33.3	32.7	33.4	32.7	33.6
Current expenditure	27.7	27.8	28.0	28.5	28.9	29.0	29.1	29.3	28.9	29.5	28.8	29.7
Wages and salaries	11.3	11.3	11.3	11.5	11.6	11.6	11.6	11.7	11.5	11.7	11.4	11.6
Other goods and services	4.9	4.8	4.8	4.7	4.7	4.7	4.7	4.7	4.6	4.7	4.6	4.7
Interest	2.8	3.0	3.1	3.3	3.5	3.5	3.6	3.7	3.7	3.8	3.7	4.0
Transfers	8.6	8.7	8.8	9.0	9.1	9.1	9.2	9.3	9.1	9.3	9.2	9.4
Capital expenditure	3.6	3.7	3.8	3.8	3.7	3.7	3.7	3.7	3.5	3.6	3.4	3.5
Payment for financial assets	0.2	0.1	0.1	0.7	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Contingency	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.2	0.4	0.4
Primary balance	-1.7	-1.2	-0.7	-1.2	-0.3	-0.4	0.1	-0.4	0.6	-0.1	0.8	0.1
Overall balance	-4.5	-4.2	-3.9	-4.5	-3.7	-3.9	-3.5	-4.1	-3.0	-3.9	-2.9	-3.9
Structural primary balance (percent of potential GDP)	-1.5	-1.1	-0.6	-0.8	n.a.	0.1	n.a.	0.2	n.a.	0.6	n.a.	0.6
Gross government debt 4/	41.1	43.9	46.5	49.0	50.7	50.8	52.3	53.1	52.9	55.1	52.4	56.0
Memorandum items:												
National budget primary balance (percent of GDP)	-2.7	-2.1	-1.7	-2.0	-0.9	-0.9	-0.5	-0.8	-0.1	-0.7	0.0	-0.8
National budget overall balance (percent of GDP)	-5.4	-4.9	-4.7	-5.1	-4.2	-4.2	-3.9	-4.3	-3.6	-4.3	-3.6	-4.6
Fiscal year GDP (billions of rand) 5/	3,320	3,612	3,865	4,119	4,410	4,409	4,741	4,710	5,129	5,041	5,546	5,420
Fiscal year real GDP growth (percent)	2.2	2.6	1.7	0.6	1.0	0.7	1.3	1.0	2.1	1.2	2.3	1.9

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

1/ Data is on a fiscal year basis (April 1-March 31). Consolidated government corresponds to the national government, social security funds, provincial governments, and some public entities. Local governments are only partially captured through the transfers sent to them by the national government. The authorities projections are based on the 2017 Budget.

2/ Tax revenue net of SACU payments.

3/ Non- tax revenue excludes transactions in financial assets and liabilities. These transactions are classified as a domestic financing item given that they involve primarily revenues associated with realized exchange rate valuation gains from the holding of foreign currency deposits, sale of assets, and other conceptually similar smaller items. This adjustment was done historically and in both the authorities and IMF staff columns for comparability purposes.

4/ Covers only national government debt.

5/ Historical nominal fiscal year GDP is computed using the average from Q2 in a given calendar year to Q1 in the following calendar year of annualized seasonally adjusted quarterly nominal GDP figures from the national accounts.

Table 3. South Africa: Balance of Payments, 2013–22

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Proj.					
	In billions of U.S. dollars									
Balance on current account	-21.6	-18.7	-14.0	-9.6	-9.6	-11.1	-12.5	-13.1	-13.7	-14.2
Balance on goods and services	-8.8	-6.1	-3.5	0.4	1.7	0.2	-0.9	-1.0	-1.1	-1.1
Exports of goods and services	113.3	109.6	96.4	89.4	95.0	96.4	99.2	103.0	107.3	112.1
Imports of goods and services	-122.0	-115.7	-99.9	-89.0	-93.3	-96.2	-100.0	-104.0	-108.4	-113.2
Balance on income	-9.6	-9.4	-7.9	-8.2	-8.8	-8.4	-8.7	-9.1	-9.5	-9.9
Income receipts	6.7	7.6	7.7	6.0	7.3	9.6	11.0	11.0	10.7	10.5
Income payments	-16.3	-16.9	-15.6	-14.2	-16.1	-18.0	-19.7	-20.0	-20.2	-20.4
Balance on transfers	-3.2	-3.2	-2.6	-1.9	-2.5	-2.9	-2.9	-3.0	-3.1	-3.2
Capital flows (including errors and omissions)	22.0	20.2	13.2	12.4	9.6	11.1	12.5	13.1	13.7	14.2
Balance on capital and financial account	19.1	24.3	15.3	13.9	9.6	11.1	12.5	13.1	13.7	14.2
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	19.1	24.3	15.3	13.8	9.6	11.1	12.5	13.0	13.7	14.2
Direct investment	1.7	-1.9	-4.0	-1.1	-1.3	-0.7	0.0	0.4	0.4	0.4
Liabilities	8.3	5.8	1.7	2.3	2.2	2.9	3.4	3.9	4.0	4.1
Assets	-6.7	-7.7	-5.7	-3.4	-3.5	-3.6	-3.4	-3.5	-3.6	-3.8
Portfolio investment	11.1	13.4	9.6	17.3	9.5	9.1	9.4	9.8	10.2	10.6
Liabilities	13.5	13.6	9.5	10.5	9.5	9.1	9.4	9.8	10.2	10.6
Assets	-2.4	-0.1	0.1	6.8	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.8	1.5	0.4	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	-19.5	-18.0	-25.2	-33.9	-35.9	-36.2	-36.6	-37.0	-37.4	-37.7
Assets	20.3	19.5	25.5	33.0	35.9	36.2	36.6	37.0	37.4	37.7
Other investment	5.6	11.2	9.3	-1.4	1.3	2.6	3.1	2.9	3.1	3.3
Liabilities	5.2	13.7	5.7	0.1	2.9	4.1	4.6	4.4	4.6	4.8
Assets	0.3	-2.4	3.7	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
Errors and omissions	2.9	-4.1	-2.1	-1.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	0.5	1.5	-0.7	2.8	0.0	0.0	0.0	0.0	0.0	0.0
Gross reserves (end of period)	49.6	49.1	45.8	47.4	47.4	47.4	47.4	47.4	47.4	47.4
	In percent of GDP									
Balance on current account	-5.9	-5.3	-4.4	-3.3	-3.0	-3.4	-3.7	-3.7	-3.8	-3.8
Balance on goods and services	-2.4	-1.7	-1.1	0.1	0.5	0.1	-0.3	-0.3	-0.3	-0.3
Balance on goods	-2.1	-1.7	-0.9	0.3	0.8	0.4	0.1	0.0	0.0	0.0
Balance on services	-0.3	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3
Exports of goods and services	30.9	31.2	30.4	30.3	29.9	29.6	29.5	29.4	29.5	29.7
Imports of goods and services	-33.3	-32.9	-31.5	-30.2	-29.4	-29.6	-29.7	-29.7	-29.8	-30.0
Balance on income	-2.6	-2.7	-2.5	-2.8	-2.8	-2.6	-2.6	-2.6	-2.6	-2.6
Balance on transfers	-0.9	-0.9	-0.8	-0.6	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9
Capital flows (including errors and omissions)	6.0	5.7	4.2	4.2	3.0	3.4	3.7	3.7	3.8	3.8
Balance on capital and financial account	5.2	6.9	4.8	4.7	3.0	3.4	3.7	3.7	3.8	3.8
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	5.2	6.9	4.8	4.7	3.0	3.4	3.7	3.7	3.8	3.8
Direct investment	0.5	-0.5	-1.3	-0.4	-0.4	-0.2	0.0	0.1	0.1	0.1
Portfolio investment	3.0	3.8	3.0	5.9	3.0	2.8	2.8	2.8	2.8	2.8
Financial derivatives	0.2	0.4	0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	1.5	3.2	2.9	-0.5	0.4	0.8	0.9	0.8	0.9	0.9
Errors and omissions	0.8	-1.2	-0.7	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	0.1	0.4	-0.2	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Gross reserves (end of period)	13.5	14.0	14.4	16.1	14.9	14.5	14.1	13.5	13.0	12.6
Memorandum items:										
Total external debt	37.2	41.3	39.1	48.5	45.2	46.2	47.0	47.6	48.1	49.0
International investment position (net)	-4.4	-7.9	15.7	3.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
GDP at current prices (US$ billion)	366.8	351.1	317.6	294.8	317.3	325.6	336.7	350.2	363.5	376.9

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

Table 4. South Africa: Monetary Survey, 2012–17

	2012	2013	2014	2015	2016 Est.	2017 Proj.
			billions of rand			
Monetary Survey						
Net Foreign Assets	504	641	600	785	742	697
Net Domestic Assets	1,869	1,872	2,097	2,190	2,415	2,675
General government	-4	-94	-87	-180	-91	-42
Public Nonfinancial Corporations	34	30	46	49	61	61
Nonfinancial Private Sector	2,233	2,381	2,552	2,764	2,918	3,059
Other items net	-394	-445	-415	-443	-474	-403
Broad Money	2,373	2,514	2,697	2,975	3,157	3,372
Central bank						
Net Foreign Assets	402	486	528	668	606	608
Net Domestic Assets	-228	-295	-323	-444	-366	-351
General government	-246	-318	-352	-484	-411	-395
Public Nonfinancial Corporations	1	1	1	1	1	1
Nonfinancial Private Sector	0	0	0	0	0	0
Depository institutions (banks)	26	30	37	49	56	56
Other items net	-9	-8	-9	-11	-13	-14
Monetary base	174	191	205	224	240	257
Currency in circulation	112	119	131	138	143	153
Reserves and others	62	72	74	86	97	104
			annual percentage change			
Memorandum items:						
Broad money growth	5.2	5.9	7.3	10.3	6.1	6.8
Monetary base growth	11.2	9.8	7.3	9.0	7.4	6.9
Credit to private sector	9.3	6.6	7.2	8.3	5.6	4.8
Broad money multiplier	13.6	13.2	13.1	13.3	13.1	13.1

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

Table 5. South Africa: Financial Soundness Indicators, 2012–17[1]

	2012	2013	2014	2015	2016	2017
Capital adequacy						
Risk-weighted capital adequacy ratio	15.9	15.6	14.8	14.2	15.9	16.1
of which Tier 1 capital	14.0	14.1	13.6	13.8	14.5	14.6
Capital to asset ratio	7.8	7.9	7.6	7.0	8.2	8.3
Asset quality						
Nonperforming loans (percent of outstanding loans)	4.0	3.6	3.2	3.1	2.9	2.4
Nonperforming loans net of provisions (percent of regulatory capital)	21.5	18.1	16.3	16.5	14.8	12.3
Earnings, profitability, and efficiency						
Return on assets	1.5	1.4	1.4	1.5	1.7	1.7
Return on equity	20.5	18.6	18.8	20.7	22.2	21.5
Interest income (percent of gross income)	41.3	48.1	53.3	49.7	51.7	56.2
Trading income (percent of gross income)	8.9	7.8	2.8	2.0	6.4	8.7
Non-interest expenses (percent of gross income)	55.0	56.3	53.5	47.8	53.3	61.0
Personnel expenses (percent of non-interest expenditure)	38.7	47.3	50.7	41.4	46.0	51.2
Liquidity						
Liquid assets (percent of total assets)	16.2	16.6	17.6	17.7	16.0	13.9
Liquid assets (percent of short-term liabilties)	33.0	33.0	33.5	35.0	30.9	33.8
Customer deposits (percent of total non-interbank loans)	52.2	53.1	53.5	54.3	54.5	48.5
Exposure to FX risk						
Effective net open FX position (percent of regulatory capital)	0.5	0.3	0.3	-0.3	1.0	1.2
Foreign-currency-denominated loans (percent of outstanding loans)	8.3	8.7	10.1	11.3	10.0	9.2
Foreign-currency-denominated liabilities (percent of total liabilities)	5.7	6.3	8.1	9.4	8.5	7.8
Sectoral distribution of loans and advances						
Residents	90.5	89.2	88.2	87.4	88.5	89.3
Central Bank and other financial corporations 2/	12.7	12.3	12.2	13.8	13.7	13.0
General government	0.8	0.7	0.7	0.6	0.5	0.5
Nonfinancial corporations	31.0	31.1	32.2	32.4	34.7	34.9
Households	46.0	45.1	43.1	40.6	39.6	39.6
Nonresidents	9.5	10.8	11.9	12.6	11.5	10.7
Derivatives (percent of regulatory capital)						
Gross asset position in financial derivatives	88.6	70.4	64.5	113.7	51.6	49.7
Gross liability position in financial derivatives	87.6	75.4	69.5	129.2	54.2	52.3
Real Estate Market						
Residential real estate prices (annual percentage change)	7.4	8.6	9.1	5.4	7.3	…
Residential real estate loans (percent of total loans)	30.3	28.5	26.6	24.8	24.8	24.8
Commercial real estate loans (percent of total loans)	9.1	8.8	9.1	9.2	7.4	4.3
Household debt						
Household debt (percent of GDP)	47.7	46.3	45.8	46.2	43.5	…
Household debt (percent of disposable income)	76.3	78.8	77.8	77.8	73.4	73.4
Household debt service (percent of disposable income)	7.7	8.6	9.3	9.7	9.5	…

Source: South African Reserve Bank.

1/ 2016 data are for December except for residential real estate prices (November). 2017 data are for April.
2/ Including interbank loans.

Table 6. South Africa: Medium-Term Macroeconomic Framework, 2013–22

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
National income and prices (annual percentage change)										
Real GDP	2.5	1.7	1.3	0.3	1.0	1.2	1.7	2.2	2.2	2.2
CPI (annual average)	5.8	6.1	4.6	6.3	5.7	5.6	5.5	5.5	5.5	5.5
Output gap (percent of potential real GDP)	0.0	-0.1	-0.3	-1.2	-1.5	-1.7	-1.5	-0.9	-0.5	-0.1
Labor market (annual percentage change)										
Unemployment rate (percent of labor force, annual average)	24.7	25.1	25.4	26.7	27.4	28.0	28.1	28.2	28.2	28.2
Savings and Investment (percent of GDP)										
Gross national saving	15.4	15.5	16.3	16.2	16.1	15.7	15.4	15.6	15.7	15.8
Public (incl. public enterprises)	-0.9	1.1	1.1	1.0	0.9	1.0	1.0	1.0	1.1	1.2
Private	16.2	14.4	15.2	15.1	15.2	14.7	14.4	14.5	14.6	14.6
Investment (including inventories)	21.3	20.8	20.7	19.4	19.1	19.1	19.1	19.3	19.4	19.6
Public (incl. public enterprises)	7.1	7.3	7.6	7.6	7.6	7.6	7.5	7.4	7.3	7.2
Private	13.3	13.3	12.8	12.0	11.7	11.7	11.8	12.1	12.3	12.5
Fiscal position (percent of GDP) 1/										
Revenue, including grants	27.3	27.6	28.3	28.9	29.1	29.4	29.6	29.7	29.7	29.7
Expenditure and net lending	31.6	31.8	32.9	32.9	33.2	33.4	33.6	33.6	33.4	33.2
Overall balance	-4.3	-4.2	-4.6	-4.0	-4.1	-4.0	-4.0	-3.9	-3.7	-3.4
Primary balance	-1.3	-1.1	-1.3	-0.5	-0.4	-0.2	0.0	0.1	0.4	0.7
Gross government debt 2/	44.1	47.0	49.3	51.7	52.6	54.7	55.9	56.5	56.9	57.0
Balance of payments (percent of GDP unless otherwise indicated)										
Exports of Goods and Services (volume, annual percentage change)	3.6	3.2	3.9	-0.1	1.9	2.4	3.1	3.2	3.4	3.4
Imports of Goods and Services (volume, annual percentage change)	5.0	-0.5	5.4	-3.7	0.9	2.5	3.2	3.1	3.1	3.1
Current account balance (billions of U.S. dollars)	-21.6	-18.7	-14.0	-9.6	-9.6	-11.1	-12.5	-13.1	-13.7	-14.2
percent of GDP	-5.9	-5.3	-4.4	-3.3	-3.0	-3.4	-3.7	-3.7	-3.8	-3.8
Overall balance	0.1	0.4	-0.2	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Gross reserves (billions of U.S. dollars)	49.6	49.1	45.8	47.4	47.4	47.4	47.4	47.4	47.4	47.4
percent of short-term debt (residual maturity)	125.9	100.5	106.9	104.4	101.3	93.3	82.4	85.4	83.8	81.3
Total external debt	37.2	41.3	39.1	48.5	45.2	46.2	47.0	47.6	48.1	49.0

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

1/ Consolidated government unless otherwise indicated.

2/ National government.

Table 7. South Africa: Indicators of External Vulnerability, 2012–17

	2012	2013	2014	2015	2016	2017 Proj.
Financial indicators						
Gross government debt (percent of GDP)	41.0	44.1	47.0	49.3	51.7	52.6
Broad money (annual percentage change)	5.2	5.9	7.3	10.3	6.1	6.8
Private sector credit (annual percentage change)	9.3	6.6	7.2	8.3	5.6	5.0
91 day Treasury bill yield (percent, end-period) 1/	5.3	5.1	5.8	6.1	7.2	7.4
91 day Treasury bill yield (real, percent, end-period) 1/ 2/	-0.4	-0.7	-0.3	1.5	0.6	2.1
External indicators						
Exports (annual percentage change in U.S. dollars)	-8.4	-3.8	-3.9	-12.2	-7.8	6.3
Export volume (goods and services, annual percentage change)	0.8	3.6	3.2	3.9	-0.1	1.9
Imports (annual percentage change in U.S. dollars)	2.1	-0.6	-5.2	-14.4	-12.2	4.5
Import volume (goods and services, annual percentage change)	4.2	5.0	-0.5	5.4	-3.7	0.9
Terms of trade (annual percentage change) 3/	-4.0	-1.4	-1.6	3.4	0.3	0.3
Current account balance (percent of GDP)	-5.1	-5.9	-5.3	-4.4	-3.3	-3.0
Capital and financial account, excl. financial derivatives (percent of GDP)	6.0	5.0	6.5	4.7	5.0	3.0
of which: Net portfolio investment (debt and equity)	3.5	3.0	3.8	3.0	5.9	3.0
Other investment (loans, trade credits, etc.)	2.2	1.5	3.2	2.9	-0.5	0.4
Net foreign direct investment	0.4	0.5	-0.5	-1.3	-0.4	-0.4
Gross international reserves (billions of U.S. dollars) 1/	50.7	49.6	49.1	45.8	47.4	46.7
in months of prospective imports of goods and services	5.0	5.1	5.9	6.2	6.1	5.8
in percent of broad money	18.2	20.7	21.1	24.0	20.5	20.6
in percent of short-term debt, residual maturity	112.3	125.9	100.5	106.9	104.4	99.9
Net international reserves (billions of U.S. dollars) 1/	47.9	45.5	42.7	40.7	40.8	41.7
Foreign currency forward position (billions of U.S. dollars) 1/	5.2	3.6	2.0	1.4	1.8	2.9
Total external debt (percent of GDP)	35.8	37.2	41.3	39.1	48.5	45.2
percent of export earnings	114.6	113.8	132.4	128.7	159.8	151.2
External interest payments (percent of export earnings)	4.4	4.9	5.2	6.9	6.3	7.4
External amortization payments (percent of export earnings)	29.4	39.9	36.0	50.7	47.9	47.7
Exchange rate (Rand/U.S. dollar, period average) 4/	8.2	9.7	10.8	12.8	14.7	13.3
Real effective exchange rate (annual percentage change, period average)	-5.4	-10.5	-6.3	-0.6	-7.3	n.a.
Financial market indicators						
Stock market index (end-period) 1/	39,250	46,256	49,771	50,694	50,654	53,817
Net purchases of bonds by nonresidents (billions of U.S. dollars)	10.4	0.1	-5.1	-2.3	-2.4	n.a.
Net purchases of shares by nonresidents (billions of U.S. dollars)	-0.4	0.0	1.2	-0.3	-8.2	n.a.

Sources: Haver and IMF staff calculations.

1/ For 2017, April data.
2/ Nominal yield deflated by current CPI inflation.
3/ The terms of trade include gold.
4/ For 2017, average of January-April data.

Annex I. External Sector Assessment

<table>
<tr><th></th><th>South Africa</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. South Africa's economy is highly integrated in international financial markets, with large external assets and liabilities. Although valuation effects led to a marked improvement of the net international investment position (NIIP) in 2015 (from -8 percent of GDP at end-2014 to 16 percent of GDP one year later), this has since moderated, with the NIIP at 3.6 percent of GDP as of end-2016. The IIP is expected to weaken further over the medium term on account of current account deficits.[1/] External assets and liabilities were equivalent to 131 and 128 percent of GDP, respectively. For FDI (usually considered harder to liquidate), liabilities were lower than assets (43 and 55 percent of GDP, respectively), owing to valuation gains on FDI assets in China. Gross external debt rose to 48.5 percent of GDP at end-2016 from 26 percent of GDP at end-2008 on the back of an increase in long-term debt. Short-term external debt (residual maturity) amounted to 15½ percent of GDP.
Assessment. Large gross external liabilities pose risks. Mitigating factors include the large external asset position and the sizable rand-denominated share of external debt (about half of total external debt).</td><td rowspan="3">Overall Assessment:
The external position in 2016 was moderately weaker than implied by fundamentals and desirable policy settings.

In 2016, the current account gap remained broadly unchanged and South Africa remains highly reliant on non-FDI flows to finance its relatively high CA deficit. Despite the REER depreciation of recent years, structural rigidities result in a relatively slow pace of CA adjustment as well as a somewhat narrower estimated CA deficit norm than would be expected for an emerging economy.

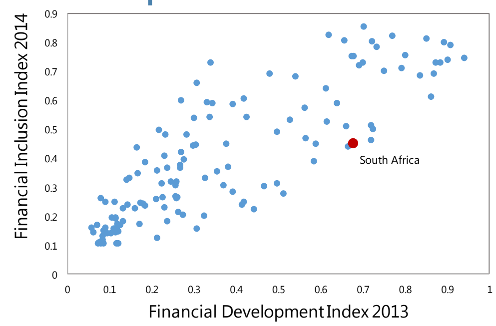
Potential policy responses:
Several measures would help to reduce the gap related to the external position by speeding up the pace of external adjustment, improving competitiveness, and increasing employment and savings. These measures include fostering entry into key product markets (such as power generation, transportation, and telecommunications); upgrades in infrastructure and education/skills; and greater financial inclusion. Reducing policy uncertainty, preserving government debt sustainability, and accelerating labor and product market reforms are also essential to continue to attract foreign inflows, especially durable inflows such as FDI. Seizing opportunities—such as large FDI inflow transactions—to build up reserves would strengthen the country's ability to deal with FX liquidity shocks.</td></tr>
<tr><td>Current account</td><td>Background. The current account (CA) deficit narrowed to 3.3 percent of GDP in 2016 from 4.4 percent in 2015, owing to an improvement in the trade balance as domestic demand growth weakened. The CA deficit is projected to further narrow to 3 percent of GDP in 2017 as the trade balance strengthens.
Assessment. The CA regression model estimates a CA norm of -0.8 percent of GDP, implying a CA gap of -2.4 percent of GDP for 2016. The CA gap is largely explained by structural factors not captured by the model. The ES approach estimates an NFA-stabilizing CA of -1.4 percent of GDP and a CA gap of -2.2 percent of GDP. Staff assesses the overall CA gap to be somewhat narrower, because (i) policy uncertainty is expected to unwind after key elections and (ii) net transfers to other members of the Southern African Customs Union (SACU) (not accounted for in the regression analysis) reduce the CA balance. Combined with estimation uncertainty, staff assesses the cyclically adjusted CA to be ½–2½ percentage points of GDP weaker than implied by fundamentals and medium-term desirable policy settings—broadly as assessed in 2015.[2/]</td></tr>
<tr><td>Real exchange rate</td><td>Background. The CPI-REER depreciated by 7 percent on average in 2016 relative to 2015. However, as of March 2017, the REER had appreciated 19 percent relative to the 2016 average.
Assessment. The REER is assessed through two REER-based regressions and by computing the implied REER gap from the CA gaps. Based on the 2016 REER-average, the REER approaches point to undervaluation of between 13 percent (level approach) and 29 percent (index approach). However, as gauging the appropriate REER for South Africa is challenging, owing to its structural changes since 1994, staff's assessment puts much greater weight on the CA approaches, while acknowledging the results of the REER approaches. For the CA approaches, the estimated CA/REER elasticity applied to the CA gap range above points to overvaluation of between 2 and 9 percent.[3/] Combining all these methods, staff assesses a REER overvaluation of 0–10 percent for 2016, broadly consistent with the CA gap.[4/]</td></tr>
</table>

Capital and financial accounts: flows and policy measures	**Background.** Net FDI flows were less negative at -0.4 percent of GDP in 2016, down from -1.3 percent of GDP in 2015. Portfolio investment picked up markedly to 5.9 percent of GDP, financing the CA deficit. Gross external financing needs stood at 18 percent of GDP in 2016. **Assessment.** High reliance on non-FDI flows and high nonresident holdings of local financial assets pose risks. These are mitigated by a floating exchange rate, the fact that nonresident portfolio holdings are mainly denominated in local currency, and a large domestic institutional investor base.	
FX intervention and reserves level	**Background**. South Africa has a floating exchange rate regime. Foreign exchange intervention is rare. Reserves cover six months of imports but are below the IMF's composite adequacy metric (77 percent of the metric without considering capital flow management measures and 84 percent of the metric after considering them). **Assessment**. As conditions allow, reserve accumulation is desirable to strengthen the external liquidity buffer, subject to maintaining the primacy of the inflation objective.	
Technical Background Notes	[1/] Of the 128 percent of GDP in total external liabilities as of end-2016, 51 percent were portfolio investment liabilities, 34 percent were direct investments, and the remaining 15 percent were financial derivatives and other investments. Total external assets amounted to 131 percent of GDP as of end-2016, of which 42 percent were direct investments, 36 percent were portfolio investment assets, 11 percent were reserve assets, and the remaining 11 percent were financial derivatives and other investment assets. [2/] The CA gap presented here results from the CA regression and External Sustainability (ES) approaches as well as staff's judgment. • Net current transfers related to the Southern African Customs Union (SACU), which are assessed to have a net negative impact on the CA, are not accounted for in the regression model and therefore warrant an adjustment of the estimated CA cap. In addition, 0.3 percentage points of GDP of the improvements in the CA norm since 2014 are attributable to a worsening of the indicator of perceived political uncertainty and institutional quality, which is assessed to be temporary, and is expected to unwind following the December 2017 elections. In sum, and considering also the uncertainty surrounding the estimated norm (standard deviation of 0.9 percent of GDP), staff believes the regression-based CA gap is smaller than what the model suggests. • The ES approach compares the CA balance expected to prevail in the medium term with the one that would stabilize South Africa's stock of net foreign assets at its EM peers' benchmark (-35 percent of GDP). According to this approach, to stabilize South Africa's net IIP at this level, South Africa's CA deficit would need to be -1.4 percent of GDP, compared to staff's medium-term projection of a CA deficit of below 4 percent of GDP, thus resulting in a CA gap of -2.2 percent of GDP. • Overall, while the model-based CA gaps for 2016 range from -2.2 to -2.4 percent of GDP, staff believes the CA gap is somewhat smaller at between ½ and 2½ percentage points of GDP. [3/] The EBA REER regressions (which use the CPI-based REER) point to undervaluation for 2016. However, gauging the appropriate REER for South Africa is challenging as the pre-2000 average REER was at a more appreciated level than the post-2000 average. In this context, REER regression-based models are likely to point to undervaluation, unless they can link the full downward trend of the REER to deteriorating fundamentals. In addition, it appears that the level of the REER that is consistent with a given level of the current account has declined over time but that empirical models are unable to fully explain this shift. Other indicators, including the EBA CA regression model and South Africa's declining share in world exports, suggest overvaluation. [4/] Using staff's assessment of the CA gap range and applying a long-run elasticity estimate of 0.27 would suggest a REER overvaluation of 2–9 percent. However, considering the uncertainty regarding the estimates as well as the REER-regression results, staff assesses REER overvaluation in the order of 0–10 percent.	

Annex II. Financial Inclusion—Falling Short Despite Deep Financial Markets

1. **South Africa has deep and sophisticated financial markets**. The nation performs well on financial development among emerging markets (EMs). For instance, South Africa compares well to BRICs and other selected EMs in terms of bank account ownership and mobile payment.

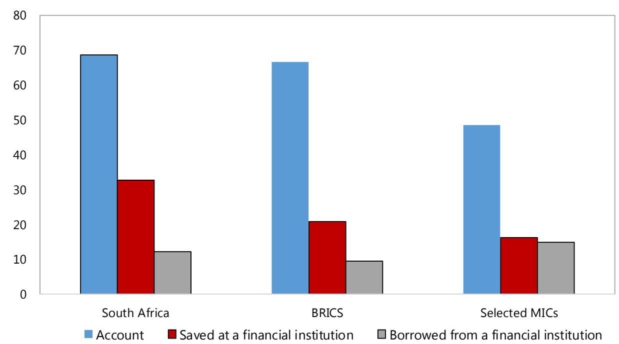
Financial Inclusion vs. Financial Development



Source: World Bank FINDEX, IMF Staff Estimates

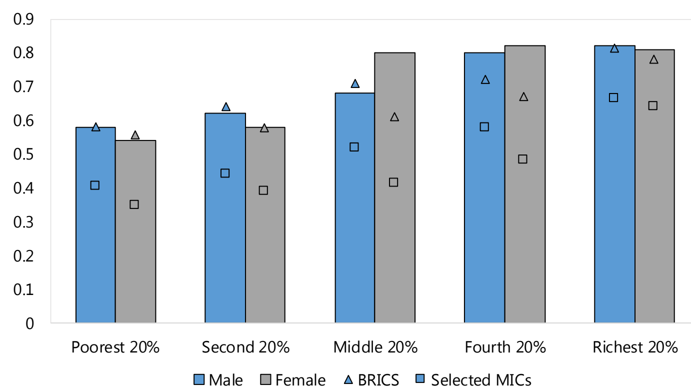
2. **However, inequalities in financial access are significant**. EMs with lower levels of financial development attain better outcomes in financial inclusion. In South Africa, only about 60 percent of the lowest quintile have bank accounts compared to over 80 percent among the top quintile. Moreover, most of the poor households' access is limited to withdrawing cash from social grants accounts, which cover 17 million recipients (1/3 of total population), with little usage of other banking services such as savings or loans. This somewhat reflects the "dual" nature of the economy, where the richest have incomes close to OECD levels, while the poorest are closer to other sub-Saharan African countries.

Percentage of Population (age 15 & above): With an Account at a financial institution



3. **Other indicators of financial inclusion on access to credit confirm that South Africa lags behind many EM peers**. South Africa generally ranked low on access to credit by households and SMEs relative to 25 EM peers.[1] Last year, only 4 percent of households in the poorest 40 percent bracket borrowed from financial institutions in South Africa, less than one half of the average for 25 EM peers of 11 percent. However, the share is significantly higher when lending by small credit providers under light supervision[2] is included. Moreover, some of the development finance institutions lend to the poor. Only 9 percent of SMEs had outstanding credit, significantly below the average for the EM peers of 30 percent. Most traditional lenders typically cite high costs of administration, perceptions of higher risks, and lack of collateral as major impediments to providing

Account Ownership: By Income Quintile and Gender



[1] http://databank.worldbank.org/data/reports.aspx?source=g20-basic-set-of-financial-inclusion-indicators#

[2] These credit providers are regulated for market conduct only by the National Credit Regulator.

small-scale lending. It appears that the relatively sophisticated financial infrastructure in terms of bank account ownership and mobile payments was not fully utilized to improve financial inclusion.

4. **Greater financial inclusion has the potential to boost growth, support job creation, and reduce income inequality.** In OECD economies, SMEs and micro enterprises account for 55 percent of GDP, 60–70 percent of employment, and a sizable share of new jobs.[3] In EMs, SMEs account for most of formal jobs and the creation of 4 out of 5 new formal positions. However, approximately 70 percent of all SMEs in EMs lack access to credit.[4] Several studies have found that greater access of firms and households to various banking services or the lifting of their financial constraints lead to higher economic growth.[5] They also caution that access to credit should be expanded with proper supervision to safeguard financial stability.

5. **Limited financial inclusion in South Africa reflects both demand-side and supply-side constraints**.[6] On the demand side, low households' access to credit stems in part from high unemployment, at 27.7 percent in the first quarter of 2017. On the supply side, high costs of opening and maintaining bank accounts are key impediments compared to other BRICS. The four largest banks control four-fifths of the market and are highly profitable. Incentives for them to service low-margin, high-risk customers, such as low-income households and SMEs, are limited. The sophisticated nature of banking operations in South Africa involves costly structures for compliance and decision-making, typically geared to more affluent segments of the population. Banks adapting best to the tighter compliance regulations, through targeted changes to the operating models and processes, would benefit from higher quality of oversight and efficiency. However, rules based customer due diligence requirements and associated high fees make banking typically inaccessible to most lower-income households.[7] Finally, the legacy of apartheid has meant high travel costs for the poorest to access banking facilities.

6. **Further efforts are needed to improve access to financial services for households and SMEs.**

- **Exploit credit information technology.** This area represents a major opportunity to expand financial inclusion for SMEs, especially by encouraging small savings and loans[8] and facilitating

---

[3] "Small Businesses, Job Creation, and Growth: Facts, Obstacles, and Best Practices" OECD (2009).

[4] World Bank. 2015. "Small and Medium Enterprises Finance."

[5] Sahay, R., M. Čihák, P. N'Diaye, A. Barajas, S. Mitra, A. Kyobe, Y. N. Mooi, and S. R. Yousefi. 2015. "Financial Inclusion: Can It Meet Multiple Macroeconomic Goals?" Staff Discussion Note 15/17. Dabla-Norris, E., R. Townsend, and D.F. Unsal. 2015. "Identifying Constraints to Financial Inclusion and their Impact on GDP and Inequality: A Structural Framework for Policy." IMF Working Paper 15/22.

[6] World Bank. 2013. "South Africa Economic Update: Focus on Financial Inclusion."

[7] An exemption has lowered regulatory costs for small value ("Mzansi") accounts.

[8] The Kenyan experience has shown that, with appropriate technology, costs of servicing the poor can be reduced, rendering this market accessible (Mlachila and others. 2016. Financial Development in sub-Saharan Africa: Promoting Inclusive and Sustainable Growth, African Departmental Paper 16/5, IMF; EIB. 2016. "Banking in sub-Saharan Africa—Recent Trends and Digital Financial Inclusion").

the establishment of SME credit bureaus. Particular care should be taken to avoid subsidizing unproductive SMEs. South Africa fares comparatively better than other MICs and BRICs with regards to the share of the population with banking accounts, but these are often used just to receive social grants. It would be important to leverage the opportunity provided by that existing infrastructure to provide additional financial services to the poorer segments of the population.

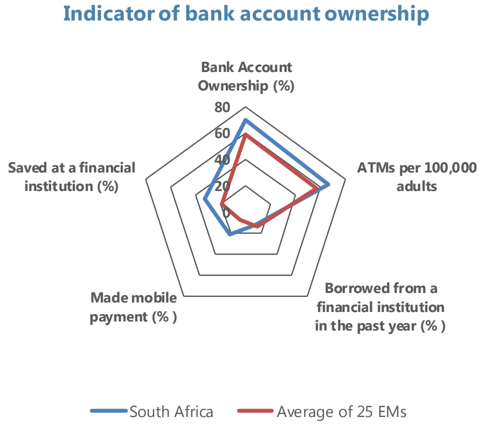
- **Encourage entry of new banks**. The planned entry of new banks should increase competition and foster financial inclusion. The granting of provisional licenses to three banks—including the PostBank, which has a large country-wide network of offices—could increase access to financial services, especially by the rural poor. That said, high capital requirements (R250 million, about US$20 million) for opening a deposit-taking institution have constrained their development. Microfinance, an underdeveloped segment of the domestic financial sector, is another area that may present opportunities.

- **Develop a separate framework for "Tier II" banks that service SMEs**. There are no other licenses that would allow smaller deposit-taking institutions, potentially focusing on SME lending. Cooperative and mutual banks licenses are not suitable because of specific governance structure requirements. The authorities are analyzing possible ways of moving toward a tiered banking system allowing for mid-sized banks with proportionally less stringent regulatory requirements.

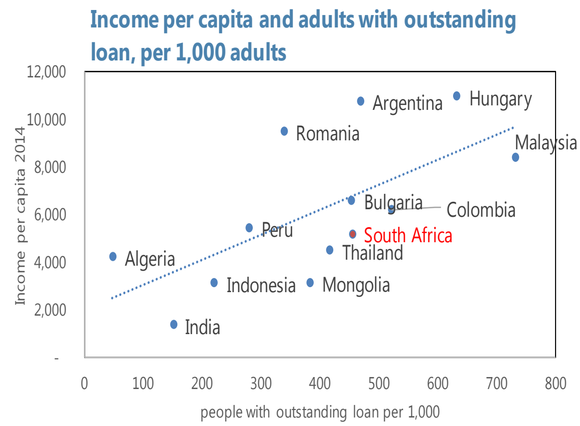
7. Efforts to enhance access to credit should be accompanied by measures to safeguard financial stability. Better financial education can help borrowers choose suitable financial products and avoid paying excessive fees and interest rates. Low income households tend to be less indebted than the wealthier segment, which enjoys easier access to credit. However, the bankruptcy of African Bank from its unsecured lending to low income customers highlights that the authorities should remain vigilant and continue efforts to strengthen the regulatory and supervisory frameworks. Establishment of the Financial Sector Conduct Authority following the enactment of the Financial Sector Regulation (FSR) Bill will provide an opportunity to close regulatory gaps on conduct supervision.

Figure A2.1. Financial Inclusion

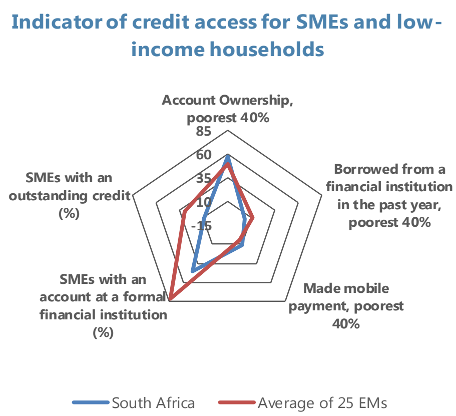
Compared to its 25 EM peers, South Africa ranks slightly better in terms of account ownership and mobile payment.



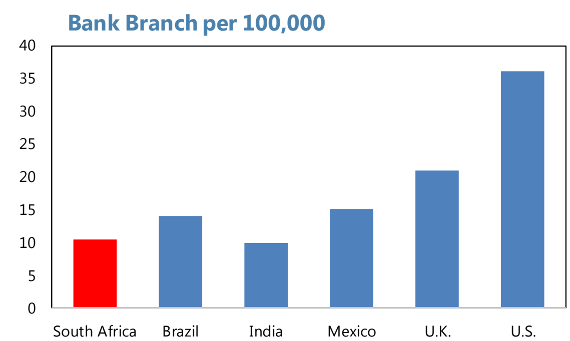
Prevalence of loans (per 1,000 adults) in South Africa is in line with income per capita.



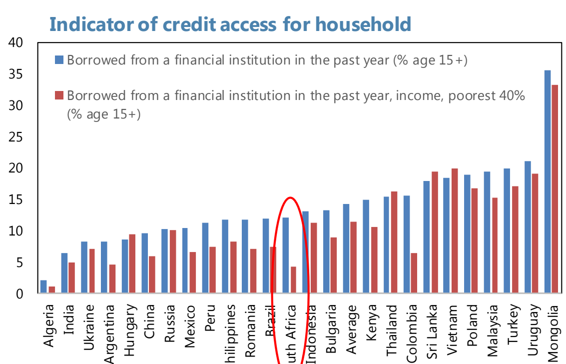
But South Africa ranks low in credit access for low-income households and SMEs.



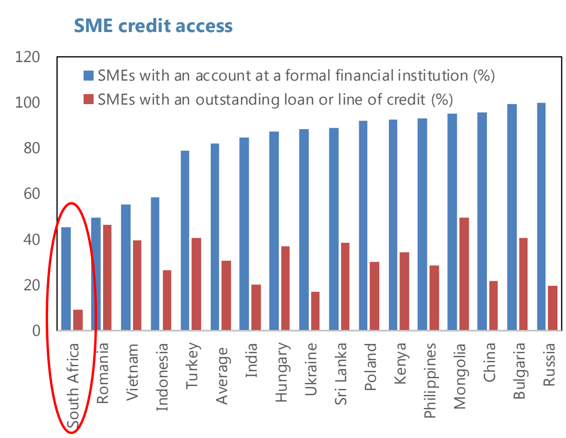
Fewer bank branches per 100,000 residents in South Africa.



Household credit access is below EM average.



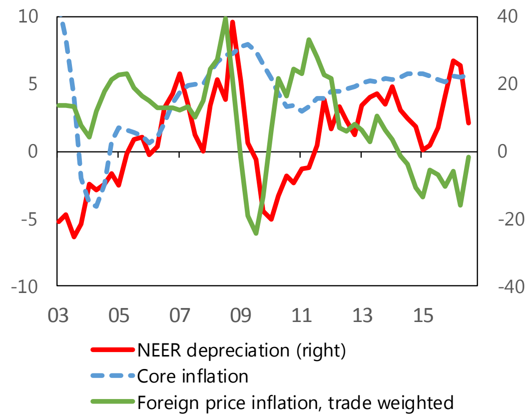
SMEs have low access to credit.



Annex III. Exchange Rate Pass-through to Core Inflation in South Africa

1. Exchange rate pass-through to core inflation in South Africa seems to have moderated in recent years. The impact of nominal effective exchange rate (NEER) depreciation (red line, top chart) on core inflation (broken blue line) may have weakened during the 2010s as the two variables co-moved to a lesser extent than in earlier years. Disinflation of producer prices in countries from which South Africa imports goods and services (green line) could have played some role.

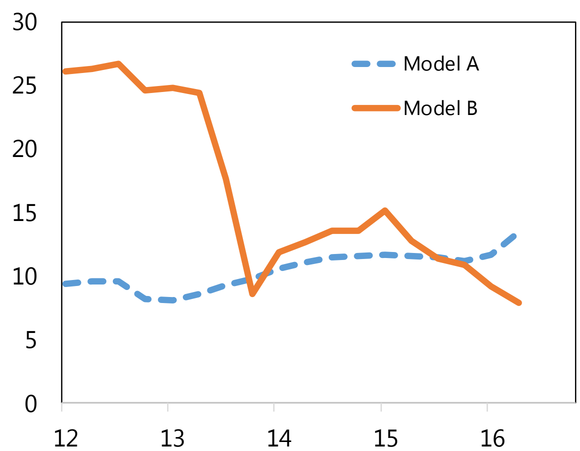
Core inflation, foreign price inflation, and NEER depreciation (percent)



Source: Haver.

2. Two approaches were used to estimate long-run exchange-rate pass-through (LRERPT). The error-correction approach (ECM, model A) was estimated drawing on recent studies on Kabundi and Mbelu (2016) and IMF (2016).[1] However, diagnostic tests for co-integration amongst included variables, a key assumption underpinning ECM, yielded mixed results. Therefore, a model in first differences and without implied co-integration constraints (model B) was also estimated, drawing on BIS (2016).[2] In both models, core inflation from 2002Q1 to 2016Q4 was regressed on NEER, while controlling for producer prices in foreign countries and domestic unit labor costs.[3]

Long-run ERPT to core inflation (percent)



Source: IMF staff estimates.

3. LRERPT in the past few years was 10–15 percent. When estimated recursively with 10-year rolling windows, both models yielded similar LRERPT for the past few years of 10–15 percent.

---

[1] Kabundi A. and A. Mbelu. 2016. "Has the Exchange Rate Pass Through Changed in South Africa?", SARB Working Paper 2016/10; IMF. 2016. *Box 5. Exchange Rate Pass-Through to Consumer Price Inflation*, in IMF Country Report 16/217.

[2] BIS. 2016. "Exchange rate pass through: What has changed since the crisis?" Working Paper 583. In this model, LRERPT is the sum of coefficients on lagged NEER depreciation (4 lags) divided by 1 minus the coefficient on lagged core inflation.

[3] NEER and foreign producer price inflation were import-weighted. In model B, data were in quarter-on-quarter percent changes.

However, results differed for earlier years. Using model A, LRERPT was stable, at 10 percent. Using model B, LRERPT was 25 percent through 2013, but subsequently fell to 10 percent when observations in 2003–04 dropped out of the sample.

4. Our results are comparable to those attained by previous studies that used similar approaches. LRERPT using model A was similar to those in Kabundi and Mbelu (2016) and IMF (2016). Our estimates were lower because a different measure of core inflation, shorter but publicly available, was used. LRERPT using model B was broadly consistent with that in BIS (2016) estimated for a panel of emerging economies.

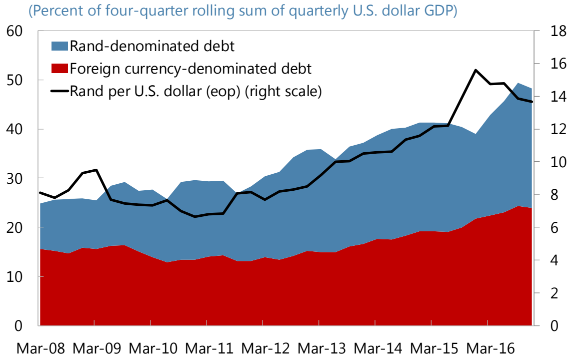
Annex IV. External Debt Sustainability Analysis

The external DSA framework suggests that South Africa's external debt will rise moderately over the medium term and is vulnerable to shocks. Gross external financing needs are high given significant short-term external debt, and external financing is largely from less-stable non-FDI flows. While a deceleration in economic activity or a higher interest rate may only lead to a moderate increase in external debt, a currency depreciation could have significantly larger impact. The fact that half of external debt is denominated in local currency is a mitigating factor.

1. **External debt picked up in 2016.** South Africa's external debt increased markedly to 48.5 percent of GDP in 2016 from 39.1 percent of GDP at end-2015. The pickup reflected an appreciation of the rand, which led to an increase in local currency-denominated debt when expressed in U.S. dollars. This reversed the impact of the 2015 rand depreciation (text chart), returning the external debt path to its previous upward trend. The increase in external debt since end-2011 was primarily driven by the general government and the banking sector.

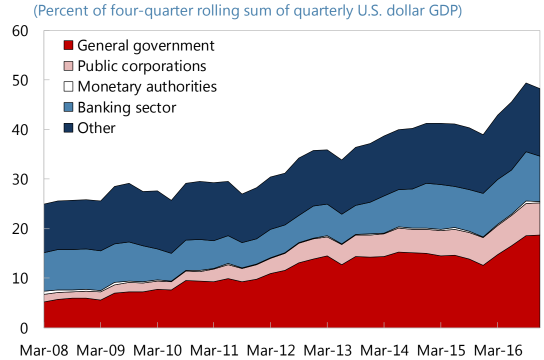
South Africa: External Debt

South Africa: External Debt by Currency
(Percent of four-quarter rolling sum of quarterly U.S. dollar GDP)



Sources: Haver Analytics, SARB.

Breakdown of External Debt by Sector
(Percent of four-quarter rolling sum of quarterly U.S. dollar GDP)



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

2. **Gross external financing needs (GEFNs) are projected to average 18½ percent of GDP in 2017–22, broadly unchanged from recent years.** Despite a decline in the non-interest current account deficit during 2013–16, GEFNs have remained largely unchanged as a share of GDP on the back of a pickup in short-term external debt (remaining maturity). With short-term external debt expected to continue to gradually rise with GDP, GEFNs (i.e. the sum of the previous year's short-term debt at remaining maturity and the current-year projected current account deficit) are projected at around 18½ percent of GDP over the medium term. Short-term external debt (remaining maturity) would account for 80 percent of total GEFNs.

3. **Financing of the current account is projected to come primarily from portfolio investment flows.** Recent statistical revisions led to a marked upward revision of net portfolio inflows after a reclassification from unrecorded transactions—which previously recorded a net positive inflow. Thus, portfolio investment inflows are now the largest financing item in the financial account (5.9 percent of GDP in 2016), while unrecorded transactions are now smaller and often of

the reverse sign (-0.5 percent of GDP in 2016). With net FDI inflows projected to remain negative or very low during the projection period, net portfolio investment is expected to continue to provide the bulk of financing, combined with net other investment inflows (primarily bank loans), which in recent years have been as large as 3 percent of GDP (Table 3).

4. Rising external debt and sizable GEFNs would keep South Africa's external vulnerabilities elevated. External debt is projected to reach 49 percent of GDP by 2022. The debt-stabilizing non-interest current account deficit is estimated at 1.6 percent of GDP (Table 1 of this annex). Stress tests indicate that a 30 percent currency depreciation could push external debt above 60 percent of GDP. Other standard shocks simulated in the external debt sustainability analysis—such as a widening of the non-interest current account deficit, a deceleration in real GDP growth, and a rise in the interest rate—would lead to moderate increases in external debt. These shocks would be mitigated by the high share of rand-denominated external debt (about half of external debt is denominated in rand).

Table A4.1. South Africa: External Debt Sustainability Framework, 2012–22

(Percent of GDP, unless otherwise indicated)

		2012	2013	2014	2015	2016	Projections 2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
1	**Baseline: External debt**	35.8	37.2	41.3	39.1	48.5	**45.2**	**46.2**	**47.0**	**47.6**	**48.1**	**49.0**	**-1.6**
2	Change in external debt	7.4	1.4	4.1	-2.2	9.4	-3.2	0.9	0.9	0.5	0.5	0.9	
3	Identified external debt-creating flows (4+8+9)	2.4	2.6	1.5	2.5	3.0	1.8	2.2	2.2	2.0	2.0	2.0	
4	Current account deficit, excluding interest payments	4.0	4.8	4.0	2.7	1.7	1.2	1.6	1.9	1.9	1.9	1.9	
5	Deficit in balance of goods and services	1.5	2.4	1.7	1.1	-0.1	-0.5	-0.1	0.3	0.3	0.3	0.3	
6	Exports	29.7	30.9	31.2	30.4	30.3	29.9	29.6	29.5	29.4	29.5	29.7	
7	Imports	31.2	33.3	32.9	31.5	30.2	29.4	29.6	29.7	29.7	29.8	30.0	
8	Net non-debt creating capital inflows (negative)	-2.2	-2.7	-3.0	-2.5	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	
9	Automatic debt dynamics 1/	0.7	0.6	0.5	2.3	2.0	1.4	1.3	1.0	0.8	0.8	0.8	
10	Contribution from nominal interest rate	1.1	1.1	1.3	1.7	1.6	1.8	1.8	1.8	1.8	1.8	1.9	
11	Contribution from real GDP growth	-0.7	-1.0	-0.7	-0.6	-0.1	-0.5	-0.5	-0.8	-1.0	-1.0	-1.0	
12	Contribution from price and exchange rate changes 2/	0.2	0.4	-0.1	1.2	0.6	...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	5.0	-1.2	2.6	-4.7	6.4	-5.1	-1.2	-1.4	-1.5	-1.5	-1.1	
	External debt-to-exports ratio (in percent)	120.4	120.5	132.4	128.7	159.8	151.2	155.9	159.7	161.7	162.8	164.7	
	Gross external financing need (in billions of US dollars) 4/	54.9	66.8	58.0	62.8	52.5	54.9	57.8	63.3	70.5	69.1	70.7	
	in percent of GDP	13.9	18.2	16.5	19.8	17.8	17.3	17.8	18.8	20.1	19.0	18.8	
	Scenario with key variables at their historical averages 5/						**45.2**	**46.6**	**47.9**	**49.2**	**50.4**	**52.0**	**-2.0**
	Key Macroeconomic Assumptions Underlying Baseline												
	Real GDP growth (in percent)	2.2	2.5	1.7	1.3	0.3	1.0	1.2	1.7	2.2	2.2	2.2	
	GDP deflator in US dollars (change in percent)	-7.0	-9.7	-5.9	-10.7	-7.4	6.6	1.4	1.7	1.8	1.6	1.4	
	Nominal external interest rate (in percent)	3.8	2.9	3.4	3.7	3.7	4.0	4.0	4.0	4.0	4.0	4.0	
	Growth of exports (US dollar terms, in percent)	-7.2	-3.9	-3.3	-12.0	-7.3	6.2	1.5	2.9	3.8	4.2	4.4	
	Growth of imports (US dollar terms, in percent)	0.0	-1.2	-5.2	-13.6	-11.0	4.9	3.1	4.0	4.0	4.2	4.4	
	Current account balance, excluding interest payments	-4.0	-4.8	-4.0	-2.7	-1.7	-1.2	-1.6	-1.9	-1.9	-1.9	-1.9	
	Net non-debt creating capital inflows	2.2	2.7	3.0	2.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7	

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

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

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

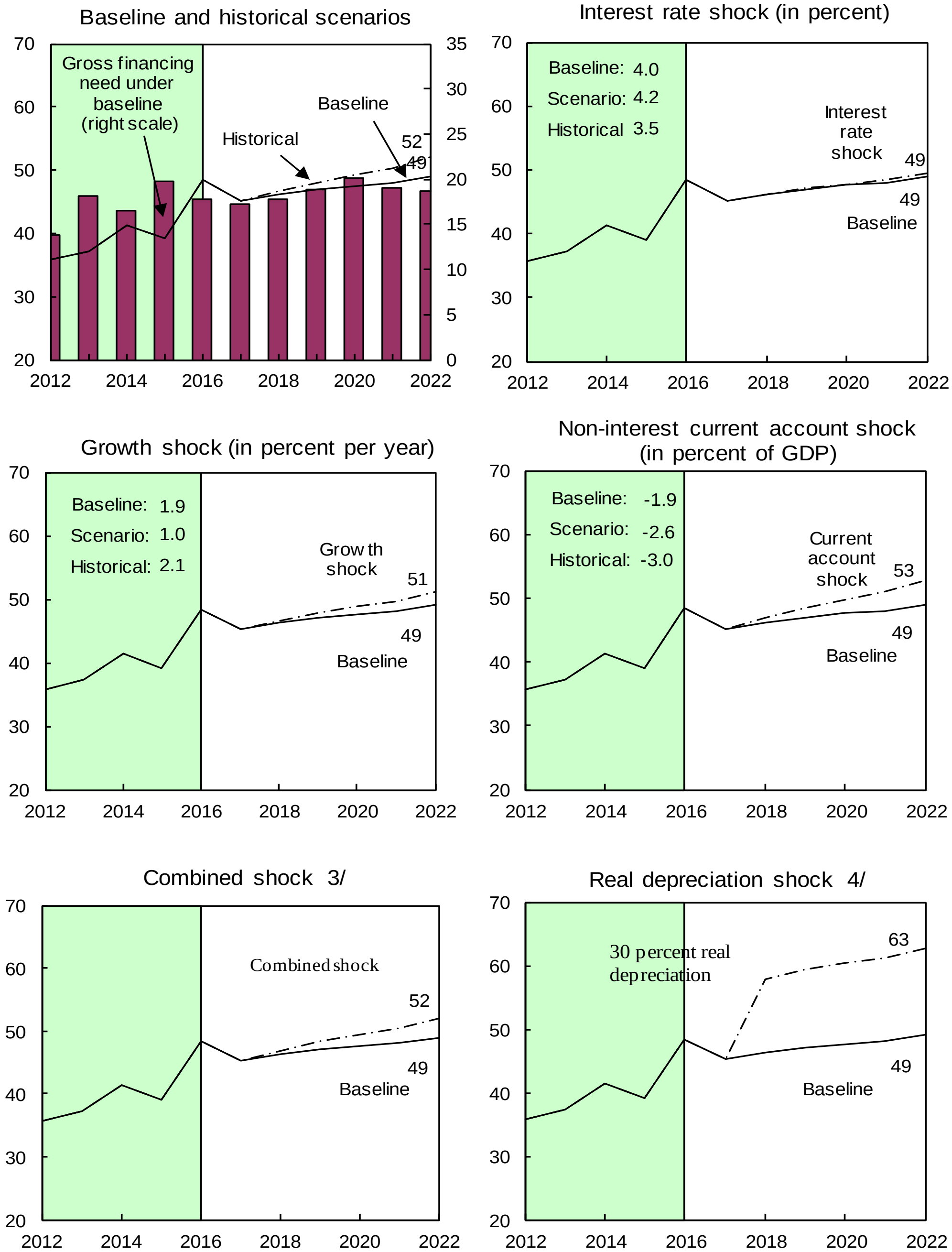
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure A4.2. South Africa: External Debt Sustainability: Bound Tests 1/ 2/

(Percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2016.

Annex V. Risk Assessment Matrix[1]

Nature/Source of Threat	Likelihood	Time Horizon	Expected Impact on Economy	Policy Responses
International Policy uncertainty and divergence including possible retreat from cross-border integration or European bank distress	*H*	*ST-MT*	*H/M*. Impact depends on whether capital flow reversals occur and/or trade flows are disrupted (see below). Stronger impacts likely if capital flow reversals occur.	Combination of measures to address capital outflows or lower demand for exports (see discussion below).
Significant further strengthening of the US dollar and/or higher rates	*H*	*ST*	*H/M.* Capital flow reversals could occur, with disorderly adjustment in twin deficits if accompanied by rating downgrades, spillovers to financial system.	If depreciation leads expected inflation to exceed target band, increase policy rate. Provide FX liquidity if dollar shortages appear. If financing becomes problematic, tighten fiscal policy while protecting poor.
Significant slowdown in China and/or other large emerging economies	*L/M*	*ST-MT*	*H/M.* Deterioration in growth, employment, and worse twin deficits, especially if accompanied by lower commodity prices. Could also lead to capital flow reversal.	Take structural measures that promote growth domestically. If external financing becomes problematic, tighten monetary and fiscal policy while protecting the poor. Provide FX liquidity if shortages appear.
Structurally weak growth in key advanced and emerging economies	*H/M*	*MT*	*M.* Protracted period of lower growth and worse twin deficits, especially if accompanied by lower commodity prices.	Take structural measures to drive growth domestically. Take additional fiscal measures to ensure debt stabilization over medium term while protecting the poor.
Protracted domestic policy uncertainty, deterioration in governance	*H/M*	*ST-MT*	*H.* Growth remains low, fiscal deficit deteriorates, debt rises, ratings downgrades trigger capital outflows, buffers are eroded, and a financing crisis ensues.	Ensure greater consistency in policy statements, centralized evaluation of policy proposals. Take structural measures that strengthen governance, both in SOEs and by implementing anti-corruption and anti-money laundering measures to boost confidence and growth.
Excessive budget deficits or other policy missteps that reduce market confidence	*M*	*ST-MT*	*H.* Interest rates rise, capital flow reversal, immediate downgrade to speculative grade, recession, could also undermine financial stability	Take fiscal measure to reduce deficit, but also protect the poor, improve governance and spending composition. Asset sales to reduce market borrowing. Take measures as below to address financial risks.
Deterioration in banks' asset quality and liquidity shortfalls due to protracted low growth.	*M*	*MT*	*H.* Lower lending to private sector, increased spillovers, with adverse impact on growth, fiscal outlook, financial stability, especially if interacted with downgrades and capital flow reversal.	Conduct asset quality reviews, and adjust provisioning accordingly. Step up risk analysis. If dollar shortages appear, provide FX liquidity.
Sudden stop in capital flows	*L/M*	*ST-MT*	*H.* In extreme scenario, imports and investment would contract abruptly. Vicious circle of falling growth and rising debt would be a possibility.	Freely floating exchange rate is first shock absorber (intervention only to prevent disorderly market conditions). If inflation expectations exceed upper limit of target band, hike rates. If financing difficulties for government or SOEs, postpone or cut spending. In extreme scenario, capital flow measures consistent with IMF's Institutional View.

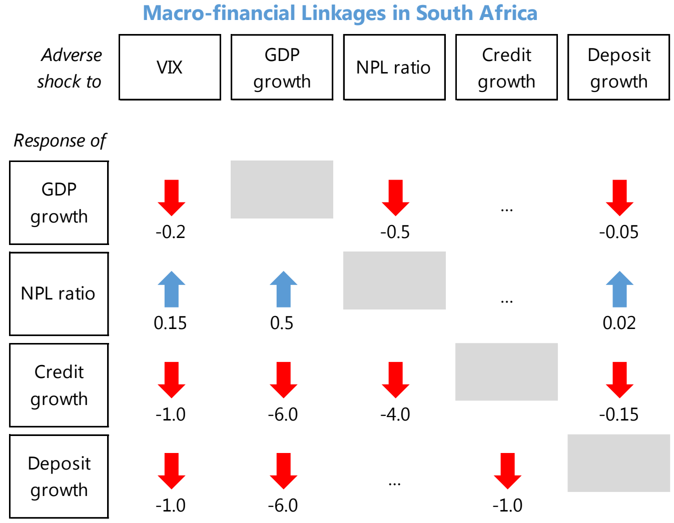
1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate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

Annex VI. Macro-financial Linkages in South Africa

1. **Adverse macroeconomic shocks can propagate through the domestic financial system and feed back to the real economy**. Subdued foreign investors' appetite for domestic assets and slower economic growth can weaken corporates' balance sheets, put banks' asset quality under pressure, and dampen bank lending. If these create negative spillbacks to the real economy, a vicious feedback loop can develop. Such linkages could also exist between domestic banks and economies outside of South Africa in which these banks operate.

2. **Macrofinancial linkages were estimated using a panel VAR model and both macro- and bank-level data spanning 2000–16**. In the baseline model, global risk sentiment was captured by VIX, the implied volatility of S&P 500 index options. Domestic economic activity was captured by real GDP growth. NPL ratios and real growth rates of credit and deposits for five large banks captured balance sheet conditions. In alternative specifications, an index of the prices of commodities that South Africa exports was used as a source of external shocks (replacing VIX). To capture linkages with regional economies, GDP-weighted average of growth in economies outside of South Africa where a large South African bank operates was calculated (replacing domestic growth).

Macro-financial Linkages in South Africa



Note: Two lags. Annual data for 2000-16. Bank level data for real credit and deposit growth and NPL ratios. Numbers represent percentage point response to a one percentage point adverse shock. "..." when statistically insignificant.

3. **The baseline results illustrate the size of the impact of adverse macroeconomic shocks onto bank balance sheets**. Following a one percentage point increase in VIX, the NPL ratios would rise by 0.1–0.2 percentage point in one to two quarters. Credit and deposit growth would fall by 1.0 percentage point in two quarters. In response to a one percentage point decline in GDP growth, the NPL ratios would rise by 0.5 percentage point in one to two quarters. Credit and deposit growth would fall by 6 percentage points in one quarter. The results were qualitatively unchanged when VIX was replaced by an index of commodity prices.

4. **Bank balance sheet variables would influence each other and create spillbacks to the real economy**. A one percentage point increase in the NPL ratios would dampen credit growth by 4 percentage points in one quarter. Tighter funding conditions, represented by lower deposit growth, would adversely affect asset quality and banks' capacity to lend. In turn, a one percentage point rise in the NPL ratios would dampen economic activity by 0.5 percentage point in two quarters.

5. South African banks' performance is interlinked with regional economies' growth in which these banks are estimated to operate, although less so than with domestic growth. The benchmark model was re-estimated after replacing domestic growth with regional economies' growth (ex-South Africa) in which one large bank operates. A one percentage point decline in regional growth would lead to a 1–2 percentage point reduction in credit and deposit growth. In turn, a one percentage point increase in the NPL ratios would dampen regional growth by 0.5 percentage point after 4 quarters. A 10-percentage point reduction in deposit growth would dampen GDP growth by 0.2 percentage point. These findings are comparable to those for other emerging economies, including Indonesia (IMF Country Report 16/82, 16/218).

Annex VII. Public Debt Sustainability Analysis[1]

The DSA framework suggests that South Africa's government debt-to-GDP ratio is sustainable in the baseline scenario, but is highly sensitive to shocks. Persistent low growth or a shock to contingent liabilities could push both South Africa's gross financing needs and debt level above the high-risk benchmarks of 15 and 70 percent of GDP, respectively, indicating an increased risk of financing difficulties and debt distress in those scenarios. Gross financing needs and the debt level could also increase significantly to slightly above 15 percent of GDP and 67 percent of GDP, respectively, if the economy were buffeted by a standard combination of macro-fiscal shocks. These results suggest limited room for policy response to further adverse shocks and underscore the urgent need for reforms to increase economic growth and reduce contingent liabilities, especially from state-owned enterprises, to increase the resilience to shocks. Insufficient reform progress risks a continuation of the ongoing vicious cycle of weak growth, a growing debt ratio, and the repeated need to take fiscal measures to keep the debt sustainable.

1. Data coverage. Consistent with the coverage of government debt reported by the fiscal authorities, the fiscal assumptions in this DSA are based on the national government's main budget (central government). While this coverage excludes provincial governments, social security funds, and extra-budgetary institutions, these entities are not allowed to incur debt. Even though municipalities are allowed to incur debt, most provincial and municipal expenditure is funded through transfers from the national government and thus is captured to a large extent in the projections. The DSA also excludes SOEs, whose indebtedness has increased rapidly in recent years. However, a scenario on the possible realization of contingent liabilities in this annex covers the potential impact of guarantees on SOE loans been called. Total contingent liabilities are estimated at 18 percent of GDP at end March 2017 with SOE loan related guarantees accounting for 56 percent of total contingent liabilities (10 percent of GDP).[2] Contingent claims to the road accident fund, post-retirement medical assistance for public employees, claims against government departments, public-private partnerships, and other guarantees to entities that are not SOEs largely account for the remaining 8 percentage points of GDP.

2. Macroeconomic assumptions. Real GDP growth is projected to improve to 1.0 percent in 2017 from 0.3 percent in 2016 as a result of better rainfall, an increase in mining output prompted by a moderate rebound in commodity prices, and prospects for lower number of days lost due to strikes. Over the medium term, growth is projected at 2.2 percent as consumption and investment recover and the output gap closes. GDP deflator inflation is expected to average 5.6 percent in 2017–2022, consistent with CPI inflation close to the upper range of the South Africa Reserve Bank's (SARB) 3–6 percent target range.

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

[2] These estimates are from Table 11 of the Statistical Annex of the 2017 budget.

3. **Fiscal assumptions.** The FY2017/18 national government primary fiscal deficit is projected to improve to 0.8 percent of GDP from a deficit of 0.9 percent of GDP in FY2016/17 as a result of fiscal measures in the 2016 and 2017 Budget Reviews— which are assumed to have the same yield as in the Budget Reviews. The primary deficit is expected to continue to improve over the medium term as a result of additional fiscal measures and the gradual improvement in growth. The amount of consolidation, however, is not expected to be sufficient to stabilize the debt-to-GDP ratio before 2019 which will reach about 56 percent of GDP by then. The projections include stock-flow adjustments to capture discounts on new issuance of existing benchmark bonds as well as valuation effects on inflation-linked bonds (Figure A6.3). The projections assume no additional fiscal measures beyond those signaled in the 2016 and 2017 budgets, contingency reserves averaging 0.2 percent of GDP for each fiscal year starting with FY 2017/2018, and a continuation of historical budget expenditure and financing trends for years after FY 2019/2020 for which budget projections are not available.

4. **Risks to the Fiscal Outlook.** Upward pressure on the fiscal deficit could stem from lower-than-anticipated growth, higher borrowing costs, and a variety of possible sources of spending pressures (e.g. rapid procurement of nuclear energy, national health insurance, free university tuition, or a potentially generous new public wage settlement in 2018). At the same time, the weak state of some SOEs' balance sheets could trigger calls for further government support.

5. **The macroeconomic forecast track record suggests that over-projection of real growth poses risks to the debt path** (Figure A7.2-top panel). Between 2007–15, the median real GDP forecast error was -1.2 percentage points, broadly in line with other surveillance countries. Although neither the primary balance nor GDP inflation projections were systematically biased, the persistent over-projection of real GDP growth poses an upside risk to the debt-to-GDP forecasts. The risk of persistently lower growth is thus analyzed in a scenario below.

6. **Fiscal adjustment assumed in the DSA is well within the recent fiscal adjustment experience in South Africa and that of market access countries** (Figure 2-lower panel). Fiscal consolidation, which occurred in a context of slowing growth and started with the 2013 Budget, has reduced the national government deficit from 5.4 percent of GDP in FY2012/13 to 4.2 percent of GDP in FY2016/17. Rising interest costs mean that the national government primary deficit has adjusted even more, from 2.7 percent in FY2012/13 to 0.9 percent in FY2016/17. Looking forward, the maximum three-year adjustment in the cyclically-adjusted primary balance over the projection period (1.2 percent of GDP) as well as the maximum three-year average level of the cyclically-adjusted primary balance (1.2 percent of GDP) are well below the thresholds in the distributions reflecting market access country experiences of 3 and 3.5 percent of GDP respectively.

7. **The heat map highlights that South Africa faces risks from lower growth and contingent liabilities** (Figure A7.1). Persistently low growth or a shock to contingent liabilities could both push the gross financing needs and the debt level above the high-risk benchmarks, indicating an increased risk of

financing difficulties and debt distress in those scenarios.[3] South Africa's elevated bond spreads, large external financing requirements, and the share of debt held by non-residents also point to risks. However, these risks are mitigated by a large domestic institutional investor base and a low share of foreign currency and short-term debt.

8. The DSA framework suggests South Africa's government debt-to-GDP ratio is sustainable in the baseline scenario, but is highly sensitive to shocks (Figures A7.3, 4, and 5)**.**

- Under the baseline, the debt-to-GDP ratio is projected to increase to 57 percent by 2022, significantly below the 70 percent high-risk threshold (Figure A7.3). Gross financing needs are estimated at 11.4 percent of GDP in 2016 and are expected to remain at similar levels during the projection period. Such gross financing needs levels are relatively high compared to other EMs average despite a favorable maturity and currency structure.

- If the primary balance failed to improve during the rest of the projection period, the projected debt level in 2022 would increase to 59 percent of GDP (Figure A7.4). The debt to GDP ratio would reach 62 percent of GDP if a one-standard-deviation temporary shock to growth were to materialize in 2018 and 2019.

- A combined macro-fiscal shock—including standard shocks to growth and interest rates, and a primary balance shock (a temporary half of a 10-year historical standard deviation deterioration in the primary balance) and an exchange rate shock (consistent with the maximum movement over the past 10 years and an exchange rate pass-through of 0.25 based on cross-country estimates of pass-through in EMs)—results in a sharp increase in the debt-to-GDP ratio to 67 percent of GDP and gross financing needs slightly above the 15 percent high risk threshold.

- A customized shock entailing a persistently low growth scenario, where growth is permanently lower than the baseline by 1 percentage point on average during 2018–2022, would result in the debt to GDP ratio reaching 71 percent of GDP in 2022. This scenario factors in the adverse impact on the primary balance of lower tax revenue elasticities, denominator effects of the lower GDP on the expenditure to GDP ratio, and a 300 basis points interest rate shock.

- A contingent liability shock entailing the calling of all SOE loan guarantees plus the contingent liabilities of Road Accident Fund would push debt above the high-risk threshold of 70 percent of GDP by 2022. While extreme, this scenario, which would entail the calling 78 percent of the government's contingent liabilities estimated at 13.8 percent of GDP at end of FY2016/17, serves

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

to underscore the growing risks posed by contingent liabilities, both to the fiscal outlook directly and indirectly through its potential impact on investor confidence and borrowing costs.

- The DSA also includes fan charts that take into consideration the impact of the historical volatility of macro-fiscal variables on the future debt path which allows to estimate, for example, the probability that the debt level goes above a certain level (Figure A7.1, middle panel). The asymmetric version reflects the predominance of downside risks while the symmetric version takes into account the possibility of more rapid progress on structural reforms that would boost growth and improve the primary balance. Under the predominance of asymmetric shocks, there is a 10 percent chance that the debt-to-GDP ratio could exceed 70 percent of GDP by 2022. Under the predominance of symmetric shocks, the probability of the debt exceeding the same level is halved to 5 percent showing the importance of structural reforms and growth in reducing the probability of debt distress.

Figure A7.1. South Africa: Public Sector Debt Sustainability Analysis—Risk Assessment

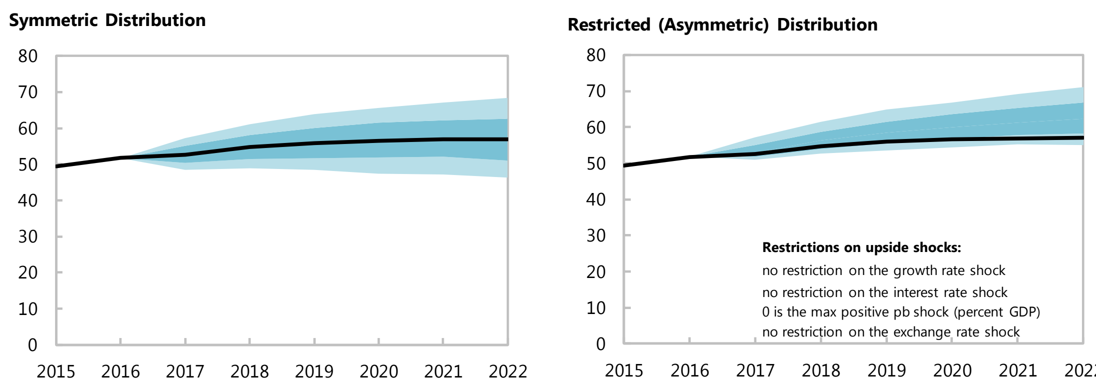
Heat Map

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

Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)

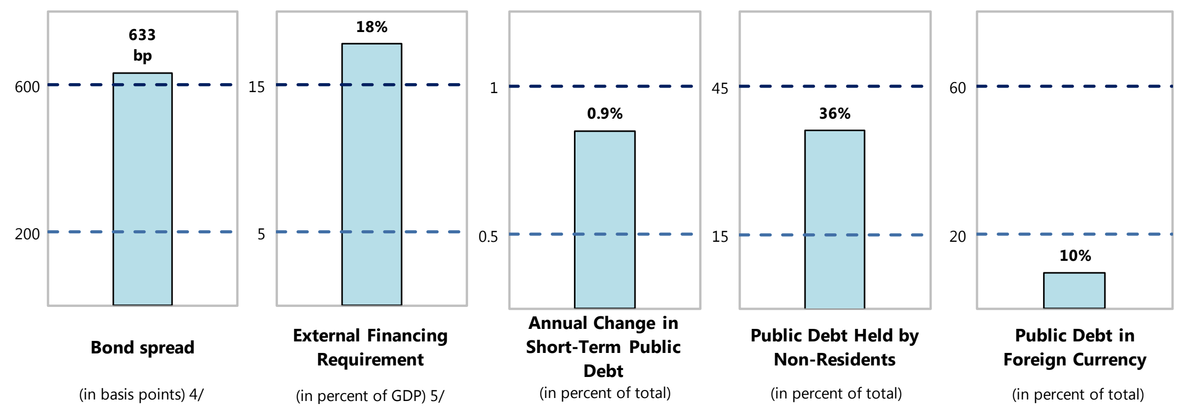
Baseline   Percentiles: 10th-25th   25th-75th   75th-90th



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)

South Africa   Lower early warning   Upper early warning



Sources: IMF staff.

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

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

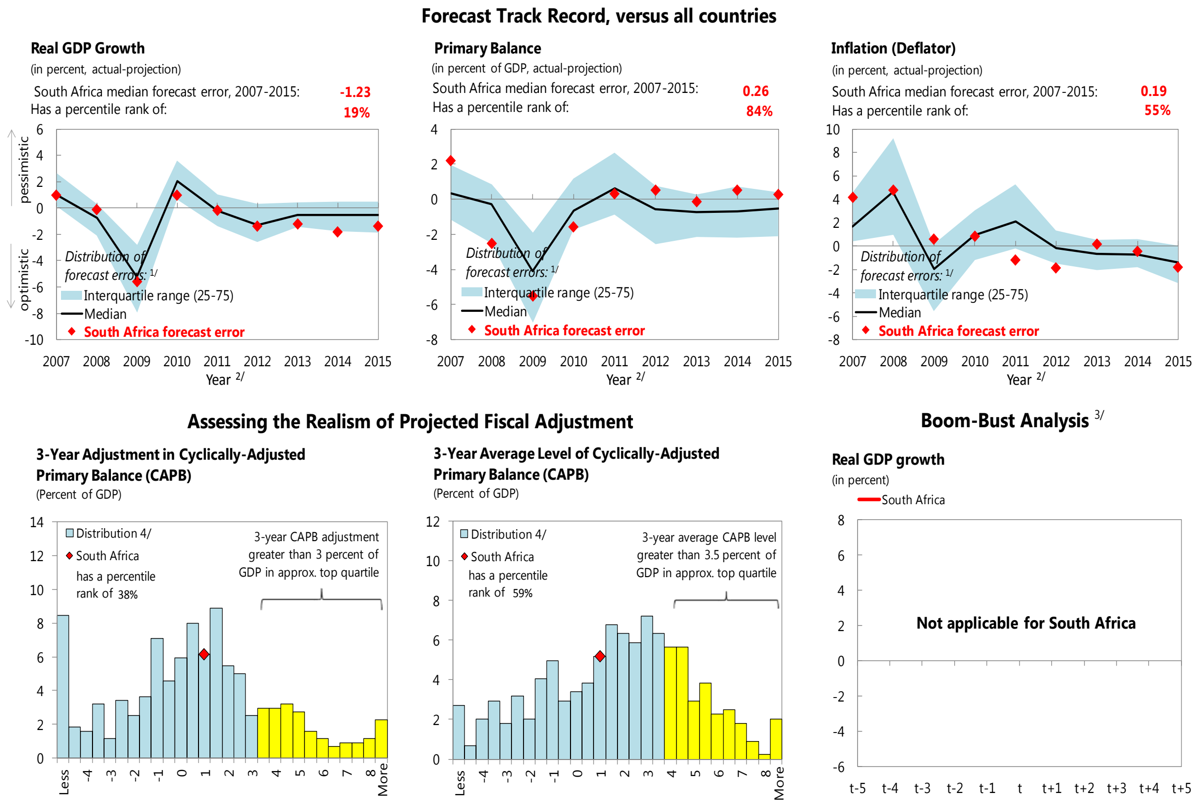
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are: 200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 10-Jan-17 through 10-Apr-17.

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

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

Figure A7.2. South Africa: Public Sector Debt Sustainability Analysis—Realism of Baseline Assumptions



Source: IMF staff.

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

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

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

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

Figure A7.3. South Africa: Public Sector Debt Sustainability Analysis—Baseline Scenario

(in percent of GDP unless otherwise indicated)

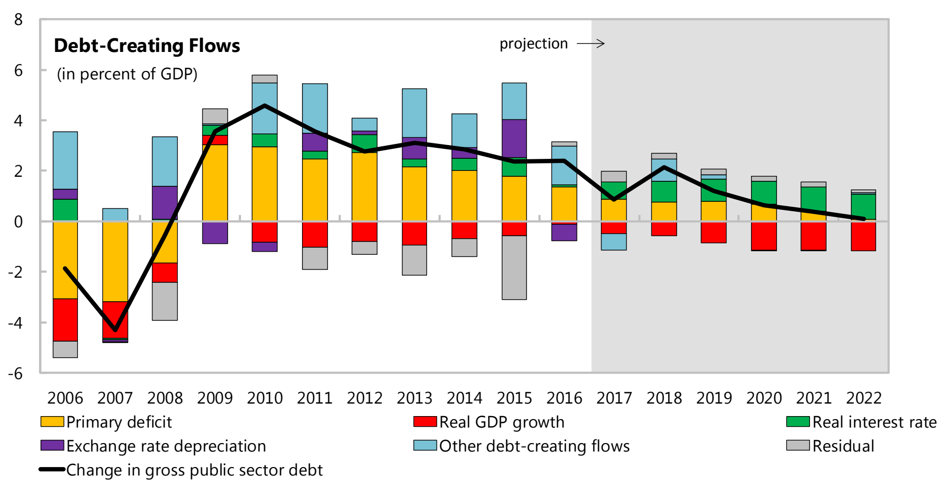
Debt, Economic and Market Indicators [1/]

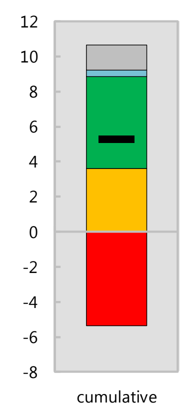
	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	35.6	49.3	51.7	52.6	54.7	55.9	56.5	56.9	57.0
Public gross financing needs	7.9	11.2	11.4	11.2	11.4	11.7	11.6	11.4	11.1
Real GDP growth (in percent)	2.8	1.3	0.3	1.0	1.2	1.7	2.2	2.2	2.2
Inflation (GDP deflator, in percent)	6.8	5.0	6.8	5.8	5.7	5.6	5.6	5.6	5.6
Nominal GDP growth (in percent)	9.8	6.4	7.1	6.8	6.9	7.4	7.9	7.9	7.9
Effective interest rate (in percent) [4/]	8.3	6.8	7.0	7.2	7.4	7.4	7.5	7.6	7.6

As of May 31, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		638
5Y CDS (bp)		190
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BB+	BBB-
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing
Change in gross public sector debt	1.5	2.4	2.4	0.9	2.1	1.2	0.6	0.4	0.1	5.3	primary
Identified debt-creating flows	2.0	4.9	2.2	0.4	1.9	1.0	0.4	0.2	0.0	3.8	balance [9/]
Primary deficit	0.8	1.8	1.4	0.9	0.8	0.8	0.7	0.4	0.1	3.6	-0.1
Primary (noninterest) revenue and grants	24.3	24.8	25.4	25.6	25.9	26.0	26.0	26.1	26.1	155.7	
Primary (noninterest) expenditure	25.1	26.6	26.7	26.4	26.6	26.8	26.7	26.5	26.2	159.3	
Automatic debt dynamics [5/]	-0.2	1.7	-0.7	0.2	0.2	0.0	-0.2	-0.2	-0.2	-0.1	
Interest rate/growth differential [6/]	-0.5	0.2	0.0	0.2	0.2	0.0	-0.2	-0.2	-0.2	-0.1	
Of which: real interest rate	0.4	0.8	0.1	0.7	0.8	0.9	0.9	1.0	1.0	5.2	
Of which: real GDP growth	-0.9	-0.6	-0.1	-0.5	-0.6	-0.9	-1.1	-1.2	-1.2	-5.4	
Exchange rate depreciation [7/]	0.3	1.5	-0.6	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.4	1.5	1.5	-0.6	0.9	0.2	0.0	0.0	0.0	0.4	
Privatization/Drawdown of Deposits	0.7	-0.3	1.2	-0.9	0.4	-0.4	-0.7	-0.6	-0.6	-2.9	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Stock-Flow adjustment	0.7	1.8	0.3	0.3	0.5	0.6	0.6	0.6	0.6	3.2	
Residual, including asset changes [8/]	-0.5	-2.5	0.2	0.4	0.2	0.2	0.2	0.2	0.1	1.4	





Sources: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

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

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

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

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

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

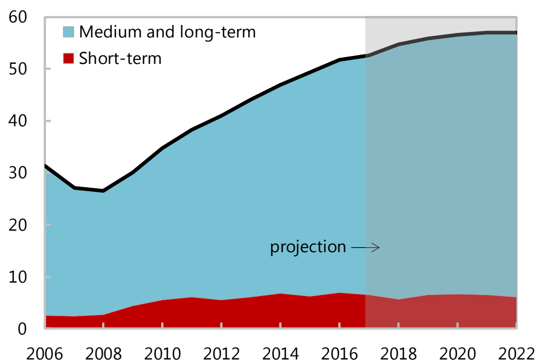
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

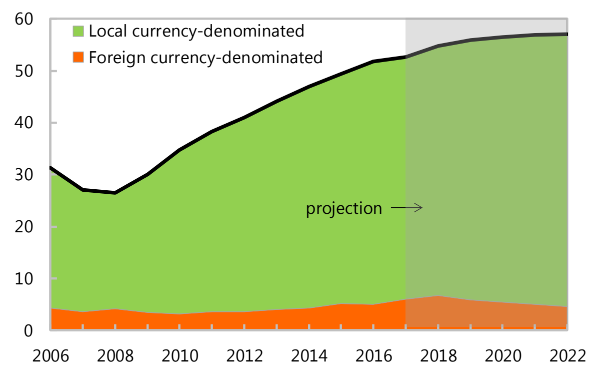
Figure A7.4. South Africa: Public Sector Debt Sustainability Analysis—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



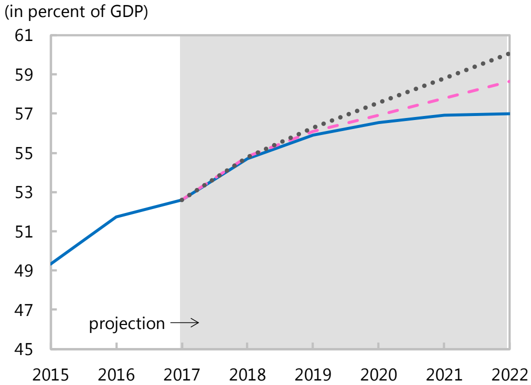
By Currency
(in percent of GDP)



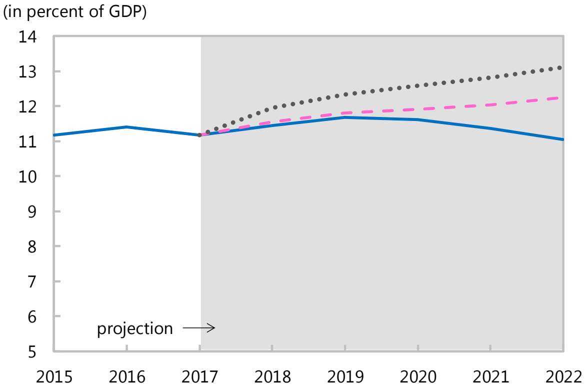
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

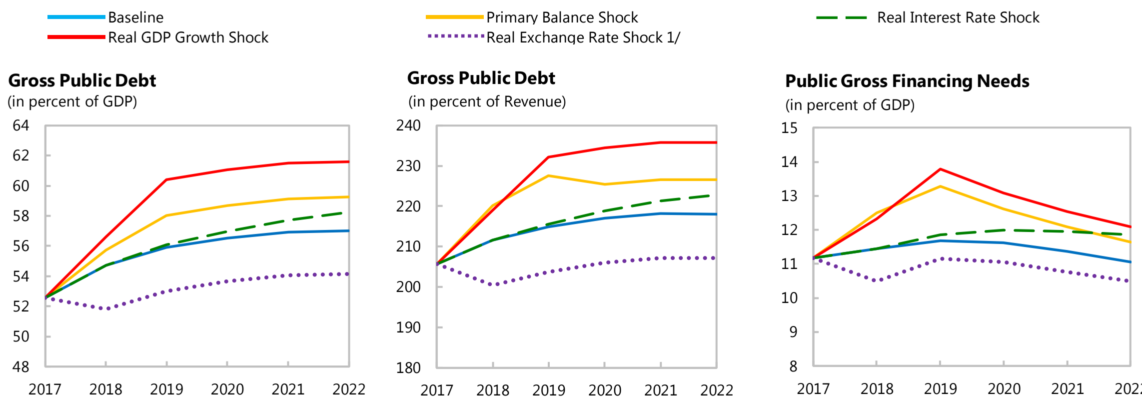
Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	1.0	1.2	1.7	2.2	2.2	2.2
Inflation	5.8	5.7	5.6	5.6	5.6	5.6
Primary Balance	-0.9	-0.8	-0.8	-0.7	-0.4	-0.1
Effective interest rate	7.2	7.4	7.4	7.5	7.6	7.6
Constant Primary Balance Scenario						
Real GDP growth	1.0	1.2	1.7	2.2	2.2	2.2
Inflation	5.8	5.7	5.6	5.6	5.6	5.6
Primary Balance	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Effective interest rate	7.2	7.4	7.4	7.5	7.6	7.6

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	1.0	2.1	2.1	2.1	2.1	2.1
Inflation	5.8	5.7	5.6	5.6	5.6	5.6
Primary Balance	-0.9	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	7.2	7.4	7.3	7.3	7.4	7.4

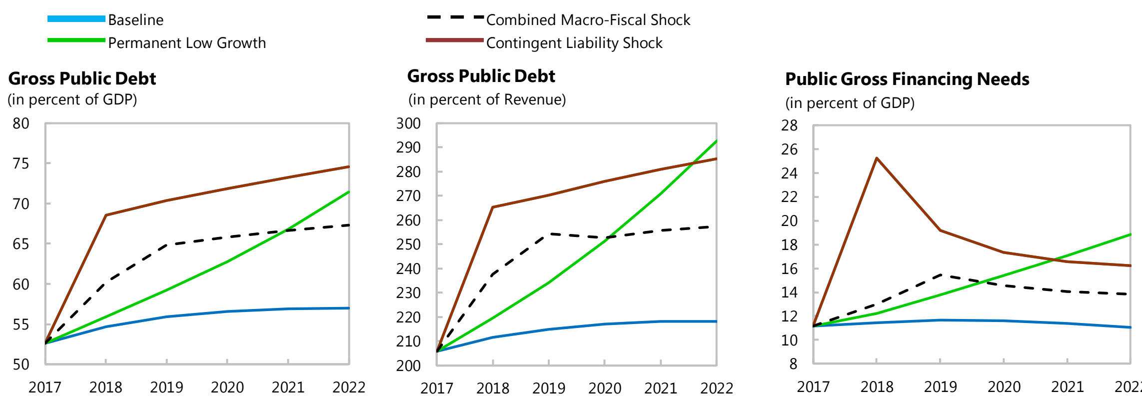
Sources: IMF staff.

Figure A7.5. South Africa: Public Sector Debt Sustainability Analysis—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	1.0	1.2	1.7	2.2	2.2	2.2
Inflation	5.8	5.7	5.6	5.6	5.6	5.6
Primary balance	-0.9	-1.8	-1.8	-0.7	-0.4	-0.1
Effective interest rate	7.2	7.4	7.5	7.6	7.6	7.7
Real Interest Rate Shock						
Real GDP growth	1.0	1.2	1.7	2.2	2.2	2.2
Inflation	5.8	5.7	5.6	5.6	5.6	5.6
Primary balance	-0.9	-0.8	-0.8	-0.7	-0.4	-0.1
Effective interest rate	7.2	7.4	7.8	8.0	8.2	8.4
Combined Shock						
Real GDP growth	1.0	-0.7	-0.2	2.2	2.2	2.2
Inflation	5.8	5.2	5.1	5.6	5.6	5.6
Primary balance	-0.9	-1.9	-2.6	-0.7	-0.4	-0.1
Effective interest rate	7.2	7.7	7.7	8.0	8.2	8.4

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	1.0	-0.7	-0.2	2.2	2.2	2.2
Inflation	5.8	5.2	5.1	5.6	5.6	5.6
Primary balance	-0.9	-1.4	-2.1	-0.7	-0.4	-0.1
Effective interest rate	7.2	7.4	7.5	7.6	7.6	7.7
Real Exchange Rate Shock						
Real GDP growth	1.0	1.2	1.7	2.2	2.2	2.2
Inflation	5.8	17.9	5.6	5.6	5.6	5.6
Primary balance	-0.9	-0.8	-0.8	-0.7	-0.4	-0.1
Effective interest rate	7.2	7.7	7.3	7.4	7.5	7.5
Contingent Liability Shock						
Real GDP growth	1.0	1.2	1.7	2.2	2.2	2.2
Inflation	5.8	5.7	5.6	5.6	5.6	5.6
Primary balance	-0.9	-14.6	-0.8	-0.7	-0.4	-0.1
Effective interest rate	7.2	7.4	8.3	8.8	9.2	9.4

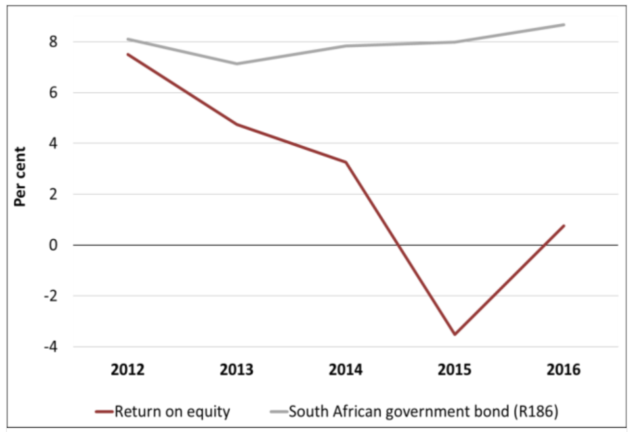
Source: IMF staff

1/ Debt dynamics are more favorable than the baseline in this scenario because the assumed depreciation would affect the numerator less than the denominator of the public debt to GDP ratio given that most of the debt stock is in local currency.

Annex VIII. SOE Reforms—International Experience

1. **State-Owned Enterprises (SOEs) can affect the efficiency of operations of many product and service markets in countries where their presence is significant.** Their impact is felt through the quality and cost of the essential services and infrastructure they provide, and thus the competitiveness of the economy. SOEs often have a dominant position in key network industries (e.g. power, telecom, and transport). They may also have certain advantages, such as tax and regulatory benefits and subsidized financing from budgets, which can affect the nature of competition with private sector firms and discourage their participation.

2. **SOEs can also be a source of fiscal costs and contingent liabilities for the budget when their inefficient operation results in poor financial performance.** In South Africa, the SOEs' financial performance has deteriorated in recent years as reflected by a downward trend in the return on equity and its consistently low level compared to government borrowing costs. According to a report by the Presidential Review Committee on State Owned Entities (2012), factors underlying the poor performance include the absence of an ownership strategy, a complex ownership and oversight model, a legislative framework dispersed among many laws which lacks uniformity, and weaknesses in sectoral regulatory frameworks—for example, in the energy sector. Lack of enforcement of the legislative framework governing SOEs, such as the Public Financial Management Act, and the absence of uniform criteria for creation and winding down of SOEs have also been a source of challenges in performance and monitoring (e.g., the number of SOEs is unknown). SOEs have received 1.2 percent of GDP annually, on average, in the last eight budget years, combining direct transfers, subsidies, and recapitalizations to address the erosion of equity due to weak financial performance. Moreover, government guarantees for rapidly growing SOE debt (See Figure 12 for SOE debt data) represent 56 percent of all contingent liabilities (10 percent of GDP) at end March 2017.



Source: 2017 Budget Review. National Treasury

3. **International experience suggests that various policies can be deployed to improve the efficiency of SOE operations and to reduce fiscal risks**. These include:

- ***Undertaking a comprehensive inventory and review of SOEs to identify an appropriate reform strategy for each SOE.*** Information is gathered on the SOEs' commercial viability and the relevance of their objectives from a public policy perspective to inform subsequent decisions on reform strategy options: (i) transformation into government agencies or budgetary institutions if they are not commercially viable but carry out relevant public policy objectives; (ii) divestment if they are commercially viable but their objectives are not relevant from a public policy perspective; (iii) liquidation if they are not commercially viable and their objectives are not relevant from a public policy perspective; (iv) retaining them as SOE but pursuing reforms to improve their performance if they are both commercially viable and have relevant objectives from a public policy perspective.

- ***Reforming SOEs that are retained as such to improve their operational and financial performance.*** Countries have pursued the following reform strategies in isolation or combining them, depending on country specific circumstances:

  - *Broadening the ownership structure to include private sector participation.* The models for this type of reform were retaining majority shareholding but implementing corporate governance reforms (e.g., Brazil, China, India, Poland) and maintaining minority shareholding after sale of majority of shares to the private sector (e.g., Brazil, UK, Norway, Spain, Poland).

  - *Stepping up monitoring of SOE performance.* Reforms of this type included: (a) implementation/enforcement of international accounting and auditing standards, timeliness of accounts, and disclosure and transparency requirements more generally (e.g., Switzerland, Turkey, Germany, Sweden, New Zealand); (b) linking main objectives to a set of key performance indicators measuring financial and non-financial performance, financial risk, and transactions with the government (e.g. Australia, Indonesia, Thailand, South Africa); (c) requiring quantification and budget compensation for quasi-fiscal operations (e.g., EU regulatory framework for the transportation sector); (d) production of consolidated information regarding the SOE sector in annual reports. (e.g. Lithuania, Finland, France, Brazil, New Zealand, Sweden).

  - *Leveling the playing field with the private sector.* These reforms involve limiting SOE tax, regulatory, and subsidized financing benefits (e.g. Directives on State Aid in EU countries, Australia's competitive neutrality policy).

  - *Balancing increased SOE autonomy with control of fiscal risks.* Reforms of this type included increasing professional qualifications of board members and strengthening rules against conflict of interest (e.g., Germany, Italy, Spain, Singapore), reducing board sizes (e.g. Korea, France, Poland, Spain), introducing guidelines for remuneration and employment (Finland, Norway, Sweden, Czech Republic), and retaining financial controls (e.g., borrowing/guarantees approval by the Ministry of Finance).

  - *Preparing framework laws on SOEs* (e.g., Cyprus, New Zealand, the Philippines, and Korea). Important components of such laws were clarifying the definition of SOEs, defining clearly the roles and responsibilities of key players such as line ministries and SOE boards, establishing sound SOE corporate governance policies, introducing requirements for the creation/winding down and sale of SOEs, tightening of sanctions for non-compliance with SOE legislation, and increased disclosure and reporting requirements for SOEs.

- *Increasing the centralization of the ownership function for SOEs* (e.g., Singapore, Denmark, Netherlands, China, Finland, France and Peru). This facilitates separating the ownership function from the policy function, implementing unified SOE guidelines and their interpretation, compiling and reporting of aggregate information on SOEs, and leveraging scarce expertise.

- **Developing and publishing a comprehensive ownership policy and reviewing it periodically** (e.g., France, Finland, Norway, Sweden and the U.K). Key features of the ownership policies include: (a) statement of the government's policy and financial objectives for the entities exercising the ownership function and each company or group of companies and associated with performance indicators (b) organization of the ownership function, including mandate and main functions of the ownership entity(ies) (c) key policy principles and policies to be followed. (e.g., adherence to corporate governance principles).

4. SOE reforms were generally carried out in stages spanning many years and responding to country specific circumstances. For example, the tightening of financing constraints (e.g., the end of the petrodollar era in the 1980s for Brazil) and recurrent scandals related to SOEs were important reform catalysts in multiple countries. While it is difficult to point to good practice reform sequencing examples given the staged and country-specific nature of many SOE reforms, an illustrative reform sequence based on the complexity of the reforms could involve:

- Short term (first year): (1) Full inventory of public sector entities; (2) Clarification of roles and responsibilities of key players; (3) Simple quantification of quasi-fiscal operations focusing on high fiscal risk SOEs; and (4) Simple performance indicators and targets.
- Medium term (first 3 years): (1) SOE legal framework revision including a possible framework law on SOEs;(2) Development of an ownership policy; (3) Consolidated annual report on all SOEs.
- Long term (later years): Refinements in: (1) set of performance indicators and targets; (2) full costing, reporting, and compensation of quasi-fiscal operations; (3) periodic reviews of the ownership policy**.**

References

Allen, Richard and Miguel Alves. 2016. "How to Improve the Financial Oversight of Public Corporations," How to Notes. Fiscal Policy." Fiscal Affairs Department, International Monetary Fund

OECD. 2015. "Stated-Owned Enterprises in the Development Process."

OECD Website on Corporate Governance at http://www.oecd.org/corporate/

Government of South Africa. 2012. "Presidential Review Committee on State-Owned Entities. Main Report."

Priority Recommendations	Progress update
Twin Peaks Reform	**Well advanced or near completion**
Define clear and comprehensive institutional, governance and accountability arrangements for prudential and market conduct regulation, including National Credit Regulator (NCR) and other relevant institutions.	The Financial Sector Regulation Bill (FSRB) to implement a Twin Peaks regulatory architecture reform was approved by the National Assembly on December 5, 2016. The FSRB is expected to be approved by the upper house towards the second half of 2017. The FSRB will ensure that there are Memoranda of Understanding between the financial sector regulators, including the NCR.
Publish a roadmap for regulatory reform, with adequate resource allocation, monitoring and evaluation, to carefully implement the move to twin peaks and minimize transition risks.	A regulatory strategy will be published as required in clause 47 of the FSRB and will serve as a roadmap. Once the FSRB is enacted, the Prudential Authority (PA) could be created towards the end of 2017 and the Financial Sector Conduct Authority (FSCA) in end-2017 or 2018. Under Twin Peaks, insurance companies will be supervised by the PA to help improve oversight of financial conglomerates. (All big banks have some insurance business). More than 50 staff are expected to move from the Financial Services Board (FSB) to the South African Reserve Bank (SARB). The SARB is ready to merge the bank and insurance supervision. The prudential supervision of securities companies will also move to the SARB. The FSB will be transformed into FSCA.

Microprudential	**Progress is uneven**
Strengthen group-wide supervision of financial conglomerates, focusing on interconnectedness by monitoring intra-group transactions and aggregate exposures, and conducting joint on-site visits.	The PA will regulate financial conglomerates, including related non-financial entities which are currently not regulated by either the SARB or the FSB (e.g., the furniture business owned by African Bank, or joint ventures between banks and retailers, which may not be on the banks' balance sheet). A separate Conglomerate Supervision Department has been established and a Conglomerate Supervisory Blueprint is being drafted. The Bank Supervision Department (future PA) and FSB (future FSCA) already conduct joint supervisory visits and reviews.
Clarify objectives and strengthen the operational independence of all financial sector supervisors in the relevant legislation in line with international standards.	The FSRB clarifies the independence and roles of the FSCA and the PA. Under FSRB and Twin Peaks architecture, memoranda of understanding among all regulators will ensure independence and collaboration on shared objectives.
Enhance regulatory requirements of Collective Investment Schemes (CIS), particularly for disclosure, valuation and accounting, introduce variable net asset valuation, and strengthen the supervision of CIS managers.	To enhance the existing legislation, the FSB drafted regulations concerning valuation, pricing, and accounting of CIS which will be circulated for comment to industry by the third quarter of 2017 and then finalized for publication. BN 92 of 2014 already sufficiently provides for requirements for the disclosure of CIS unit prices. Board Notice 90 of 2014 permits use of variable Net Asset Value (NAV) for money market funds (MMFs). MMFs are not required to apply variable NAV and may continue using a daily constant price. All MMFs that do apply a constant NAV must perform a monthly mark-to-market valuation and report it to the regulator, indicating the variance from the constant price. The relevant regulations (BN90) will be reviewed during 2017 and all latest relevant IOSCO principles will be considered.

Fully implement the Solvency Assessment and Management regime and Treating Customers Initiative; give high priority in legislation to protecting policyholder rights and entitlements.	Under the FSRB, the PA will be responsible for the prudential aspects of insurance supervision, particularly the new risk-based solvency framework, Solvency Assessment and Management (SAM). As part of the process to implement the SAM framework, the Financial Soundness Standards for solo insurers, Lloyd's, branches of foreign reinsurers, micro-insurers and insurance groups were released on November 4, 2016 for informal public comment by January 31, 2017. The Governance and Operational Standards for Insurers were released on April 24, 2017 for informal public comment by May 24, 2017. The remainder of the prudential standards under SAM are expected to be released for informal public comment by the end of June 2017. The Insurance Bill, which will give effect to the SAM framework, was tabled in Parliament on January 28, 2016 and is currently in parliamentary processes. The finalization and implementation of the Insurance Bill and the prudential standards are dependent on the finalization and implementation of the FSRB. At this stage the envisaged implementation date of the SAM framework is July 1, 2018. Treating Customers Fairly (TCF) conduct matters is already being implemented by FSB through its TCF Roadmap and will remain with the FSCA. The Conduct of Financial Institutions Bill (CoFI Bill) is being drafted, consolidating 13 sectoral laws, and will further enhance the rights of customers. CoFI Bill will go to the parliament by end-2017. Policyholders and depositor's rights and entitlements will be addressed as part of the drafting process of the Designated Institutions Resolution Bill, 2017 (Resolution Bill). An update of the Retail Distribution Review (RDR) discussion document was published in December 2015. A further update, "Status Update: Retail Distribution Review – status as at December 2016" was published on December 13, 2016. The RDR discussion document issued in November 2014 proposed reforms to the regulatory framework for distributing financial products to customers. The RDR discussion document proposes 55 specific regulatory objectives. The RDR status update confirms that these proposals would be implemented in three broad phases and aligned to the broader reform of financial regulation in terms of the Twin Peaks regulatory model. Proposed amendments to the Regulations made under the Long-term Insurance Act, 1998 and Short-term Insurance Act, 1998 (collectively referred to as the "Insurance Acts") giving effect to a number of regulatory reforms focusing on conduct of business that cannot be deferred until the enactment of the CoFI Bill were issued for public comment on December 9, 2016 with comments due by February 22, 2017. The proposed replacement of the Policyholder Protection Rules made under the Insurance Acts giving effect to a number of regulatory reforms focusing on conduct of business that cannot be deferred until the enactment of the CoFI Bill was published in Board Notice 192 of 2016 and issued for public comment on December 15, 2016 with comments due February 22, 2017.

Macroprudential	
Continue building a top-down stress test framework for both the banking and insurance sectors and give SARB more resources for data collection and analysis.	The Financial Stability Department (FinStab) developed a top-down (TD) stress-testing framework which consists of (i) a risk assessment matrix, (ii) scenarios design, (iii) data management, (iv) development of TD models, and (v) calculation and reporting. During October 2015–February 2016, FinStab conducted a solvency scenario stress test. Banks undertook bottom-up tests, the results of which were validated by TD tests conducted by the Stress Testing Division. The aggregated results were published, and were the first published by SARB. The Stress Testing Division recruited an additional staff member with quantitative and banking experiences. The Deutsche Bundesbank performed an independent assessment of the TD stress-testing framework and recommendations are considered in SARB framework. In addition, the stress test exercise was subjected to a peer review by the IMF and the suggestions from this exercise are also being considered by the SARB in its stress testing framework.
Financial Safety Nets	
Introduce a resolution regime compliant with the Key Attributes for, and make the SARB the resolution authority of, all banks and SIFIs.	In August 2015, the National Treasury (NT), the SARB and the FSB-SA jointly published a discussion paper "Strengthening SA's Resolution Framework for Financial Institutions" for public comment and held a series of public consultations thereafter. The paper proposes, for instance, to establish an explicit deposit insurance scheme and broaden the scope of resolution to holding companies. The NT, in collaboration with the SARB, is drafting a legislation (Resolution Bill). The first draft legislation is intended to be published for public comment by end-2017 and submitted to parliament for approval thereafter.
Adopt depositor preference and introduce an ex-ante funded deposit insurance scheme, with a back-up credit line from the NT.	Deposit insurance will be introduced through the Resolution Bill. The NT and the SARB have published a policy document on the deposit insurance scheme for comment. The Resolution Bill will cover all banks and systematically important financial market infrastructures (FMIs), insurance companies and financial conglomerates, and will establish the deposit insurance fund. The level of deposit insurance coverage is expected to be R100,000 per person per bank (most deposits are below R3,000). The funding mechanism for the deposit insurance fund is yet to be finalized.
Remove constraints to early intervention powers and improve legal protection for resolution officials.	The envisaged strengthened resolution framework, in line with the powers assigned in the Resolution Bill, will allow SARB as the resolution authority to take early intervention measures. The Resolution Bill will consolidate the previously fragmented resolution powers under different regulators. SARB can initiate early intervention based on actions taken in terms of its pre-resolution powers, that the financial position of an institution is significantly overstated and/or that it is, in fact, non-viable or likely to be non-viable. SARB can request the PA to implement recovery actions. The legislation will provide resolution officials with legal protection as set out in the NT and SARB discussion paper proposals.

OTC derivatives Market Reforms and Oversight	**Draft bill under review**
Improve data collection of OTC derivatives and enhance surveillance of the OTC derivatives market	In July 2016, the NT, the FSB and the SARB jointly published a 3rd draft on the OTC derivative regulatory framework proposing that the regulations be submitted for parliamentary review. However, the timeline to finalize the OTC derivatives regulations is dependent on the promulgation processes that are currently underway for the FSRB and Financial Markets Act (FMA) consequential amendments. The central clearing mandate will be reviewed during 2017. The code of conduct and central clearing mandate are expected to be implemented during 2018. These regulations will encourage central clearing and central reporting for standard derivative contracts while implementing capital and margin requirements for non-centrally cleared transactions. An OTC steering committee consisting of officials from the NT, the FSB, and the SARB are in the process of considering the various OTC issues in the context of the FSRB, of which some OTC matters will partly fall in SARB's mandate in the future. Given the large size of the OTC derivative market, timely data collection is vital for risk monitoring.
Consider establishing a local CCP, with credit lines to the central bank and securities collateral placed at a central securities depository to reduce dependency on local banks.	CCP issues are also part of the deliberations of the OTC steering committee. More progress is expected in the future.

Competition	**Some progress**
Adopt the international best practices on provision and disclosure of market information to retail customers and to potential entrants into the payments and clearance systems.	The National Payment System Act, 1998 (NPS Act) does not specifically provide requirements for payment participants in relation to retail customers. Although the National Payment System Department (NPSD) has been applying the CPSS Core principles for systemically important payment system and subsequently the CPMI-IOSCO Principles for Financial Market Infrastructures (PFMIs), these principles have not been formally adopted into domestic law. NPSD has publicly expressed its commitment and support to adopting the PFMIs. FSRB currently in Parliament makes provision for conduct regulation of payment services providers (PSPs) by FSCA for consumer protection purposes. It is envisaged that once promulgated, the FSR Act will provide legal authority for the regulation, supervision and oversight of PSPs and their conduct in relation to retail customers. In anticipation of the promulgation of FSRB, FSB is also in the process of developing the CoFI Bill which will apply to PSPs and include provisions on, among others, disclosure to retail customers of PSPs. The NPSD is part of the Working Group on the CoFI Bill. In addition, further clarity will also be provided in the National Payment System Amendment Bill. In this regard, NPSD is also in the process of reviewing the NPS Act to align it with FSRB, to among others, align with international standards. With regards to disclosure to potential market entrants, section 6A (3), (4) and (5) of the NPS Act make provision for market access. In addition, once the PFMIs have been adopted, these provisions will be fully aligned to the PFMIs principle on access and participation, and the broad public policy on disclosure and transparency.
Adopt a rules-based entry and exit framework, and lower entry hurdles to the financial system.	NPSD is currently reviewing the NPS Act to address among others, entry and exit frameworks in line with the PFMIs and other applicable international standards. In this regard, NPSD has taken a policy view to include a broader definition of payment services in the NPS Amendment Bill and to ensure that NPS is more accessible to non-banks. It is envisaged that restrictions relating to bank sponsorships for non-banks in the clearing and settlement systems would be removed provided that the non-banks meet entry requirements to help increase competition in the NPS particularly in the remittance, mobile money/payments, clearing and settlement environment. The proposal has been included in the NPS Act Review Policy paper to be submitted to Treasury during the third quarter of 2017 for translation into the NPS Amendment Bill.

Annex X. Introduction of a National Minimum Wage

An agreement was reached in February 2017 among social partners (government, trade unions, and employers' associations) to establish, for the first time in South Africa, a national minimum wage (NMW). The agreement was informed by extensive consultation of a wide range of domestic stakeholders and a comprehensive study.[1] National minimum wages have the potential to improve incomes and well-being for workers currently earning less than the proposed minimum. Moreover, other aspects of the agreement (not discussed in this note), such as measures to reduce the likelihood and duration of strikes, are expected to improve labor relations and economic efficiency. At the same time, minimum wages can induce some firms that currently pay workers less than the proposed minimum to reduce employment. This note places the new NMW in context through comparisons to other countries and to existing sectoral minimum wages in South Africa. It also analyses how many workers are currently employed at wages below the NMW in each sector.

Level and Modalities

1. The NMW is set at R20 per hour (equivalent to $1.35 at market exchange rate at end-2016 or $3.44 at 2016 purchasing power parity). The expectation is that this would normally translate into R3,500 per month, given a mode of 175 hours per month. It is envisaged that the NMW would become effective in May 2018. Two sectors will have a lower minimum wage upon introduction of the NMW: farm workers (R18, or 90 percent of NMW) and domestic workers (R15, or 75 percent of NMW). It is expected that the exemption will be a transitional arrangement lasting for two years.

International Comparisons

2. Several indicators are widely used to compare minimum wages internationally, including (i) the minimum-to-median wage ratio, (ii) the minimum-to-mean wage ratio, and (iii) the minimum wage to gross national income (GNI) ratio. The first measure, the minimum-to-median wage ratio, is usually considered the most appropriate one because the median wage is generally closer than the mean wage or GNI to the wage levels of workers in the proximity of the minimum wage. (In all countries, the mean is higher than the median, because a large share of the population earns relatively low wages, and a small share earns very high wages). This is even more so for South Africa, where the distribution of wages is highly unequal, and thus the gap between the median and the mean is especially large.

3. The international minimum-to-median ratio has been computed using the latest available data (usually for 2015) for the minimum and median wages from the OECD database.[2] For 11 emerging market countries not covered by that source, the Rani et al. (2013) estimation has been

---

[1] National Minimum Wage Panel Report to the Deputy President, 2016, *A National Minimum Wage for South Africa*. This note draws on that report and uses some of the same data sources.

[2] The OECD data is from https://data.oecd.org/

used.[3] For South Africa, the data refer to the projected median monthly wage of R3,250 in May 2018 (when the NMW may become effective). The projection is obtained by applying the median wage growth rate of 2 percent observed from 2014 to 2015[4] to the 2015 median monthly wage of R3,100 (LMDS2015). On that basis, the NMW would be slightly above the median wage (1.08 ratio), that is, the NMW would be higher than the projected wage for slightly more than half of the workers. Indeed, South Africa's minimum-to-median ratio would be the highest in the sample (Figure A10.1). Alternatively, considering the minimum-to-median ratio of 0.72 estimated in the panel's report based on the 2014 wage distribution excluding the agriculture and domestic workers and adjusting the median wage by inflation till May 2018, South Africa would rank as the fifth highest.

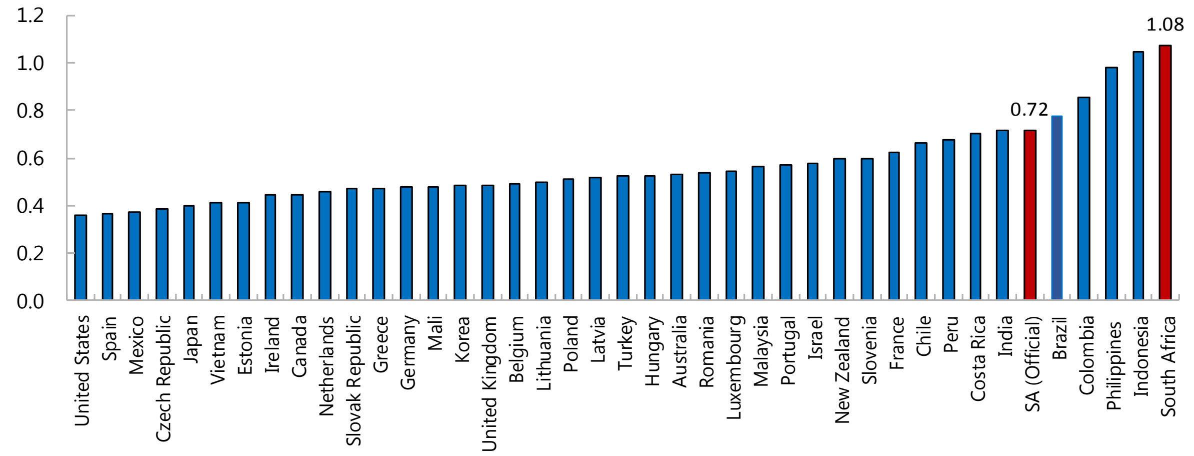
4. Considering instead the minimum-to-mean wage ratio (Figure A10.2), South Africa is among the lowest in the sample. This result holds using the 0.33 ratio estimated in the panel's report or the 0.36 computed as the ratio between the minimum wage and the projected mean wage for May 2018 (applying the IMF staff's projected CPI inflation in 2017 and 2018 to the mean wage in 2016). As noted above, the large discrepancy between the minimum-to-median ratio and the minimum-to-mean ratio reflects major wage inequality in South Africa, which drives down the median wage substantially for a given average wage.

5. Using the ratio of the minimum wage to the per capita GNI for 2015, South Africa is the highest among the BRICS countries and higher than the majority of the countries in the sample. As the GNI data refer to 2015, to compute the ratio for South Africa, the minimum wage of R3500 (effective in May 2018) was converted to 2015 prices by using actual CPI inflation in 2016 and the projected inflation for 2017 and 2018.

[3] Since South Africa has aspects of both an advanced and an emerging economy, this annex seeks to compare the minimum wage level in South Africa with the one prevailing in a broad sample of advanced and emerging economies. For this purpose, the OECD database and the database from Rani et.al (2013) have been combined given their broad coverage of advanced and emerging economies respectively.

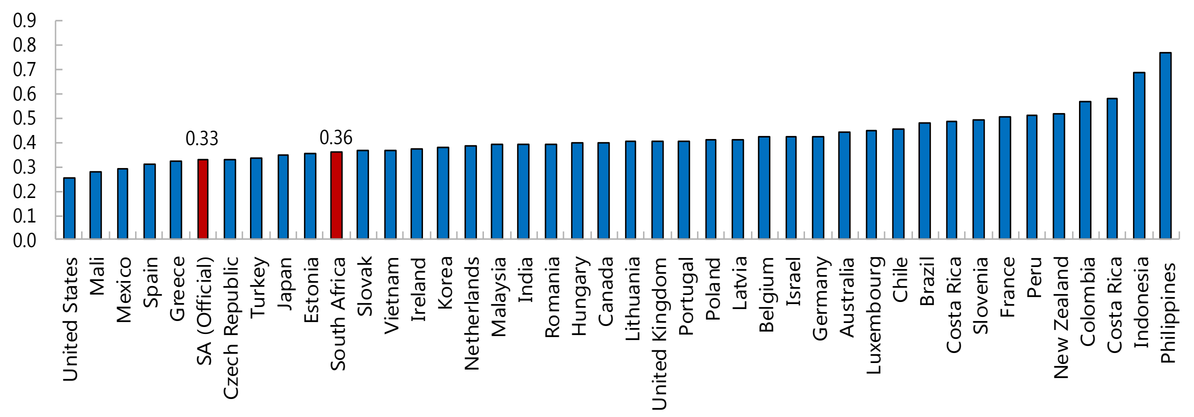
[4] The median monthly wages are R3,033 and R3,100 for 2014 and 2015 respectively. An alternative is to use the past 5-year average median wage growth rate (1.4 percent given that the 2010 median monthly wage is R2,900), which would generate similar results

Figure A10.1. Minimum-to-median wage ratio



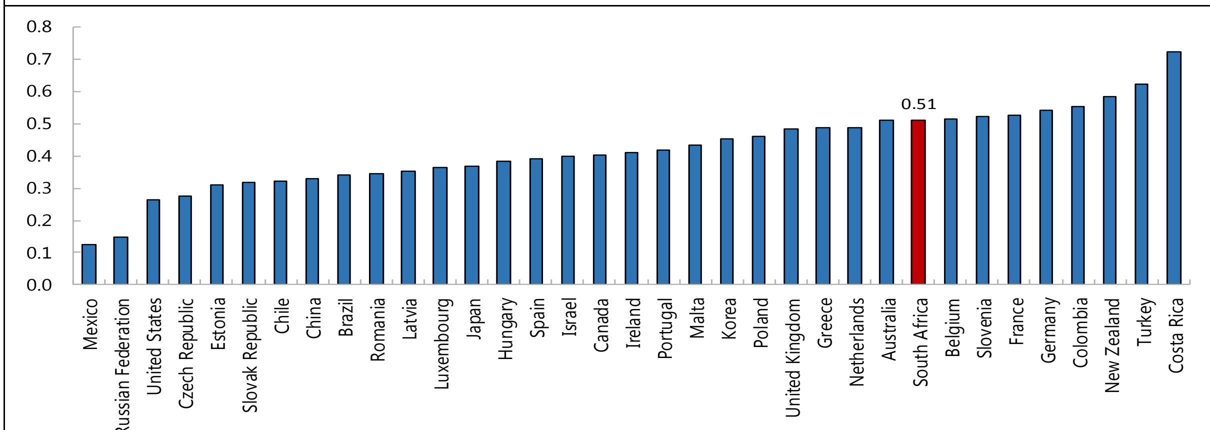
Sources: OECD 2015, Rani et.al 2013, LMDS2015 and IMF staff calculation

Figure A10.2. Minimum-to-mean wage ratio



Sources: OECD 2015, Rani et al. 2013, LMDS 2015 and IMF staff calculation

Figure A10.3. 2015 Minimum wage (PPP)/GNI (PPP)



Sources: OECD 2015, World Bank and IMF staff calculation

Comparing the NMW with the Existing Wage Distribution and Sectoral Minimum Wages

6. The proposed NMW is higher than the wages currently earned by 47.3 percent of total employed workers (Table A10.1).[5] The sectors with the largest shares of workers currently below the NMW are agriculture (84.5 percent) and the private household sector (90.7 percent). Half of the workers in construction as well as wholesale and retail trade also currently earn less than the NMW. The bulk of workers in modern, formal firms in internationally-integrated industries, especially mining, manufacturing, and financial services earn wages well in excess of the NWM.

7. The proposed NMW is also above a majority of the sectoral minimum wages already in place in South Africa (Table A10.2). The May 2018 NMW has been converted to 2016 prices using the projected average inflation of 6 percent in 2017–18 and it has been adjusted for agriculture (90 percent of NMW) and domestic workers (75 percent of NMW). In some cases, existing minimum wages depend not only on the sector but also on factors such as job subcategories, seniority, etc. Existing sectoral minimum wages are at or below the proposed NMW except the top end of the minimum wages for private security as well as wholesale and retail trade.

Table A10.1. Workers currently earning less than NMW, by sector

Sector	Number of Workers	Number of Workers within Industry Earning Below R3500	Workers Within Industry Earning Below R3500	Share of Total Number of Workers Earning Below R3500	Share of Total Number of Workers Earning Below R3500
Agriculture	657,286	555,193	84.5%	4.2%	8.9%
Mining and Quarrying	427,869	77,912	18.2%	0.6%	1.3%
Manufacturing	1,565,716	622,181	39.7%	4.7%	10.0%
Electricity, gas and water supply	117,118	27,982	23.9%	0.2%	0.5%
Construction	948,331	517,786	54.6%	3.9%	8.3%
Wholesale and Retail Trade	2,307,491	1,112,935	48.2%	8.5%	17.9%
Transport, storage and communications	810,423	319,453	39.4%	2.4%	5.1%
Financial Services	1,816,839	671,008	36.9%	5.1%	10.8%
CSP	3,261,921	1,190,986	36.5%	9.1%	19.2%
Private Households	1,235,770	1,120,636	90.7%	8.5%	18.0%
Other	3,933	2,021	51.4%	0.0%	0.0%
Total	13,152,697	6,218,092		47.3%	100.0%

Sources: National Minimum Wage Panel Report to the Deputy President 2016 and IMF staff calculations.

[5] Wage data are drawn from the National Minimum Wage Panel Report to the Deputy President 2016.

Table A10.2. Comparison between the 2016 sectoral minimum wages and the NMW

Sectoral	SD Range	SD-to-NMW Ratio
Agriculture	R2,789	0.96
Forestry	R2,789	0.96
Domestic Workers	R1,940-R2,210	0.80-0.91
Private Security	R2,212-R6,586	0.69-2.04
Wholesale and Retail	R2,690-R6,961	0.84-2.16
Taxi	R2,261-R3,232	0.70-1.00
Hospitality	R2,954-R3,292	0.92-1.02
Contract Cleaners	R3,043-R3,341	0.94-1.04

Sources: Department of Labor and IMF staff calculations.

Notes: The sectoral minimum wages in some cases depend on factors such as the subcategory of job, seniority, etc. Thus, the table reports the range of minimum wages for each sector. The NMW (May 2018) has been adjusted to 2016 prices using the projected 6 percent inflation rate. The domestic workers minimum wage is 75 percent of the NMW and agricultural minimum wage is 90 percent of the NMW.

Compliance Rates

8. The impact of introducing the NMW on both employment and inequality depends on the extent to which employers comply with it. International experience suggests that, especially in non-advanced economies, high minimum wages are usually accompanied by a significant share of informal employment as well as low compliance. For instance, considering the three countries with the highest minimum-to-median wage ratios following South Africa in Figure A10.1, the share of informal employment is estimated at 55 percent for Colombia (ILO 2014), 60 percent for Indonesia (Rani et al. 2013) and 71 percent for the Philippines (ILO 2014). Rates of compliance with the minimum wage are estimated at 47 percent for Indonesia and 59 percent for the Philippines, as well as 30 percent for Costa Rica—another country with a relatively high minimum wage (Gindling and Trejos 2010). Similarly, in Turkey, it is estimated that half of women and 30 percent of men are employed in the informal sector (IMF 2016).[6]

9. International experience suggests that increases in minimum wages can reduce compliance as well. For example, in Indonesia, 21 percent of regular wage employees received wages below the applicable provincial minimum wage in August 2001. Between 2003 and 2008, when minimum wage was steadily increased and average wages stagnated, non-compliance rose to nearly 40 percent. The empirical association between higher minimum wages and a lower share of workers in formal activities has also been documented for Kenya (Andalón and Pagés 2007), Nicaragua (Alaniz, Gindling and Terrell 2011), and Turkey (IMF 2016).

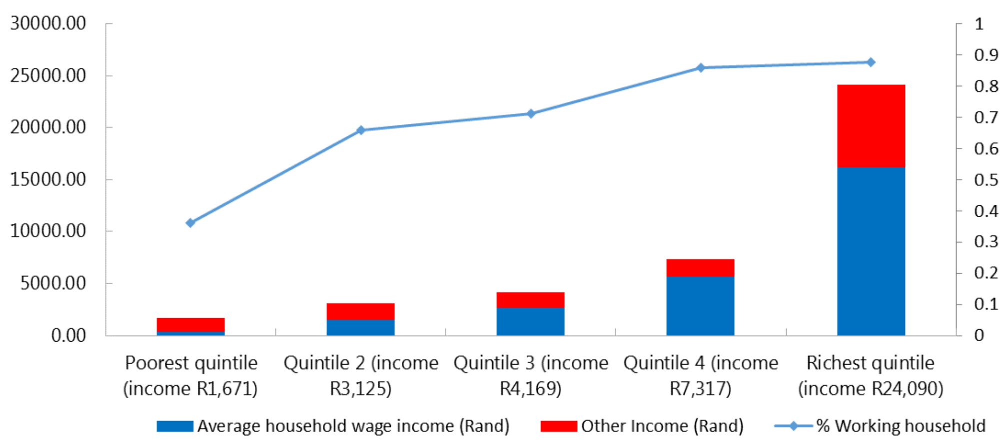
[6] To encourage compliance and to reduce any associated adverse effects on employment, Turkey reduces the fiscal burden on minimum wage earners and their employers.

In South Africa, whereas informal workers represent a relatively low share of total employees (16.7 percent in 2016Q4, Quarterly Labor Force Survey), the rate of compliance with minimum wages in the formal sector is estimated to be only 55 percent, with an average shortfall of 36 percent of the applicable minimum wage (Bhorat, Kanbur and Mayet 2010, 2012). The impact of introducing a NMW would be mitigated by such relatively low compliance rates, and they could drop further as a result of the rise in applicable minimum wages.

Poverty Reduction

10. Whereas the NMW would likely reduce inequality, the impact on poverty of introducing the proposed NMW is likely to be limited. Families in the lowest-income quintile (containing almost one third of the population) earn only 24 percent of their family income, that is R1,671 on average, from wages, and only 36.2 percent of the households in the lowest-income quintile are working households. About 76 percent of the monthly family income of this quintile is from social grants (R1,270). Moreover, people in the lowest-income quintile are usually employed in the informal sector or the sectors with the lowest compliance with minimum wages, such as agriculture, security, and domestic work and would therefore be less likely to see wage increases as a result of the introduction of the NMW. Overall, the NMW's effects in reducing poverty for the poorest families should not be overestimated. Other policies are needed to make a more significant dent in poverty.

Figure A10.4. Household income structure and working household percentage



Impact on Employment and Other Macroeconomic Variables

11. South African studies provide supporting evidence to allow fragile sectors, such as agriculture and domestic work to have a lower minimum wage upon introduction of the NMW. Conradie (2004), using data from a survey of 190 grape farmers, shows that a wage increase of 10 percent will decrease employment by between three and 6 percent. Bhorat, Kanbur and Stanwix (2015) and Garber (2015) show that after the sectoral minimum wage law in agriculture was launched in 2003, wages rose by approximately 17 percent, and the probability of employment for a farmer fell by approximately 13 percent in the post-law period. The elasticity of employment demand with respect to wages, and thus the impact on jobs of increases in the minimum wage, depends on various factors difficult to estimate. Among them is the extent to which firms enjoy economic rents. In cases where such rents exist and currently accrue to the firms' owners, an increase in the minimum wage would shift part of the rents to the workers, with limited effect on employment. On the other hand, job losses could be more sizable in more competitive markets.

12. The impact of the NMW on international competitiveness or the government's wage bill is likely to be limited, because most workers in firms engaged in international trade as well as government employees already earn wages above the proposed NMW. Likewise, no mechanism is envisaged whereby the introduction of the NMW would shift the entire wage structure in firms or the government.

Conclusion

13. The NMW level seeks to balance the objectives of ensuring a reasonable living standard for millions of workers who are currently near or below the poverty line, and of preserving employment levels. The proposed NMW, at R20 per hour, is nevertheless on the high side of several comparisons (i.e., with other countries, with existing sectoral minimum wages in South Africa, and with the current wage levels for large segments of South Africa's employed labor force) risking adverse employment effects. Employment performance should therefore be closely monitored after the NMW becomes effective, especially in the sectors most likely to be affected. To reduce the possibility of undue employment reductions, rules-based exemptions beyond those for agriculture and domestic workers could be considered—for example, for newly-hired youth. Should employment performance worsen significantly for small- and medium-sized enterprises, the introduction of complementary measures should be considered to provide them with adequate support

References

Alaniz, Enrique, T.H. Gindling and Katherine Terrell. 2011. "The Impact of Minimum Wages on Wages, Work and Poverty in Nicaragua", *Labour Economics,* Vol. 18.

Allen, Emma. 2016. "Analysis of Trends and Challenges in the Indonesian Labor Market", Asian Development Bank Papers on Indonesia.

Andalón, Mabel and Carmen Pagés. 2008. "Minimum Wages in Kenya", Institute for the Study of Labor Discussing Paper, No. 3 390.

Bhorat, Haroon, Ravi Kanbur, and Natasha Mayet. 2010. "Minimum Wage Enforcement in South Africa: Measurement and Determinants", Trade & Industrial Policy Strategies Annual Forum Papers.

________. 2012. "Minimum Wage Violation in South Africa", *International Labour Review*, Vol. 151, Issue 3.

Bhorat, Haroon Ravi Kanbur and Benjamin Stanwix. 2014., "Estimating Impact on Minimum Wages on Employment, Wages, and Non-Wage Benefits: The Case of Agriculture in South Africa", American Journal of Agricultural Economics, 96(5).

Conradie, B. 2004. "Wages and wage elasticities for wine and table grapes in South Africa," Centre for Social Science Research, Working Paper 90, University of Cape Town. Available from: http://www.cssr.uct.ac.za

Garbers, Chris. 2015. "The Impact of the Agricultural Minimum Wage on Farmworker Employment in South Africa: A fixed Effects Approach", Stellenbosch University Working Paper.

Gindling, T. H. and Juan Diego Trejos. 2010. "Improving Compliance with Legal Minimum Wages in Costa Rica", Working Paper No.1 27, Department of Economics, University of Maryland.

IMF. 2016. "Turkey: Selected Issues", IMF Country Report No.1 6/105 (Washington).

ILO. 2012. "Statistical update on employment in the informal economy", Working Paper.

ILO. 2014. "Trends in informal employment in Colombia: 2009 –2013", Notes on Formalization.

Murray, J. and C. van Walbeek. 2007. "Impact of the Sectoral determination for farm workers on the South African sugar industry: case study of the Kwazulu-Natal North and South Coasts," Centre for Social Science Research, Working Paper 181, University of Cape Town, available from: http://www.cssr.uct.ac.za

Rani, U., P. Belser, S. Oelz and S. Ranjbar. 2013. "Minimum wage coverage and compliance in developing countries", International Labour Review, Vol. 152, Issue 3–4.

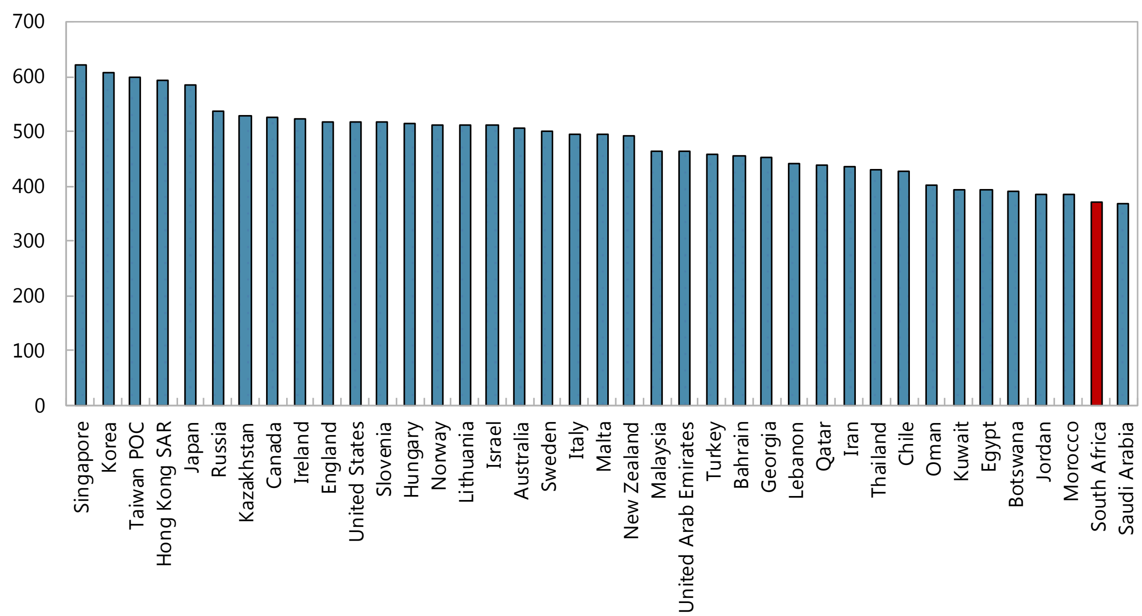
South African Department of Labour, 2016Q4, "Quarterly Labour Force Survey 2016 Q4"

Annex XI. Educational Outcomes: Causes and Consequences

1. South Africa suffers from weak educational attainment, despite public spending on education equivalent to over 6 percent of its GDP, on par with many OECD countries. South Africa was second-to-last in a ranking of 39 countries by the International Association for Evaluation of Educational Achievement for eighth-grade student mathematics performance in 2015 (Figure A11.1). About half of South Africa's students drop out of school before completing secondary education. Among the students attending the end of school examination, about a quarter fail. Less than 5 percent of students who start primary school end up with a university diploma. Another OECD report shows that more than two-thirds of South African students lack basic skills, a significantly worse performance than in most countries surveyed.[1]

2. The performance of South Africa's education system lags considerably behind other countries (such as Romania, Thailand, and Tunisia) with similar education spending in 2015 (Figure A11.2). South Africa's scores are also well below the line-of-best-fit between educational attainment and GDP per capita (Figure A11.3). South Africa's results in terms of basic skills are similar or, in some cases, significantly worse than in neighboring countries, as evidenced by the Southern and Eastern African Consortium for Monitoring Education Quality (SACMEQ) mathematics and reading skill evaluation for six-grade students (Table A11.1), although South Africa spends 2-3 times more per pupil than do its neighbors.

Figure A11.1 2015 TIMSS Eighth-Grade Student Mathematics Evaluations Score



Sources: IEA, World Bank and IMF staff calculation.

[1] OECD, July 2015, South Africa Policy Brief.

Figure A11.2. PISA Score and Education Spending, 2015

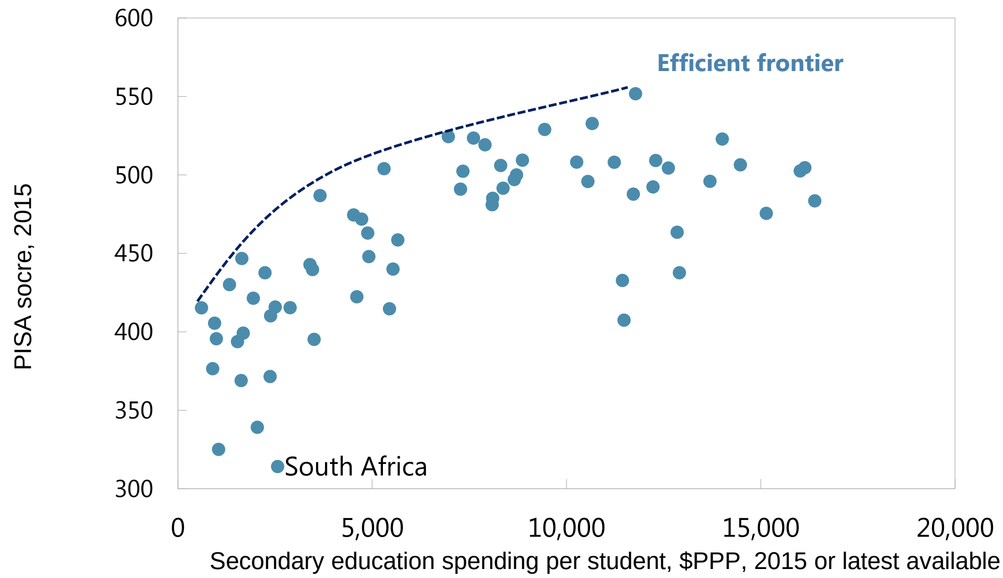
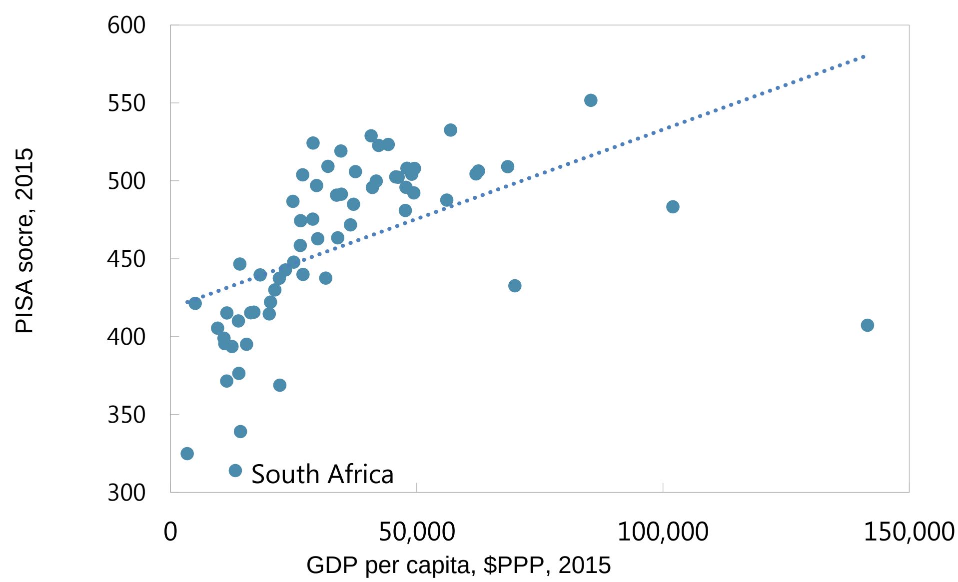


Figure A11.3. PISA Score and GDP per capita $PPP, 2015



Sources*:* Organization for Economic Co-operation and Development; World Bank; and IMF staff estimates.

Note: PISA (Program for International Students Assessment) scores assess the competencies of 15-year-olds in reading, mathematics, and science. Education spending is measured in dollars at purchasing-power parity (PPP). The estimated South Africa PISA score is a mapping from the TIMSS score using the methodology of OECD, 2015, *Universal Basic Skills*.

Table A11.1. 2007 and 2013 SACMEQ test results

Country	Learner reading score			Learner mathematics score		
	2007	2013	Difference	2007	2013	Difference
Mauritius	574	597	23	623	694	71
Kenya	543	601	58	557	651	94
Seychelles	575	602	27	551	630	79
Swaziland	549	590	41	541	601	60
Botswana	535	582	47	521	598	77
South Africa	495	558	63	495	587	92
Uganda	479	554	75	482	580	98
Zimbabwe	508	528	20	520	566	46
Lesotho	468	531	63	477	559	82
Namibia	497	599	102	471	558	87
Mozambique	476	519	43	484	558	74
Zambia	434	494	60	435	522	87
Malawi	434	434	0	447	522	75
SACMEQ (Average)	500	507	7	507	584	77

Sources: Southern and Eastern African Consortium for Monitoring Education Quality (SACMEQ).

3. **Multiple and complex factors contribute to South Africa's underperformance in education, often related to the legacy of apartheid, as reflected in differences in educational attainments among the various races.** A sizable share of today's teachers received inadequate education as they grew up under apartheid.[2] While total spending on education is comparable to that of many other countries, a likely contributing factor to weak outcomes is its uneven distribution. Notwithstanding the government's pro-poor school funding policy, public schools in urban areas and those located in richer neighborhoods tend to have more resources per pupil than those in poorer areas, sometimes supplemented by private resources. Moreover, although children from low-income families have been exempted from school tuition, other costs such as transport and uniforms remain burdensome for them.

4. **Weak educational attainment has profound social and economic consequences.** It contributes to wide income disparities and high unemployment, perpetuates the intergenerational transmission of poverty, and constrains economic growth. The rate of unemployment decreases sharply with the level of education, with an especially large premium for having a university degree.

5. **To improve educational outcomes, several reforms could be considered:** (i) strengthening the training and accountability of teachers, some of whom may need to be upgraded; (ii) improving equity and efficiency in the allocation of resources between rural and urban areas; and (iii) closer coordination between tertiary educational institutions and employers

[2] OECD, 2013, *Improving Education Quality in South Africa*.

to strengthen the labor market relevance of education, including internships and other avenues for school-to-work transition, particularly for disadvantaged youth.

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

June 9, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

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

CONTENTS

RELATIONS WITH THE IMF

As of May 31, 2017

Membership Status

Joined: December 27, 1945

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

General Resources Account	**SDR Million**	**%Quota**
Quota	3,051.20	100.00
IMF holdings of currency (Exchange Rate)	2,630.68	86.22
Reserve Tranche Position	420.55	13.78
Lending to the Fund		
New Arrangements to Borrow	57.92	

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	1,785.42	100.00
Holdings	1,492.60	83.60

Outstanding Purchases and Loans	None	

Latest Financial Arrangements:

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

Projected Payments to the IMF

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

	Forthcoming				
	2017	2018	2019	2020	2021
Principal					
Charges/interest	0.80	1.66	1.66	1.66	1.66
Total	0.80	1.66	1.66	1.66	1.66

Exchange rate arrangement

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

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

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

Article IV consultation

The 2016 Article IV consultation was concluded by the Executive Board on July 1, 2016. South Africa is on the standard 12-month Article IV consultation cycle.

Technical assistance

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

In April 2013, an FAD TA mission visited Cape Town to support the authorities in the establishment of a new Parliamentary Budget Office (PBO). An FAD mission visited Pretoria in August 2013 to discuss options for the National Treasury to strengthen their performance management systems. In December 2013, the National Treasury and FAD held a joint workshop on fiscal risks. In June 2014, FAD missions provided advice on expenditure reviews and on options for further strengthening the PBO, while a mission visited the South African Revenue Service (SARS) to conduct a pilot of the Tax Administration Diagnostic Assessment Tool (TADAT). As part of the technical support for the Davis Tax Committee, an FAD mission on VAT gaps took place in August 2014 and January 2015, and missions on natural resource taxation took place in January and November 2015. An FAD mission visited Pretoria in March 2015 on public sector balance sheets. In December 2015, an FAD mission conducted a workshop on wage bill management and PBO analysis. In March 2016, an FAD mission followed up on the review of mining and petroleum fiscal regimes.

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

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

In May 2014, an MCM mission took place to conduct the training on banking sector stress test for the SARB. In August 2015, an MCM mission conducted seminars on stress testing.

Legal Department (MCM) technical assistance (TA) missions

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

THE JMAP WORLD BANK IMF MATRIX

The IMF South Africa team led by Mr. Paolo Mauro (mission chief) met with the World Bank South Africa team led by Mr. Sebastian Dessus in May 2017, to discuss macrocritical structural issues.

The teams agreed that South Africa's macroeconomic challenges include promoting job creation and improving the long-run inclusive growth needed for maintaining social cohesion, and macroeconomic stability.

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

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

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

Table 1 lists the teams' separate and joint work programs during May, 2017–May, 2018.

Table 1. South Africa: Bank and IMF Planned Activities in Macrocritical Reform Areas, May 2017-May 2018		
Title	**Products**	**Expected Delivery Date**
1. World Bank Work Program[1]	▪ $3.75b IBRD Eskom operation	Ongoing
	▪ Ongoing $250m CTF renewable (solar and wind) operation	Ongoing
	▪ Isimangaliso Wetland Project (GEF) $9.0 m	Ongoing
	▪ Carbon Capture and Storage Development TA, US$14 million	Ongoing
	▪ Land Bank Financial Intermediation Loan (US$100m)	Ongoing
	▪ Cities Support Program Reimbursable Advisory Services (RAS)	Ongoing
	▪ Rural Development and land reform Reimbursable Advisory Services (RAS)	Ongoing
	▪ PFM dialogue	Ongoing
	▪ Economic Updates	Semiannual
	▪ Systematic Country Diagnostic	December 2017
	▪ National Health Insurance TA	Ongoing (Knowledge Hub)
	▪ TB and HIV/AIDS Program	Ongoing (Knowledge Hub)
	▪ Financial sector stability, including financial inclusion dialogue	Ongoing
	▪ TA on helping the NT and the relevant stakeholders decide on how to improve the secondary market architecture	Ongoing
	▪ Analysis of productivity trends and labor demand in South Africa (w/ National Treasury)	Ongoing
	▪ Contingent Liability TA with National Treasury	Ongoing
	▪ Analysis of effect of potential downgrade to sub-investment grade on public borrowing costs	Complete
	▪ Analysis of effective tax rates and efficacy of tax incentives	Complete
	▪ Analysis of innovation policy (w/ National Treasury and Department of Science and Technology)	Ongoing
	▪ Doing Business Reform	Ongoing

	▪ Analysis of competition policy ▪ Analysis of impact of rand volatility on investment ▪ Poverty and Inequality Assessment	Ongoing Ongoing Ongoing
	▪ TA supporting the revision of the strategic benchmarks by the NT based on cost and risk analysis through an analytical tool to be developed	Ongoing
	▪ Technical advisory services with the SARB and GEPF/PIC on the management of the official foreign currency reserves and the pension assets respectively ▪ Private Investment Program	Ongoing Ongoing
	▪ TA supporting the revision of the strategic benchmarks by the NT based on cost and risk analysis through an analytical tool to be developed	Ongoing
	▪ Technical advisory services with the SARB and GEPF/PIC on the management of the official foreign currency reserves and the pension assets respectively ▪ Private Investment Program	Ongoing Ongoing
2. IMF Work Program	▪ Introduction of a National Minimum Wage	Ongoing
	▪ Financial Inclusion	Ongoing
	▪ Macro-financial linkages in South Africa ▪ Exchange rate pass-through to core inflation ▪ SOE reform ▪ Educational Outcomes: Causes and Consequences	All Ongoing
3. Joint products in the next 12 months	No joint products planned at this time	
1/ Missions are ad hoc, but generally occur twice a year.		

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance

General: Data provided to the IMF are adequate for surveillance.

Real sector statistics: Reporting of real sector data for International Financial Statistics (IFS) is timely. Statistics South Africa (SSA), which has been responsible for compiling GDP data by production, has now also taken over the compilation of GDP data by expenditure from the South African Reserve Bank (SARB). The revised 2010−15 GDP data were published in May 2016. GDP data are compiled according to SNA2008, with a base year of 2010.

Quarterly labor market statistics are published one month after the end of the previous quarter. Given the seriousness of the unemployment problem, labor market analysis and policy design would benefit from better and more frequent labor market data. A new Quarterly Labor Force Survey (QLFS) was launched in January 2008 based on major revisions to the old Labour Force Survey that was in existence since 2000. Since 2015, a new Master Sample has been introduced based on the 2011 census data. The new Master Sample should improve the level of precision in the estimates produced compared to the prior Master Sample which was only based on the prior census in 2001.

The consumer price index (CPI) covers all households living in metropolitan and urban areas, which represent approximately 61 percent of the total number of households based on the 2010/11 Income and Expenditure Survey. The current CPI weights were derived primarily from SSA's household expenditure survey. Current price indices are compiled with December 2016=100.

Government Finance Statistics: To move toward fiscal analysis based on the Government Finance Statistics (GFS) framework in compliance with the GFS Manual 2014, fiscal data provided for surveillance by the Treasury Department and data reported to IMF's Statistics Department (STA) for GFS database need to be fully reconciled. Treasury Department's fiscal data covers a part of the general government and do not include the corresponding balance sheet data. Data reported for GFS database, compiled by the South African Reserve Bank (SARB), cover all the general government subsectors and include the balance sheet data.

Monetary and Financial Statistics: Monetary statistics compiled by the SARB are consistent with the methodology of the Monetary and Financial Statistics Manual. South Africa reports regular and good quality monetary statistics for publication in the IFS, although there is room for improving the timeliness of the data on other financial corporations.

Financial sector surveillance: South Africa reports quarterly Financial Soundness Indicators (FSIs) to the Fund, which are published on the IMF's FSI website. The reported information comprises all the core FSIs, 13 encouraged FSIs for deposit takers, and 2 encouraged FSI for other financial corporations (OFCs).

External sector statistics: Balance of payments and international investment position data are reported quarterly and are broadly consistent with the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)*. The authorities improved the coverage of trade flows within the Southern African Customs Union (SACU) in 2013. Work is needed to improve the reliability and accuracy of balance of payments data with the aim of reducing errors and omissions.

Data on the international reserves position are disseminated in line with the requirements of the IMF's *Data Template on International Reserves and Foreign Currency Liquidity*. South Africa also participate in the IMF's Coordinated Portfolio Investment Survey (CPIS) and Coordinated Direct Investment Survey (CDIS).

II. Data Standards and Quality

South Africa subscribed to the Special Data Dissemination Standard (SDDS) on August 2, 1996, and is in observance of the specifications for coverage, periodicity, and timeliness of data.

A Report on Observance of Standards and Codes—Data Module, Response by the Authorities, and Detailed Assessments Using the Data Quality Assessment Framework (DQAF) was published on October 16, 2001.

Table 2. South Africa: Table of Common Indicators Required for Surveillance (as of June 9, 2017)

	Date of Latest Observation	Date Received[7]	Frequency of Data[8]	Frequency of Reporting[8]	Frequency of Publication[8]	Memo Items: Data Quality – Methodological Soundness[9]	Memo Items: Data Quality – Accuracy and Reliability[10]
Exchange rates	6/9/2017	6/9/2017	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities[1]	5/31/2017	6/7/2017	M	M	M		
Reserve/base money	4/30/2017	5/30/2017	M	M	M		
Broad money	4/30/2017	5/30/2017	M	M	M		
Central bank balance sheet	5/31/2017	6/7/2017	M	M	M	O, O, LO, O	LO, O, O, O
Consolidated balance sheet of the banking system	4/30/2017	5/30/2017	M	M	M		
Interest rates[2]	6/9/2017	6/9/2017	D	D	D		
Consumer Price Index	4/30/2016	5/24/2016	M	M	M	O, O, O, O	O, O, O, O
Revenue, expenditure, balance and composition of financing[3] – consolidated government[4]	FY16/2017	2/22/2017	Y	Y	Y	O, O, O, O	O, O, O, O
Revenue, expenditure, balance and composition of financing[3]–central government	4/2017	5/30/2017	M	M	M		
Stocks of central government and central government-guaranteed debt[5]	12/2016	3/22/2017	M	Q	Q		
External current account balance	Q4 2016	3/22/2017	Q	Q	Q	LO, LO, LO, LO	LO, LO, LO, LO
Exports and imports of goods and services [6]	4/2017	5/30/2017	M	M	M		
GDP/GNP	Q1 2017	6/06/2017	Q	Q	Q	O, LO, LO, LO	LO, O, O, O
Gross external debt	Q4 2016	3/31/2017	Q	Q	Q		
International investment position	Q4 2016	3/31/2017	Q	Q	Q		

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The consolidated government consists of the central government, provincial governments, social security funds, and certain public entities.
[5] Including currency and maturity composition.
[6] Monthly data for goods. Goods and services are published quarterly on the same schedule as the rest of the balance of payments.
[7] Reflects the latest information released by the IMF Statistics Department by 5/26/2016.
[8] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[9] Reflects the assessment provided in the data ROSC (October 2001) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed LNO), or not observed (NO).
[10] Same as footnote 8, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation, and revision studies.

Statement by Ms. Tshazibana, Alternate Executive Director for South Africa, and Mr. Sishi, Senior Advisor to the Exective Director
June 26, 2017

On behalf of the South African authorities, we thank staff for the useful and detailed discussions during the 2017 Article IV Consultation. We also welcome the comprehensive analysis of economic developments and policy issues. Overall, structural challenges continue to weigh down on economic growth and the living standards of much of the population, making economic transformation even more urgent. The authorities remain concerned about low growth and declining per capita incomes. They broadly share staff's assessment on the economic outlook and risks, and the need to focus on inclusive growth.

As reflected in the 2017 Budget and all stakeholder engagements, the authorities remain determined to bolster business and consumer confidence and promote investment to stimulate economic growth. While concerns over poor growth are warranted and shared, it is critical to bear in mind that South Africa still has strengths that are essential foundations of growth, including deep and liquid capital markets, a significant majority of total liabilities in domestic currency, a relatively diversified industrial base, and strong constitutional institutions.

Recent Economic Developments and Outlook

Recent economic developments reflect a combination of macroeconomic improvements alongside deterioration in some other areas. The normalization in rainfall patterns has supported a rebound in agricultural output, while mining production is up on the back of moderate improvements in commodity prices. Household debt stocks – which peaked at nearly 90 percent of disposable incomes in 2008 – are now back to 2006 levels, slightly above 70 percent. The current account deficit has also narrowed on the back of an increasingly positive trade balance, moving to below 4 percent of GDP in 2016, while inflation has moderated. However, subdued manufacturing production and weakness in the retail and financial sectors continued to weigh on growth, resulting in the contraction of GDP in the fourth quarter of 2016 as well as in the first quarter of 2017.

Consistent with the broad trends in staff's assessment, the authorities expect a rebound in economic performance over the medium-term. Official forecasts tabled in February 2017 are for growth of 1.3 percent in 2017 and 2 percent in 2018. A revised forecast that takes first and second quarter growth outcomes into account will be published in the Medium-Term

Budget Policy Statement in October 2017. Meanwhile, the authorities expect inflation to remain within the target range of 3-6 percent. Import growth is expected to remain low due to the subdued levels of domestic demand, thus containing the current account deficit to around 3.5 percent of GDP.

The authorities assess risks to the outlook to be titled towards the downside due to rising global policy uncertainty, persistently low consumer and business confidence and the constraining effects of long-run structural challenges of unemployment and inequality. This underlines the importance of the authorities' goal of achieving better income distribution through transformation for inclusivity.

Fiscal Policy and Public Debt Management

The authorities' fiscal stance is driven by three overarching considerations: the macro-economic outlook; budget execution; and risks emanating from the financial position of state-owned entities (SOEs). Despite weaker growth in recent years, the authorities have maintained an excellent record of containing the fiscal deficit. Accordingly, the main budget balance was reduced to -3.9 percent in 2016/17.

The 2017 Budget re-emphasizes the authorities' determination to protect public finances and create an enabling environment for economic growth. Based on the authorities' growth forecasts, the consolidated deficit is projected to narrow to 2.6 percent in 2019/20, aided by additional fiscal consolidation measures that will further reduce the spending ceiling by R26 billion and raise additional revenues of R13 billion. Nevertheless, the authorities have taken note of staff's growth projections. Within the budget framework, they have made it clear that should growth outcomes disappoint, they would adjust their medium-term spending plans accordingly while protecting social spending for the most vulnerable.

Within the lower spending ceiling, the authorities have reprioritized spending by cutting the government wage bill and other current spending, and re-allocated the funds to education, health services, social protection, and municipal functions in rural areas. The newly-reformed government procurement system is already a major tool for efficiency and transparency.

Recent ratings downgrades and the hike in US interest rates pose risks for government debt, while low growth remains the main reason for the rise in gross debt. In this regard, the authorities will continue to manage public debt through active debt-management practices and in terms of the strategic portfolio risk benchmarks published annually in the Budget. The limit for foreign-currency denominated debt is set at 15 percent of the total debt portfolio, and domestic markets continue to be the main source of government borrowing. In the meantime, short-term risks have been substantially mitigated by lower inflation and sustained appetite for emerging market securities, largely offsetting the impact of ratings downgrades.

The public-sector borrowing requirement is also affected by the financial position of SOEs. In response to elevated risks, no additional guarantees are currently planned for SOEs, and reductions in overall transfers to state owned entities are reflected in the 2017 Budget. Meanwhile, the authorities have taken several steps to improve governance, including through approval by the Cabinet of a collaboration framework between SOEs and the private sector, guidelines for the remuneration and appointment of board members and corporate executives, as well as a new shareholder policy. The Cabinet is also expected to consider new efficiency rules for SOEs during the 2017/18 fiscal year.

Monetary Policy

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) kept the policy rate unchanged at its most recent meeting in May 2017. Headline inflation has declined to within the target range of 3-6 percent, and the SARB expects it to reach levels of around 5.4 percent in the final quarter of 2017, due to a sustained slowdown in food, fuel and electricity price increases. Core inflation also decelerated due partly to the resilience of the currency during much of 2016, supported by an improved current account and positive global sentiment towards emerging markets.

Given the overall macro-economic developments, including the widening negative output gap, the SARB has indicated that it is likely that the end of the tightening cycle that began in 2014 has been reached. However, the improvement in the outlook is still modest and inflation expectations remain elevated. In this regard, the longer-term forecast trajectory is uncomfortably close to the upper end of the target range, leaving little headroom to absorb unforeseen shocks. Therefore, risks to the inflation outlook are assessed as more or less balanced.

Import cover was above 5 months in December 2016 and has slowly improved in the first quarter of 2017. In the meantime, as reflected in the staff report, the current account deficit continues to narrow due to an improving trade balance, while non-financial corporations remain well-hedged against foreign currency risks, and the fully flexible exchange rate continues to be a key aspect of the economy's fundamentals. The authorities will continue to utilize occasional foreign exchange inflows to replenish reserves.

Financial Sector Policy

The domestic financial sector remains robust and resilient, aided by effective supervision of the sector through established rules and standards, historically deep and liquid domestic markets, a flexible exchange rate, and low foreign currency exposure. The banking sector continues to achieve high capital adequacy levels of around 15.9 percent, with non-performing loans remaining stable at 2.9 percent in 2016. The liquidity coverage ratio has continued to rise above the minimum requirement of 70 percent, reaching 107.8 percent in December 2016. Meanwhile, credit growth has fallen, with growth in gross loans retreating to around 3 percent in 2016 compared to 11.3 percent at the end of 2015. While lower credit extension has negative implications for household consumption, this reflects an expected outcome of the more stringent lending rules that are bringing correction to the market and helping with needed deleveraging among households.

Since the last Article IV consultation the Financial Sector Regulation (FSR) Bill was passed by the lower house of Parliament and is likely to be enacted soon. The Bill assigns primary responsibility for protecting and enhancing financial stability, which used to be shared with the Financial Services Board, to the SARB. In addition, the Financial Intelligence Center Act (FICA) has been signed into law, thus fully aligning the country with international standards on AML/CFT. With stress tests already institutionalized, thematic on-site inspections and reviews by the SARB's Bank Supervision Department now include AML/CFT checks.

The authorities agree with staff that financial inclusion and increased competition in the banking sector should be a major priority. There are currently 32 banking institutions in the country, excluding mutual and cooperative banks. In 2016, three institutions were granted new banking establishment authorizations, and the SARB is focused on promoting a multi-tiered system, which can provide more tailored financial services, including to small and medium-sized enterprises (SMEs). In the meantime, while appreciating staff's useful analysis, the authorities maintain a prudent and balanced approach to financial inclusion, by also focusing on preventing high household indebtedness and the associated risks.

Structural Reforms

Policy actions continue to be guided by the National Development Plan (NDP), which emphasizes inclusive growth through broad-based transformation and breaking down structural impediments to new economic activities, increased competition in industries dominated by a few participants, accelerated market inclusion for previously disadvantaged groups, and a return to a path of rising per capita incomes. To achieve this, the authorities will prioritize education and skills development, strengthen competition laws, increase private sector participation in industries dominated by public sector enterprises, provide support to labor-intensive sectors such as agriculture and tourism, and overcome spatial fragmentation in urban areas.

The authorities are committed to tackling infrastructure bottlenecks that hinder growth. Economic infrastructure accounts for around 77 percent of all government infrastructure spending over the medium-term. In this regard, one of the most important reforms is the establishment of a new facility that is designed to streamline many of these projects through a uniform life-cycle costing and budgeting process, thus achieving greater efficiency within the existing budget. In addition to these, the authorities have committed to signing off on the outstanding power purchase agreements with independent power producers (IPP) in renewable energy and gas. The IPP program has contributed not only to minimize electricity supply shortages over the past year but to also diversify the energy mix and increase private sector participation in the electricity sector.

The government procurement system will also become an important vehicle for transformation. In 2017, revised preferential procurement policy regulations, designed to channel most of the government's R500 billion annual procurement towards local producers and previously disadvantaged groups, took effect. The budget also supports private sector job creation, including through allocations to promote tourism, small and medium enterprises and cooperatives, agriculture, as well as scientific and industrial research.

The most recent initiative to address inequality is the agreement between business, labor, and the government on a national minimum wage. When implemented, this could contribute towards reducing wage inequality and increase domestic demand. Negative employment effects will be mitigated by the existence of sector-determined minimum wages already in place in several sectors. In addition, provision has been made for exemptions of small enterprises that cannot afford the wage increases, while any inflation-inducing indexation moves will be prevented. The authorities continue to recognize that addressing education shortcomings and wage rigidities should be prioritized.

Conclusion

The authorities remain committed to macro-economic policies that promote growth, confidence, and financial stability. They view the macro policy stance, including inflation targeting, a flexible exchange rate, and deficit reduction as broadly appropriate for promoting growth and reducing volatility. Additional policies to deliver a more inclusive growth outcome are indispensable to achieving long-run growth and the authorities agree with staff that these can be implemented in a manner that promotes socio-political stability. The authorities look forward to the Fund's continued contribution to their reform efforts.