INTERNATIONAL MONETARY FUND

SOUTH AFRICA

Staff Report for the 2008 Article IV Consultation

Prepared by Staff Representatives for the 2008 Consultation with South Africa

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Executive Summary

Background: After several years of relatively high growth, a number of shocks are slowing growth, while pushing inflation and the current account deficit up. Global increases in food and fuel prices have pushed inflation into double digits, while strong investment, including an ambitious public investment program, is contributing to a worrisome widening of the external current account deficit. Policies remain broadly appropriate, with substantial monetary tightening and a small fiscal surplus aiming to moderate domestic demand. The financial sector is sound and well regulated, but now faces a less benign environment.

Challenges: In the near term, it will be critical to preserve macroeconomic stability by containing inflation and addressing external vulnerabilities so that the push to accelerate growth and spur job creation will not be derailed. More fundamentally, higher output and employment growth are needed to reduce still high unemployment and inequality.

Staff views: Risks to macroeconomic stability have increased with rising inflation and the widening current account deficit, the financing of which has become less assured. Further monetary tightening may be needed to prevent second-round effects from the food and fuel price shocks. Given the large public infrastructure program and low private saving, a gradual increase in the structural fiscal balance would avoid exacerbating current account pressures and bolster confidence. In the medium term, increases in saving and investment, deficit-neutral tax and spending policies to strengthen incentives to invest and work, and structural reforms to boost competitiveness and productivity could raise growth and employment.

Authorities' views: While broadly sharing staff's assessment, the authorities were more optimistic regarding risks to external stability as they consider markets to be willing to finance the investment-driven increase in the current account deficit, which they also expect to be somewhat lower than staff's projections. They felt they had little alternative but to increase public investment to address critical infrastructure bottlenecks and noted there was little leeway and support for increasing government saving. The SARB indicated its intention to tighten monetary policy as needed to anchor inflation expectations.

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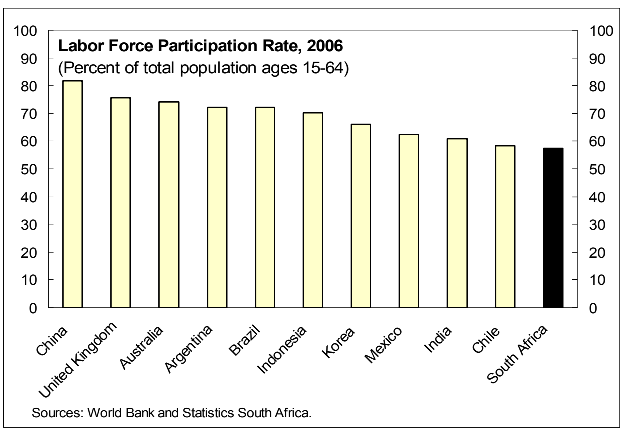
GLOSSARY

ANC	African National Congress
ASGISA	Accelerated and Shared Growth Initiative for South Africa
CAB	Current Account Balance
CAD	Current Account Deficit
CGER	Consultative Group on Exchange Rate Issues
CPI	Consumer Price Index
CPIX	CPI excluding the interest on mortgage loans
EMEs	Emerging Market Economies
EPA	Economic Partnership Agreement
EU	European Union
FDI	Foreign direct investment
FSAP	Financial Sector Assessment Program
FSSA	Financial Sector Stability Assessment
IFS	International Financial Statistics
MPC	Monetary Policy Committee
NPL	NonPerforming Loans
PSBR	Public Sector Borrowing Requirement
REER	Real Effective Exchange Rate
SACU	Southern African Customs Union
SADC	Southern African Development Community
SARB	South African Reserve Bank
SDDS	Special Data Dissemination Standard
SOEs	State-owned enterprises
TFP	Total Factor Productivity
WDI	World Development Indicators
WEO	World Economic Outlook

I. BACKGROUND: STRONG MACROECONOMIC PERFORMANCE AND RISING CHALLENGES[1]

1. **South Africa has made strong economic progress in the past several years**. Good macroeconomic management and favorable external conditions raised growth to 5–5½ percent in 2005–07, lowered inflation to mid-single digits until recently, strengthened the public finances, and improved the external reserve position (Figure 1). Employment grew steadily, allowing the unemployment rate to decline from over 30 percent in 2002 to 23 percent by 2007. The expansion was led by strong domestic demand. Household consumption was driven by growing disposable income and wealth effects from rising housing and stock prices, while private investment was buoyed by strong business confidence and high commodity prices.

2. **At the same time, South Africa has continued to face difficult challenges in overcoming its apartheid legacy and addressing high levels of unemployment and inequality.** Unemployment is high in part because of the strong increase in labor force participation following the end of apartheid, and also because various factors, such as weak product market competition, have supported a two-tier labor market comprising relatively well-paid formal sector workers and others—particularly less-skilled black workers—who have been excluded from employment altogether.[2] Nevertheless, labor force participation remains low by international comparison and growth, although rising, has trailed behind rates in dynamic emerging market economies (EMEs). Income inequality remains among the most acute in the world, highlighting the pressing need to ensure that growth is shared broadly, as underscored by the government.



Income Distribution, latest year

	Gini Index 1	Share of Income Held By:	
		Top 20 %	Bottom 20 %
South Africa	**58**	**62.2**	**3.5**
Brazil	57	60.8	2.9
Chile	55	60.0	3.8
Argentina	51	55.4	3.1
China	47	51.9	4.3
Mexico	46	55.1	4.3
Indonesia	39	47.3	7.1
India	37	45.3	8.1
United Kingdom	36	44.0	6.1
Australia	35	41.3	5.9
Korea	32	37.5	7.9

Source: World Bank, World Development Indicators.

[1] A measure of distribution of income or consumption, where 0 represents perfect equality and 100 represents perfect inequality.

[1] The discussions were held during June 18–July 1, 2008. The mission met with the Minister of Finance, the Deputy Governor of the South African Reserve Bank, senior officials, and representatives from Parliament, the private sector, trade unions, and the academic community. The staff team comprised Ms. Corey (head), Messrs. Cuevas, Gueorguiev, and Eyraud (all AFR), and Ms. Nkusu (PDR). Messrs. Nolan and Burgess, resident representatives in Pretoria, participated in the mission. Mr. Wajid (MCM) joined the mission to discuss the conclusions of the FSAP Update. Mr. Aboobaker (OED) also attended the meetings.

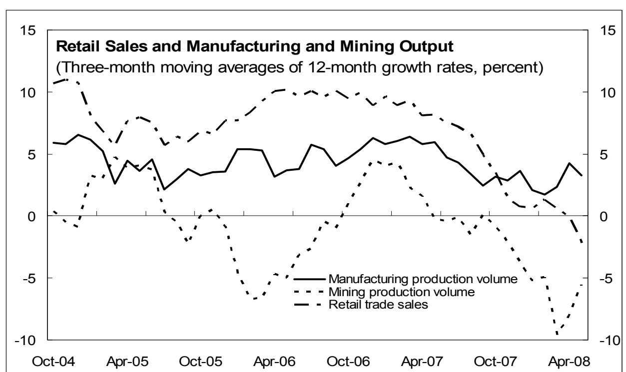
[2] OECD, *Economic Assessment of South Africa,* July 2008.

3. **President Mbeki's government is in its final year in office, with national elections expected in April 2009.** The leadership of the ruling African National Congress (ANC) experienced a major turnover in December 2007, with many incumbents losing office. The new leadership, headed by former Deputy President Jacob Zuma, has underscored the party's commitment to policy continuity in key areas.

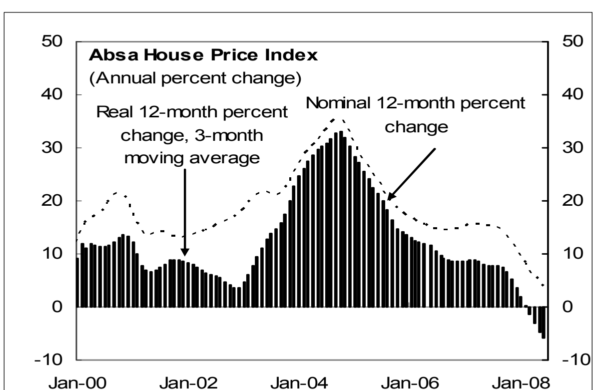
4. **Since the beginning of 2008, the South African economy has been buffetted by a series of shocks.**

- In January, power cuts disrupted output and exports (particularly in mining), taking the public by surprise (Box 1). Continuing power rationing is expected to constrain output growth until additional generation capacity is brought on stream over several years.
- The global financial market turmoil in early 2008 heightened investors' sensitivity to South Africa-specific risk, reflecting concerns about the power crisis, the rising current account deficit (9 percent of GDP in 2008Q1), and the impending political transition. Risk premia on South African debt increased and portfolio inflows turned negative, weakening the stock market index and the rand, which depreciated by about 20 percent between end-2007 and mid-March, before recovering somewhat (Figure 2).
- Global food and fuel price shocks intensified, leading to sharp increases in consumer price inflation (11.6 percent in June) and inflation expectations.

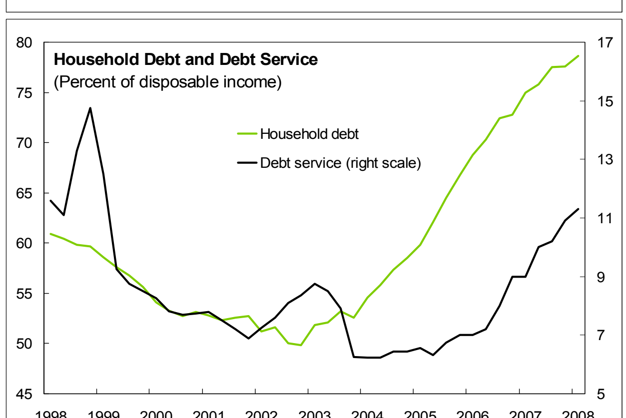
5. **Recent indicators point to a slowdown in activity reflecting the cumulative effect of power shortages, the global slowdown, and past monetary tightening.** Growth of manufacturing and mining output has weakened; retail and vehicle sales have contracted; and residential property price growth has slowed to low single digits. Business and consumer confidence indices now point to



Source: Statistics South Africa.



Source: Amalgamated Bank of South Africa (Absa).

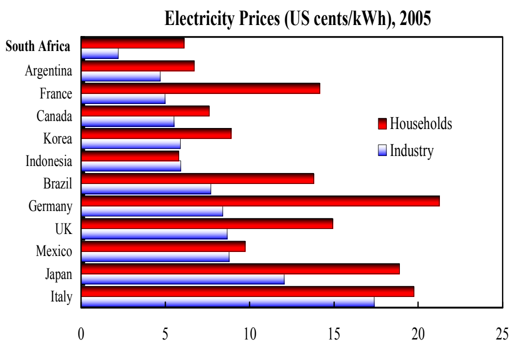


Source: South African Reserve Bank (SARB).

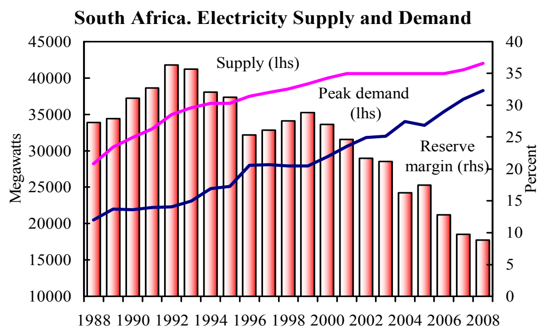
a weakening economy. The expansion in credit to the private sector has moderated somewhat, partly reflecting stricter lending standards introduced in June 2007. Households' debt has reached a record high, while the continued rise in debt service—largely reflecting the rise in mortgage interest rates—has dampened consumption. Investment, however, remains strong reflecting in part higher public infrastructure spending.

Box 1. South Africa's Power Crisis

South Africa has long produced low-cost electricity, reflecting its abundant coal reserves. Electricity prices have been among the lowest in the world, some 60 percent below the average price in major economies—a key factor in the development of energy-intensive mining and mineral processing sectors.



Source: International Energy Agency.



Source: Eskom.

South Africa's electricity-generating capacity has stagnated in recent years while demand has continued to rise. Private investment in generation did not materialize, partly because electricity tariffs were set too low to provide the returns sought by investors, while investment by the state-owned electricity provider Eskom was delayed. As a result, the reserve margin in the system has declined, causing periodic power cuts. In January 2008, unplanned emergency maintenance and a drop in coal stocks forced power cuts to large industrial users for the first time, leading to a temporary shutdown of mining production.

The government's response to the crisis aims to reduce demand by about 10 percent until new capacity comes on stream. Most large mines and other industrial customers remain rationed to 90–95 percent of their normal electricity needs. Eskom's plans include an ambitious increase in its generating capacity by some 50 percent over the next 9–10 years. Electricity prices have been raised by 27½ percent on average since July 1, 2008 and are set to increase substantially over the next several years to help finance rising costs of operation and investment, while promoting conservation. Nevertheless, the supply-demand balance is likely to remain tight for the next few years, with significant risk of power disruptions.

6. **A critical challenge in the period ahead will be to ensure that possible instability related to the current account deficit does not derail the push to accelerate growth and spur job creation.** Within this overarching theme, discussions focused on:

- ***assessing the economic outlook and risks***;

and policies to:

- ***contain inflation*** in the face of successive large global food and fuel price shocks and slowing growth;
- ***address vulnerabilities***, including by ensuring the health of the financial sector, reflecting the Financial Sector Assessment Program (FSAP) Update;[3] and
- ***foster shared growth*** by addressing the main constraints to growth.

II. Discussions on the Outlook: A Slowing Economy with Increasing Downside Risks

7. **The short-term outlook for South Africa has weakened over the last year.** Staff projects output growth to moderate to below 4 percent in 2008 and 2009 due to power supply constraints, lower demand in partner countries, and the cumulative effect on consumption of previous monetary policy tightening. Inflation is expected to peak later this year and to remain above the target band for a significant period, reflecting the pass-through of higher food, fuel and electricity prices as well as second-round effects. Despite slowing private consumption growth, the current account deficit is projected to rise to 9–9½ percent of GDP in 2008–09—provided external financing remains available—due to strong public investment, high oil prices, and output constraints in the mining sector.

8. **Potential output growth is being affected by the constraints in the electricity sector, but investment should restore growth potential down the road.** Emergency rationing schemes will constrain potential output in the short term, implying that pressures on the current account and inflation will persist despite the slowdown in demand and output growth. An ambitious public infrastructure investment program seeks to address the bottlenecks in electricity, rail, and ports, and as infrastructure constraints are eventually relaxed, potential growth should rise towards an estimated 5 percent in the medium term.

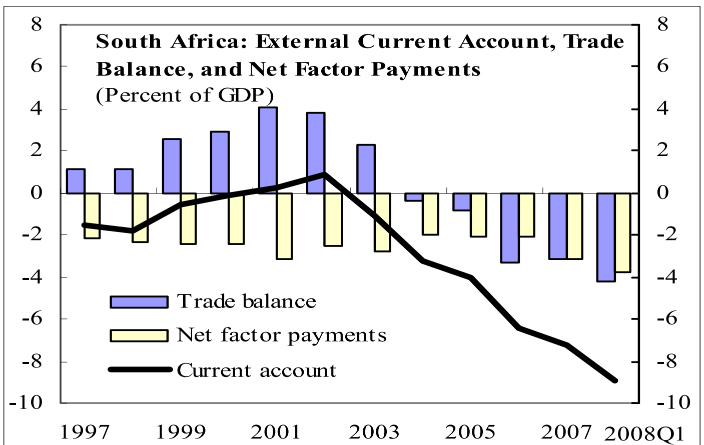
[3] See accompanying Financial System Stability Assessment report.

Key Macroeconomic Variables	2008	2009	2010	2011	2012	2013
GDP growth, percent	3.8	3.7	4.4	4.8	5.0	5.0
Inflation (CPIX, eop), percent	11.6	8.1	5.9	4.5	4.5	4.5
Current account balance, percent of GDP	-9.0	-9.6	-9.5	-9.3	-9.1	-8.9
Electricity Supply and Potential Output						
Electricity supply growth rate, percent	2.1	2.9	3.9	4.1	4.1	4.1
Improvement in average energy intensity, percent	1.6	1.0	1.0	1.0	1.0	1.0
Potential GDP growth rate, percent	3.7	3.9	5.0	5.0	5.0	5.0
Output gap, percent	1.1	0.9	0.3	0.1	0.1	0.0

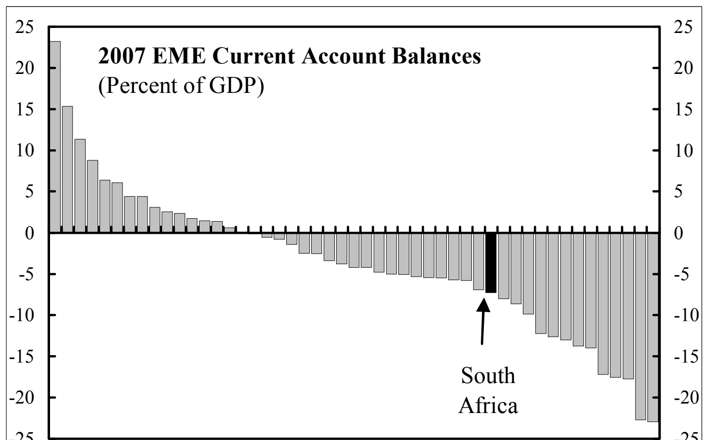
Source: IMF staff projections based on Eskom data.

9. Downside risks have increased significantly:

- ***the large current account deficit,*** which leaves South Africa vulnerable to a loss in investor confidence and a sudden stop in capital inflows (Box 2) that would result in an abrupt adjustment in domestic demand and a sharp depreciation of the exchange rate, implying renewed inflationary pressures and necessitating further interest rate increases;
- ***further increases in global food and fuel prices,*** which would put direct additional pressure on the current account deficit and inflation, and would also slow down the economies of partner countries; and
- ***and, on the domestic side, elevated debt service burdens among households,*** which pose risks to consumption growth and possibly to pockets of the financial system as interest rates remain high or are raised further.



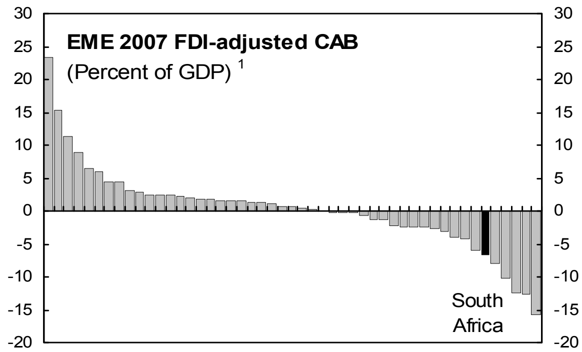
Source: SARB.



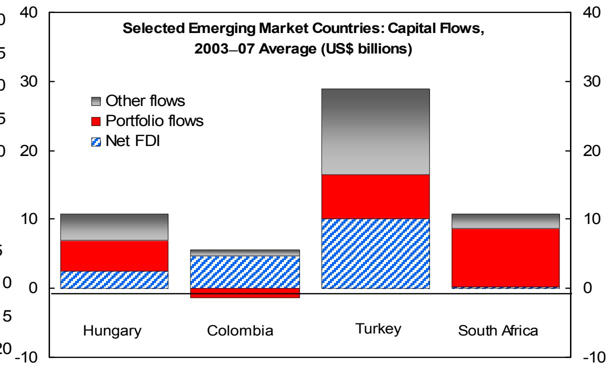
Source: World Economic Outlook (WEO).

Box 2. Current Account Vulnerabilities

South Africa's current account deficit (CAD) is high relative to those of most EMEs and tends to be financed by potentially more volatile capital inflows. Compared with other EMEs, foreign direct investment (FDI)—which tends to be relatively stable—accounts for a smaller proportion of South Africa's CAD financing. Among countries with large CADs, South Africa remains an outlier in its heavy reliance on portfolio flows, reflecting its well-developed financial markets.



Source: WEO.
[1] Current account balance plus net FDI inflows.



Sources: SARB and WEO.

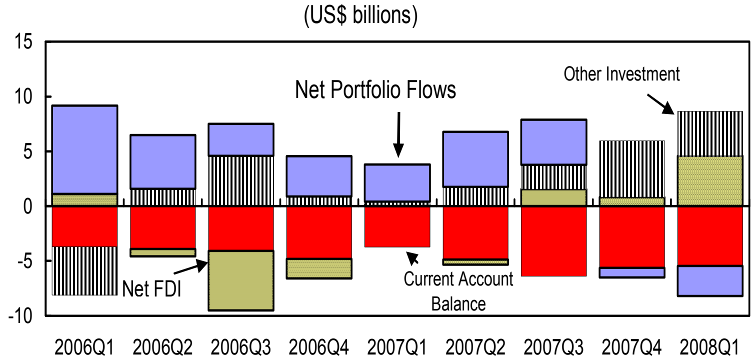
Capital inflows to South Africa have become more volatile lately. In late 2007 and early 2008, nonresidents' net purchases of South African equities and bonds shrank significantly and total portfolio flows turned negative. By end-March 2008, reflecting political uncertainty and power outages, South Africa's EMBIG spread widened more than those of other EMEs with large current account deficits, before receding somewhat by mid-year.

Selected EMEs:
Change in EMBIG spreads vs. end-October 2007

	Basis point change as of		
	1/31/2008	3/31/2008	6/30/2008
South Africa	**111**	**157**	**118**
EMBIG	79	112	98
Colombia	99	96	60
Turkey	66	140	176
Hungary	29	49	63

Source: IMF, Global Markets Monitor.

South Africa: CAD and Financing by Type of Identified Flows
(US$ billions)



Source: SARB.

Financing of the current account deficit has become less reliable. In 2007Q4, widening interest rate differentials vis-à-vis mature markets appeared to have encouraged banks to repatriate foreign assets to the tune of US$3.5 billion. In 2008Q1 a one-off deal—the purchase of a 20 percent stake in Standard Bank by ICBC, a major Chinese bank—led to a large net FDI inflow (US$4.5 billion). In addition, nonresidents increased deposits with South African banks by some US$2.5 billion, possibly reflecting a shift in the composition of inflows in response to higher interest rates. These flows could be volatile and thus not a reliable source of financing for the current account deficit in the longer run.

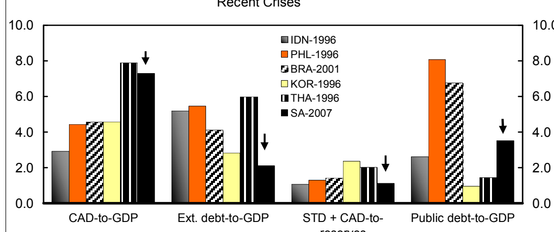
10. **The authorities broadly agreed with the staff's macroeconomic projections, the principal difference being their more optimistic outlook for the current account.** They envisage a current account deficit in 2008–09 of 7–8 percent of GDP mainly reflecting lower oil price assumptions (by 19 percent on average in 2008–09) and lower projections for net factor payments abroad, compared with the staff's projection.

11. **The authorities concurred that risks have sharpened, particularly with regard to the current account deficit, but underscored that the outlook remains positive on the whole, and the risks manageable.** They stressed that the widening of the current account deficit reflects in part the ongoing investment drive to address infrastructure constraints—which the staff agreed was essential for South Africa to maintain its growth momentum over the medium term. They were confident that nonresident investors would continue to fund the current account deficit, as they would recognize that these resources were being channeled to productive investments that would yield a globally competitive rate of return.

12. **The authorities also emphasized that South Africa's fundamentals prepare it to weather possible shocks.** The country still has a low level of external debt (26½ percent of GDP at end-2007), over 40 percent of which is denominated in rand. Gross reserves exceed short-term foreign currency debt by a comfortable margin. The banking sector is sound, and corporate and financial sector balance sheet exposures to exchange rate and interest rate shocks are limited, even if pockets of weakness exist among over-extended households. The authorities underscored their continued commitment to the current stability-oriented macroeconomic policy framework, which would bolster investor confidence. Should sentiment change anyway, foreign investors would share in the adjustment due to the flexible exchange regime and the high proportion of their investments held in rand, particularly in the form of equity.

13. **Staff agreed that South Africa's fundamentals remain strong, but emphasized that the size and relatively rapid expansion of the current account deficit itself posed risks.** Staff analysis suggests that South Africa's external and government debt is sustainable under a variety of shocks, remaining below 43 percent of GDP in stress tests (Appendix I). However, international experience shows that sharp adjustments in the current account have occurred even when external and public debt were at relatively moderate levels. Moreover, although the widening current account deficit reflected mainly the rise in investment, long-term solvency did not preclude the possibility of a liquidity crisis should investor sentiment turn negative.

External Indicators: A Comparison of South Africa in 2007 and Some Recent Crises [1]



Source: WEO.

[1] IDN, PHL, BRA, KOR, SA, and THA stand for Indonesia, Phillipines, Brazil, Korea, South Africa, and Thailand, respectively. The CAD-to-GDP is in percent while other indicators are divided by 10, except the STD + CAD-to-reserves, which is a simple ratio. For all indicators, the higher the number, the higher the vulnerability. STD is short-term external debt at residual maturity. In the ratio of STD plus CAD to reserves, same year's CAD is considered for crisis countries while for SA, it is following year's deficit.

III. Policy Discussions

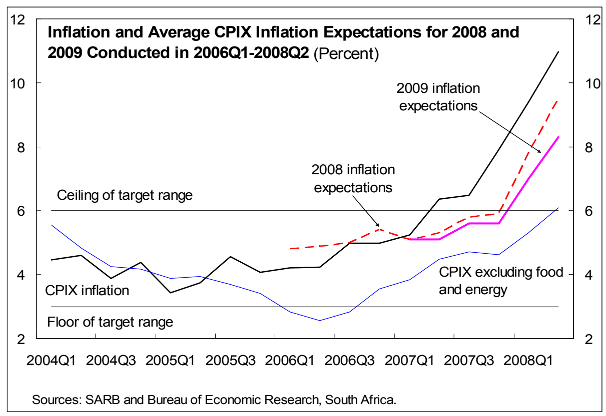
Box 3. Summary of Previous Consultation Discussions

There has been broad agreement on policies, as the Fund has generally supported the authorities' choices on fiscal policy, inflation targeting, exchange rate policies, international reserves accumulation, and exchange control liberalization. On structural policies, the Fund has supported South Africa's fiscal and financial sector reforms, and trade liberalization. It has encouraged identifying and revising aspects of labor legislation and institutions that constrain job creation. The Fund has also recommended further liberalization and simplification of the trade regime; the authorities have indicated that actions in this area depend on the outcome of multilateral negotiations.

A. Containing Inflation Pressures

Monetary tightening to limit second-round effects

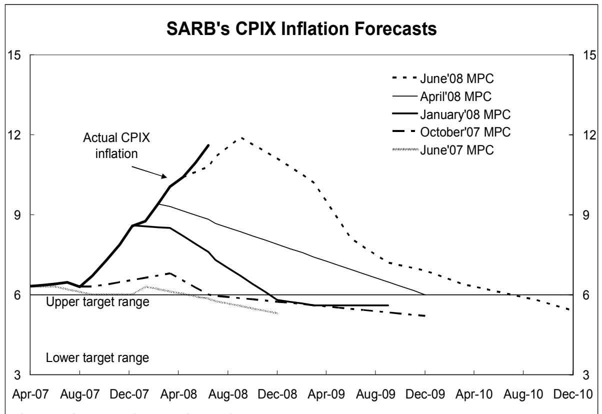
14. **Like in other countries, inflation in South Africa has been rising strongly owing in part to global shocks to fuel and food prices.** The direct first-round effects from such shocks have been large since food represents a sizable fraction of the consumption basket and world oil price changes are fully and quickly passed through to domestic prices.[4] Second-round effects from those shocks are in train as reflected, for example, by recent double-digit wage settlements and the sharp increase in inflation expectations. The CPIX excluding food and energy has also broken through the top end of the inflation target range, although it is too early to say whether this is limited to the pass-through of higher energy input prices or includes second-round effects.



15. **SARB officials stressed the challenges of addressing the most recent wave of global food and fuel price increases, which has caught South Africa late in a monetary tightening cycle launched initially to address domestic demand pressures.** The SARB has raised its policy rate by a cumulative 300 basis points since June 2007, on top of the 200 basis point increase in 2006 (Figure 3). It has faced a sharp increase in inflation and inflation expectations since the beginning of this year, at a time when its tightening cycle would have been expected to end as activity slowed. The SARB has noted that it will tighten as needed to

[4] Food items account for 26 percent of the CPIX basket, and gasoline for about 5 percent. These weights will, however, decline to about 18 percent and 3½ percent, respectively, from January 2009, based on weights from the 2005–06 household survey.

anchor inflation expectations and contain the second-round effects of global price shocks. Even as it has continued to tighten its policy stance, the SARB has implicitly accepted a lengthening of the time horizon within which inflation is forecast to return to the target band. Officials explained that this reflected their preference for raising the policy rate at an even pace (usually 50 basis points) to avoid the risk of policy volatility, given the uncertainty surrounding the inflation forecast.



Sources: SARB and Statistics South Africa.

16. **Staff supported the tightening of monetary policy and suggested that further rate increases are likely to be needed to bring inflation down.** The SARB's actions are in line with those of many other central banks facing similar shocks and the professional consensus on the appropriate response.[5] In staff's view, further tightening is likely to be needed for inflation to fall within the target band in a reasonable time period, provided supply shocks do not reverse and the output slowdown does not exert stronger-than-expected downward pressure on inflation. Staff also supported the effective lengthening of the monetary policy horizon given the large size of the shocks—the full effects of which are still working their way through the price system—and the unusual degree of uncertainty surrounding both their future path and the inflation forecast.

17. **High levels of household debt pose a risk of unintended side effects from monetary policy tightening**. The average household debt service ratio is approaching levels last seen in the second half of 1998, when an interest rate spike caused a noticeable deterioration in loan quality. Practically all household loans in South Africa carry a floating interest rate that tracks the policy rate closely. As the distribution of debt by household income is not reliably known, monetary tightening could have a larger-than-expected effect on household consumption and, eventually, the output gap. Given the strength of the financial system (see paragraphs 28–32), the risk is mainly macroeconomic, rather than systemic, in nature (Box 4). SARB officials noted that they keep a close watch on the average ratio of households' debt service to disposable income and felt that there was room for some additional tightening. Staff suggested that monetary policy deliberations ought to be informed by the collection and regular analysis of data on the distribution of household debt and debt service by income category since averages can mask tail risks. Assessments of financial system stability should also feed in to ensure—particularly at this stage of an extended tightening cycle—that cyclical and financial system effects of policy rate increases are assessed correctly.

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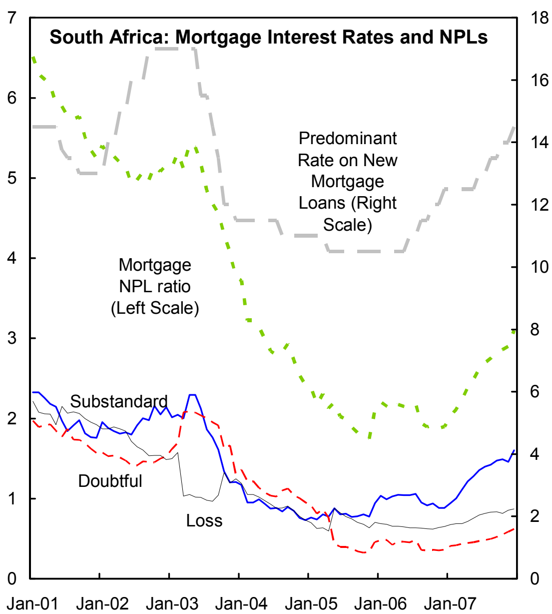
[5] See *Selected Issues* paper, "*Monetary Policy and Large Shocks to Relative Prices: Issues and Implications for South Africa*."

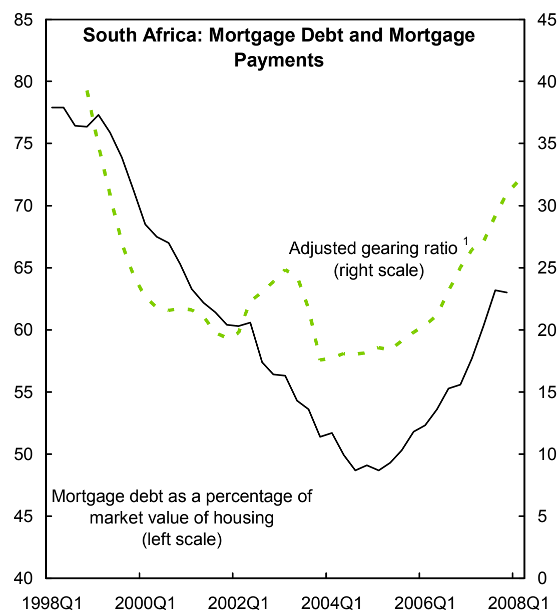
Box 4. Risks from Rising Household Debt

Mortgage nonperforming loan (NPL) ratios are rising, most likely as a result of the increase in interest rates. Rising mortgage rates seem to affect NPL ratios with a lag of 4–6 months. This impact could be accelerated and amplified by the slowdown in housing prices and real disposable income since late 2007.

The increase in mortgage NPL ratios has been steeper than in the previous cycle in 2002. Since the interest rate tightening cycle started in June 2006, mortgage debt repayments have expanded by some 36 percent. Each 100 basis points increase in mortgage rates has been associated with a rise in the mortgage NPL ratio of 0.5 percent—an impact four times larger than during the previous tightening cycle in 2002. This effect may be due in part to the much higher household indebtedness in June 2006 relative to the start of the previous tightening cycle. It could also indicate that a new class of borrowers—middle-income households—is being disproportionately affected by rising interest rates. Recent surveys (Credit Suisse Standard Securities, 2007 and 2008) show that most of the expansion in debt has occurred among the middle class, while higher-income households' debt exposure has remained constant or even declined. Still, the risk of large-scale foreclosures appears limited, as the "originate and hold" mortgage model prevails and banks tend to engage in debt workouts with troubled borrowers.



Source: SARB.



Source: SARB.

[1] Debt serice as a percentage of disposable income of households with mortgages.

The banking system appears to be resilient to a deterioration in asset quality. FSAP Update stress tests suggest that banks could easily withstand a variety of large shocks. Specifically, basic stress tests assuming a default of all counterparties with a probability of default greater than 10 percent indicate that the impact would be limited to below 3¾ percentage points of bank capital for each large bank.

Clear communications to contain inflation expectations

18. **Staff noted that the ongoing supply shocks and rising inflation expectations heighten the importance of clear communication, a key part of the inflation targeting regime.** The quality of the SARB's written communications is high, with analysis of economic risks and rationale for policy decisions clearly laid out. At the same time, to help contain the rise in inflation expectations and discourage backward-looking wage indexation, additional efforts could be made—both by the SARB and the government—to educate the public about the nature of the current shocks and the absence of a long-run tradeoff between inflation and growth. As also noted by some market analysts, the SARB could also improve communication at the margin, for instance, by having the inflation fan chart reflect the Monetary Policy Committee's (MPC's) assessment of the inflation outlook and risks and publishing it and the quantitative outlook each time the MPC's decision is announced. It may also be useful to explore the possibility of communicating in broad terms the MPC's future policy intentions in the statement issued after MPC meetings, as is the practice among some inflation targeting central banks.

19. **The authorities agreed on the importance of a careful communications strategy**. Their efforts have been geared at explaining their actions to the public, both through their publications and through public fora held all over the country on a semi-annual basis. They have set out to explain the global nature of recent shocks and to offer context by discussing the actions of other central banks around the world. The authorities also felt that they convey sufficient information on their outlook for inflation, and that attempting to provide additional or more structured signals of their possible future actions to diverse audiences would be risky, as such signals would be easy to misinterpret as commitments.

B. Addressing Vulnerabilities

Tighter fiscal policy to avoid exacerbating current account pressures

20. **South Africa's large current account deficit reflects a somewhat overvalued exchange rate (see paragraph 26) and a rising rate of investment that is funded by foreign saving.** External stability therefore depends closely on maintaining foreign investors' confidence in South Africa's continued stable macroeconomic policies and good growth prospects. The inflation targeting framework, including the operational independence of the SARB, and prudent fiscal policy are both critical to investor perceptions of stable macroeconomic policies.

21. **The steady strengthening of the public finances has been a positive factor in maintaining investor confidence even as the current account deficit has widened** (Figure 4)**.** For the second year running, the national government posted a fiscal surplus in 2007/2008. Revenue was boosted beyond budgeted levels by strong income growth and commodity prices, as well as improved efficiency in tax collection. On the expenditure side,

an increase in social spending and transfers to municipalities and public corporations more than offset a decline in interest payments. The public sector borrowing requirement (PSBR) was broadly balanced, which allowed public sector debt to decline to 35.4 percent of GDP by end-2007.

National Government Main Budget [1]	2005/06	2006/07	2007/08
	(Percent of GDP)		
Total revenue and grants	26.0	26.6	27.3
of which:			
Tax revenue	25.4	26.0	26.7
Income tax	14.5	15.5	16.1
Indirect taxes	9.5	9.7	9.5
Trade and other	1.3	0.9	1.0
Total expenditure	26.3	26.0	26.3
of which:			
Interest expenditure	3.2	2.9	2.6
Social expenditure [2]	14.4	14.6	14.9
Budget Balance	-0.3	0.6	0.9
Memorandum items:			
Public sector borrowing requirement	-0.7	-0.3	-0.3
National government debt	33.3	30.5	27.9
Domestic	29.1	26.0	23.2
Foreign	4.2	4.6	4.7

Sources: South African authorities and IMF staff estimates.

[1] For fiscal year beginning April 1.

[2] Consolidated central and provincial government. Education, health, transfers, and other.

22. **The authorities indicated their intention—which the staff supported—to maintain a broadly neutral stance in FY 2008/9 as envisaged in the budget.** In nominal terms, revenue is projected to be higher than originally budgeted given higher-than-expected inflation this year. Together with likely underspending in certain areas, this would provide room for some additional targeted social expenditure in response to high food prices, despite higher-than-budgeted wage expenditure reflecting the recent 10.5 percent public sector wage increase.

Main fiscal balances, 2005/6 - 2010/11, percent of GDP	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
National government:						
Overall balance [1]	-0.3	0.6	0.9	0.3	-0.3	0.4
Primary balance [1]	2.9	3.5	3.5	2.5	1.7	2.2
Cyclically adjusted primary balance [2]	3.1	3.2	3.0	2.4	1.7	2.0
Cyclically adjusted overall balance [2,3]	-0.1	0.3	0.5	0.3	-0.3	0.3
Extrabudgetary funds and institutions	0.8	0.5	0.5	0.3	0.4	0.4
Provincial and local governments	-0.5	-0.4	-0.4	-0.5	-0.4	-0.3
Nonfinancial public enterprises	0.8	-0.5	-0.7	-1.6	-1.7	-1.9
Cyclically adjusted public sector borrowing requirement	-1.0	0.0	0.2	1.5	2.1	1.5

Sources: National Treasury and IMF staff estimates.

[1] According to staff's fiscal and GDP projections.

[2] IMF staff's cyclical adjustments using tax-specific elasticities to tax-specific base gaps (see IMF Country Report 06/328).

[3] Cyclically adjusted primary balance less interest expenditure.

23. **In view of the risks from the large current account deficit, the already high burden on monetary policy, and plans to raise public investment significantly, staff suggested that government saving could be increased gradually to bring the structural PSBR to zero over the medium term.** With existing government and public enterprise investment plans treated as a given, this would imply increasing the government's cyclically-adjusted overall balance by 1½–2 percentage points of GDP over the next three years starting in FY2009/10. Such an increase in government saving would help assure markets and foreign investors that the government is taking firm action to ensure that the public sector does not add to the rising external imbalance. As the offsetting decline in private saving for a given increase in public saving tends to be greater for tax increases than for expenditure cuts, the

fiscal strengthening would be more effective if achieved by containing the growth in current spending.

24. **While agreeing that the current account deficit posed risks, the authorities indicated that there was little leeway to increase government saving given the rising demand for public services.** South Africa's comparatively weak outcomes in education and health, and high crime rate limited the scope for containing current spending. With little prospect of raising national saving, they had no choice but to rely on foreign saving to fund the higher public investment needed to relieve the constraint on growth from electricity and other infrastructure bottlenecks. That said, the authorities stressed their commitment to a prudent budget policy and their expectation that these policies would continue after the political transition next year as well. The authorities also noted that they had taken advantage of the strong growth over the last several years to reduce government and public debt to moderate levels, and hence a modest widening of the PSBR to fund investment needs posed limited risks. Staff recognized the constraints faced by the authorities, but felt there was some scope for increasing saving by seeking better value for money and placing more emphasis on policy reform, rather than additional spending—especially since spending in areas such as education was not low by international comparison (see paragraph 36).

External policies geared to cushioning shocks

25. **South Africa maintains a flexible exchange rate system**. The rand is a relatively volatile currency—partly reflecting the relatively high proportion of off-shore trading. Officials noted that, in line with its published policy, the SARB purchases foreign exchange in the market to build up gradually its reserve position, without seeking to influence the value of the exchange rate. They emphasized their commitment to a freely floating exchange rate, and indicated that the rand would be allowed to depreciate in the event of capital outflows, as in early 2008. Staff agreed that the exchange rate should be allowed to adjust flexibly, including in the event of an adverse shock.

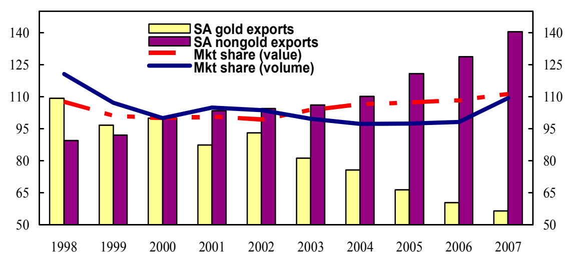
26. **The Fund's methodology for assessing the level of the exchange rate suggests that the rand may be moderately overvalued, although considerable uncertainty surrounds this estimate**. Staff's assessment, based on two methodologies, suggests that the rand's overvaluation was about 13–16 percent in mid-2008, reflecting the projected large current account deficits (Box 5). However, a third methodology suggests *under*valuation of about 12 percent, indicating the range of uncertainty surrounding the estimates. The authorities view the exchange rate as the outcome of market forces and in line with fundamentals. They dismissed as counterproductive—and the staff agreed—calls from some quarters to try to influence the level of the real exchange rate through intervention.

Box 5. The Real Exchange Rate and Competitiveness

Staff's assessment of South Africa's exchange rate is based on the IMF's CGER methodology, using data as of mid-2008.[1] Two of the methods—the macroeconomic balance approach and the external sustainability approach, which compare the medium-term current account deficit to a "norm" derived from cross-country analysis—yielded an *over*valuation of about 13 and 16 percent, respectively, reflecting the substantial projected current account deficits, even after adjusting for the temporary rise in public investment.[2] Under the third method—the equilibrium REER approach (a single-equation method relating the real effective exchange rate to its fundamental determinants)—the rand appeared *under*valued by 12 percent, mainly reflecting high commodity export prices.

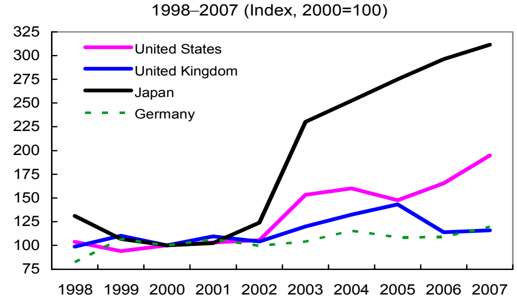
South Africa's export performance has been somewhat lackluster. In value terms, South Africa's market share has been rising gently since 2002, in line with the upward trend in world commodity prices. In real terms, however, market share has been on a declining trend reflecting in part the falling volume of gold exports. Export performance has varied across the four largest destinations.

South Africa: Market Share and Exports Volumes, 1998-2007
(2000=100)



Source: IMF, Direction of Trade and WEO.

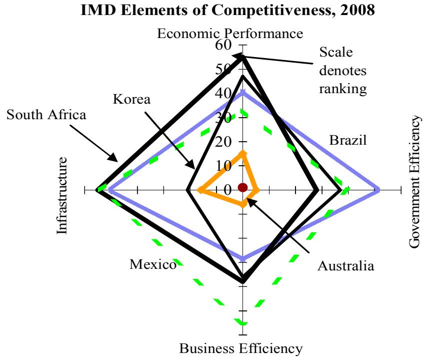
South Africa: Real Export Market Shares by Destination
1998–2007 (Index, 2000=100)



Sources: IMF, Direction of Trade and WEO.

Survey-based evidence suggests that South Africa has room for improving competitiveness in some areas. It scores relatively weakly on economic performance (reflecting its large current account deficit and high unemployment) and infrastructure, and comparatively well on government efficiency. Overall, among selected EMEs, South Africa ranks close to Brazil and Mexico, but not as high as Chile and the more dynamic Asian economies.

IMD Elements of Competitiveness, 2008



Source: IMD World Competitiveness Yearbook (2008).

World Competitiveness Ranking [1]

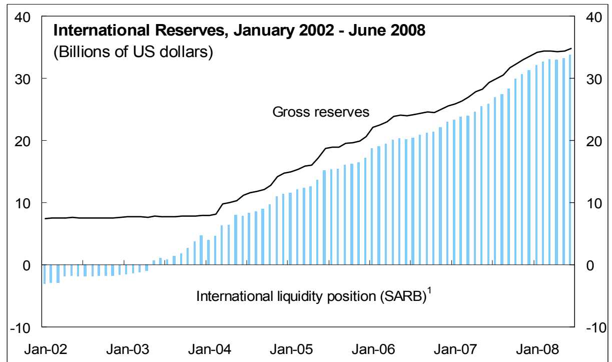
	WEF		IMD	
	2006	2007	2007	2008
Australia	18	19	12	7
Brazil	66	66	49	43
Chile	27	26	26	26
China	54	34	15	17
India	43	48	27	29
Korea	24	11	29	31
Mexico	58	52	47	50
South Africa	45	44	50	53
Memorandum items				
Number of countries ranked	125	131	55	55
South Africa's rank on infrastructure	49	43	55	55

Sources: World Economic Forum (WEF) and International Institute for Management Development (IMD).
[1] The years mentioned refer to the timing of the surveys.

[1] The methodology uses three approaches, which the staff has adapted to South Africa's circumstances. Using comparisons with other EMEs, staff estimates South Africa's current account norm at about 3.3–4.1 percent of GDP, although estimates are sensitive to assumptions (see *IMF Country Report* 07/274). The medium-term (2013) current account deficit, stripped of temporary factors, is projected at 7.2 percent of GDP.

[2] Temporary factors should be excluded from the assessment of the equilibrium exchange rate. Including the surge in public investment, the estimated overvaluation would rise to 20 and 24 percent, respectively.

27. **The authorities indicated that they intend to continue strengthening gradually their gross international reserves, which rose to US$34.9 billion at end-June 2008.** They noted that reserves were still insufficient to cover the sum of the current account deficit and short-term debt and were also low compared with levels in other EMEs. As in the past, they noted that they did not have a specific timetable, nor a particular target level of reserves in mind. Staff agreed with this approach, observing that a larger reserve cushion would mitigate the risks from the widening current account.



Source: SARB.

[1] Gross reserves minus foreign liabilities and minus forward position (closed in February 2004).

South Africa: Indicators of Reserve Adequacy at end-2007

	South Africa	Other emerging markets [1]: All countries	Other emerging markets [1]: Independent float [3]
	(In percent, unless otherwise indicated)		
Ratio of international reserves to:			
Short-term debt [2]	177.6	140.9	141.1
Short-term debt plus current account deficit [2]	70.9	89.7	111.8
GDP	11.7	17.4	13.9
Imports of goods and services (in months)	3.2	4.1	3.5
Broad money	14.0	31.3	28.9

Source: South African authorities and IMF staff estimates.

[1] Median values for a group of almost 48 emerging market countries.

[2] Short-term debt at remaining maturity.

[3] Countries with independently floating exchange rate regime as defined by the IMF Annual Report on Exchange Arrangements and Exchange Restrictions (2007).

Enhancing the resilience of the financial system

28. **A robust financial system is critical for maintaining macroeconomic stability and increasing the economy's resilience to shocks.** The FSAP Update found that South Africa's financial system is sound, underpinned by a well-established legal and financial infrastructure and a generally effective regulatory framework. Financial institutions have enjoyed good profitability, capitalization levels and reserves, and the system so far has weathered the global financial market turmoil without major pressures. The implementation

of Basel II at the start of 2008 has proceeded smoothly and is largely capital-neutral for the largest banks.

29. **Financial institutions are now, however, facing a less benign environment and are beginning to see the effects of slowing economic activity and rising interest rates on asset quality and returns**. With households' indebtedness at record levels and their debt service burden rising, the banking system is facing elevated credit risk in its household loan portfolio. Also, the concentration of banks' deposits on relatively few large corporations makes their balance sheets sensitive to changes in sentiment about the relative strength of individual banks. In such an environment, staff recommended that the SARB should continue its forward-looking proactive engagement with banks and use the scope available under Basel II to ensure that capital buffers in banks are adequate to cope with increasing risks. In addition, it would be important to closely monitor emerging risks through robust financial stability analysis, particularly regular offsite integrated top-down and bottom-up stress testing, including of adverse macroeconomic scenarios. Such tests of systemic stability based on individual bank data would allow the identification of tail risks that may not be evident in aggregate top down exercises. Staff also recommended that bank liquidity and funding risks should also be monitored closely.

30. **Staff welcomed the strengthening of the framework for contingency planning and emergency liquidity assistance as a bulwark for mitigating the fallout, should an adverse event occur.** The Financial Sector Contingency Forum aims to facilitate inter-agency coordination and preparedness for addressing crises. Staff suggested that the arrangements should be periodically tested and the authorities should consider undertaking a crisis simulation exercise relating to a macrofinancial shock such as a capital outflow or distress in a large financial sector institution.

31. **The FSAP Update also found that South Africa's regulatory framework for the financial sector is modern and generally effective and suggested some areas for further strengthening, including:**

- ***Consolidated supervision of financial conglomerates.*** This should be possible within existing organizational arrangements by combining strong sectoral supervision with a focus on risks that cut across intermediaries within a financial group. Coordination among regulators and policy makers could be strengthened, with gaps and overlaps minimized, and respective responsibilities clearly delineated;

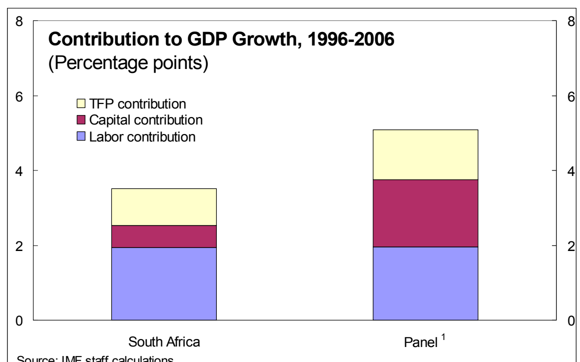
- ***Risk management, corporate governance, internal controls in the nonbank sector.*** Continue efforts by the Financial Services Board to develop standards for corporate governance, risk management, and internal controls and harmonize its risk-based models for different sectors. Further measures are also needed to encourage the consolidation of pension funds and to strengthen their governance and risk management;

- ***Furthering the reach of financial services.*** Fostering greater competition and innovation in developing affordable, flexible, and appropriate financial products for the low-income market. This will require a regulatory environment that provides space for innovation while maintaining financial stability.

32. **The authorities broadly agreed with the findings and recommendations of the FSAP Update**. They indicated that they would continue to enhance their risk analysis, including by exploring ways to conduct systemic stress testing while protecting the confidentiality of individual bank data. Staff encouraged the authorities to explore mechanisms used by other countries to overcome this hurdle. The authorities noted that their crisis management systems had been tested to some extent by several actual (nonsystemic) crises, but agreed to consider a simulation of the sort suggested by staff, provided they could ensure that the simulation itself does not become a source of risk. The authorities indicated that they were exploring possibilities for consolidating supervision of financial conglomerates, for instance, by establishing supervisory "colleges" (comprising supervisors from different agencies) for each conglomerate. The authorities also indicated that they would consider the various detailed recommendations of the FSAP Update, including those pertaining to insurance, pensions, and securities markets. They planned to convene an inter-agency forum to discuss the detailed findings and to develop proposals for addressing them.

C. Fostering Shared Growth

33. **The authorities' medium-term growth strategy (ASGISA) aims to raise growth from 4½ percent in 2005–09 to 6 percent in 2010–14 by addressing six key constraints on growth:** (i) inadequate infrastructure and logistics; (ii) skills shortages; (iii) barriers to entry and competition in several key economic sectors; (iv) the regulatory environment; (v) capacity limitations within the government; and (vi) the volatility of the exchange rate.[6] However, structural reforms to address these constraints have lagged, in part because of the complexities of addressing problems inherited from the apartheid era and resistance by vested interests.



Source: IMF staff calculations.
1 Panel of fast-growing countries: China, India, Korea, Bangladesh, Iran, Morocco, Spain, Egypt, Malaysia, and Mexico.

Increasing investment by raising national saving

34. **Staff's work suggests that the main constraint on growth has been South Africa's comparatively low investment and saving rates and, to a lesser extent,**

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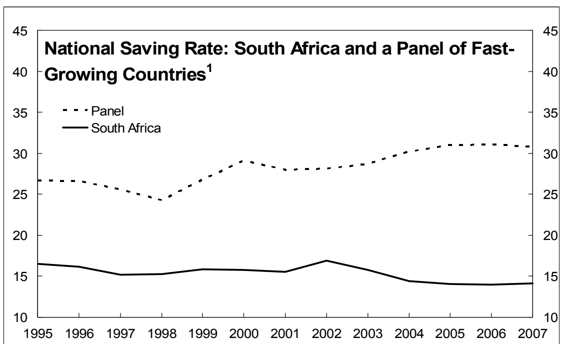
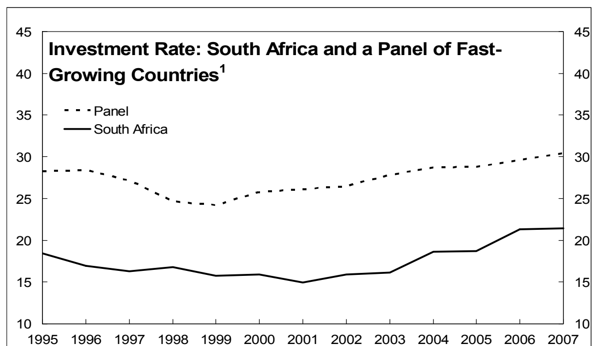
[6] Previous staff analysis found that while exchange rate volatility could pose certain problems, mostly related to long-term investment, the overall evidence on its harmful effects was inconclusive (see IMF Country Report 06/328).

lower total factor productivity growth.[7] While a number of factors have affected investment, low national saving seems to be the most important one. South Africa's national saving rate has fallen sharply since the mid-1980s and is now low compared with that of other EMEs. While the household saving rate is very low, it is mainly the decline in corporate saving (which comprised 97 percent of nongovernment saving in 1997–2007) that has driven the national ratio downward. Closer analysis suggests that private saving has evolved in line with the structural (e.g., urbanization, demographics) and economic fundamentals of the economy, which would be difficult to reverse. Higher public saving appears to be the main option available to raise national savings over the medium term, even with a partial offset from the private sector. To the extent that it is politically infeasible to increase public saving by an adequately large amount, staff argued that more emphasis would need to be placed on (i) modifying government revenue and expenditure policies to support growth and employment; and (ii) implementing structural reforms to boost total factor productivity growth.



Sources: World Development Indicators, International Financial Statistics, and IMF staff calculations.
[1] China, Vietnam, India, Russia, Poland, Ukraine, Korea, Bangladesh, Iran, and Romania.



Sources: World Development Indicators, International Financial Statistics, and IMF staff calculations.
[1] China, Vietnam, India, Russia, Poland, Ukraine, Korea, Bangladesh, Iran, and Romania.

35. **Growth and employment could be strengthened by continuing to rebalance the government's revenue-expenditure policies within a given overall fiscal stance.** For instance, combining the increase in public infrastructure investment with cuts in the corporate income tax could boost growth.[8] Cuts in the personal income tax—aimed at benefiting the middle income range of skilled workers and small business—or a wage subsidy could raise employment, although the gains may be modest. Such a package could be financed by the planned introduction of mining royalties—capturing some of the economic rents provided by high mineral prices—environment-friendly levies, or property taxes, and slower growth in government consumption than currently planned. Adverse distribution consequences could be addressed by appropriate adjustments in the transfer system. In a similar vein, staff noted that it will be important over the medium term to make sure that the

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[7] See *Selected Issues* paper, "*Constraints on Growth in South Africa: Lessons from a Cross-country Comparison*."

[8] See *Selected Issues* paper. "*Can Fiscal Policy Boost Growth and Employment in South Africa?"*

planned social security reform is designed to avoid negative effects on labor costs, competitiveness, the fiscal balance, and national saving.

36. **Structural reforms, particularly in labor and product markets, are critical for improving total factor productivity and employment growth**. The ASGISA framework has already identified limited competition, skill shortages, and implementation capacity within government among the factors constraining growth. While efforts are being made to address these issues, much remains to be done. Staff suggested that:

- opening up the economy to greater international competition is critical for efficiency. The overall level of protection could be further reduced and the MFN import tariff structure simplified, including by reducing the number of tariff bands and lines;

- lowering administrative and regulatory burdens in product and labor markets could also help foster labor-intensive growth in tradables;[9]

- involving the private sector in public service provision could improve efficiency, including through greater competition in electricity generation and distribution, port services, and rail transport;[10] and

- improving educational attainment is important for ensuring labor productivity gains in the long term. Since South Africa already spends comparatively generously on education, efforts need to focus on improving results within the existing budget envelope and raising student achievement towards international standards.

37. **The authorities agreed that growth would benefit from further structural reforms, but had different views on the potential for reform in certain areas**. They were skeptical of the growth dividend from additional cuts in the corporate tax rate. While they agreed that further opening the economy to external competition would increase efficiency, their preference was to take decisions in this area in the context of multilateral negotiations. They pointed to efforts to identify interventions to raise the productivity of education

[9] A recent OECD report links weak product market competition and low labor utilization in South Africa, noting that the former has enabled "large incumbent firms to set high prices and make excess returns, which in turn makes possible for them to pay wages above…the market clearing wage rate". The report stresses the complementarities between measures to strengthen product market competition and policies to facilitate mobility in labor markets, which would permit more job-rich, equitable growth. OECD, *Economic Assessment of South Africa*, July 2008, pp. 5–6.

[10] The OECD report also finds that "the overall burden of regulation is relatively heavy by OECD standards and …state ownership and interference impose high barriers to entry in many areas. In particular, the lack of competition and uncertain decision-making processes in network industries impede their efficient development in terms of productivity and innovation, with negative spillover effects for the whole economy." OECD, *Economic Assessment of South Africa*, July 2008, Summary, p.2.

spending—which they considered unsatisfactory—but noted that improvements in quality may require additional public spending.

D. Regional Integration

38. **South Africa attaches high importance to efforts to promote regional economic integration within the framework of the Southern African Development Community (SADC).** SADC is scheduled to initiate a free trade agreement (FTA) at its annual summit meeting in mid-August, although not all fourteen members of SADC will participate. The FTA was to be a stepping stone towards implementing a SADC customs union in 2010, but South African officials noted that this timetable was no longer achievable. In their view, a realistic plan for a regional customs union would likely have to be based on some form of gradual expansion of the existing Southern Africa Customs Union (SACU).

39. **Seven SADC countries have been negotiating an Economic Partnership Agreement (EPA) with the European Union.** Four of the five members of SACU (Botswana, Namibia, Lesotho, and Swaziland), along with Mozambique, initialed an Interim EPA with the EU in late 2007, and discussions on elements of a full EPA with the EU are ongoing. South Africa did not sign the Interim EPA, but is continuing negotiations with the EU on trade and market access issues.

IV. Staff Appraisal

40. **South Africa has made significant economic strides over the past several years.** Output and income have expanded steadily, while inflation has remained moderate until recently. Strong employment growth has reduced unemployment despite a sustained increase in labor force participation. These achievements can be attributed in no small measure to sound macroeconomic policies, implemented in the context of a transparent policy framework, which have provided a stable environment for private sector activity.

41. **The short-term outlook has deteriorated and downside risks have increased significantly.** Growth is expected to be constrained for some time until the infrastructure investment program bears fruit, while inflation stays elevated due to global price shocks and the external current account deficit remains high, underscoring the dependence on potentially volatile capital inflows. The main risks stem from a possible loss in investor confidence and sudden stop in capital inflows; a possible further deterioration in the global economic environment, especially a significant increase in the world oil price; and high levels of household indebtedness, particularly as interest rates are raised to combat inflation and income growth slows. The impact of any shocks would be mitigated to some extent by South Africa's strong fundamentals, which include a sound macroeconomic policy framework, a low level of short-term external debt, and strong financial system balance sheets.

42. **The SARB's tightening of monetary policy and effective lengthening of the policy horizon have been appropriate responses to the successive supply shocks from**

food and energy prices. Further monetary policy tightening may be needed to anchor inflation expectations and contain second-round effects, if supply shocks do not reverse and the downward pressure on inflation from slowing activity does not turn out to be larger than expected. It will be important, in this context, to monitor closely the impact of high interest rates on overextended households. Clear and consistent communications to the markets and public will also be important in influencing inflation expectations and containing second-round effects.

43. **Fiscal policy could be geared to addressing vulnerabilities by not adding to the rising external imbalance and bolstering investor confidence.** Given plans to raise public investment, government saving could be increased starting next fiscal year to reduce the structural public sector borrowing requirement to zero over the next three years. Maintaining a broadly unchanged cyclically-adjusted overall government balance this year would help safeguard macroeconomic stability by allowing the full play of automatic stabilizers in response to cyclical conditions. Beyond that, taking public sector investment plans as a given, the PSBR could be reduced to zero by increasing the cyclically-adjusted general government balance by 1½–2 percent of GDP over the next three years. Containing current expenditure, rather than raising taxes, may be more effective as offsetting behavior by the private sector is likely to be less pronounced for spending than for taxes.

44. **South Africa's floating exchange rate regime provides an important buffer against external risks.** The flexibility of the rand has contributed to limiting foreign exchange exposure in corporate and financial sector balance sheets and discourages speculative inflows when interest rate differentials vis-à-vis the rest of the world widen. Moreover, in the event of a sudden stop in capital inflows, the flexible rate implies that foreign investors would share in the adjustment burden. The exchange rate appears moderately overvalued, but is driven by private sector behavior rather than public policies.

45. **The government's policy of gradually building up international reserves remains appropriate.** An adequate reserve cover is also an important cushion against current account vulnerabilities. Although reserves are comfortable in relation to short-term debt, they are less so when measured against other indicators.

46. **The FSAP Update found that South Africa's sophisticated financial system is broadly sound, well capitalized, and well regulated, but now faces a less benign environment as activity slows and interest rates rise.** In this context, the SARB should continue its forward-looking proactive engagement with banks and use the scope available under Basel II to ensure that capital buffers in banks are adequate to cope with increasing risks. In addition, it would be important to closely monitor emerging risks, particularly related to high levels of household debt, through integrated, forward-looking financial stability analysis based on bank-level data. The strengthening of the framework for financial contingency planning and emergency liquidity assistance is welcome and periodic testing, including through crisis simulations, may be useful. The regulatory framework could be

further strengthened by consolidating the supervision of financial conglomerates; continuing efforts to strengthen insurance and pension supervision; and fostering greater competition and innovation in meeting the needs of the low-income market.

47. **The pressing need to accelerate growth and employment over the medium term is clear, the question is how to do this without jeopardizing macroeconomic and financial stability.** South Africa's low national saving rate is a constraint on raising investment on a sustained basis to levels seen in comparable emerging market countries. Raising public savings should be the first step in boosting national savings. If the scope for raising public saving, and hence investment, is limited, more emphasis needs to be placed on other policies to boost productivity and employment growth. Modifying government revenue and expenditure policies within a given overall fiscal stance to strengthen incentives to invest and work is an option. Possibilities could be explored—for instance, further cuts in corporate taxes or well-targeted wage subsidies financed by the planned introduction of mining royalties or property taxes, or a slowdown in government consumption.

48. **Structural reforms, particularly in labor and product markets are also critical for improving productivity and employment growth.** More focus could be given to: (i) opening up the economy to greater international competition by reducing and simplifying tariffs; (ii) strengthening product and labor market competition by lowering administrative and regulatory burdens; (iii) improving efficiency in public service provision by greater private sector involvement, particularly in electricity generation and distribution, port and rail transport; and (iv) reforms to improve education outcomes for given public spending.

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

Table 1. South Africa: Selected Economic and Financial Indicators, 2003-09

Nominal GDP (2007): US$ 282.6 billion
Population (2007): 47.9 million
GDP per capita (2007): US$ 5,907

	2003	2004	2005	2006	2007	2008 Proj.	2009 Proj.
	(Annual percent change, unless otherwise indicated)						
National income and prices							
Real GDP	3.1	4.9	5.0	5.4	5.1	3.8	3.7
Real GDP per capita	2.1	3.8	4.0	4.3	4.1	2.8	2.7
Real domestic demand	5.2	7.9	5.7	9.2	6.0	4.2	4.1
GDP deflator	4.6	5.5	5.2	7.2	8.9	11.6	9.7
CPI (annual average)	5.8	1.4	3.4	4.7	7.1	11.3	9.2
CPIX (end of period) [1]	4.0	4.3	4.0	5.0	8.6	11.6	8.1
Labor market							
Unemployment rate (percent)	28.0	26.2	26.7	25.5	23.0	22.9	22.9
Average remuneration (formal nonagricultural sector)	8.4	9.1	7.1	7.5	6.7	11.2	11.2
Labor productivity (formal nonagricultural sector)	5.0	2.7	3.9	2.7	2.5	2.7	2.8
Nominal unit labor costs (formal nonagricultural sector)	3.2	6.2	3.2	4.7	4.0	8.2	8.1
External sector							
Merchandise exports, f.o.b. [2]	21.6	25.0	15.0	16.0	18.3	20.5	5.0
Merchandise imports, f.o.b. [2]	30.1	38.1	16.6	25.0	15.9	28.3	8.0
Export (goods and services) volume	0.1	2.9	8.0	5.6	8.3	3.5	5.0
Import (goods and services) volume	8.1	14.5	10.3	18.8	10.4	4.9	5.8
Terms of trade	3.8	0.8	0.6	4.3	3.3	-2.2	-1.6
Nominal effective exchange rate (period average) [3]	25.1	9.1	1.1	-5.6	-9.7	-16.3	…
Real effective exchange rate (period average) [3]	25.1	6.7	0.5	-2.5	-3.4	-12.7	…
Money and credit							
Net domestic assets [4]	7.2	11.3	14.6	15.4	21.4	21.9	19.0
Broad money (including foreign exchange deposits)	12.9	13.1	20.5	22.5	23.6	26.3	20.8
Velocity (GDP/average broad money)	1.6	1.6	1.5	1.4	1.3	1.2	1.1
Bank rate/repurchase rate (end of period, percent) [5]	8.0	7.5	7.0	9.0	11.0	12.0	…
	(Percent of GDP, unless otherwise indicated)						
Investment and saving							
Investment (including inventories)	16.9	17.7	18.1	20.4	21.4	22.4	23.1
Of which: public fixed investment (including public enterprises)	4.4	4.3	4.3	4.9	5.5	5.8	6.7
private fixed investment	11.5	11.9	12.5	13.7	15.1	15.9	16.0
Gross national saving	15.8	14.5	14.0	14.0	14.1	13.4	13.4
Public (including public enterprises)	1.8	1.5	3.1	3.8	4.4	4.0	4.1
Private	14.0	12.9	11.0	10.1	9.8	9.4	9.4
National government budget [6]							
Revenue, including grants	23.2	24.1	25.6	26.5	27.1	27.0	26.8
Expenditure and net lending	25.2	25.7	26.2	26.1	26.3	26.5	27.0
Overall balance	-2.0	-1.6	-0.6	0.4	0.9	0.5	-0.2
National government debt	37.3	36.4	35.3	33.1	28.6	25.6	22.8
Borrowing requirement of the nonfinancial public sector	2.0	1.7	-0.2	-0.4	-0.3	1.0	1.9
External sector							
Current account balance	-1.1	-3.2	-4.0	-6.5	-7.3	-9.0	-9.6
Overall balance of payments	-0.4	2.7	2.2	1.7	2.4	1.2	0.9
Total external debt	23.6	20.8	19.1	22.2	26.6	29.6	31.2
Gross reserves (SARB, billions of U.S. dollars)	8.0	14.7	20.6	25.6	33.0	36.6	39.6
(months of next year's total imports)	1.6	2.6	2.9	3.1	3.2	3.3	3.3

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

[1] CPIX is the consumer price index (CPI) excluding the interest on mortgage loans. It is the targeted definition of inflation.
[2] In U.S. dollars; annual percent change.
[3] For 2008, April relative to December 2007.
[4] Contribution (in percentage points) to the growth of broad money.
[5] For 2008, as of July 31.
[6] Calendar-year figures, based on staff's fiscal and GDP projections for 2008 and 2009.

Table 2. South Africa: Selected Economic and Financial Indicators in the Medium Term, 2006-13

	2006	2007	2008	2009	2010	2011	2012	2013
			Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percent change, unless otherwise indicated)							
National income and prices								
Real GDP	5.4	5.1	3.8	3.7	4.4	4.8	5.0	5.0
Real GDP per capita	4.3	4.1	2.8	2.7	3.4	3.7	3.9	4.0
Real domestic demand	9.2	6.0	4.2	4.1	5.0	4.9	5.1	5.0
GDP deflator	7.2	8.9	11.6	9.7	7.4	5.5	4.9	4.8
CPI (annual average)	4.7	7.1	11.3	9.2	6.5	4.8	4.5	4.5
CPIX (end of period) [1]	5.0	8.6	11.6	8.1	5.9	4.5	4.5	4.5
Labor market								
Unemployment rate (percent)	25.5	23.0	22.9	22.9	22.0	20.6	19.3	18.0
Average remuneration (formal nonagricultural sector)	7.5	6.7	11.2	11.2	9.9	8.1	7.6	7.6
Labor productivity (formal nonagricultural sector)	2.7	2.5	2.7	2.8	2.9	2.8	3.0	3.0
Nominal unit labor costs (formal nonagricultural sector)	4.7	4.0	8.2	8.1	6.8	5.2	4.6	4.5
External sector								
Merchandise exports, f.o.b. [2]	16.0	18.3	20.5	5.0	5.9	6.9	7.1	7.0
Merchandise imports, f.o.b. [2]	25.0	15.9	28.3	8.0	7.7	7.2	7.4	7.2
Export (goods and services) volume	5.6	8.3	3.5	5.0	5.3	6.0	6.0	6.1
Import (goods and services) volume	18.8	10.4	4.9	5.8	6.9	6.1	6.2	5.9
Terms of trade	4.3	3.3	-2.2	-1.6	1.5	0.8	0.7	0.5
Nominal effective exchange rate [3]	-5.6	-9.7	…	…	…	…	…	…
Real effective exchange rate [3]	-2.5	-3.4	…	…	…	…	…	…
Money and credit								
Net domestic assets [4]	15.4	21.4	21.9	19.0	17.7	16.5	16.2	16.0
Broad money (including foreign exchange deposits)	22.5	23.6	26.3	20.8	18.9	17.7	17.2	16.9
Velocity (GDP/average broad money)	1.4	1.3	1.2	1.1	1.1	1.0	0.9	0.9
Bank rate/repurchase rate (period end, in percent)	9.0	11.0	…	…	…	…	…	…
	(Percent of GDP, unless otherwise indicated)							
Investment and saving								
Investment (including inventories)	20.4	21.4	22.4	23.1	23.5	23.7	23.9	23.9
Of which : public fixed investment (including public enterprises)	4.9	5.5	5.8	6.7	6.8	6.8	6.8	6.8
private fixed investment	13.7	15.1	15.9	16.0	16.1	16.3	16.4	16.6
Gross national saving	14.0	14.1	13.4	13.4	14.1	14.4	14.8	14.9
Public (including public enterprises)	3.8	4.4	4.0	4.1	4.3	4.4	4.4	4.4
Private	10.1	9.8	9.4	9.4	9.7	10.0	10.4	10.5
National government budget [5]								
Revenue, including grants	26.5	27.1	27.0	26.8	26.9	26.8	26.8	26.8
Expenditure and net lending	26.1	26.3	26.5	27.0	26.7	26.4	26.4	26.4
Overall balance	0.4	0.9	0.5	-0.2	0.2	0.4	0.4	0.4
National government debt	33.1	28.6	25.6	22.8	20.7	18.8	17.2	15.7
Borrowing requirement of the nonfinancial public sector	-0.4	-0.3	1.0	1.9	1.5	1.4	1.4	1.4
External sector								
Current account balance	-6.5	-7.3	-9.0	-9.6	-9.5	-9.3	-9.1	-8.9
Overall balance of payments	1.7	2.4	1.2	0.9	0.8	0.8	0.7	0.7
Total external debt	22.2	26.6	29.6	31.2	32.8	35.0	34.7	34.9
Gross reserves (SARB, billions of U.S. dollars)	25.6	33.0	36.6	39.6	42.6	45.6	48.6	51.6
(months of next year's total imports)	3.1	3.2	3.3	3.3	3.3	3.3	3.3	3.3

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

[1] CPIX is the consumer price index (CPI) excluding the interest on mortgage loans. It is the targeted definition of inflation.

[2] In U.S. dollars; annual percent change.

[3] Annual average, South African Reserve Bank.

[4] Contribution (in percentage points) to the growth of broad money.

[5] Calendar-year figures, based on staff's fiscal and GDP projections.

Table 3. South Africa: National Government Main Budget, 2004/05-2010/11 [1]

	2004/05	2005/06	2006/07	2007/08	2008/09 Proj. [2]	2009/10 Proj. [2]	2010/11 Proj. [2]
	(In percent of GDP)						
Total revenue and grants	24.4	26.0	26.6	27.3	26.9	26.8	26.9
Tax revenue	23.9	25.4	26.0	26.7	26.3	26.2	26.3
Income tax	13.7	14.5	15.5	16.1	15.8	15.8	15.7
Of which : personal income tax (PIT)	7.8	8.0	7.8	8.2	8.1	8.1	8.1
corporate taxes (CIT+STC)	5.5	6.3	7.4	7.9	7.6	7.6	7.5
Indirect taxes	9.2	9.5	9.7	9.5	9.5	9.5	9.7
Of which : value-added tax (VAT)	6.9	7.2	7.4	7.3	7.2	7.2	7.4
excises	2.3	2.2	2.1	2.0	2.0	2.0	2.0
Trade and other (less SACU payments)	1.0	1.3	0.9	1.0	1.0	0.9	0.9
Other tax revenue	1.0	1.1	0.9	0.9	0.9	0.8	0.8
Of which : trade taxes	0.9	1.1	1.3	1.3	1.3	1.3	1.3
Of which : SACU payments [3]	0.9	0.9	1.4	1.2	1.3	1.2	1.2
Nontax revenue	0.4	0.5	0.6	0.6	0.6	0.6	0.6
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	25.8	26.3	26.0	26.3	26.6	27.2	26.5
Interest	3.4	3.2	2.9	2.6	2.2	2.0	1.8
Transfer to subnational governments	10.7	10.8	11.4	11.8	11.9	12.1	12.4
Of which: provinces	9.7	9.7	9.9	10.0	10.1	10.2	10.4
municipalities	1.0	1.1	1.5	1.8	1.8	1.8	2.0
Other	11.7	12.3	11.8	12.0	12.5	13.1	12.4
Budgetary balance	-1.4	-0.3	0.6	0.9	0.3	-0.3	0.4
Extraordinary payments [4]	0.7	0.3	0.2	0.0	0.0	0.0	0.0
Augmented balance	-2.1	-0.6	0.4	0.9	0.3	-0.3	0.4
Financing	2.1	0.6	-0.4	-0.9	-0.3	0.3	-0.4
Domestic borrowing (net)	2.8	1.8	0.3	0.2	0.5	0.1	0.1
Foreign borrowing (net)	0.3	0.0	0.0	-0.2	-0.1	-0.3	-0.1
Privatization and other extraordinary receipts	0.2	0.4	0.2	0.1	0.0	0.0	0.0
Change in cash and other items	-1.1	-1.7	-0.9	-0.9	-0.7	0.5	-0.4
Memorandum items:							
GDP (billions of rand)	1,428	1,586	1,807	2,056	2,394	2,707	3,025
Real GDP growth, percent	5.4	4.9	5.5	4.8	3.7	3.8	4.6
GDP deflator, percent change	5.1	5.9	8.0	8.6	12.2	9.0	6.8
Primary balance, in percent of GDP	2.0	2.9	3.5	3.5	2.5	1.7	2.2
Cyclically-adjusted overall balance, in percent of GDP [5]	-1.3	-0.1	0.3	0.5	0.3	-0.3	0.3
Debt, in percent of GDP	35.1	33.3	30.5	27.9	24.9	22.1	20.2
Domestic	30.3	29.1	26.0	23.2	20.4	18.1	16.3
Foreign	4.9	4.2	4.6	4.7	4.4	4.0	3.9

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

[1] For fiscal year beginning April 1. National government comprises the central government and subnational spending financed by transfers from the national revenue fund.

[2] Staff projections based on the 2008 Budget Review, discussions with the authorities, and staff estimates.

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

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

[5] Before extraordinary payments.

Table 4. South Africa: Nonfinancial Public Sector Operations, 2004/05-2010/11 [1]

	2004/05	2005/06	2006/07	2007/08	2008/09 Proj. [2]	2009/10 Proj. [2]	2010/11 Proj. [2]
			(In percent of GDP)				
General government (excl. local governments) [3]							
Total revenue and grants	25.9	27.7	28.3	28.8	28.4	28.3	28.4
National government	24.4	26.0	26.6	27.3	26.9	26.8	26.9
Provinces (own revenue)	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Social security funds (own revenue)	1.0	1.3	1.1	1.1	1.1	1.1	1.1
Extrabudgetary and other	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Total expenditure	26.8	27.5	27.3	27.8	28.0	28.5	27.9
Current	25.7	26.2	26.1	26.5	26.2	26.1	25.8
Wages and salaries	9.0	8.8	8.6	8.6	8.6	8.6	8.6
Other goods and services	3.5	3.7	3.8	3.8	4.0	4.0	4.0
Interest	3.4	3.2	2.9	2.6	2.2	2.0	1.8
Transfers	9.8	10.3	10.8	11.5	11.5	11.5	11.5
Capital expenditure	1.1	1.3	1.3	1.3	1.3	1.4	1.4
Net lending	0.1	0.0	0.0	0.0	0.4	1.1	0.7
Overall balance	-0.9	0.3	1.0	1.1	0.4	-0.2	0.5
Public sector borrowing requirement (PSBR)	1.5	-0.7	-0.3	-0.3	1.5	2.1	1.4
National government [4]	2.0	0.2	-0.6	-1.0	-0.4	0.3	-0.4
Other government borrowing	0.0	-0.1	-0.2	0.0	0.2	0.0	-0.1
Provincial governments	-0.1	0.0	0.0	0.0	0.0	-0.1	-0.2
Local goverments and local enterprises	0.6	0.5	0.4	0.4	0.5	0.5	0.5
Extrabudgetary funds and institutions	-0.5	-0.6	-0.6	-0.4	-0.3	-0.4	-0.4
Nonfinancial public enterprises	-0.4	-0.8	0.5	0.7	1.6	1.7	1.9
			(In percent of GDP)				
Memorandum items:							
Non-financial public sector debt (gross)	43.3	40.4	37.8	34.7	...	...	...
SOE investment	1.7	1.9	2.1	2.7	3.0	3.7	3.8
Social spending [5]	13.9	14.4	14.6	14.9	15.1	15.3	15.5
Defense spending	1.5	1.6	1.4	1.3	1.3	1.2	1.2

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

[1] For fiscal year beginning April 1.
[2] Staff projections based on the 2008 Budget Review, discussions with the authorities, and staff estimates.
[3] Consolidated national and provincial governments.
[4] Includes extraordinary payments less extraordinary receipts.
[5] Health, education, welfare, and community development.

Table 5. South Africa: Balance of Payments, 2006-13

	2006	2007	2008	2009	2010	2011	2012	2013
			Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Billions of U.S. dollars)							
Balance on current account	-16.6	-20.6	-26.9	-31.7	-34.0	-35.9	-38.0	-40.2
Balance on goods and services	-8.5	-8.8	-14.9	-18.8	-20.2	-20.7	-21.3	-21.8
Exports of goods and services	76.2	89.5	108.6	114.3	122.6	131.9	142.0	152.7
Exports of goods	64.2	75.9	91.5	96.1	101.8	108.8	116.5	124.7
Nongold	59.0	70.3	84.5	89.4	95.0	102.0	109.6	117.8
Gold	5.2	5.7	7.0	6.7	6.7	6.9	7.0	7.0
Exports of services	12.0	13.5	17.1	18.2	20.9	23.1	25.4	28.0
Imports of goods and services	-84.7	-98.2	-123.5	-133.1	-142.8	-152.5	-163.3	-174.5
Imports of goods	-70.4	-81.6	-104.7	-113.1	-121.8	-130.5	-140.1	-150.2
Imports of services	-14.3	-16.6	-18.7	-20.0	-21.0	-22.0	-23.2	-24.3
Balance on income	-5.3	-8.9	-8.8	-9.7	-10.2	-11.5	-12.8	-14.3
Income receipts	5.9	6.5	7.5	8.4	9.4	9.8	10.6	11.4
Income payments	-11.2	-15.4	-16.3	-18.0	-19.7	-21.3	-23.4	-25.7
Balance on transfers	-2.8	-2.9	-3.3	-3.3	-3.5	-3.7	-3.9	-4.1
Capital flows (including errors and omissions)	21.0	27.3	30.5	34.7	37.0	38.9	41.0	43.2
Balance on capital and financial account	15.1	23.1	30.5	34.7	37.0	38.9	41.0	43.2
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	15.1	23.1	30.5	34.7	36.9	38.9	41.0	43.1
Direct investment	-7.3	2.0	4.5	2.4	2.6	2.9	3.1	3.4
Liabilities	-0.5	5.7	8.3	6.3	6.6	6.9	7.2	7.6
Assets	-6.7	-3.7	-3.8	-3.9	-4.0	-4.0	-4.1	-4.2
Portfolio investment	19.1	11.8	12.5	13.8	15.0	16.1	17.4	18.8
Liabilities	21.3	15.2	16.2	17.8	19.3	20.8	22.5	24.2
Assets	-2.2	-3.4	-3.6	-4.0	-4.3	-4.7	-5.1	-5.4
Other investment	3.2	9.3	13.5	18.6	19.3	19.8	20.4	21.0
Liabilities	9.5	8.2	8.7	9.6	10.5	11.3	12.2	13.1
Assets	-6.2	1.1	4.8	8.9	8.9	8.6	8.3	7.9
Errors and omissions	5.9	4.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	4.4	6.8	3.6	3.0	3.0	3.0	3.0	3.0
Gross reserves (SARB) [1]	25.6	33.0	36.6	39.6	42.6	45.6	48.6	51.6
International liquidity position of the SARB [1, 2]	23.0	31.3	34.9	37.9	40.9	43.9	46.9	49.9
	(Percent of GDP, unless otherwise indicated)							
Balance on current account	-6.5	-7.3	-9.0	-9.6	-9.5	-9.3	-9.1	-8.9
Balance on goods and services	-3.3	-3.1	-5.0	-5.7	-5.6	-5.3	-5.1	-4.9
Exports of goods and services	29.6	31.6	36.2	34.6	34.2	34.1	34.0	34.0
Imports of goods and services	-32.9	-34.7	-41.2	-40.3	-39.8	-39.4	-39.2	-38.8
Capital flows (including errors and omissions)	8.2	9.7	10.2	10.5	10.3	10.0	9.8	9.6
Balance on capital and financial account	5.9	8.2	10.2	10.5	10.3	10.0	9.8	9.6
Errors and omissions	2.3	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	1.7	2.4	1.2	0.9	0.8	0.8	0.7	0.7
Gross reserves (SARB) [1]	10.0	11.7	12.2	12.0	11.9	11.8	11.7	11.5
International liquidity position of the SARB [1, 2]	8.9	11.1	11.6	11.5	11.4	11.3	11.2	11.1
Memorandum items:								
Total external debt	22.2	26.6	29.6	31.2	32.8	35.0	34.7	34.9
Foreign currency debt	13.9	15.4	16.4	16.6	17.0	17.3	16.7	16.3
Of which : Short-term debt (at remaining maturity)	6.6	6.6	7.5	7.4	7.4	7.5	7.0	6.7
Total external debt service (billions of U.S. dollars)	6.3	7.9	8.8	10.1	10.6	11.7	17.5	17.8
Gold price (period average; U.S. dollar per ounce)	604	697	910	895	935	980	1,025	1,050
Crude oil price (period average; U.S. dollar per barrel)	64.3	71.1	116.5	125.0	123.5	123.5	123.5	123.8

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

[1] End of period.

[2] Gross reserves minus foreign loans and minus forward position. The SARB's open position in the forward market was closed in February 2004.

Table 6. South Africa: Monetary Survey, 2003-07

	2003	2004	2005	2006	2007
	Dec.	Dec.	Dec.	Dec.	Dec.
	(Billions of rand)				
Net foreign assets	126.7	141.4	195.2	274.3	304.5
Gross reserves	214.5	229.6	297.8	409.8	561.7
SARB	52.9	82.8	130.5	178.3	224.3
Other monetary institutions	161.6	146.7	167.3	231.5	337.4
Liabilities	87.8	88.2	102.6	135.5	257.2
SARB	20.0	19.8	22.2	19.3	12.0
Other monetary institutions	67.8	68.4	80.4	116.2	245.2
Net domestic assets	681.4	772.8	906.0	1,075.0	1,363.8
Credit to government, net	45.8	42.6	0.8	-29.5	-32.5
Claims on government	104.2	116.1	107.4	112.4	116.5
Government deposits	58.4	73.4	106.6	141.8	149.0
Credit to private sector [1]	838.3	954.0	1,140.0	1,434.7	1,744.2
Other items, net	-202.7	-223.9	-234.8	-330.2	-347.9
Broad money (M3)	808.0	914.2	1,101.1	1,349.3	1,668.3
Of which: M1	387.8	421.5	503.1	605.7	739.1
	(Annual percentage change)				
Net foreign assets	46.8	11.6	38.0	40.5	11.0
Net domestic assets	8.2	13.4	17.2	18.7	26.9
Credit to private sector	19.2	13.8	19.5	25.8	21.6
Broad money (M3)	12.9	13.1	20.5	22.5	23.6
	(Contribution to growth of M3, unless otherwise specified)				
Net foreign assets	5.6	1.8	5.9	7.2	2.2
Net domestic assets	7.2	11.3	14.6	15.4	21.4
Credit to government, net	-1.7	-0.4	-4.6	-2.7	-0.2
Credit to private sector [1]	18.8	14.3	20.3	26.8	22.9
Other items, net	-9.9	-2.6	-1.2	-8.7	-1.3
Memorandum item:					
Income velocity of M3	1.65	1.61	1.52	1.40	1.30

Source: South African Reserve Bank (SARB).

[1] Part of the increase in private sector credit in 2003 is due to a change in accounting rules for derivatives.

Table 7. South Africa: Indicators of External Vulnerability, 2003-08

	2003	2004	2005	2006	2007	2008	*date*
	(Percent of GDP, unless otherwise specified)						
Financial indicators							
Government debt [1]	37.3	36.4	35.3	33.1	28.6	...	
Broad money (percent change; 12-month basis)	12.9	13.1	20.5	22.5	23.6	20.1	*June*
Private sector credit (percent change; 12-month basis)	19.2	13.8	19.5	25.8	21.6	20.3	*June*
Repurchase rate (percent) [2]	8.0	7.5	7.0	9.0	11.0	12.0	*July*
Repurchase rate (percent; real) [2, 3]	3.8	3.1	2.9	3.8	2.2	0.4	*June*
External indicators							
Exports of goods and services (percent change; US$ value)	27.5	23.6	15.1	14.6	17.4	...	
Imports of goods and services (percent change; US$ value)	32.7	36.5	16.9	23.7	15.9	...	
Terms of trade (percent change)	3.8	0.8	0.6	4.3	3.3	...	
Current account balance	-1.1	-3.2	-4.0	-6.5	-7.3	...	
Capital and financial account balance	-1.1	3.3	4.9	5.9	8.2	...	
Gross official reserves (US$ billion) [2]	8.0	14.7	20.6	25.6	33.0	35.0	*July*
Short-term foreign liabilities of SARB (US$ billion) [2]	0.5	0.4	0.7	2.6	1.7	0.8	*July*
International liquidity position of SARB (US$ billion) [2, 4]	4.8	11.4	17.2	23.0	31.3	34.2	*July*
Short-term external debt plus open forward position (US$ billion)	11.7	10.4	14.1	17.0	18.6	...	
Gross official reserves as a percent of the above	68.0	141.2	145.9	150.5	177.5	...	
Foreign currency-denominated external debt (US$ billion)	27.3	27.9	28.1	35.8	43.6	...	
As a percent of total exports	58.5	48.3	42.2	46.9	48.8	...	
External interest payments (as a percent of total exports)	4.6	3.8	3.8	3.5	3.8	...	
Exchange rate (per U.S. dollar; period average) [5]	7.56	6.45	6.36	6.77	7.05	7.64	*July*
Real effective exchange rate appreciation (period average; percent) [6]	25.1	6.7	0.5	-2.5	-3.4	...	
Financial market indicators [2]							
Stock market index (1994=100) [5]	175	213	303	419	487	466	*July*
Percent change [5]	12.0	21.9	42.6	38.0	16.2	-4.3	*July*
Foreign currency debt rating–Standard & Poor's	BBB	BBB	BBB+	BBB+	BBB+	BBB+	*July*
Foreign currency debt rating–Moody's	Baa2	Baa2	Baa1	Baa1	Baa1	Baa1	*July*
Spread of benchmark bonds (basis points) [7]	149	101	84	87	166	227	*July*

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

[1] National government debt, end of period.
[2] End of period.
[3] Deflated by the percent change in end-period CPIX (consumer price index less interest on mortgage loans).
[4] Gross reserves minus foreign loans and minus forward position. The SARB's open position in the forward market was closed in February 2004.
[5] For 2008, as of July 30; stock market index change with regard to end-2007.
[6] SARB.
[7] Until end-2005: a 2017 US$ denominated bond vs. a comparable synthetic U.S. bond from Merrill Lynch; Since 2006: JP Morgan's EMBI+ Global Bond Spread for South Africa. End of period.

Table 8: South Africa: Financial Soundness Indicators, 2002-07

	2002	2003	2004	2005	2006	2007
	(Percent, unless otherwise indicated)					
Capital adequacy:						
Regulatory capital to risk-weighted assets [1]	12.6	12.4	14.0	12.7	12.3	12.8
Regulatory tier 1 capital to risk-weighted assets [1]	8.7	8.9	10.5	9.7	9.0	9.5
Asset quality:						
Nonperforming loans to total gross loans [2]	2.9	2.4	1.8	1.5	1.1	1.4
Nonperforming loans net of provisions to capital [2]	13.2	8.5	6.2	6.4	5.6	8.2
Share of mortgage advances in domestic private credit [3]	40.7	39.6	43.3	46.2	47.7	48.9
Earnings and profitability:						
Return on assets (average)	0.4	0.8	1.3	1.2	1.4	1.4
Return on equity (average)	5.4	11.6	16.2	15.2	18.3	18.1
Interest margin to gross income	52.3	38.3	41.6	38.2	43.8	58.5
Noninterest expenses to gross income	60.4	74.8	68.5	61.5	48.5	48.9
Liquidity:						
Liquid assets to total assets	4.7	4.7	4.7	4.8	4.6	4.6
Share of short-term deposits in total deposits	47.9	45.7	43.7	43.5	42.8	42.5
Exposure to FX risk:						
Maximum effective net open FX position to capital	3.6	1.3	0.8	1.9	1.4	0.7
Share of foreign currency loans in total lending	13.6	11.9	10.9	11.1	11.4	9.3
Share of foreign currency deposits in total deposits [4]	4.4	2.7	2.7	2.7	3.3	3.0
Share of foreign liabilities in total liabilities [5]	6.3	3.8	4.0	4.2	5.3	6.0

Source: South African Reserve Bank.

[1] Total (banking and trading book).
[2] The official definition of nonperforming loans comprises doubtful and loss loans. Doubtful are loans overdue for 180 days unless well secured, or with a timely realization of the collateral.
[3] Domestic private credit not seasonally adjusted.
[4] Foreign funding to total funding.
[5] Foreign funding to total liabilities (including capital).

Table 9. South Africa: Social and Demographic Indicators

(2007, unless otherwise specified)

Area		**Population**	
1.22 million square kilometers		Total (September 2007)	47.9 million
		Annual rate of growth	1.0 percent
Population characteristics		**Health**	
Population density	39.3 per sq. km.	Life expectancy at birth	
		Total (years, 2005)	47.7
Urban population (percentage of total, 2005)	58		
Proportion in capital city as a percentage of urban population (census 2001)	8	Infant mortality per thousand live births (2005)	54
Population age structure (percent)		**Labor force**	
0-14 years	32		
15-64	63	Female (percentage of labor force)	46
65 and above	5		
Population below $2 a day, PPP basis (percent of population, 2000)	34.1		
GDP per capita at current prices		Percentage of employment (September 2007)	
In U.S. dollars	5,907	Agriculture	8.8
		Mining	3.4
		Industry [1]	22.5
		Trade	22.3
		Other services	43.0
Nutrition (1999)		**Education**	
Per capita calorie intake per day		Adult literacy (15+, percentage)	
Mean	2,424	Male	84
Median	2,358	Female	81
		Total	82

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

[1] Comprises the manufacturing, construction, and utilities sectors.

Table 10. South Africa: Millennium Development Goals, 1990-2006 [1]

	1990	1995	2000	2003	2006
1. Eradicate extreme poverty and hunger	2015 target = halve 1990 $1 a day poverty and malnutrition rates				
Population below $1 a day (%)	…	6.3	10.7	...	...
Poverty gap at $1 a day (%)	...	0.6	1.7	...	...
Percentage share of income or consumption held by poorest 20%	...	3.6	3.5	...	...
Prevalence of child malnutrition (% of children under 5)	...	9.2	...	...	...
Population below minimum level of dietary energy consumption (%)	…	3.0	...	...	3.0
2. Achieve universal primary education	2015 target = net enrollment to 100				
Net primary enrollment ratio (% of relevant age group)	90.0	...	92.0	89.0	88.0
Youth literacy rate (% ages 15-24)	…	93.9	93.5	91.8	…
3. Promote gender equality	2005 target = education ratio to 100				
Ratio of girls to boys in primary and secondary education (%)	104.0	...	100.0	100.4	101.5
Ratio of young literate females to males (% ages 15-24)	...	101.0	99.9	100.0	…
Share of women employed in the nonagricultural sector (%)	42.6	43.6	44.6	...	42.9
Proportion of seats held by women in national parliament (%)	3.0	25.0	30.0	30.0	32.8
4. Reduce child mortality	2015 target = reduce 1990 under 5 mortality by two-thirds				
Under 5 mortality rate (per 1,000)	60.0	59.0	63.0	66.0	69.0
Infant mortality rate (per 1,000 live births)	45.0	45.0	50.0	53.0	56.0
Immunization, measles (% of children under 12 months)	79.0	76.0	77.0	83.0	85.0
5. Improve maternal health	2015 target = reduce 1990 maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	…	…	230.0	…	400.0
Births attended by skilled health staff (% of total)	…	82.0	84.0	…	…
6. Combat HIV/AIDS, malaria and other diseases	2015 target = halt and begin to reverse prevalence of diseases				
Prevalence of HIV (% ages 15-49)	…	…	…	19.0	18.8
Contraceptive prevalence rate (% of women ages 15-49)	57.0	…	…	…	14.8
Number of children orphaned by HIV/AIDS (thousands)	…	…	660.0	780.0	…
Incidence of tuberculosis (per 100,000 people)	224.0	392.4	465.0	536.4	940.0
Tuberculosis cases detected under DOTS (%)	…	6.0	58.0	…	71.0
7. Ensure environmental sustainability	2015 target = various [1]				
Forest area (% of total land area)	7.6	8.0	7.3	...	8.0
Nationally protected areas (% of total land area)	...	6.1	...	5.5	6.1
GDP per unit of energy use (2000 PPP $ per kg oil equivalent)	...	...	3.8	3.9	…
CO2 emissions (metric tons per capita)	9.4	...	9.0	…	9.4
Access to an improved water source (% of population)	83.0	84.0	…	87.0	88.0
Access to improved sanitation (% of population)	69.0	68.0	66.0	67.0	65.0
8. Develop a Global Partnership for Development	2015 target = various [1]				
Youth unemployment rate (% of total labor force ages 15-24)	…	…	44.2	60.1	...
Fixed line and mobile telephones (per 1,000 people) [2]	94.3	116.0	302.3	473.1	825.1
Personal computers (per 1,000 people) [2]	7.1	28.1	66.4	72.6	84.6
General indicators					
Adult literacy rate (% of people ages 15 and over)	…	82.4	85.2	86.0	...
Total fertility rate (births per woman) [2]	3.3	3.1	…	2.8	2.8
Life expectancy at birth (years) [2]	61.9	58.0	48.5	45.7	47.7

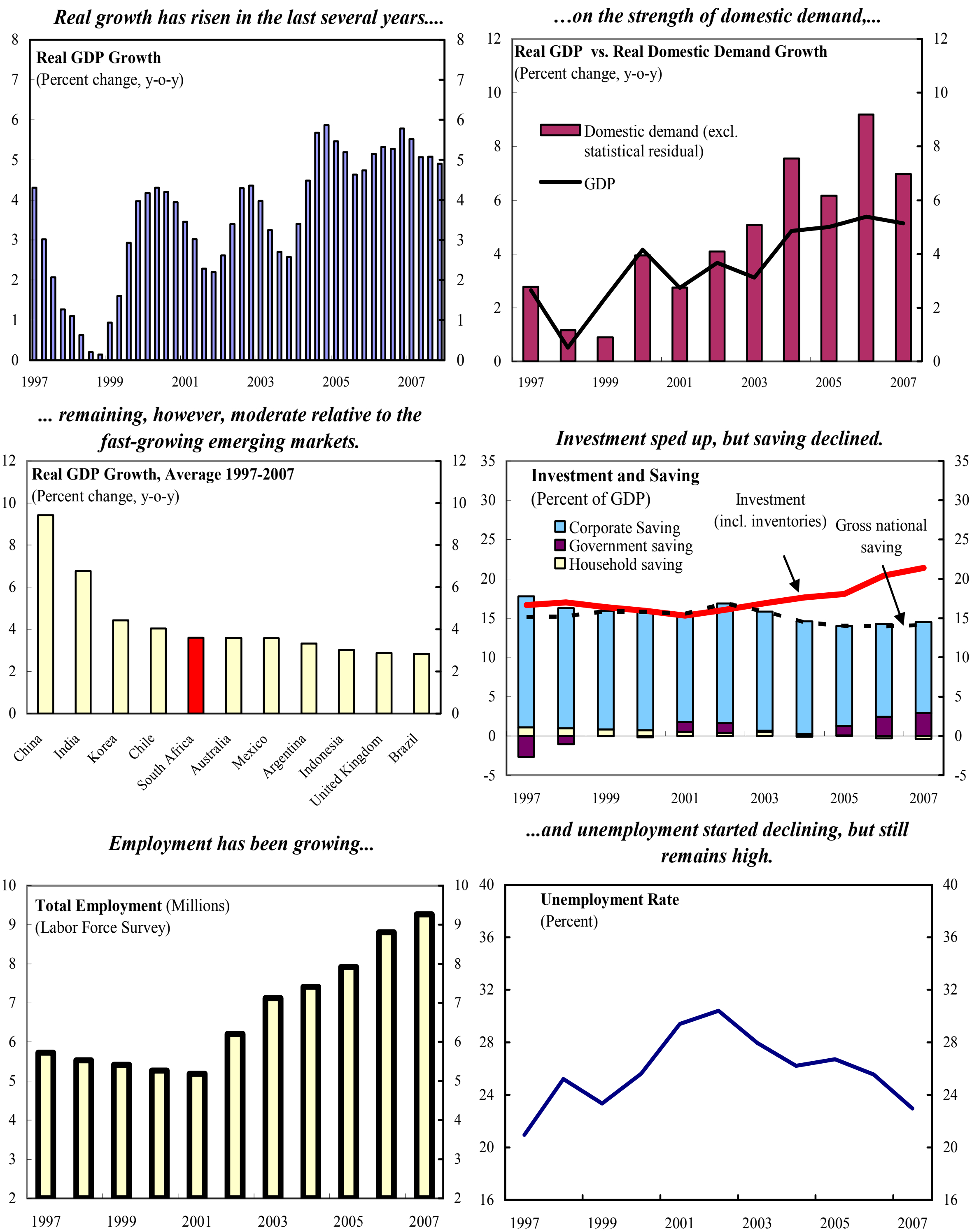
Sources: World Bank and Statistics South Africa.

Note: In some cases the data are for earlier or later years than those stated.

[1] For definitions of Goal 7 and 8 targets, see http://ddp-ext.worldbank.org/ext/GMIS/gdmis.do.

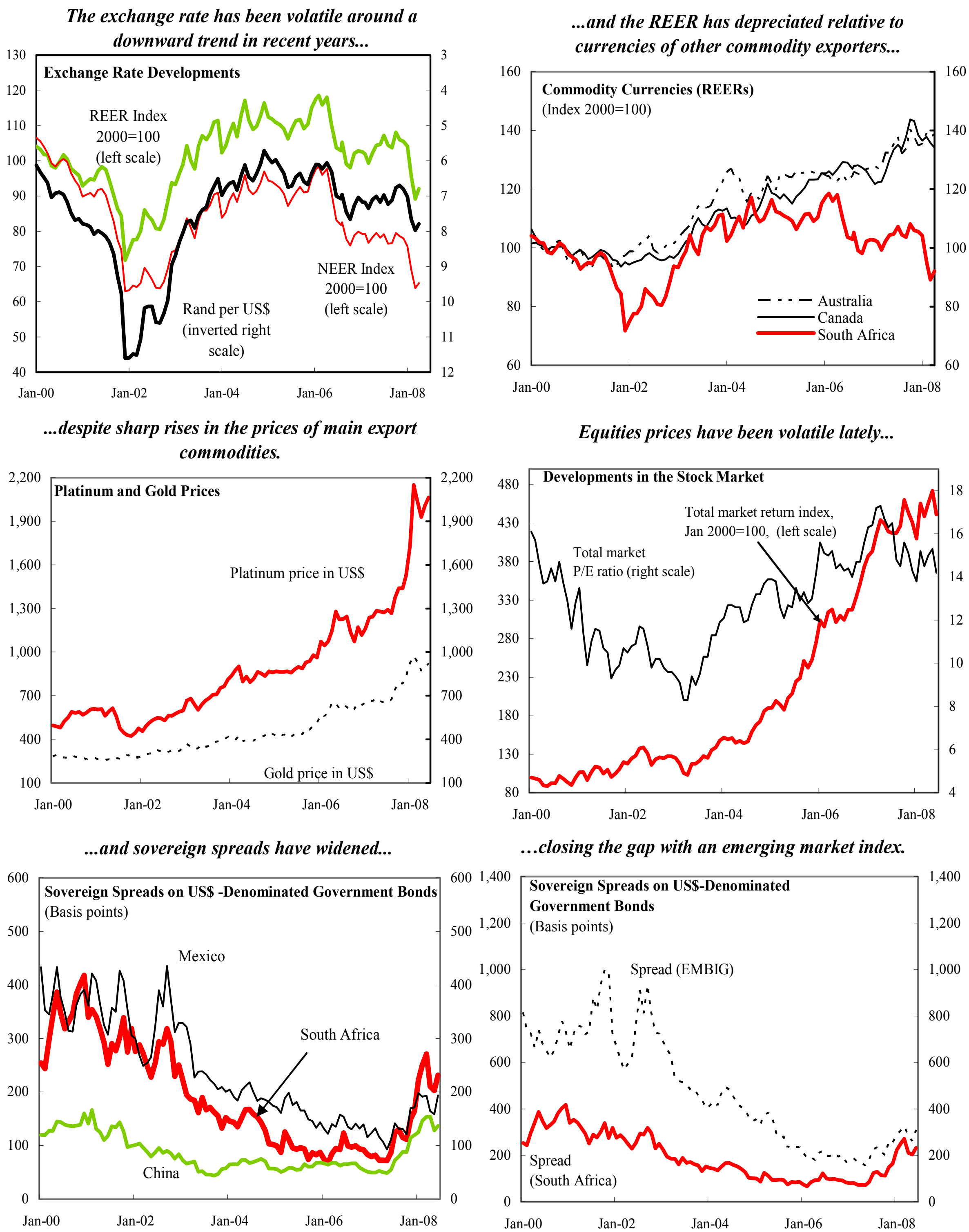
[2] 2005 figures.

Figure 1. South Africa: Real Sector Developments



Sources: SARB and IMF.

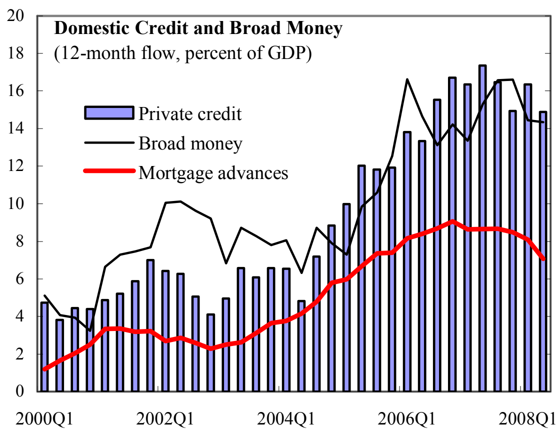
Figure 2. South Africa: Exchange Rates, Asset Prices and Spreads



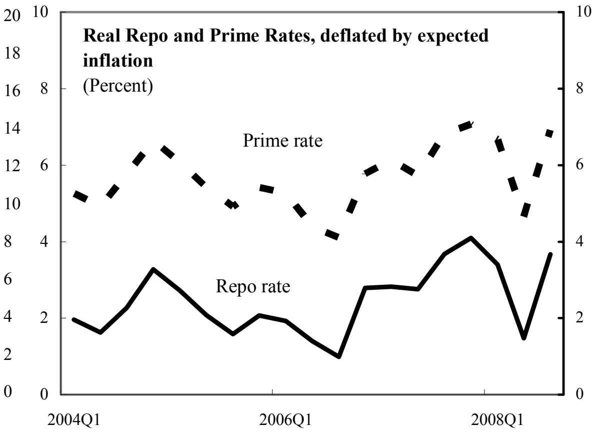
Sources: SARB, Datastream, Absa, and IMF.

Figure 3. South Africa: Money, Prices and Interest Rates

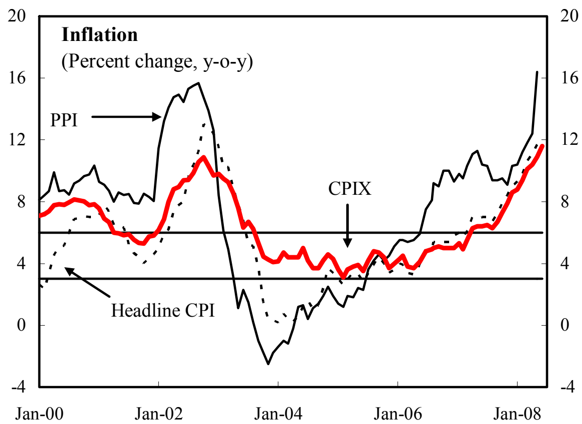
Money and credit flows have begun to moderate...



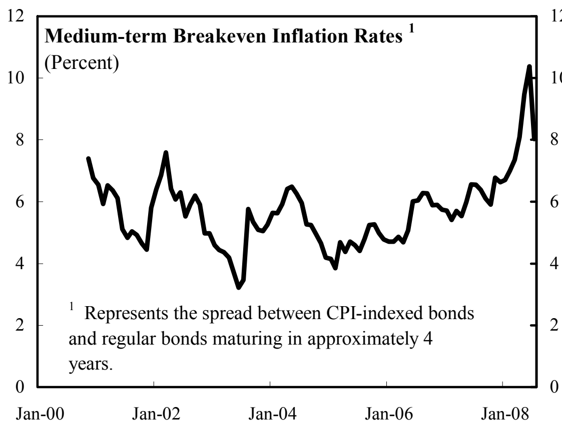
...as ex-ante real interest rates picked up.



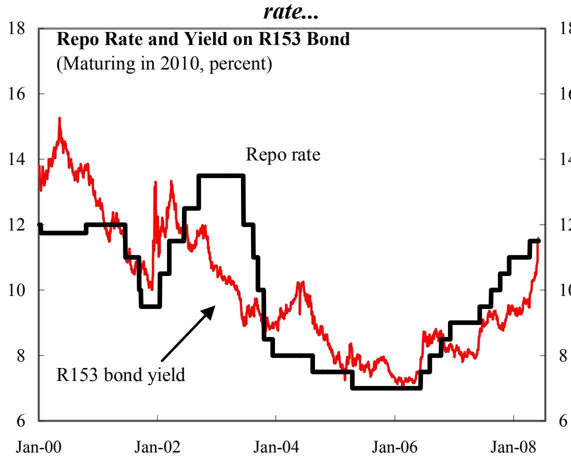
Inflation has been rising ...



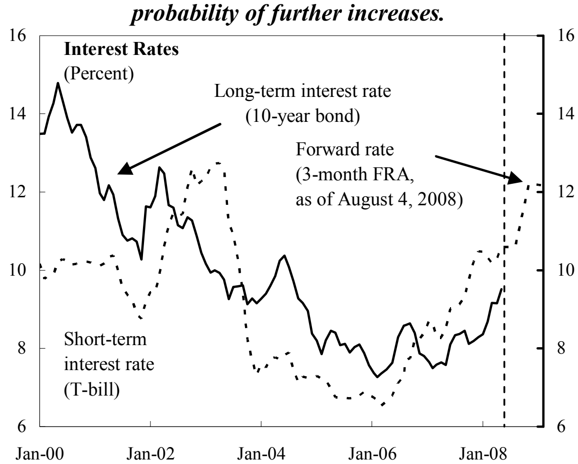
...and so have measures of inflation expectations.



Short-term bond yields have caught up with the repo rate...

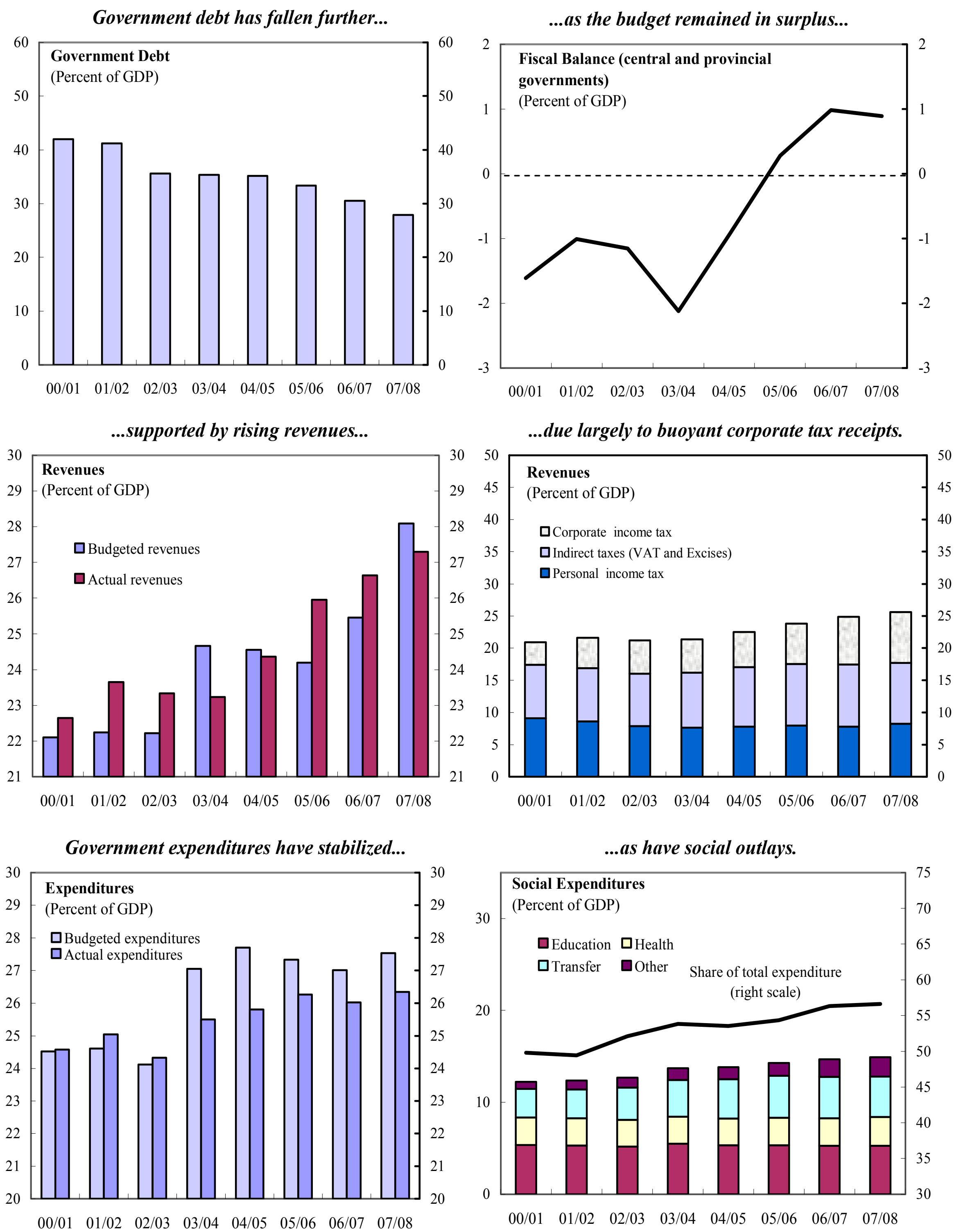


...but forward rates are downplaying the probability of further increases.



Sources: SARB, BER, Datastream, and IMF.

Figure 4. South Africa: Fiscal Developments



Sources: National Treasury and IMF.

APPENDIX I. SOUTH AFRICA—DEBT SUSTAINABILITY ANALYSIS

South Africa's public debt position remains sustainable. The ratio of government debt to GDP continues to fall steeply, from 35¼ percent in 2005 to 28½ percent at end-2007. Under the policies outlined in the 2008/9 budget and the medium-term expenditure framework, government debt should continue to decline to below 16 percent of GDP over the next five years. Gross financing needs should fall to less than 2 percent of GDP per year in the medium term, significantly below the average of the past five years (Figure 1). Total public debt would fall more gradually, as public enterprise borrowing to finance their investment expansion would add about 5½ percent of GDP in debt by 2013 (Table 1).

The declining trend in the public debt-to-GDP ratio appears to be broadly robust to a variety of shocks, including weaker GDP growth, a lower primary balance, a 30 percent real depreciation of the exchange rate, and a 10 percent increase in the debt stock (Figure 1). Under most of these scenarios, the government debt ratio is only slightly above the baseline over the projection period, and in the case of the "no policy change" scenario it falls well below. It picks up somewhat, while remaining manageable, in the case of a hypothetical 10 percent contingent liability shock, which is more than the sum of the projected increase in public enterprise debt over the period and the current stock of government financial guarantees (3.4 percent of GDP by February 2008).

South Africa's external debt is projected to rise to about 35 percent of GDP in the medium term. The current account deficit is projected to remain large during the entire projection period. During 2008–09, despite slower domestic demand growth, the current account deficit is projected to widen, reflecting deteriorating terms of trade and the pick up in public investment with a high import content. The deficit will peak at just over 9½ percent of GDP in 2009 and decline slightly to about 9 percent of GDP by 2013, as import growth subsides. The deficit is envisaged to be financed by a mixture of debt and nondebt creating capital inflows, driving the external debt-to-GDP ratio up to about 35 percent of GDP by 2011, at which level it would remain in subsequent years.

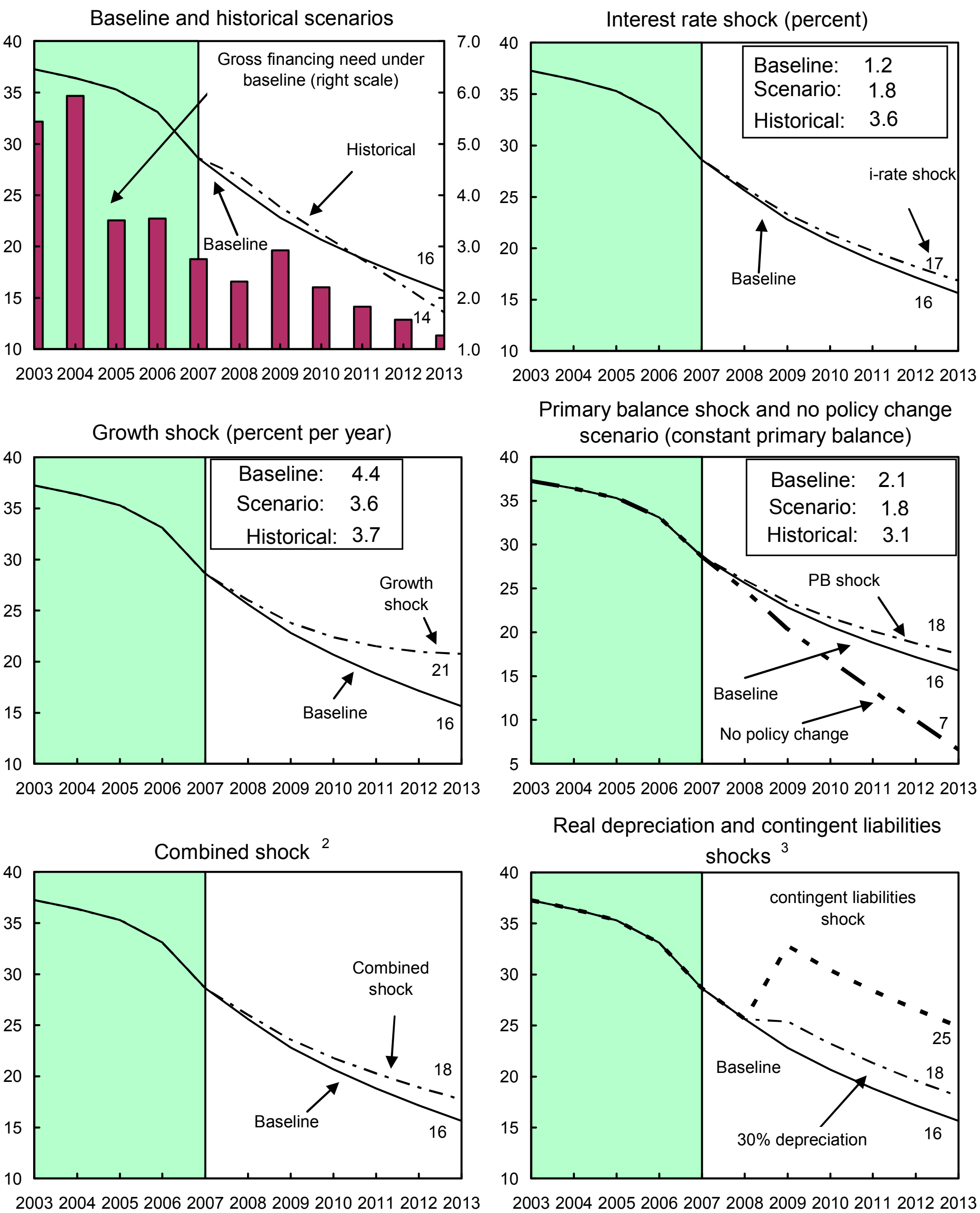
The outlook for South Africa's external debt deteriorates without becoming overly unfavorable under a broad range of shocks (Figure 2). With rand-denominated debt accounting for 42 percent of external debt at end-2007, currency risk is moderate; the share of short-term debt in foreign-currency denominated debt (42½ percent at end-2007) implies moderate rollover risk as well. The results of various stress tests indicate that the largest adverse impact on the external debt would arise from a larger than projected current account deficit—a noninterest current account deficit higher by about 1½ percentage points of GDP on average over the next five years would bring the debt-to-GDP ratio to about 42 percent by end-2013. Permanent adverse shocks to real GDP growth and real interest rates, whether considered individually or together, or a 30 percent one-time real exchange rate depreciation would have only a minor-to-moderate effect.

Table 1. South Africa: Public Sector Debt Sustainability Framework, 2005-13
(In percent of GDP, unless otherwise indicated)

	Actual			Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	Debt-stabilizing primary balance [9]
Baseline: Government debt [1]	35.3	33.1	28.6	**25.6**	**22.8**	**20.7**	**18.8**	**17.2**	**15.7**	**-0.3**
o/w foreign-currency denominated	4.5	4.6	3.9	4.5	4.1	3.9	3.7	3.3	3.0	
Change in public sector debt	-1.1	-2.2	-4.5	-3.0	-2.8	-2.1	-1.8	-1.7	-1.5	
Identified debt-creating flows (4+7+12)	-2.9	-4.5	-5.4	-4.5	-3.1	-2.8	-2.5	-2.3	-2.1	
Primary deficit	-3.2	-3.8	-3.7	-2.8	-2.0	-2.1	-2.0	-1.9	-1.7	
Revenue and grants	27.3	28.2	28.7	28.5	28.3	28.4	28.3	28.3	28.3	
Primary (noninterest) expenditure	24.0	24.4	25.0	25.6	26.4	26.2	26.3	26.4	26.5	
Automatic debt dynamics [2]	0.4	-0.7	-1.6	-1.6	-1.1	-0.7	-0.5	-0.4	-0.4	
Contribution from interest rate/growth differential [3]	-0.2	-1.1	-1.5	-1.6	-1.1	-0.7	-0.5	-0.4	-0.4	
Of which contribution from real interest rate	1.5	0.6	-0.1	-0.7	-0.2	0.2	0.4	0.4	0.4	
Of which contribution from real GDP growth	-1.6	-1.7	-1.5	-0.9	-0.8	-0.9	-0.9	-0.8	-0.8	
Contribution from exchange rate depreciation [4]	0.5	0.4	-0.1	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization and other extraordinary receipts (negative)	-0.4	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other	0.4	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) [5]	1.8	2.3	0.9	1.5	0.3	0.7	0.7	0.6	0.6	
Public sector debt-to-revenue ratio [1]	129.4	117.5	99.7	90.0	80.6	72.9	66.6	60.7	55.4	
Gross financing need [6]	3.5	3.5	2.8	2.3	2.9	2.2	1.8	1.6	1.3	
in billions of U.S. dollars	8.5	9.1	7.8	6.9	9.6	7.9	7.1	6.6	5.7	
Scenario with key variables at their historical averages [7]				**26.8**	**23.8**	**21.3**	**18.7**	**16.2**	**13.6**	**0.0**
Scenario with no policy change (constant primary balance) in 2008-2013				**24.8**	**20.3**	**16.8**	**13.3**	**9.9**	**6.6**	**-0.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline										
Real GDP growth (in percent)	5.0	5.4	5.1	3.8	3.7	4.4	4.8	5.0	5.0	
Average nominal interest rate on public debt (in percent) [8]	9.9	9.5	9.2	9.2	9.0	8.9	8.1	7.8	7.8	
Average real interest rate (nominal rate minus change in GDP deflator, in percent	4.7	2.3	0.2	-2.3	-0.7	1.5	2.6	2.9	3.0	
Inflation rate (GDP deflator, in percent)	5.2	7.2	8.9	11.6	9.7	7.4	5.5	4.9	4.8	
Growth of real primary spending (deflated by GDP deflator, in percent)	7.8	7.0	7.8	6.4	6.7	3.9	4.9	5.6	5.5	
Primary deficit	-3.2	-3.8	-3.7	-2.8	-2.0	-2.1	-2.0	-1.9	-1.7	
Memorandum items:										
Debt of nonfinancial public enterprises	5.8	5.8	5.7	7.5	8.4	8.9	10.5	10.9	11.1	
Debt of local governments and local enterprises	1.5	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3	
Total public sector debt under the baseline	42.5	40.3	35.6	34.4	32.6	30.9	30.7	29.5	28.1	

Sources: National Treasury and IMF staff estimates.
[1] National government includes the central government, and provincial and local government activities financed with transfers from the central government.
[2] Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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 the local currency value of the U.S. dollar).
[3] The real interest rate contribution is derived from the denominator in footnote 2 as r - π (1+g) and the real growth contribution as -g.
[4] The exchange rate contribution is derived from the numerator in footnote 2 as ae(1+r).
[5] For projections, this line includes exchange rate changes.
[6] Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
[7] The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
[8] Derived as nominal interest expenditure divided by previous period debt stock.
[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 1. South Africa: Public Debt Sustainability: Bound Tests [1]
(Public debt in percent of GDP)



Sources: International Monetary Fund, South African authorities, and IMF 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] Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

[3] One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in the dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 2. South Africa: External Debt Sustainability Framework, 2005-2013
(In percent of GDP, unless otherwise indicated)

	Actual			Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	Debt-stabilizing non-interest current account [6]
Baseline: External debt	19.1	22.2	26.6	**29.6**	**31.2**	**32.8**	**35.0**	**34.7**	**34.9**	**-5.8**
Change in external debt	-1.8	3.1	4.5	3.0	1.6	1.7	2.2	-0.3	0.1	
Identified external debt-creating flows (4+8+9)	-3.3	2.0	1.3	2.2	3.6	3.2	2.8	2.4	2.2	
Current account deficit, excluding interest payments	3.0	5.4	6.1	7.5	8.0	7.7	7.3	6.9	6.7	
Deficit in balance of goods and services	0.8	3.3	3.1	5.0	5.7	5.6	5.3	5.1	4.9	
Exports	27.5	29.6	31.6	36.2	34.6	34.2	34.1	34.0	34.0	
Imports	28.3	32.9	34.7	41.2	40.3	39.8	39.4	39.2	38.8	
Net non-debt creating capital inflows (negative)	-5.2	-2.9	-3.7	-5.8	-5.0	-5.0	-5.1	-5.1	-5.1	
Automatic debt dynamics [1]	-1.1	-0.5	-1.1	0.6	0.7	0.6	0.5	0.6	0.6	
Contribution from nominal interest rate	1.1	1.0	1.2	1.5	1.7	1.8	2.0	2.2	2.2	
Contribution from real GDP growth	-0.9	-1.0	-1.0	-1.0	-1.0	-1.3	-1.5	-1.6	-1.6	
Contribution from price and exchange rate changes [2]	-1.2	-0.6	-1.3	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) [3]	1.6	1.1	3.2	0.8	-2.0	-1.5	-0.6	-2.7	-2.1	
External debt-to-exports ratio (in percent)	69.4	74.9	84.2	81.8	90.0	96.0	102.8	102.0	102.7	
Gross external financing need (in billions of US dollars) [4]	19.3	28.6	38.4	45.3	54.5	58.0	62.5	71.3	68.9	
in percent of GDP	8.0	11.1	13.6	15.1	16.5	16.2	16.1	17.1	15.3	
Scenario with key variables at their historical averages [5]				**29.6**	**25.8**	**22.2**	**19.4**	**14.4**	**10.2**	**-4.1**
Key Macroeconomic Assumptions Underlying Baseline										
Real GDP growth (in percent)	5.0	5.4	5.1	3.8	3.7	4.4	4.8	5.0	5.0	
GDP deflator in US dollars (change in percent)	6.6	0.8	4.5	2.2	6.1	4.1	3.0	2.7	2.7	
Nominal external interest rate (in percent)	5.7	5.7	5.9	6.0	6.2	6.3	6.5	6.7	6.8	
Growth of exports (US dollar terms, in percent)	15.1	14.6	17.4	21.4	5.3	7.3	7.5	7.7	7.6	
Growth of imports (US dollar terms, in percent)	16.9	23.7	15.9	25.7	7.8	7.3	6.8	7.0	6.9	
Current account balance, excluding interest payments	-3.0	-5.4	-6.1	-7.5	-8.0	-7.7	-7.3	-6.9	-6.7	
Net non-debt creating capital inflows	5.2	2.9	3.7	5.8	5.0	5.0	5.1	5.1	5.1	

Sources: SARB and IMF staff estimates.

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

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

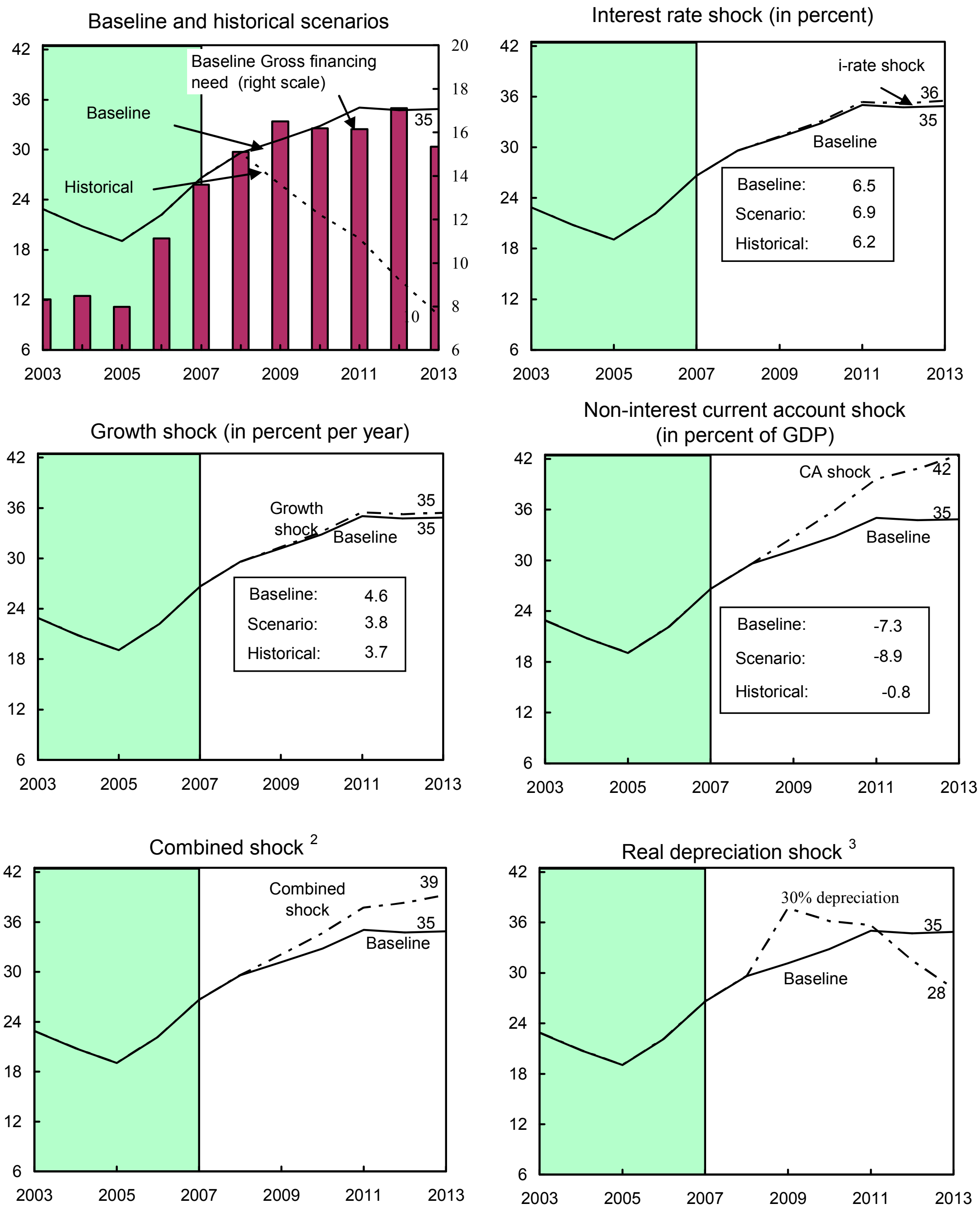
[3] For projection, line includes the impact of price and exchange rate changes.

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

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

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

Figure 2. Country: External Debt Sustainability: Bound Tests [1]
(External debt in percent of GDP)



Sources: International Monetary Fund and IMF 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] Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

[3] One-time real depreciation of 30 percent occurs in 2009.