INTERNATIONAL MONETARY FUND

South Africa: Staff Concluding Statement of an IMF Staff Visit
December 13, 2016

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. This mission will not result in a Board discussion.

An International Monetary Fund (IMF) mission visited South Africa December1-9, 2016, to discuss the outlook, risks, and policy challenges facing the South African economy. At the end of the visit, the staff issued the following statement:

Reforms to Lift Growth and Permit More Gradual Fiscal Adjustment

Since 1994, economic growth and sound policies have been mutually reinforcing, fostering economic transformation and improving living conditions. However, the long-run economic growth rate has gradually slowed over the years. Following the onset of adverse shocks such as the decline in commodity prices, economic activity has come to a near-standstill in 2016 and the projected recovery to almost 1 percent in 2017 remains insufficient to keep pace with population growth. With monetary and fiscal policies constrained by the need to keep inflation and the rising public debt in check, there is an urgent need to reinvigorate policies to allow greater entry by new firms into key service and product markets as well as to reduce impediments to job creation in the labor market.

Both global and domestic factors will likely weigh on output growth next year. Global commodity prices are projected to remain low, despite a recent recovery. U.S. long-term interest rates have picked up during the past few weeks and a gradual normalization of U.S. monetary policy is expected. Among domestic factors, despite the strength of South Africa's institutions, perceptions of weakening governance and of rising uncertainty regarding the direction of policies have been associated with low investment and consumer confidence. On the positive side, wage agreements have been reached with limited strike activity, and greater availability of power supply may be expected to foster an increase in output.

Weak economic growth impedes the economy's ability to curb unemployment and inequality. Moreover, should the slowdown be prolonged, the state of the public finances would face greater risks from declining investor confidence. If a sudden stop in capital

inflows were to ensue, South Africa's floating exchange rate, deep investor base, small share of foreign-currency-denominated government debt and reasonably well-hedged private-sector balance sheets would help to cushion the blow. Nevertheless, imports of consumer and investment goods and services would contract abruptly, and a vicious circle of falling growth and rising debt could not be ruled out.

In the baseline scenario of a moderate resumption of economic growth next year, monetary policy can remain on hold unless inflation expectations rise or external financing becomes challenging. Expectations of headline consumer price inflation are well anchored close to the ceiling of the target range. Inflation is projected to return below the 6 percent ceiling in 2017, as temporary factors—including the severe drought—that pushed it somewhat above the ceiling in late 2016 unwind.

The fiscal measures envisaged under the medium term budget policy statement (MTBPS) strike a balance between maintaining debt sustainability and safeguarding the fragile economic recovery. The modest scale of the measures is consistent with the view that the slowdown reflects both temporary and prolonged factors. Assuming that the policies are fully implemented, and using IMF staff macroeconomic projections, the debt would peak at 54 percent of GDP in fiscal year 2018/19. In the event that economic growth projections for the medium term were further revised downward, additional measures—such as lower increases in public sector wage rates and a moderate increase in consumption taxes—would be needed to stabilize the debt ratio.

Significant fiscal risks stem not only from further downward revisions to the growth forecast, but also from rising contingent obligations in state-owned enterprises (parastatals), which may ultimately fall upon the state budget. As noted by the Presidential Review Committee on State-Owned Entities, reducing risks in this area is key, and work by the National Treasury to distill new guidelines on parastatals is welcome. Priorities include enforcing sanctions for breaches of the Public Financial Management Act, quantifying the costs incurred by SOEs for public service mandates, and compiling a comprehensive database with SOE information for all levels of government. More generally, imposition of penalties is warranted for failures to adhere to procurement guidelines and other irregular expenditures, for which the Auditor General recently found a notable acceleration not only in SOEs but also government departments.

To foster economic growth and job creation, the cost of crucial inputs for businesses and of services for workers—such as electrical power, telecommunications, and transportation—needs to be brought down. To that end, private companies (for example, in electricity generation) should be allowed to compete on a more equal footing with parastatals. Barriers to entry, including those resulting from multiple and occasionally conflicting regulations, need to be reduced. Vigorous action by the Competition Commission to dismantle cartels and to prevent abuse of dominant market positions should also be supported. Moreover, trade liberalization to promote regional integration would reduce input costs and facilitate gaining economies of scale. By undertaking reforms that spur growth, thereby slowing the rise in the public debt ratio, there is an opportunity to reduce the pace of fiscal adjustment.

Recent efforts to reform the labor market have focused on the introduction of a national minimum wage (NMW)—based on a consultative process and the NMW panel report to the Deputy President—and on requiring secret balloting ahead of strikes and mandatory advisory arbitration during prolonged strikes. The proposed NMW level seeks to balance the objective of ensuring a reasonable living standard for millions of people who are currently near or below the poverty line, while preserving employment levels. To reduce the possibility of undue employment reductions, rules-based exemptions beyond those for agriculture and domestic workers could be considered—for example, expanded exemptions for newly hired youth. Experience during the phase-in period should be carefully reviewed and, should significant employment losses be observed, for instance, in the small- and medium-size enterprise (SME) sector, the authorities should stand ready to introduce complementary measures to support SMEs. Further policies to strengthen employment growth include facilitating opt-outs for SMEs from the automatic extension of sectoral wage agreements.

Although vulnerabilities in the financial sector remain low despite anemic economic growth, ongoing initiatives to modernize prudential regulation, financial service consumer protection, and to enhance the resolution framework are needed and welcome. In this regard, it is important to ensure that the Financial Sector Regulation Bill, which moves to group-wide supervision under a single Prudential Authority and establishes a new Financial Sector Conduct Authority, is brought to fruition early in 2017, to be followed later in the year by a financial sector resolution bill, including the establishment of a deposit insurance system.

Finally, greater coordination within the public sector would reduce perceptions of uncertainty and improve the effectiveness of policies. To that end, greater consistency in statements about policies by different public sector representatives and implementation of centralized evaluation of all policy proposals prior to their approval would be warranted.

Completion of a set of initial reforms in product and labor markets would help to strengthen confidence, foster investment, and restore much-needed economic growth and job creation.

We thank the authorities for productive discussions and their warm hospitality.

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

Social Indicators

GDP		**Poverty**	
Nominal GDP (2015, billions of U.S. dollars)	315	Headcount ratio at $1.90 a day (2011 PPP) (percnet of population)	16.6
GDP per capita (2015, U.S. dollars)	5,721	Undernourishment (2012, percent of population)	5.0
Population characteristics		**Inequality (2011)**	
Total (2015, million)	55		51.3
Urban population (percent of total), 2014	64		2.5
Life expectancy at birth (years), 2016	62		63.4

Economic Indicators

	2012	2013	2014	2015	2016	2017
					Proj.	
National income and prices (annual percentage change unless otherwise indicated)						
Real GDP	2.2	2.3	1.6	1.3	0.3	0.8
Real GDP per capita	0.7	0.8	0.1	-0.3	-1.3	-0.8
Real domestic demand	3.5	3.3	0.6	1.6	0.0	0.4
GDP deflator	5.3	6.6	5.7	4.0	6.5	6.1
CPI (annual average)	5.7	5.8	6.1	4.6	6.4	6.0
CPI (end of period)	5.7	5.4	5.3	5.2	6.7	5.5
Labor market (annual percentage change unless otherwise indicated)						
Unemployment rate (percent of labor force, annual average)	24.9	24.7	25.1	25.4	26.3	27.0
Average remuneration (formal nonagricultural, nominal)	7.5	10.5	7.5	7.8	8.2	7.8
Labor productivity (formal nonagricultural)	1.1	-2.5	-0.2	2.3	2.8	2.8
Unit labor costs (formal nonagricultural)	6.4	13.4	7.6	4.9	5.2	4.9
Savings and Investment (percent of GDP unless otherwise indicated)						
Gross national saving	14.8	15.2	15.5	16.4	16.0	15.6
Public (incl. public enterprises)	-0.9	-0.9	1.1	1.1	1.0	1.1
Private	15.7	16.0	14.4	15.3	15.0	14.5
Investment (including inventories)	20.0	21.0	20.7	20.7	19.4	18.9
Public (incl. public enterprises)	6.8	7.0	7.3	7.6	6.9	6.6
Private	12.5	13.3	13.2	13.0	12.1	11.9
Fiscal position (percent of GDP unless otherwise indicated) 1/						
Revenue, including grants	27.3	27.6	28.2	29.6	29.7	29.9
Expenditure and net lending	31.4	31.5	31.9	33.4	33.4	33.6
Overall balance	-4.0	-3.9	-3.7	-3.8	-3.8	-3.6
Primary balance	-1.3	-0.9	-0.6	-0.5	-0.3	0.1
Structural balance (percent of potential GDP)	-3.8	-3.8	-3.4	-3.0	-3.0	-2.8
Gross government debt 2/	41.0	44.0	46.9	49.8	51.2	52.8
Government bond yield (10-year, percent) 3/	7.6	7.3	8.2	8.2	9.0	...
Money and credit (annual percentage change unless otherwise indicated)						
Broad money	5.2	5.9	7.3	10.3	6.7	7.0
Credit to the private sector	9.3	6.6	7.2	8.3	6.7	7.0
Repo rate (percent, end-period)	5.0	5.0	5.75	6.25	7.0	...
3-month Treasury bill interest rate (percent) 3/	5.3	5.1	5.8	6.1	7.2	...
Balance of payments (percent of GDP unless otherwise indicated)						
Current account balance (billions of U.S. dollars)	-20.3	-21.6	-18.6	-13.7	-9.4	-9.4
percent of GDP	-5.1	-5.9	-5.3	-4.3	-3.3	-3.3
Exports growth (volume)	0.8	3.6	3.3	4.1	0.7	2.7
Imports growth (volume)	4.2	5.0	-0.5	5.3	-0.4	1.4
Terms of trade (percentage change)	-4.0	-1.4	-1.6	3.4	1.2	-0.6
Overall balance	0.3	0.1	0.4	-0.2	0.7	0.0
Gross reserves (billions of U.S. dollars)	50.7	49.6	49.1	45.8	47.8	47.8
percent of short-term debt (residual maturity)	133.2	130.2	123.8	134.8	128.0	125.3
Total external debt	35.8	37.1	41.3	39.4	48.3	48.2
of which short-term (residual maturity)	9.6	10.4	11.3	10.8	13.3	13.2
Nominal effective exchange rate (percentage change, end-period) 4/	-5.2	-15.4	-2.7	-16.6	-2.0	...
Real effective exchange rate (percentage change, end-period) 4/	-2.0	-12.5	1.3	-13.1	2.7	...
Exchange rate (Rand/U.S. dollar, end-period) 4/	8.5	10.5	11.6	15.6	13.6	...

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

1/ General government unless otherwise indicated.

2/ National government.

3/ January-October for 2016.

4/ October for 2016.