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IMF Executive Board Concludes 2014 Article IV Consultation with South Africa

On December, 3, 2014, the Executive Board of the International Monetary Fund concluded the Article IV consultation[1] with South Africa.

South Africa has made substantial progress in its first 20 years of democracy, achieving much improved living standards for its citizens. But growth has slowed in recent years, specifically relative to other emerging markets. Although weak trading partners' growth contributed to the slowdown, increasingly binding structural constraints, such as protracted strikes and electricity constraints, have been important factors. Unemployment remains high at 25.5 percent.

Consumer Price Index (CPI) inflation declined to 5.9 percent in September after staying above the South African Reserve Bank (SARB)'s 3-6 percent band for six months, mainly driven by depreciation. The SARB has raised the repo rate by 75 basis points since January 2014.

South Africa's twin deficits remain elevated. Despite a 26 percent real effective exchange rate depreciation since 2010, the current account deficit remains high (5.8 percent of Gross Domestic Product (GDP) in 2013), reflecting persistent competitiveness problems, soft terms of trade, supply bottlenecks, and subdued external demand. Notwithstanding expenditure discipline, the general government budget deficit was 4.5 percent of GDP in 2013, and public debt rose to 45 percent of GDP from 27 percent in 2008. In the recently-announced Medium-Term Budget Policy Statement, the authorities have announced that they will take measures to improve the public finances.

The Financial System Stability Assessment (FSSA) concluded that financial sector risks are elevated but manageable. The financial system is large, highly interconnected, dependent on wholesale funding, and credit risk is rising due to sluggish growth and tighter financial

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

conditions. However, capital buffers are relatively high, financial regulation and supervision are strong, and capital controls limit liquidity risks.

The outlook is lackluster with considerable risks. Growth is projected to slow to 1.4 percent in 2014 and rebound only modestly to 2.1 percent in 2015 on improved industrial relations, while private consumption remains depressed under tighter financial conditions. Slowly easing infrastructure constraints and stronger external demand are expected to raise growth to 2.75 percent in 2016–19 but not enough to lower unemployment significantly. Fiscal and current account deficits are expected to fall moderately over the medium term. Inflation is projected to decline in 2015 on account of lower oil and food prices and tighter policies. Structural reforms are essential to generate more growth and jobs and to address the challenges of poverty, inequality, and unemployment.

Risks are tilted to the downside. A sharp surge in global financial market volatility could lead to capital flow reversals and trigger a disorderly adjustment in the current account deficit. Lower global growth and commodity prices, further delays in relieving electricity constraints, and more labor market disruptions are additional key risks.

Executive Board Assessment[2]

Executive Directors commended the authorities for the progress made in improving living standards and for maintaining macroeconomic stability in the last twenty years. However, against the backdrop of a weak external environment, the country is faced with the challenges from elevated external and fiscal deficits, rising public debt, and high unemployment and inequality. Directors agreed that strong and prudent policies and structural reforms are key to strengthening economic resilience, boosting inclusive and sustainable growth, creating jobs, and reducing poverty.

Given the risks facing the outlook and reduced policy space, Directors called for decisive structural reforms to unblock supply-side constraints, lift growth, and rebalance the economy towards exports and investments. They welcomed the ongoing infrastructure projects, especially in power supply, and encouraged greater private sector participation, supported by careful preparation and sound frameworks. Directors commended the government's enhanced focus on implementing the National Development Plan and promoting SMEs. They recommended that high priority be given to enhancing productivity and competitiveness by accelerating product and labor market reforms, reducing skill mismatches, and normalizing industrial relations.

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

Directors welcomed the envisaged fiscal consolidation in the 2014 Medium-Term Budget Policy Statement, and highlighted that containing the wage bill and raising taxes will be essential. They noted that further adjustment may be necessary to stabilize debt over the medium term, and in this context, underscored the importance of focusing on growth-friendly measures, including improvements in spending efficiency. They welcomed plans to increase state-owned enterprises' efficiency so as to limit contingent liabilities. A few Directors noted that a formal debt anchor could strengthen the fiscal framework.

Directors commended the South African Reserve Bank (SARB) for a finely balanced monetary policy stance. While recent declines in oil prices and the planned fiscal consolidation could allow the SARB to remain accommodative for some time, risks to the inflation outlook need continued careful monitoring. In general, Directors highlighted the importance of effective communication to help guide inflation expectations.

Directors viewed exchange rate flexibility and the favorable currency composition of external debt as effective buffers against volatile capital flows. To boost resilience, they generally encouraged the authorities to explore options to build reserves, while taking into account related costs. Directors noted the opportunities provided by robust growth in the rest of the continent and invited careful analysis of South Africa's spillovers to the region and potential spillbacks.

Directors noted the findings that the financial sector remains sound but is subject to vulnerabilities. To strengthen the sector's resilience, they encouraged timely implementation of the FSAP recommendations, in particular enhancing scrutiny of asset quality and liquidity risks, including through enhanced stress tests. Introducing deposit insurance and strengthening regulation of collective investment schemes could reduce liquidity risks and boost market discipline. Directors concurred that South Africa's deep and highly interconnected financial system requires group-wide supervision and better coordination among regulators. Directors noted that more competition could improve financial access and lower intermediation costs.

South Africa: Selected Economic and Social Indicators, 2010–15

Social Indicators

GDP		**Poverty**	
Nominal GDP (2013, billions of U.S. dollars)	351	Headcount ratio at $1.25 a day (2011, percent of population)	9.4
GDP per capita (2013, U.S. dollars)	6599	Undernourishment (2012, percent of population)	5.0
Population characteristics (2013)		**Income distribution (2011)**	
Total	53.2	Income share held by highest 10 percent of population	53.8
Urban population (percent of total)	64	Income share held by lowest 20 percent of	2.5
Life expectancy at birth (years), 2014	61	Gini index	65.0

Economic Indicators

	2010	2011	2012	2013	2014	2015
					Proj.	
National income and prices (annual percentage change unless otherwise indicated)						
Real GDP	3.1	3.6	2.5	1.9	1.4	2.1
Real GDP per capita	1.6	2.1	0.9	0.3	-0.2	0.5
Real domestic demand	4.4	5.2	3.9	2.5	1.2	1.8
GDP deflator	7.7	5.9	4.5	5.8	5.9	5.4
CPI (annual average)	4.3	5.0	5.7	5.8	6.1	5.2
CPI (end of period)	3.5	6.1	5.7	5.4	5.7	5.5
Labor market (annual percentage change unless otherwise indicated)						
Unemployment rate (percent of labor force, annual average)	24.9	24.8	24.9	24.7	25.3	25.2
Average remuneration (formal nonagricultural, nominal)	13.5	7.2	7.5	7.6	6.8	7.1
Labor productivity (formal nonagricultural)	3.9	1.4	1.3	1.4	1.4	1.5
Unit labor costs (formal nonagricultural)	9.3	5.8	6.2	6.1	5.3	5.4
Savings and Investment (percent of GDP unless otherwise indicated)						
Gross national saving	17.1	16.8	14.2	13.5	13.6	14.0
Public (including public enterprises)	-0.5	0.8	-0.9	-0.9	-0.9	-0.6
Private	17.6	16.0	15.1	14.4	14.5	14.6
Investment (including inventories)	19.1	19.1	19.4	19.4	19.3	19.4
Public (including public enterprises)	7.0	7.0	7.1	7.2	7.3	7.3
Private	12.1	11.8	11.8	12.1	12.3	12.3
Fiscal position (percent of GDP unless otherwise indicated) 1/						
Revenue, including grants	27.5	27.9	28.3	28.9	29.2	29.5
Expenditure and net lending	32.4	31.9	32.6	33.1	33.7	33.8
Overall balance	-4.9	-4.0	-4.3	-4.2	-4.4	-4.3
Primary balance	-2.3	-1.3	-1.4	-1.1	-1.2	-0.9
Structural balance (percent of potential GDP)	-3.6	-3.8	-4.2	-3.9	-3.9	-3.7
Gross government debt 2/	35.3	38.8	42.1	45.2	48.1	50.5
Government bond yield (10-year, percent) 3/	8.5	8.3	7.6	7.3	7.9	…
Money and credit (annual percentage change unless otherwise indicated)						
Broad money	6.9	8.3	5.2	5.9	6.4	7.6
Credit to the private sector	3.3	5.7	9.3	6.6	7.7	7.9
Repo rate (percent) 3/	5.5	5.5	5.0	5.0	5.8	...
Balance of payments (percent of GDP unless otherwise indicated)						
Current account balance (billions of U.S. dollars)	-7.2	-9.4	-20.0	-20.4	-19.4	-19.0
percent of GDP	-2.0	-2.3	-5.2	-5.8	-5.7	-5.4
Exports growth (volume)	9.0	6.8	0.4	4.2	2.6	3.5
Imports growth (volume)	11.0	10.0	6.0	4.7	1.8	2.3
Terms of trade (percentage change)	7.3	2.2	-2.2	-1.9	-1.8	-0.1
Overall balance	1.2	1.1	0.3	0.1	0.0	0.0
Gross reserves (billions of U.S. dollars)	43.8	48.9	50.7	49.6	49.6	49.6
percent of short-term debt (residual maturity)	145.8	151.6	133.2	130.2	126.1	115.7
Total external debt	30.5	29.2	37.1	38.9	42.4	44.9
of which short-term (residual maturity)	8.2	8.0	10.0	10.9	11.6	12.3
Nominal effective exchange rate (percentage change, end-period) 4/	11.3	-16.6	-5.4	-15.3	-7.3	…
Real effective exchange rate (percentage change, end-period) 4/	12.0	-4.7	-12.2	-12.4	-2.9	…
Exchange rate (Rand/U.S. dollar, end-period) 3/	6.6	8.1	8.5	10.5	10.9	…

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

1/ General government unless otherwise indicated.

2/ National government.

3/ For 2014, end-October data.

4/ For 2014, September data.